Three experts discuss electronic trade today and tomorrow

Electronic Trade Finance means different things to different people, but leading experts in this field agree on many aspects of the subject. Jacob Katsman, CEO of GlobalTrade Corporation (GTC), asked three experts – John J. Ahearn, Global Head of Trade, Citi Global Transaction Services (US); Ashutosh Kumar, Global Head of Local Corporate Products & Receivables Management, Standard Chartered Bank (Asia); and Markus Wohlgeschaffen, Managing Director and Head of Global Trade Finance & Services in Global Transaction Banking, UniCredit (Europe) – about what has changed over the last several years and what could serve as drivers for change from paper to electronic documents in traditional trade finance.

Katsman *How do you define electronic trade and what would you say are the noteworthy developments in the last 12 months?*

Ahearn: I define electronic trade as being able to provide support materials to our clients, being able to receive documents electronically from them and to have them settle their trade and financing electronically.

I don't believe there has been much forward movement in this area in the last 12 months. Most banks have spent their time working around the issues of the credit crisis, trying to make sure that credit is made available and that there are capabilities to provide clients with the credit they need.

We have done some work in open account transactions. We have done some work in obtaining receivables information electronically, and we have done a lot of work around our supply chain finance initiatives – but would consider all more in the normal course of doing business.

The SWIFT Trade Services Utility (TSU) is a very interesting application, but I'm not sure that it has been taken up in many markets. To me, it is much more of an electronic invoicing platform and there is still a lot of work that needs to be done around standards.

The reality is that many of our clients are not moving to electronic invoicing in a meaningful way. In the United States, while there is considerable local electronic invoicing, there are not a lot of changes for cross-border trade.

From left to right, top to bottom, Katsman, Ahearn, Wohlgeschaffen, Kumar

Katsman: *Is supply chain finance electronic trade?*

Ahearn: What most people call supply chain finance involves providing financing against the supply chain. We have a large payables discounting business, as do our competitors, and we use a great deal of receivables discounting and that interchange is becoming electronic. For payables discounting, we receive electronic file downloads from our clients, and we feed them out to various suppliers. The suppliers decide if they are going to discount.

We are getting large pools of receivables electronically from various suppliers. They, in turn, are giving these pools to many of their buyers, and we are making a decision if we are going to discount these. But this is really not electronic trade. This is digitizing what was previously done manually.

The eUCP, where you receive the letter of credit advice electronically and then prepare a set of all documents electronically, is what I would call electronic trade. Doing payables discounting and receivables discounting with electronic interchange is really only one component of electronic trade.

Wohlgeschaffen: Supply chain finance should not be considered to be new and revolutionary. We are predominantly dealing with well-known product mechanisms such as forfaiting, calculation of net present value, a notion of selling a trade credit, a receivable or payable on a with or without recourse basis. This is the essence of supply chain finance and also of electronic supply chain finance.

The big difference is that we finally have the means to use modern technology to have access to the biggest asset class in the world, trade receivables that are generated in the ERP systems of our customers. Being able to upload the data that is available electronically was the biggest leap forward in the last decade.

Katsman: *So, in your view, when somebody says electronic trade they are speaking about electronic supply chain finance?*

Wohlgeschaffen: This is mainly what we observe. This has been the most quoted buzzword in recent months. There is, of course, the ongoing endeavour to electrify trade documents, but developments there are languishing.

Katsman: *What, then, in your view has really changed in the last 12 months?*

Wohlgeschaffen: We see more and more clients implementing supply chain finance programs, not just speaking about it but actually doing it. Banks are also starting to really increase their margins on this business.

I would define supply chain finance as unleashing trapped working capital, liquidating receivables, payables and reducing operational risk and costs that are intrinsic in the physical value chain of our corporate customers. The concept of what we call Global Trade Management comprises, not only the financial aspect, but also the risk-taking and procedural aspects. This means arranging bonding facilities with state-of-the-art IT platforms like @GlobalTrade or offering cross-border solutions for export documentary credit processing using customer-centric platforms that offer tailor-made solutions for clients, thereby differentiating our bank from its competition. In other words, what we call Global Trade Management is combining supply chain finance with processing products alongside cash management and e-banking products.

Kumar: In my view, electronic trade is an ecosystem that comprises physical, financial and information delivered by electronic means.

