

# **International Trade Finance Problems & Solutions Part 1**



# Understand International Trade Finance Problems & Their Solutions Before You Regret

Today, the world is a global community. More and more products are purchased and sold in the markets. This results in companies lending money in order to keep the global supply chain functioning. Suppose an Indian wants to import the best in class coffee beans from Ethiopia, the process would be grilling. How will the Indian buyer purchase from the natives in Africa in another currency? Who will ensure that he doesn't fall prey to trade frauds? Who will ensure that he will only deal with vendors with proven track records? Who will make sure that he will receive the product within the respective timelines? Who will guide him along the customer onboarding process?

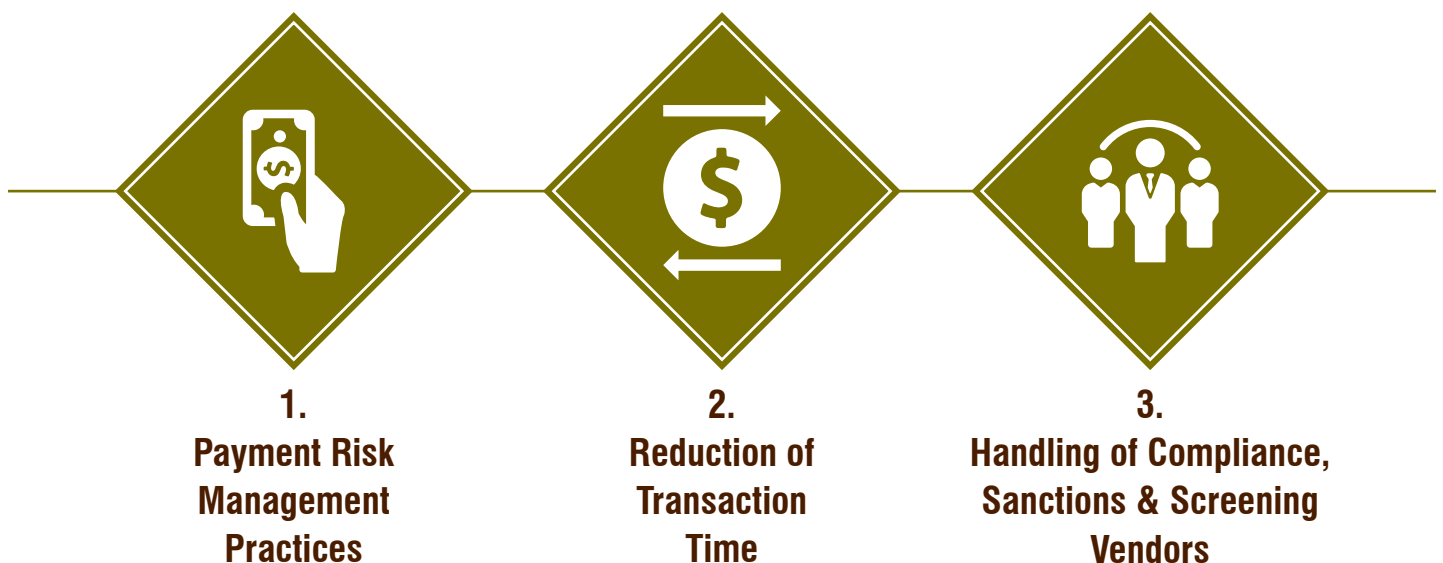


## CHAPTER 1

### 3 Eye-Openers In International Credit Policy Problems & Their Concrete Solutions

In order to cope up with constant changes and to strengthen the ability to adapt to global market conditions, a proactive credit management is required. In international environment, one needs to employ the best credit management practices by taking into consideration the stakeholders, building flexible policies for reducing risk involved with payment, minimizing the transaction time issue, identifying internal and external schemes to handle boycotts, regulations, sanctions and compliance, complete understanding of domestic trade vs. International trade, export licensing to handle export of sensitive technologies etc.

#### Topics to Be Covered:



## 1. Payment Risk Management Practices

Risk management is one of the most important factors for smooth active trading. One bad decision is enough for a trader to lose all the profits that he made during his lifetime if proper risk management is not planned. Following are some of the most important problems associated with payment risk management practices and their solutions.

