



May 28, 2021

FICC Markets Standards Board (FMSB)
125 Old Broad Street
London, EC2N 1AR
Via email: secretariat@fmsb.com

RE: Transparency Draft of Standard on use of Term SONIA reference rates

Dear FMSB Secretariat:

BAFT (The Bankers Association for Finance and Trade) appreciates the opportunity to comment on the FMSB Transparency Draft of Standard on use of Term SONIA reference rates. BAFT is an international financial services industry association whose membership includes a broad range of financial institutions throughout the global community. As a worldwide forum for analysis, discussion, and advocacy in international financial services, BAFT's nearly 300 members provide leadership to build consensus in preserving the safe and efficient conduct of the financial system worldwide. BAFT member institutions have been working steadily to prepare for the transition away from LIBOR. Recognizing the unique characteristics and requirements necessary for trade finance products to transition, in January 2020 BAFT formed a global working group to assess and address the challenges that institutions will face during the transition.

Trade finance products broadly reference LIBOR term rates due to their transparency of pricing and certainty of funding costs. It is estimated that 80-90% of global merchandise trade (approx. USD19.48 trillion for the year 2018) is reliant on trade finance¹. The transition away from GBP LIBOR to SONIA will have a deep impact across the suite of trade finance products. Trade financing assists customers with direct financing of their commercial activities with buyers and suppliers to meet their domestic and international financing requirements and cross border import and export finance requirements, risk mitigation and improving working capital efficiency. Trade finance exposures are diverse in nature, shorter in tenor, self-liquidating and exhibit different terms and payment patterns than other corporate banking products. Trade transactions have multiple counterparties across different client segments which include consumers, top tier local corporates, large multinational corporations, global suppliers, financial institutions and government agencies.

BAFT members have closely tracked the development of Term SONIA. We understand that limited use of Term SONIA will help to preserve the necessary conditions for a robust Term SONIA rate for the benefit of all market participants. We welcome the recognition that, Term SONIA, is needed where market

¹ WTO Economic Research , Global Trade Finance Data

participants need advance knowledge and certainty of their interest rate obligations or where the rate is used for discounting future cash flows such as in trade finance.

Use of Term SONIA for trade finance enables the effective ability to price trade financing activity across the product set. Forward-looking term rates have been used by the global trade industry for financing and risk mitigation and allow for simplicity in daily high volume, low value activity across a myriad of underlying products, many of which commonly have discounting features. The following section provides an overview of the different types of trade finance products and demonstrate the rationale for use of Term SONIA.

Discounted trade finance products

A large number of trade finance products currently rely on a forward-looking term rate, which is transparent, observable and fixed for a defined period of time, for instance a 24-hour window. In trade transactions, there are often multiple parties involved, the buyer, supplier and the two counterparties' banks. In the absence of a transparent and observable forward-looking term rate, with the 24 hour fixed window, the banks in these transactions could be applying different rates. In a discounted trade finance product a bank provides cash flow to a supplier today, which is otherwise due to them at a point in time in the future based on the original terms of sale, and therefore, it is provided at a discounted value.

Trade payable and receivable discount financing products are usually initiated by larger corporate buyers and often geared towards helping to improve working capital efficiency of their SME corporate suppliers, who may be less sophisticated, often lack a dedicated treasury function and may have less capability to adapt their processes and technologies to handle the transition. While the suppliers may be smaller, the importance of these products and costs of using them upfront cannot be ignored. The discount is passed on to these smaller suppliers who pay a lower discount rate for an early payment option that if it were too costly, would not be a viable solution to improve their working capital.

The financing of account receivables in trade finance receivables products are often initiated by more sophisticated suppliers to receive early payment on their outstanding invoices to their customers (i.e. accounts receivables on the suppliers' balance sheet). The supplier sells a receivable or multiple receivables to a financial institution. The discounted cost of account receivable financing typically includes a reference rate component with such rate derived from the forward LIBOR curve, matching the financing tenor of the receivable being purchased, and therefore will be affected by the transition. A Term SONIA rate is required to avoid disruption in the flow of commercial goods and settlement of payments.

This calculation of the discount must be completed on the day that the money is advanced. Therefore, there must be a forward-looking rate to enable the calculation that is also observable and transparent to the parties involved so that the costs of utilizing this funding option are known to all parties and all parties can effectively manage their cash flows and working capital.