In the last 12 months, a noteworthy development has been the SWIFT initiative for corporates that has picked up in the last 12 months on the cash management side, but also on the trade side.

What we need is more standardization and harmonization across industries. If I am a buyer and I have five different suppliers, I probably receive five different formats of invoices and packing lists. If one looks at various transport documents he will see differences as well. Most bills of lading look similar, but they are not exactly the same. If one goes to Bank A, and then to Bank B to open an L/C, he will see different L/C opening applications. They look similar, but there are still differences among them. SWIFT has come up with a MT 798 message type that works like a trade envelope. From a corporate perspective it sounds very good.

If I want to simplify my process, I may go into my ERP system to generate a message. How do I do this? There is probably no ready solution now, but there are software companies that claim they can develop a middleware to do this. But if you build the middleware without standardization concerning what an L/C application should encompass, there are challenges. Different middleware solutions may have their own differences that banks would need to adapt to.

Although a lot of work has been done in the last 12 months, that is just the tip of the iceberg. I would say that 90 per cent of the work remains to be done to take electronic trade to a whole new level.

"We see more and more clients implementing supply chain finance"

Katsman: *Did technology and the Internet really change the trade finance business?*

Ahearn: In supply chain finance, what most banks are really doing is inserting themselves into the payables or the receivables discounting side of the business. Technology has helped that business in a way, and now one can use it on a much larger scale. We have some clients that upload thousands of payments to us that are due to various suppliers, and all of the suppliers receive electronic notification that these future payments are available to be discounted. If this business were in a paper format, it could never have reached this scale. Has the technology created a whole new business? Not really. It has allowed an existing business to scale up.

Wohlgeschaffen: Experience has shown that if we want to offer comprehensive solutions we need to be able to handle large volumes with smaller value transactions. We call this "bulk receivables financing". It would not be possible without technology. This business existed before and it is not new, but the scalability we see today is only possible with modern technology.

We need to be able to automatically reconcile payments of invoices while, at the same time, being flexible in offering solutions such as prolongation of maturity dates or early repayment. Considering the huge volumes and the magnitude of transactions we handle, that would never be possible without modern technology.

Kumar: Supply chain finance has different meanings to different people. The most popular version is what people call reverse factoring or receivables financing where a large buyer submits accepted supplier invoices and a bank purchases these receivables. But there is more to it than that. There is pre-shipment, in-transit, and post-shipment components involved. Technology is enabling this to happen, but the most important thing is to understand the supply chain linkages. Technology is an enabler but it is not the main thing.

With technology you can receive more information in a much more proactive, robust and structured manner.

I agree with Mr. Wohlgeschaffen: technology has made the business more scalable, but it has not really changed the business.

Katsman *What needs to happen for the eUCP to start getting used in daily business? Do you think that because international trade was historically based on intensive paper documentation that we've had very slow adoption of electronic documents?*

Wohlgeschaffen There are a number of factors at work here. First, it is a niche product. Second, not many people know how to handle this type of business. It is also missing a kind of lobby. By default, letters of credit are still very much paper-driven and used in emerging markets where you need a high level of security. I do not expect a bank in an emerging market to invest a lot of money in an electronic trade system.

I am not one who says the L/C business is dead and that we will move 100 per cent to open account. But I am sceptical that we will soon see fully electronic handling of letters of credit documents. This is largely because we are facing diverse levels of IT development in different countries.

Ahearn: To a degree, the eUCP is looking for a business problem to solve. We, at Citi, are using parts of the eUCP, but many of our clients have not made the investments to have eUCP take off. We do not see a drive on the logistics side to go electronic. We do see Customs offices around the world starting to take electronic documents for the clearance of goods. As this becomes more accepted and standardized, it can influence a further flow of electronic documents to the banks.

Katsman *What parts of the eUCP are you using?*

Ahearn: We have some clients that have agreed to give us documents electronically subject to eUCP. We receive images of these documents, print them out and send them to issuing banks in paper form for negotiation. We are sending documents only to one bank electronically subject to eUCP.

There are two different legs that need to be fixed. One is the interface between the client and its relationship bank, and the other is the electronic relationship between the two banks. You need to have that two-way electronic flow. I am not sure there is a massive market demand to drive investment or change this way.