### A. 3 Key Problems Associated With Payment Risk Management Practices

**I. Cheque Frauds:** Though the use of cheques has gone down significantly, it still represents large dollar transactions. Fraudsters often alter the payee name, forge signatures and counterfeit details. Another risky proposition is Cheque Kiting in which a person first deposits a non-sufficient fund cheque into an account subsequent to which he creates another cheque against that amount for a different account.

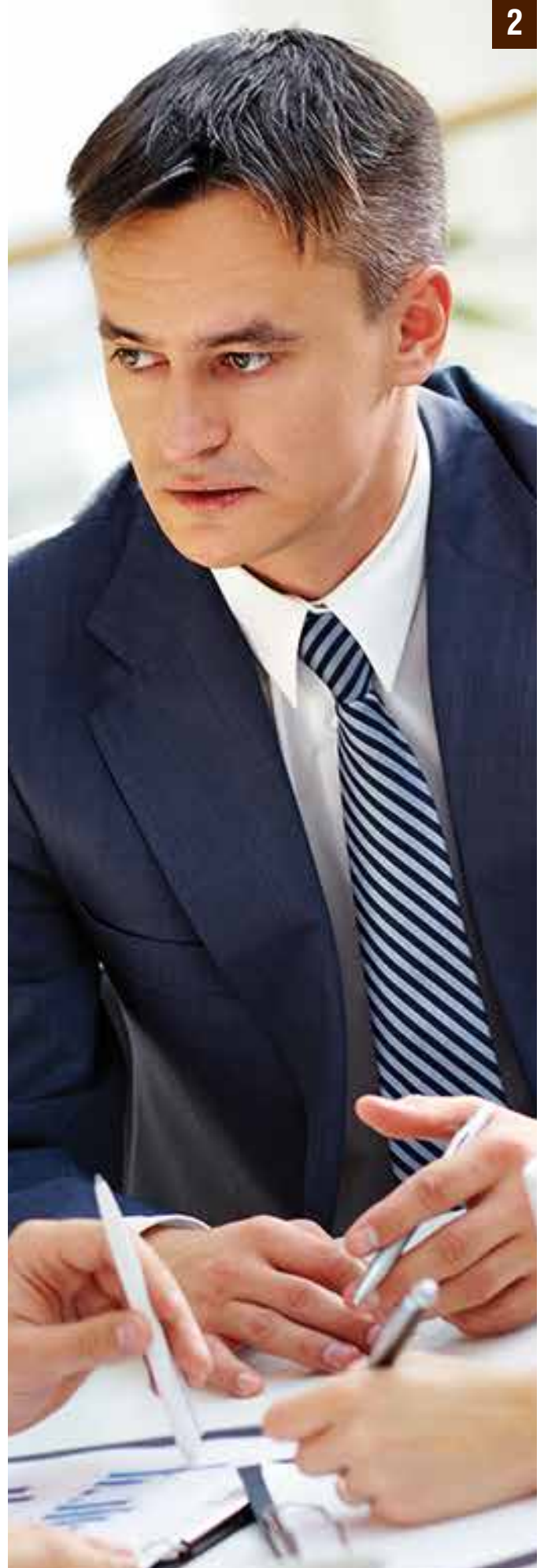
**II. Email Schemes:** Fraudently hooking and using a charitable organization's proprietary information known as Phishing is a common technique to ensure bigger paydays. Such emails often ask for financial information by means of captivating and influential language and also contain links to bogus websites that collect sensitive information on the garb of declining a payment, updating account data, or ensuring account security.

**III. ACH(Automated Clearing House) Fraud:** With many organizations electrifying their payments, ACH scams are on a rise. Methods such as hijacking are being used to access accounts for unauthorised ACH payments. Fraudsters also use Reverse Phishing to send not-for-profit emails consisting of duplicitous banking details that redirects the ACH payments to an account that the fraudsters controls.

