Cautious, conservative… consistent!

Alexander R. Malaket speaks with leaders in Canada's trade finance sector to get an update on trade and international banking, Canadian style.

Cristian Mandachescu at Scotiabank in Toronto

Philippa Fitzsimons at BMO Financial Group in Toronto

The trade finance environment in Canada continues to attract grudgingly admiring interest from many quarters, as banks continue to do well, and the Canadian regulatory regime proves to be effective through the global crisis. While the strong Canadian banking sector has avoided any need for government bailout, and has attracted interest in international markets as a source of liquidity and effective, credible risk mitigation, there is no rush among Canadian bankers or trade financiers, to capitalise on the apparent competitive advantages.

Canada has done relatively well in responding to, and managing, its way through the global economic crisis, this despite the country's very close business and economic ties with the United States which place it at the epicentre of the crisis.

The Canadian banking sector has been recognised as one of the most robust, conservatively managed financial sectors in the world, and the regulatory regime which surrounds the Canadian financial sector has been lauded for its effectiveness in mitigating the impacts of global crisis.

Canada styles itself a trading nation, yet the reality is that for many years the vast majority of import and export trade involved shipments to and from the United States. Accordingly, most of the trade engaged in by Canadian companies was conducted on open account terms or using relatively straightforward trade financing mechanisms. The global crisis and its particular flavour and impact North America has driven Canadian businesses to diversify their international business activities.

The crisis of confidence which so badly affected the inter-bank lending market, and in so doing, triggered the global credit crisis and liquidity shortage, had limited direct effect on the Canadian financial sector or the Canadian economy, due to the regulatory regime under which Canadian banks operate and due equally to the cautious lending and investment practices of Canadian financial institutions. The crisis as relates to Canada, is linked more closely to reduced demand for Canadian exports from the US, and the adverse impacts of significant appreciation of the Canadian dollar against the American currency.

The business of trade finance in Canada exhibits patterns and characteristics very similar to those of the broader banking sector in the country. Trade financiers in Canada are generally a cautious, conservative group, managing a line of business that is poorly understood, not well supported and in several financial institutions, has been largely ignored or treated as an afterthought.

Just as the global financial crisis has brought a greater, and more favourable profile to the Canadian regulatory and banking sectors, it has clearly brought a welcome, higher profile for the business of trade finance within Canadian financial institutions.

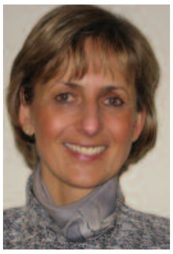
Observes Cristian Mandachescu, vice president, trade services and financial institutions, global transaction banking at Scotiabank: "In our view, the global crisis changed, significantly, the way that banks look at the business of trade finance. The profile of trade finance has been greatly enhanced, both as a profitable, capital-efficient business, and as a key contributor to the now all-important relationship approach we are adopting – both with commercial clients and with financial institution partners across the globe."

Mandachescu continues: "Our view is that the Canadian banking sector has become even more selective and conservative at all levels – in terms of geographic coverage, in terms of the number of FI relationships maintained in each country, and in terms of the corporate relationships we will pursue. For us, one of the enduring outcomes of the crisis is that we have been able to articulate the value and the contribution of trade finance to the bank, to the extent that our sales team now understands the value of "leading with trade" as a means of establishing new relationships."

Transaction versus relationship

While it may have been tempting for Canadian trade financiers to take advantage of the newfound profile and confidence afforded Canadian banks by the international community, it is clear that the Canadian banking sector as a whole has continued to focus on careful management, stewardship and conservative, disciplined management of both its domestic and international activities.

Although the global crisis created significant gaps in liquidity, and resulted in significant opportunity for solid financial institutions with the risk appetite and balance sheet strength to take advantage of such opportunities, Canadian bankers largely resisted the➤



Silvia Brudar at CIBC in Toronto

➤temptation to pursue opportunities on a transactional basis. As one senior executive puts it, there is no appetite for transaction-based "suitcase banking", where bankers fly in to a market, do a deal, and fly out. Indeed, the global financial crisis has reinforced the commitment of Canadian bankers to relationship banking, be it at the commercial level or at the level of correspondent and financial institution relationships. The latter is critically important now, given that traders across the world must worry about the credit standing of their counterparty, but must now also be concerned about the health and viability of the financial institutions engaged in the transaction.