Katsman: *But aren't these L/Cs really subject to UCP, not eUCP, and aren't you just accepting documents electronically and remotely printing them? This is very similar to what one of our clients Metsa Group is doing with Nordea Bank in Finland. It is making documents available for pre-checking and later for presentation on its @GlobalTrade Platform, then Nordea uploads its cover letter to the issuing bank to the platform. Metsa then prints the cover letter and sends all documents to the issuing bank directly via courier, thereby saving time and getting their money quicker on sight export documentary credits.*

Ahearn: We are doing the same thing a little bit differently. We have this solution called Direct Presentation Service. With this, clients are using our DocPrep platform or they are imaging documents to us. We check them manually; clients certify that these are the documents they are going to submit; we print out the documents with our cover letter and send the package to the issuing bank. We are doing this with about 25 clients today.

The real value and cost savings in electronic documents is for the banks. If we could get real electronic documents, we could build logic to allow automatic checking of these documents that would be much more efficient than the current manual document checking. The current process is a mixture of paper and electronic presentation. We played around with OCR and found that we had an accuracy rate of around 97 per cent. But the remaining 3 per cent can cost a lot of money.

Katsman *What will be the driver for automatic checking and electronic presentation?*

Ahearn: Customs. If Customs says the only way you can have goods cleared is to present documents electronically, people will start doing that. After that, taking this flow and sending it to the banks will not be difficult. On the other hand, if banks start using electronic documents while everywhere else there's a need to present paper documents, that will not be enough to drive the change.

Katsman *Don't you think corporates can drive change in this area?*

Ahearn: Local US trade is happening electronically in cases where minimal documentation is required. With cross-border trade, by contrast, you still need original bills of lading, certificates of origin, insurance certificates, packing lists and other documents, and there's not enough standardization to trade electronically. Much of this work is outsourced by corporates to their freight forwarders, and freight forwarders create paper. As I said, the only way they will stop producing paper is if they are told by Customs that the only way they will get the goods into the country is by producing electronic documents.

There are still many countries that do not accept electronic documents. To invest large amounts of money to digitize part of the flow when the rest of the flow needs to be paper, will not drive change unless there is a huge cost savings for the corporates.

Katsman *Why are clients looking for multi-bank trade solutions and what role does modern technology have in this?*

Kumar Larger companies are looking for multi-bank solutions. Multi-banking has started in Germany and moved to other parts of Europe. In Asia we have not seen significant demand yet, especially from purely Asian-based companies.

It is interesting to note that first there was a challenge to develop multiple bank proprietary platforms for corporates, and now there are various corporate-centric platforms like GTC, Bolero and others coming to market, and the challenge for banks is how to connect to these various platforms. What would really help, as I said, is harmonization and standardization.

Katsman *Is SWIFT for corporates not an answer to this?*

Kumar The short answer to that is yes, but work still needs to be done. I will give you an example. If a company has to generate a MT 700 message, how does it do this? It requires technology, and there is different middleware for this. The technology solution picks up some information from the corporates' ERP systems and converts it into MT 700s or MT 798s. But some banks may need, say, seven additional fields more than those provided by the electronic solution.

"Demand for multi-bank trade solutions will become greater and greater"

So the corporate may go to the IT vendor and say: "I need you to add seven additional fields to the application", and the vendor will do this in compliance with its client's request. The problem is that another bank might say: "I don't need all of these seven fields; I only need five." And still another bank might say: "I only need three additional fields", and this never ends. Corporates and banks are 95 per cent there, but the industry still needs to fix the five per cent to have a harmonized system.

Ahearn: I think that demand for multi-bank trade solutions will become greater and greater. On a global basis we are seeing traction in two places. First, for standbys and guarantees – a number of companies are starting to realize that many of their business units issuing standbys and guarantees do not have a real understanding of how much exposure they have, nor do they know what their pricing is. Second, we see more concern about counterparty risk. Especially after the financial crisis, corporates want to know how much exposure they have to a particular issuing bank.

On the export side we are also seeing more demand for multi-bank solutions. In my view, this has not so much to do with the delivery channel; it has more to do more with risk monitoring and risk mitigation.

Wohlgeschaffen One important reason why more corporates are embracing multi-bank platforms is the new Basel II and Basel III rules. These rules imposed by banking regulators make it more difficult for banks to offer huge credit lines for letters of credit and bonding facilities. Corporate customers, if they have not already done so, are compelled to deal with several banks. This is a must.