### B. Solutions to The Above Listed Problems

**I.** To counter frauds by cheques, you should use high quality cheque stocks fitted with built-in security attributes such as chemical resistance, watermarks, micro printing, thermo-chromatic ink, fluorescent fibres, bleach-reactive stains, endorsement backer etc. Also, enforcing secure financial document destruction processes and buying stocks only from trusted merchants is a good strategy. Moreover, storing deposit slips, bank statements, cancelled cheques, and cheque stocks under tight security and vigilance is a good safety measure. Companies should also incorporate the "Positive Pay" technique in which every cheque issued by the user is matched against the cheques presented for settlement, including serial number, account number, and the amount. By authorizing the payee name on the issue file by the user with the payee name on the cheque, Positive Pay becomes more robust.

**According to American Bankers Association:**



About

**1.2M**

Fraudulent Cheques  
Enter The System  
Every Day

**&**

Losses  
Are  
Growing

**2.5%**

Annually



## A Highly Secure Cheque & Positive Pay Are The Foundation of Every Successful Cheque Fraud Prevention Program.

**Frank W. Abagnale Jr.**  
An American Security Consultant

II. Apart from creating a strong deterrent by transmuting paper-based documents into electronic delivery wherever possible, you should also mask Tax ID numbers and account numbers in your correspondence and use encrypted email for private information and confidential matters. Since a lot of decision makers are of the opinion that wrongdoers and delinquents are mostly found above board, conducting rigorous vetting of all the suppliers is a smart strategy. Furthermore, passwords of those employees who have quit your company must be changed at the earliest so that such subtle and sensitive information is not traded between your ex-employee and your competitor. The IRS (Internal Revenue Service) of the U.S Government has allowed masking of all recipient Tax ID Numbers for security purposes. So now the payee's full number is not displayed. Instead only the rightmost 4 digits are displayed so that the recipient knows his number and both his Social Security Numbers (SSNs) and company Employer Identification Numbers (EINs) are secured. As far as vetting a supplier is concerned, it is quite important to do so. John Campi, a former procurement officer and supply chain guru of various Fortune 500 firms says the following about suppliers, "How critical are they to your business, how commonly available is their product or service, and what would it cost you to switch to another vendor?"



**John Campi** further suggests that **"If your present vendor fails to deliver his services, you must give 20-30 percent of your business to an alternate vendor."**

III. ACH is becoming an increasingly popular method to siphon money from the bank accounts of unsuspecting victims by hackers. They need only two information, a bank routing number and a checking account number to perform the fraud. The best way to shield from such frauds is by using ACH Debit Block as it sanctions charitable organizations to prescribe the companies which are and which are not permitted to post ACH debits to their accounts. This process filters those companies which are not authorized to do so. ACH Debit Blocks uses system technology to juxtapose user-defined criteria against incoming ACH debits. So, when you make an ACH transfer into your company, it begins with your utility company's bank transferring an ACH debit entry to their ODFI. After this the RDFI and the ODFI communicate with the customer account in order to know that the funds are available in your bank account that is being debited. In case you have adequate funds for the amount needed, the transaction is done and the funds are transferred to your utility company's bank account otherwise the ODFI receives a return code. For example, the return code 'R01' signifies that there wasn't enough money in that bank account due to which the transaction failed. There are many other return codes that signify different results. Companies should also take advantage of ACH Transaction Review as it allows not-for-profit decision makers to create the processing rules. Combination of credits and debits can be used to filter the transactions that require review.

FBI reported

**\$100M**

Has been Siphoned  
Due to **ACH Frauds**  
in **October 2009**



**IV.** For timely and focused evaluation of each and every payment activity taking place, companies must sequester the various payment vehicles. Passive accounts must be exterminated and the active accounts must be further consolidated. Also, reporting, reconciling, and online statements must be used to expedite the process. Moreover, creating an awareness, training your employees and updating them regularly about the latest fraud trends within the organization will save them from downloading malicious software or unknowingly furnish sensitive information. Moreover, companies must also build personal rapport with a trusted financial partner who will provide new-fangled encryption techniques, exhaustive fraud vigilance and detection systems for 24/7 protection.