Loan-type trade finance products

Loan type Trade products generally have specific, larger underlying principal amounts, longer tenor terms and commercial conditions that differ from shorter-term discount instruments and supply chain programs. Trade finance loan products include import and export loans as well as Export Credit Agency Loans that are supported by sovereign Export Credit Agency, ("ECA") credit support. These export credit agency loans, structured import and export finance trade loans, currently reference forward-looking term rates when determining the rate applied. Clients utilizing a trade loan may be sophisticated borrowers (large corporate, banks, other financial institutions and government agencies) that require alignment between anticipated

cash flows and derivative products to ensure effective and efficient hedging on these larger and longer-term transactions.

Export Credit Agency (ECA) backed financing is often used to cover longer-dated and emerging market related transactions. An ECA provides repayment guarantee to lenders for these transactions. ECA loans typically support the building and production for aviation, shipping, energy and infrastructure projects. Without these trade loans these large capital projects would be more difficult to plan and execute and would have an adverse impact to the underlying overall economy. To assist in the continued facilitation of these trade loans, a Term SONIA rate enables determination of the future interest payments and allows borrowers to plan their cash flows in advance of the due dates. In most cases the limiting factor is not the product, but the jurisdictions and types of borrowers involved. Such borrowers may not have access to derivatives markets to obtain forward rates, while advanced knowledge and certainty of principal and interest payments is a prerequisite. ECA lending and export/import finance currently utilize a forward-looking rate that is needed to continue to provide clarity for settlement regarding the payment of principal and interest, as well as hedging.

There is a robust rationale for using Term SONIA for all trade finance products. A limitation for some trade loans would be hugely disruptive to trade asset pricing and trade clients. We urge the FMBS to clarify that Term SONIA may be applied to all trade finance assets as this will simplify implementation and system changes, as well as ongoing operational risks. Operationally, the use of SONIA compounded in arrears is not appropriate or operationally achievable for the global ecosystem supporting trade finance. Offering overnight SONIA compounding in arrears would be hugely disruptive to trade asset funding and trade clients who will not have clear sense of upfront costs e.g. for a 90 day import loan.


Multiple examples of trade financing use cases demonstrate the suitability of Term SONIA which apply many of the characteristics described above.

- Trade financing request such as a pre-export loan in emerging markets for corporate counterparties where the underlying flow is GBP-denominated benefit from Term SONIA for pricing as it allows the exporter to have advanced knowledge and certainty of the interest charge for the expected cost of the trade transaction.
- Trade discounting requests such as supply chain financing activity or discounting of trade bills (in Asia) and advancing payment tied to an underlying trade flow to enhance the working capital cycle of import and export activity for global counterparties. Interest is fixed ahead of the period, can be deducted upfront to accelerate payment ahead of the standard payment term of the buyer/seller commercial terms.
- Forward-looking term rate enables the ability for the industry to interpolate mid-period dates for trade financing where the short-term periods align to the payment flow, e.g. 75 days, 120 days.
- Trade financing requests to financial institution (FI) counterparties are tied to underlying trade flows and cover pre and/or post-shipment activity where an FI client can use the advance with the interest fixed and transparent upfront to finance the underlying trade flows originated by them with their corporate counterparties. The global industry leverages standard SWIFT format for each transaction which includes the simple remittance instruction that the fixed rate allows. There are no fluctuations in the financing amount unless it is prepaid in advance of the maturity date (typically less than 1 year).

The trade finance industry's ability to fully transition the product suite to Term SONIA will ensure a smooth transition for FIs and increasing pricing transparency for clients. As the trade finance industry prepares for cessation across all currencies, we look to FMSB to set the standard for trade finance use of term reference rates. This will especially key as the ARRC moves forward with Term SOFR and establishes use cases.

We appreciate you taking into account our response. Should further information regarding or discussion of any of these matters be desired, please do not hesitate to contact Diana Rodriguez, Vice President, International Policy at drodriguez@baft.org.

Very truly yours,

A handwritten signature in black ink that reads "Tod R. Burwell". The signature is written in a cursive, flowing style.

Tod R. Burwell
President and Chief Executive Officer