Trade Finance Faces Challenges from Increased Regulation

New challenges for trade finance continue to spring up in our volatile world. Paperwork that used to be relatively easy has become ever more complicated due to regulations in the trade finance industry. As regulators take a magnifying glass to how money flows to prevent money laundering and terrorist financing, credit professionals need to ensure compliance through a wide range of new rules, as recently described in the webinar "Effects of Regulatory Compliance on Trade Finance," hosted by FCIB and presented by Fred Dons, head of CTF flow, Netherlands, at Deutsche Bank.

Trade finance was once about making sure your documents conformed under letters of credit and the only record of a transaction was made when money came in. Now there are a host of regulations for which credit personnel must make sure that all transactions, clients and service providers comply with laws, embargoes and regulations during the lifetime of the transaction. Globally, regulators are increasingly requesting that financial institutions widen the checks within the trade flows running through their networks, Dons said. They are on the lookout for trade-based money laundering schemes, dual-use goods and know-your-customer compliance. The result is in more time needed to process documentation, a substantial increase in false positives and a potential reluctance by banks to deal with certain counterparts or countries.

In the case of preventing trade-based money laundering, the bank will check that the price of the product reflects the correct amount. This can be easy for commodity prices, which can be found online, but it is trickier for machinery, which has no market price. The process requires increased investigation from the bank community. Also, if you give a discount, the reason needs to be given so that it is considered reasonable.

Remember that you are responsible for the complete supply chain. If you sell a high-quality paint that is also used in the nuclear industry, for example, you need to know if the company you are selling to is the end user or if they, in turn, will sell such an item to a third party for a different use than you intended. Be familiar with products and if they are on the dual-use list, Dons said.

The concept of Know Your Customer is not just about knowing your client but being able to trace and reconcile the entire chain of trade, including correspondent banks, intermediaries, shippers, etc. Several indicators may trigger enhanced due diligence by banks, including the parties and goods involved and the transaction structure itself. If a shipment of fertilizer is going to a private individual as opposed to an agricultural firm, this can set off a red flag, since fertilizer can be used to make explosives. If a document is missing or in the wrong format, this can also trigger due diligence. If a company is based in Singapore but its document team is in the Netherlands, it may take several hours to get the transaction released, since the documentation is coming from a different country. If a transaction structure is overly complicated, this can also send up a red flag.

To limit problems that may arise, make sure that your own company's Know Your Customer file is permanently updated, Dons said. Also, make sure the parties you are dealing with are not sanctioned; check before sending the transaction to the bank. Be as transparent as possible with your bank about your products and communicate the price of those products if they are not normally listed. Check with your bank what correspondent banks are acceptable. Understand that delays can occur from regulation compliance and allow time to find alternatives as they arise. Finally, perform regular checks on your clients, such as checking on Google if a company's address actually exists.

As compliance to regulation becomes more complicated, financial technology (fintech) companies are searching for solutions to make the process easier and even to automate it. Just recently, Commerzbank, Bank of Montreal, Erste Group Bank and CaixaBank joined an initiative started by UBS Group and IBM whose purpose is to build a blockchain-based technology that supports trade finance transactions, Reuters reported. The platform, called Batavia, would assist banks and their clients to automate the trade finance process. It will allow parties to track a transaction from when a shipment leaves a port to when it reaches its destination, with all parties involved sharing a data record rather than each maintaining its own records, thus reducing errors and increasing efficiency. (For more information, see NACM's blog post on the subject.)

Knowing your customer also involves knowing yourself. Regardless of what new technologies may be coming down the pike, it is always good to have a better understanding of your clients and the way your supply chain works, Dons said.