Large and multinational corporations are responsible for the vast majority of import and export business. According to the Federal Statistical Office, in Germany 0.3% of all corporations account for 80 per cent of export business. These companies act globally and usually deal with 15 to 50 banks. Technology solutions that allow customers to control their ongoing business as well as connect the various legal entities and banks are very important. UniCredit is offering such solutions through its partnership with GTC.

Katsman: *How do you see the SWIFT initiatives for corporate to bank connectivity?*

Wohlgeschaffen: SWIFT has understood that the number of banks on the SWIFT network is not growing, and if they want to present interesting business models to their shareholders they have to find new customers. They have apparently defined corporates as a new target group. Consequently, all activities concerning corporate to bank connectivity, such as SWIFT Net, are very interesting for the future, and all the software providers that are SWIFT-enabled will certainly benefit from this development.

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Chinese banks and off-balance sheet loans

Bank guarantees and L/Cs are partly responsible for a big increase in off-balance sheet loans reported by Chinese banks. According to data from the People's Bank of China, the country's banks have increased these loans by 110 per cent. China's banks extended the equivalent of US$50 billion of off-balance sheet loans to companies in the first quarter of 2011. Research by Fitch reckons the value of disclosed off-balance sheet items by 16 Chinese banks is between US$3.5-$4 trillion.

Special report

Sanctions and trade finance (Part 2)

by **Kim Christensen**

In my article on sanctions in the last issue of *DCInsight*, I discussed the troublesome issue of sanctions clauses that are appearing more and more in letters of credit and noted that sanctions can be directed against countries, but are normally directed against persons, entities or specified goods and/or commodities (such as petroleum, drugs and weapons) imported from or exported to certain countries. I also observed that the main concern is clauses that go beyond informing the parties that the (issuing/confirming) bank is subject to sanctions. Some clauses may also include the bank's special provisions, which ask for more than what the sanctions imposed require.

In the second part of this article, I will look at the problems that arise concerning sanctions clauses in different trade finance instruments – documentary credits, guarantees and collections.

Sanction texts and customers

Although sanctions and compliance are governmental requirements that banks can do nothing about, there are questions that arise vis-à-vis banks and their customers – the buyers and sellers.

Most customers, when they think about sanctions at all, perceive them to be an evil created by banks in order to include some kind of "reserve" in their undertaking – e.g., "a confirmation with an escape clause". The result is that banks have a big task explaining why compliance checks have to be carried out. But since not all banks include a sanctions text in their documentary credits, confirmations and guarantees, this has become, in some ways, a competitive issue; i.e., "If your bank insists on this clause I will go to Bank X that does not have such a clause."

This attitude may not be reasonable, because the same compliance requirements would apply without the sanctions text, just as the same (most likely[1]) would apply to other banks in the same country. There are, however, some specific issues for companies doing international trade using trade finance instruments.

At the outset it is the customers who are the key here. They are the ones who determine with whom they do business, what goods they ship and to which destinations, with whom they ship, etc. It is ultimately their risk if there is a sanctions breach. There is also a global challenge in that customers may not be subject to the same legislation as issuing or confirming banks. For example, consider an EU-based company exporting goods to Myanmar. It is not prohibited for EU companies to do business with that country; however, some banks in Myanmar are on the US OFAC SDN list of sanctioned companies, which means that banks applying the list must not handle such transactions. This can be difficult to monitor, even for the most proactive banks and enterprises.

In any case, banks should be discouraged from using sanctions to gain a competitive advantage. The issues are too important for that.

Different challenges

Different trade finance products raise different challenges. Consider first documentary credits.

In the trade finance community, it is likely that the sanctions texts in documentary credits that have been the most discussed. It is here that the majority of "hits" are to be found, because the involved banks have access to the full documentation of the transaction. As mentioned in my previous article, sanctions texts in documentary credits can be troublesome if they interfere with the irrevocable nature of the instrument. But if a text merely states what governmental sanctions apply to the issuing/confirming bank, it is hard to argue against it.

Unfortunately, however, there are situations where the documentary credit text goes far beyond this. One I mentioned in my last article: ("Bank X has adopted policies which in some cases go beyond the requirements of applicable laws and regulations"). Another one, equally troublesome, was the following: