

UNOFFICIAL TRANSLATION

Federal Department of Finance
Banking Section of the State Secretariat for International Financial Matters (SIF)

Geneva, September 15, 2022

The French version is authoritative

Statement within the consultation procedure: Capital Adequacy Ordinance (OFR)

Dear Sir or Madam,

We refer to your letter of July 4, 2022 and ask you to accept our position on the amendment of the Capital Adequacy Ordinance (OFR).

The Swiss Trading & Shipping Association (STSA) is a non-profit and politically neutral association. We represent companies active in commodity trading and shipping, banks that finance trading, as well as related services. Since its foundation in 2014, STSA has been the umbrella organization for the sector in Switzerland, bringing together three regional associations (Geneva, Zug, Lugano) with over 180 members.

Although this revision concerns primarily the Capital Adequacy Ordinance due to the implementation of the Basel III final reforms, we would like to raise the following elements of concern for our industry, which we believe should also be reconsidered. We refer to the Net Stable Funding Ratio (NSFR) introduced by the Basel Committee following the financial crisis of 2007-2008 and during the Basel III reform. The NSFR concerns the one-year liquidity. For the implementation of this ratio, the Federal Department of Finance and the FINMA have amended the Ordinance on the liquidity of banks and securities firms, and this amendment came into force on July 1, 2021. However, the implementation of the NSFR ratio as adopted in Switzerland poses a twofold challenge for Swiss banks specializing in Commodity Trade Finance (CTF):

1. The regulation creates a major interest rate risk and funding mismatch for certain lending business of banks, which goes against the aim of the Liquidity Ordinance and that of the NSFR. Furthermore, the ratio requires banks to refinance with debt with a maturity of more than one year the loans granted to clients, which in our industry are very short-term (one to three months) and whose amounts fluctuate significantly. These requirements obviously lead to a significant additional cost of refinancing for the banks with, in return, not a reduction of risks, but an increase of risks. Indeed, banks, forced to finance operations with a maturity of less than 3 months within one year or with retail deposits, are now exposed to the financial risks of such an "anti-transformation".

- Moreover, given the very specific characteristics of the commodity trading related transactions (very short maturity, mostly less than 30 days, uncommitted credit facilities, transactions secured by physical collateral, etc.), the proportion of Required Stable Funding (RSF) applied to them, i.e., 50% uniformly, is perceived as too high. It is in fact equivalent to that applicable to a six-month firm cash advance without associated collateral. Moreover, the European Union, in its implementation of Basel III, has provided for a special provision for Commodity Trade Finance transactions with a duration of less than 6 months (i.e., the majority of transactions) which sets the weighting and therefore the liquidity requirements associated with these transactions at 10% (instead of 50%)¹. **As a consequence, since July 1, 2021, Swiss banks specialized in commodity trade finance are penalized vis-à-vis European banks (which benefit from requirements 5 times lower), which leads to a distortion of competition between Switzerland and the European Union to the detriment of Swiss banks, even though they are leaders in this sector.** We note that the Basel Committee considered this deviation by the EU from the BCBS NSFR standard as not material in its latest report of the “Regulatory Consistency Assessment Programme (RCAP) – Assessment of Basel NSFR regulations in the European Union”².

The Federal Council, in its answer of August 18, 2021 to the parliamentary question raised by Mr. Christian Lüscher (21.1041) on this subject, defended the maintenance at 50% of the ratio applied to Commodity Trade Finance operations by questioning the effective maturity of the operations and the sovereign decision of the banks (absence of obligation) as to their renewal. The players in this market unanimously disagree with these arguments and reaffirm that, in Commodity Trade Finance, transactional credit lines are uncommitted, the contractual maturity of each drawdown or credit operation strictly sets the limits of their commitment, and consequently, of their need for liquidity. There is therefore no reason to overweight these transactions in relation to their maturity, to cover supposedly implicit additional commitments.

As for the question of the distortion of competition highlighted above, it is real and significant and all the more so since most banks active in CTF also operate (via a parent company, another subsidiary or branch) in an EU country, and may thus be tempted to make unfavourable arbitrage for Switzerland. The improvement in the treatment of off-balance sheet contingent liabilities (reduction of the weighting from 5% to 0%) stated in the above-mentioned response of the Federal Council, and incorporated in the amended Liquidity Ordinance that entered into force on July 1, 2022, cannot compensate for the current distortion, given the smaller volume of irrevocable off-balance sheet liabilities and the relatively small impact of the proposed modification on the overall ratio. **The distortion of competition has become even more significant with the recent rise in interest rates. One-year USD rates (Swap OIS) have risen from 0.10% to 3.40% in one year (i.e. an increase of 3.30%) while at the same time overnight rates (SOFR Overnight) have risen from 0.05% to 2.30% (i.e. an increase of only 2.25%). This steepening of the yield curve increases the penalty for Swiss banks.**

¹ Art. 428v of Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019 – CRR2.

² [Regulatory Consistency Assessment Programme \(RCAP\): Assessment of Basel Committee's Net Stable Funding Ratio standard - European Union \(bis.org\)](https://www.bis.org/regulatory/consistency/assessment-programme/rcap/).

The Federal Council agrees that Switzerland's position in world commodity trade is based on economically advantageous framework conditions.

In order to maintain this advantage and taking into account the secured and short-term nature of these transactions, **we request the Confederation to grant commodity trade finance transactions with a maturity of less than 6 months a specific weighting coefficient for the required stable financing (RSF) of 10% (by creating a new subcategory 2.2 - Unencumbered trade finance on balance sheet related products with a residual maturity of less than 6 months in Appendix 5 (Art. 17m)).**

I am convinced that the Confederation will support the development of the Swiss commodity trading and shipping hub in the face of competition from foreign markets. Please accept the assurances of my highest consideration.



Florence Schurch

Secrétaire générale, STSA