The Important Role of Transaction Banking in Global Economic Recovery

Introduction

BAFT-IFSA is an international financial services trade association whose membership includes a broad range of financial institutions throughout the global financial community. As a worldwide forum for analysis, discussion, and advocacy in international financial services, BAFT-IFSA members provide leadership to build consensus in preserving the safe and efficient conduct of the financial system worldwide. BAFT-IFSA focuses on the needs of its membership and the transaction banking industry as a whole.

BAFT-IFSA members are concerned about the unintended consequences that Basel Committee on Banking Supervision recommendations for capital and liquidity requirements could have on the transaction banking industry. Transaction banking remains an integral facilitator for driving global economic recovery.

The Importance of Transaction Banking Services

Transaction banking businesses facilitate and enable the management of short-term cash, payments, securities safe keeping, trading and settlement, and cross-border trade for corporate and bank clients. The nature and scope of transaction banking varies across different banking organizations, but there are common components amongst banks. As an intermediary for the global commercial flows of corporates and institutions, bank transaction service businesses are the means by which trillions of dollars in global settlement flows travel. These payments naturally give rise to operating and reserve account balances maintained with a service provider or infrastructure in current and other depository accounts. In addition, transaction banks offer an array of linked liquidity management tools and short-term investment options to optimize working capital for commercial activity.

Transaction banking comprises three fundamental client services which enable the generation and execution of global trade and commerce. First, payment and cash management products include electronic/paper-based payments, receivables solutions, liquidity management solutions, and electronic delivery channels to multinational companies, middle market companies, small- and medium-size enterprises, financial institutions and public authorities. Second, securities services provide comprehensive cross-border and domestic securities solutions to corporate and institutional clients through custody, fund administration, clearance, corporate trust and loan agency arrangements. Third, trade and supply chain financing assists customers ranging from small businesses to global multinationals with their import and export requirements, by providing import/export financing, trade risk mitigation, documentary processing, electronic trade products, structured trade finance and supply chain solutions.

The provision of securities services, payments and cash management is performed by banks, non-bank financial institutions, fund managers, and brokers. Trade and supply chain business is provided through
confirming, reimbursing and advising banking institutions. Corporate customers also use transaction banking services through sole traders (sole proprietorships), partnerships, and limited companies at various ends of the supply chain and payments businesses.

Transaction banking is crucial for the provision of liquidity within banking systems and between national markets. Interbank payments and related interbank lending ensure the smooth functioning of national economies and have a direct influence on the safety and soundness of the global banking system.

Transaction banking is also historically less risky than other forms of financial services. This is particularly true of the trade finance business undertaken by banks worldwide. Trade finance liabilities arise from trade-related obligations underpinned by the movement of goods or services and secured by commercial contracts that document the arrangements between buyer and seller. Trade finance exposures are also generally short term in nature and self-liquidating. A survey by the International Chamber of Commerce (ICC) and the Asian Development Bank (ADB) in September 2010, indicates that banks have experienced relatively minimal losses on trade lending. According to the survey, 1,140 defaults have been reported within a full data set of 5,223,357 trade finance transactions over five years.\(^1\)

Transaction banking is fundamental to global commerce. World Trade Organization (WTO) and International Monetary Fund (IMF) statistics valued global trade alone at $16 trillion in 2008 and a vast amount of this trade was underpinned by the services of transaction banking. Many SME’s in emerging markets use trade finance as an alternative to revolving bank loans. This could have a significant impact on SME’s which generally do not have an alternative source of funding. Given the importance of the emerging markets and SME’s in economic recovery, any limits on the availability of trade finance could slow economic recovery.

Given the essential daily role of transaction banking in international commerce, BAFT-IFSA members are concerned that certain recommendations of the Basel Committee may limit banks’ ability to provide these necessary services to customers and could have an adverse effect on economic recovery. BAFT-IFSA submitted comment letters to the Basel Committee regarding these concerns in April 2010\(^2\).

**Conclusion**

BAFT-IFSA members support the Basel Committee efforts to strengthen the banking sector; however, the unintended consequences of current proposals affecting transaction banking may limit a full and meaningful economic recovery. These banking services, particularly trade, are fundamental to maintaining a sound global banking environment and remain a critical component of facilitating global economic recovery. BAFT-IFSA believes that a more rational treatment of transaction banking activity by the Basel Committee will ultimately have a positive effect on financial markets and will help spur economic growth worldwide.


\(^2\) www.baft-ifsa.com