## 2. Reduction of Transaction Time

A lot of working capital is required for exporting materials. Also, the credit period for transport and drawn-out sales process is quite long and enlarging the credit period from 30 to 60 days or even 90 days will only exacerbate the situation as it means a trebling of funds bound in the stock of debtors. These receivables can be used as a source of liquidity and it is really essential to consider these possibilities. Moreover, the perfect use of trade Finance instruments also help reinforce the exporters' competitive power by delivering supplier credits.

**Enlarging The Credit Period From 30 To 60 Days or Even 90 Days Means A Trebling of Funds Bound In The Stock of Debtors.**

### A. 2 Key Problems Associated With Transaction Time

**I.** Absence of secure digital payment transactions: Insecure digital payment transactions is an important inhibitor of global trade. In the past few years, many instances have occurred where either the exporter or the importer has either not received the pre-decided amount of money or received it after much delay. For example, an Istanbul based textile producer who exported knitted dresses was duped by an Italian importer. The freight forwarder exported the dresses even before the payment was made and as a result of which the exporter had to pay a heavy price. When the Italian importer received the articles, he claimed that the goods were not in accordance to the description as mentioned by him. As a result, the exporter filed a case against the freight forwarder in Turkey and the latter against the importer in Italy. The Italian court declared the importer to make the payment to the exporter but the importer escaped on the garb of liquidation. On the other hand, the Turkish court asked the freight forwarder to pay to the exporter. Finally the freight forwarder paid the money but unfortunately the exporter received it after a duration of five years.

**II.** Heavy paper based documentation delays the transaction time: Paper based documentation is another inhibitor of global finance trade. About 4 billion pages of documentation is generated annually which in itself is a major hurdle in the perpetuation of global trade finance. Due to paper based documentation, traders have to deal with multiple government agencies located in different locations to obtain papers, clearances and permits. Such traditional methods of documentation not only results in the rejection of more than 50% of SME trade finance requests but also does not allow banks to increase their revenues by 10% according to BCG. Hence paper based documentation either needs to be automated, simplified or completely exterminated.



## B. Solutions to The Above Listed Problems

I. Various disruptive technologies such as MT798, BPO, eBLs have emerged that make digital payment transactions secure. MT798 (also referred as the trade envelope) is a standardized SWIFT messaging protocol that can simplify LC origination between banks and trading companies. It kept the framework for a standardized link between a corporate and its financial establishments. As soon as a bank gets an envelope message MT798, it performs various sub-message instructions that are incorporated in the file. Ideally, the communication between the bank and the firm is linked unswervingly to the firm's internal enterprise resource planning (ERP) as a result of which all the departments and the subsidiaries of the group are able to utilize a single application instead of going to separate trade portals discretely. It not only reduces process complexity but also allows companies to deal with multiple banks without any difficulty. Also, it reduces bank's costs and expands their customer base. Apart from MT798, BPO (Bank Payment Obligation) is another way of secure payment transactions. It is an irreversible document that is received by the supplier or the seller's bank from the buyer's bank after an agreement is reached to pay a designated amount of money on a mutually agreed future date by placing a constraint of electronic matching of data. It uses electronic data matching for smooth transactions between the exporter's bank and the importer's bank. It is not only faster and cheaper than LCs but also circumvents the risk of open-account trading. Foreign exchange transactions and exporter receivables financing has been made possible by BPO-secured transactions.

II. One way to inhibit the use of paper based documentation is to use Electronic Bills of Lading (eBLs). This is an electronic document that acts as a functional equivalent of a paper bill of lading as it digitizes its legal acceptance as a receipt, as a proof of or consisting the contract of carriage and also as a certificate of title. These transfer shipping documents and many other supporting documents such as certificates of origin, warehouse warrants instantly between the parties thereby leading towards paperless transactions. Digital documentation is quite secure as it is not only traceable but also cheap as compared to paper documentation. And last but not the least it diminishes the payment cycle which ultimately increases the working capital position of exporters. Recently CargoDocs conducted a client case study according to which eBLs saved approximately quarter of a million dollars per year using the platform for the refinery industry. It led to improved jetty utilisation and saved about \$100,000 per year. This impression has generated more additional time for maintenance, minimized knock-on costs while the jetty operation is quite high due to demurrage costs, and has allowed an increased capacity for loading vessels per jetty per month. Moreover, due to eBLs, there is no need of high-capacity printers, printer cartridge, courier costs, paper costs, error related costs, and document storage costs as compared to the benefits such as auto-filling and auto-distribution associated with eBLs. Furthermore e-documentation removes the necessity of appointing agents, weeds out the requirement of chasing original paper documents and re-cutting them if necessary. Also, courier costs that attract approximately 5% of shipments is also removed.

