Effects of Regulatory Compliance on Trade Finance

NEW CHALLENGES IN A VOLATILE WORLD

Historically the following challenges (in no particular order) were part of your regular Trade Finance

- Making sure your documents were credit conform under letters of credit.
- Ensuring the costs of securing your trade remained within reason
- The burden of admin within documentary trade
- And who is actually responsible for trade finance in your company (is it sales, admin, treasury, clientservices ?)

Well now there is a new challenge in town

- Making sure you, your transactions, your clients and your service providers are in compliance with every law, regulation and embargos you and all of the abovementioned happen to be subject to during the lifetime of your transaction.

- *(And this in a world whereby the your bank is shrinking his corresponding network because of all of this)*

A little bit of Background

- Regulators globally are more and more requesting financial institutions Banks to widen the checks within trade flows running through their network, i.e. checking for Trade Base money Laundering, KYC, Sanctions, Dual Use goods etc. This has a trickle down effect (and with trickle down I mean a regular downpour)

- This has 2 immediate effects; - more time needed to process documentary trade (within the limited timeliness set by for instance the UCP)
- A subtstantial number of false positives
- A potential reluctance by these banks to work with certain counterparts or countries (and even industries)

What are the main topics your Bank will focus on ?

- TBML – checking for Trade Based money laundering, can a deviation from market practice be explained, does your trade processing Bank understand the products you are selling ?
- Dual Use goods – are your exports compliant with applicable law (and what is actually applicable ?)
- KYC – can your bank properly identify all the parties it needs to identify involved in your Trade Finance ?

TBML

- One of the (many)checks required from banks ;
- - the price of the product, does the price as mentioned in the transaction reflect the correct price (trying to detect under- over –invoicing)
- If and when you give a discount to your product, is this discount “reasonable”
- This requires quite an in-depth knowledge of bank employees sometimes to a level which clearly goes beyond the expected skillset of said employees (Wolfsberg acknowledges that there are limits to what for instance a Docchecker should be able to check beyond public sources)
- A Bank can within a few percentage points quote some of the commodity prices which are quoted online, but what is the correct price of a Gasturbine, or for a cargo of printers ?

Dual Use

- Please find the common denominator:
- A mascara holder
- An inline skate
- A custom aluminum bycle
- An AK 47

From the dual goods list :

- **7068 aluminium alloy**
- From Wikipedia, the free encyclopedia
- **7068 aluminium alloy** is one of the strongest commercially available aluminium alloys, with a tensile strength comparable to that of some steels.[1] 7068-T6511 has typical ultimate tensile strength of 710 MPa (103 ksi)

http://trade.ec.europa.eu/doclib/docs/2008/september/tradoc_140595.pdf

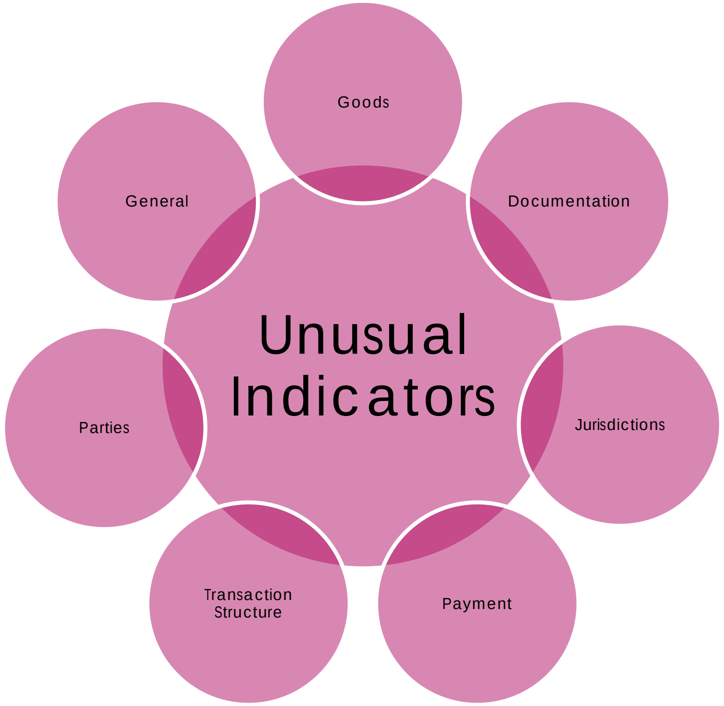
4. Aluminium alloys having any of the following:
   a. A tensile strength of 240 MPa or more at 473 K (200°C); or
   b. A tensile strength of 415 MPa or more at 298 K (25°C);

KYC

- Not just knowing your client but basically being able to reconcile the whole chain within Trade (Correspondent banks, intermediaries, insurance, shippers etc)

- Example; A Bank should do a full KYC on his correspondent bank, so far so good
- The client now requests the bank to open an **Irrevocable** import l/c available with any bank for negotiation.
- Documents are presented through a bank on which the issuing bank does not have a KYC file – and therefore he should not pay, yet his instruments obliges him to pay – do you see the conflict ?

What can trigger an enhanced due diligence



The near future

- What is happening because of this ?
- - A shrinking network – if banks would need to KYC all correspondent banks (and we are talking about thousands of entities) banks would need twice the number of staff, but actually this will not happen as the cost of KYC are to prohibitive to maintain the current networks
- - bank refusing to handle certain business- coming back to the Aluminium example, if a bank is not sure whether the product is dual use or not the safest way out is to refuse to handle the transaction (!)

What can you do to limit the effect of these measures ?

- Ensure as a corporate that your own KYC file is permanently updated
- Make sure that the parties you are dealing (logistics providers, insurers, counterparts etc) are not sanctioned; check before sending your transaction to the bank
- Be as transparent as possible with your bank on your products, as an example you could communicate the price of your products if not publicly listed to avoid delays later on when presenting documents under lc's or documentary collections
- Check with your Bank what correspondent banks are acceptable (and accept that this might change overnight)

What can you do to limit the effect of these measures ?

- Understand that delays might occurs because of this and provision for this; make sure you have enough time to do necessary repairs or find alternatives
- If the size of your company permits this, make someone responsible for compliance.
- Do a regular check on your clients, KYC is not just for Financial institutions

Some final thoughts

- I'm convinced that the trade finance community will find a way to work with these additional challenges and I have seen some Fintech companies offering tools which can automate compliance check so that transactions can again be handled in a more smooth manner

- Having a better understanding of your clients and the way your supply chain works and being able to explain this to various stakeholders like Banks, regulators but also to your service providers is actually a good thing !