Far from responding to the multitude of opportunities that surround them or trying to fill the many market gaps opened up by the global crisis, Canadian bankers have gone back to basics in both their domestic operations and their international activities, and are very selective in the clients they will take aboard, and the deals they will support. Happily for the banks, commercial and corporate clients are also wary in their choice of financial institution and, once satisfied, appear more willing to consolidate their business with one bank, than they might have been before the crisis.

While varying degrees of "internationalism" exist between the major Canadian banks and financial institutions, the shift to relationship banking is a common theme across the sector, and one which guides the actions of the most domestically oriented bank, just as it shapes the strategy and approach of the most international of the Canadian financial institutions today.

The business of trade finance

The past year has certainly been profitable at the line of business level, and trade finance units generally surpassed revenue and profit targets, despite the significant reduction in global trade flows. Margins continue to be attractive, in the 150 to 300 basis point range, certainly in sharp contrast to the pre-crisis days when deals could be done at rates of "Libor plus lunch", as one senior executive colourfully put it.

Margins aside however, Canadian trade bankers, like their counterparts across the globe, are engaged in internal competitions for capital, and have had to put unprecedented focus on promoting the business of trade finance within their respective financial institutions. By all accounts, those promotion efforts have paid off, though clearly more so for some institutions than others.

In terms of the regulatory context, Canadian banks and trade financiers are finally extracting some advantage from the stringent capital and regulatory requirements under which they operate. By some measures, Canadian banks are already 75% to 80% of the way to fully meeting the requirements of Basel II capital adequacy standards as well as related regulatory requirements flowing out of the global crisis. By contrast some suggest that American and European financial institutions are from 35% to 50% advanced in their efforts to meet those same requirements.

In concrete terms, this reality is reflected in the fact that the Office of the Superintendent of Financial Institutions (OSFI), the Canadian regulatory agency overseeing the banks, has granted Canadian trade bankers a Loss Given Default (LGD) factor which is more favourable than the Basel II default of 100%, more properly reflecting the risk profile of the trade finance business, and therefore, making the business (appropriately) more attractive from a capital perspective, than traditional lending.

Most observers agree that, political rhetoric notwithstanding, global financial markets are in for a period of increased regulation, increased monitoring and perhaps increased intervention. However that reality evolves, it is clear that the need to respond to more stringent regulatory demands, will imply greater cost for financial institutions and within that, greater relative cost for those institutions not yet accustomed to such levels of incursion by regulatory authorities.

Silvia Brudar, head of global banking and trade solutions at CIBC in Toronto, notes: "We are back to a focus on fundamentals: while banks blurred the distinction between trade credit and conventional finance for a time, as well as adding in various flavours of financial engineering and balance sheet-driven structures, with the result that too many flavours of financing ended up under the trade finance business, the global crisis has motivated a return to first principles.

"The industry – including regulators – is again focused on the importance of differentiating short-term, asset-based self-liquidating trade credit from other types of financing, and it makes sense again to test the notion of whether trade finance is an asset class with inherent advantages compared to other forms of financing. While the crisis has certainly created opportunities of different types, at CIBC, our approach has been to remain conservative, stay focused on our existing client base, and continue to grow our SME segment, and to remain, at our core, a Canadian bank supporting our clients in their international ventures."

Trade finance in Canada: a partnership approach

While Canada is seen by most to be a safe, secure and dependable market, the global crisis has demonstrated that even the most advanced, secure economies in the world will sometimes find themselves in the need of some form of safety net.

Despite some pre-crisis talk about whether or not export credit and insurance agencies played a useful role in the facilitation of global trade, and some serious discussion about whether it was time to dismantle the global ECA network, the financial and economic crisis has put an end to such ruminations.

Most commentators, including those least favourably disposed to ECAs, have acknowledged that top-tier export credit and insurance agencies have played a critical, even indispensable role in mitigating the impacts of the credit crisis and the financial and economic crisis which followed.

In this respect, Canada's experience has mirrored that of several leading economies across the globe. The competitive tension – some would say animosity – that had characterised the relationship between the banks and Canada's ECA, has been materially reshaped by the global financial crisis and by the partnership-based response which quickly took shape between the➤

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Scott Shepherd at Northstar Trade Finance in Vancouver

➤banks and Export Development Canada (EDC).

In addition to the increased profile of trade finance within the Canadian financial sector, this partnership dynamic between the banks and EDC, may be one of the important, enduring consequences of the global crisis for Canadian trade finance.

