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Trade Finance in Today's Regulatory Environment

Three decades ago, trade practitioners only had to focus on the International Chamber of Commerce (ICC) rules that govern the business of documentary credits. Now, in addition to the recently revised documentary credit rules, ICC publication No. 600, they must adhere to the International Standard Banking Practice for the Examination of Documents (ICC Publication No. 681E), a checklist of procedures for document examiners to follow when examining documents under letters of credit (L/Cs), as well as a host of US and international regulations that are enforced more vigorously than in the past.

What's more, the August 2007 modifications to the Federal Financial Institutions Examination Council (FFIEC) manual specific to trade finance are certainly testing the resolve and skills of trade practitioners and compliance organizations. Organizations need to conduct a full trade finance vulnerability assessment, deal with under/over pricing of goods and services, as well as establish new policies and procedures.

Clearly, these changes are meant to ensure that enough focus and scrutiny are being applied to trade transactions. However, the degree of difficulty associated with adhering to these new requirements could be staggering. Regulators are focused on these issues and are adding to their exams the following red flags that identify unusual and suspicious transactions that must be reported:

- **Items shipped are inconsistent with the nature of the customer's business.** You must know who the customer is, what business they are in and their future plans. A steel company that starts dealing with paper goods is probably going to be viewed suspiciously.

- **Customers conducting business through high-risk jurisdictions, including transit through non-cooperative countries.** Your process must be robust enough to detect the origination and transit points to determine if you are carrying any risk with the transaction.

- **Obvious under- or over-pricing of goods.** You must recognize that a tractor doesn't cost $100 and, conversely, that the cost of a small quantity of pencils isn't going to be $10,000. Pricing is certainly challenging to monitor. However, assistance may be around the corner. An organization that says it has an innovative solution may soon enter the goods pricing space.

- **Obvious misrepresentation of the quantity or type of goods imported or exported.** Identifying such misrepresentations requires reviewing transactions with a fine-tooth comb and then making a decision based on experience and knowledge.

- **Customer directs payments to an unrelated third party.** This is rather obvious, but third-party information — who they are and what they do — needs to be known.

Additional red flags that must be investigated include overly complex transactions, significantly amended L/Cs, and shipment locations or descriptions of goods inconsistent with the terms of the L/C.

Trade finance activities require the active involvement of multiple parties on both sides of the transaction, making the process of due diligence more difficult. Additionally, the trade finance business is more document-based than other areas of banking and can be susceptible to documentary fraud, which can be linked to money laundering, terrorist financing or the circumvention of Office of Foreign Assets Control (OFAC) sanctions or other prohibitions. Due to these risk factors, banks must monitor their clients for exposure to reputational and anti-money laundering risk through a robust transaction monitoring process.

In recent years, the sophisticated products of investment banks and corporate finance departments lured clients from more traditional trade finance players. But lately, customers are flocking back to the simplicity and transparency of trade finance.

Trade finance continues to be the easiest, most cost-effective and most collateralized form of credit. It is in these difficult times that trade finance reveals itself to be a tried-and-tested method of financing.

What does all this mean to trade finance organizations? Simply that a new level of surveillance must be applied to each transaction. These new requirements raise the bar for the monitoring of money laundering and terrorist financing activities. And, without the correct advice, direction and technology, these tasks could be overwhelming.

At Deutsche Bank, our clients depend on us to take a greater role as trusted adviser and facilitator of technological efficiency and trade finance risk mitigation. We continue to strive to support their business and protect them, as well as fulfill our commitment to safeguard our country.