Stephen Poloz, senior vice president, financing at EDC notes: "The global crisis has demonstrated, compellingly, the continuing value in maintaining a global network of ECA's, even in Canada where our financial institutions and our regulatory environment were among the most robust and effective in the world in withstanding the shocks related to the crisis. At EDC, we have adopted – and executed – a strategy of genuine partnership with the financial sector in Canada, even as our mandate has been temporarily extended to enable a broader range of engagement, both geographically and in terms of the transactions we can now support. In the end, the crisis is demonstrating that in Canada, we have devised one of the more effective trade financing models in the world, and at EDC, we have been able to step up and support this system quickly, decisively and effectively over the course of the crisis."

While the crisis has certainly shifted the bank-ECA dynamic in many parts of the world, most agree that the relationships will again 'normalise' in a post-crisis world, and that the scope of operations of ECA`s, including Canada's EDC, will end up somewhere between where it was pre-crisis and where it is today.

The strength, resilience and stability of the Canadian trade finance market is recognised both locally and internationally, and while some might persist in faulting Canadian trade financiers for their decidedly conservative streak, it must be acknowledged that caution, conservatism and consistency have been important in cushioning Canadian business and the Canadian financial sector from the worst effects of the global crisis.

Vision and innovation have their place

Even as top names in global banking and trade finance in the US, Europe and elsewhere have been effectively nationalised, face the prospect of bankruptcy or perhaps worse, the probability of being disassembled, decisively and unceremoniously by regulatory authorities, there are indications that vision and innovation still have a place in the business of trade finance, even in one of the most conservative markets on the globe today.

As they revert to basic principles, Canadian bankers remain cautiously open to the notion of innovation in the business of financing international trade. The increased credibility and profile earned by trade finance within Canadian financial institutions will provide a more solid foundation than has historically been available, for trade finance executives to undertake such innovation.

Philippa Fitzsimons, director, supply chain and trade solutions at BMO Financial Group in Toronto observes: "The Canadian trade finance market has indeed been resilient throughout the crisis; at BMO, we are working to strike a balance between continued careful application of our credit and due diligence measures, and a commitment to innovate in support of our clients' activities in international trade. We remain engaged in the development of solutions which address traditional trade finance needs, as well as those associated to open account and supply chain finance, given the importance of such transactions to our North American client base."

She adds: "At the level of our FI relationships, we are open to exploring a variety of partnership models, from operations insourcing to risk-sharing transactions. Overall, our value proposition in trade finance is very solid, across North America and in the international markets where we support our clients' activities."

Most foreign banks have been forced to retreat from the Canadian market and many non-bank providers of trade finance have disappeared from the global market over the course of this crisis. Technology-based trade finance providers have, some say, lost ground as clients look to align with those traditionally best placed to provide financing in addition to technical infrastructure. Amidst this re-drawing of the trade finance map, the market in Canada remains active and vibrant, supported by banks, government agencies and private sector providers throughout the worst crisis since the Great Depression.

Scott Shepherd, president and CEO of Northstar Trade Finance in Vancouver observes: "At Northstar, the global crisis has been a proving ground for our unique an innovative partnership model; while we certainly faced an increase in funding costs, the critical success for us has been our ability to stay the course – to meet our commitments to our clients and expand our service to new exporters and borrowers, and yet to continue to treat our clients consistently and well though the worse parts of the crisis. If Northstar did not exist since 1994, we would have had to invent it today, to provide an alternative trade financing source to certain segments of the market. Going forward, we continue to develop our partnership model into a solution which provides value to importers and exporters under the globalization-based 'Integrative Trade' model, where we can leverage our credit adjudication and loan administration skills, in support of exporters, internationally."

The global financial crisis has created immeasurable hardship in many parts of the world and although there is increasing, if cautious, talk of recovery, it is clear that the Canadian financial sector has gained in profile and in stature as a result of its ability to withstand the impact of the crisis. Similarly, the business of financing international trade has earned some measure of its due credit within the context of the broader Canadian financial system, and more widely in international markets.

Is there an opportunity to export the Canadian brand of international trade finance, and if so, will that opportunity be taken up by trade financiers in the Great White North? It would not be the first time Canada's international presence and moderating influence were felt to a level that exceeds its proportional size, financially, economically and politically. In the evolving reality of the post-crisis world, it should likely not be the last. ■