Approximately

**\$250k**

eBLs Saved/Year Using  
The Platform For  
The Refinery Industry

&

Led to Improved  
Jetty Utilisation  
& saved about

**\$100k**

per year

&

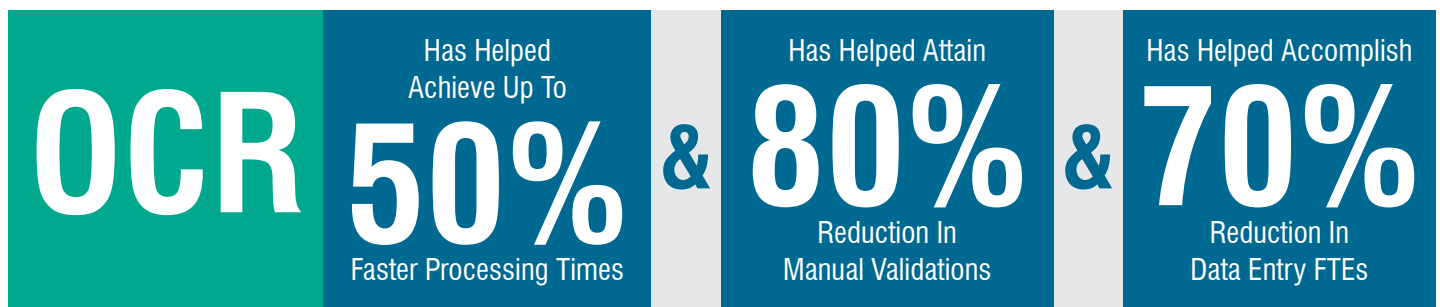
Courier Costs  
That Attract Approximate

**5%**

of Shipments is  
Also Terminated



**III.** The second way to increase the use of paperless documentation is by making use of Intelligent OCR (Optical Character Recognition) technique. It scans images and documents and converts them into files in various formats. It also recognizes document templates and automatically transfers the handwritten and paper-based content into back-end fields. This technique minimizes the compliance and the operational risks that crop up while performing tracking activities on paper. It allows financial analysts and accountants to concentrate more on technical jobs, leaving the routine jobs such as decoding and decrypting old statements and receipts to computers. It also helps better auditing and reporting on expenses as it allows audits to be conducted with efficient depth and improved turnover due to an easier search through budget reports and expense documents. This method is further enhanced by blending it with machine learning which further automates the process by insuring compliance and consistency of the document and feeding the data into the issuance systems. This helps to reduce the human-errors and also saves humans from entering repetitive data which is not only tiring to the eye but also saves the overhead costs like electricity. Moreover, it also helps to decrypt the key data available on a static layout that lets you perform functions such as depositing checks through phone thereby eliminating the need to go to a bank and stand for hours in a line. You can simply take your photo and the check amount will be available in your account in no time. After implementing this technology, banks have reported achieving up to 50% faster processing times, an 80% reduction in manual validations, and a 70% reduction in data entry FTEs (Full Time Equivalent).



**IV.** The third way to reduce the use of paper based documentation is to make use of Intelligent Document Recognition (IDR). It not only recognizes tax forms, invoices, survey forms and other administrative documents even with informal structure but also has an inbuilt storage and retrieval system. It uses a mixture of the above explained OCR technology along with rule based engines to characterize documents and organize them appropriately. For example if the document fed consists of the word 'invoice', then it will initially guess that it is handling an invoice. Later, if it finds that the document also contains terms like 'item description', 'tax rates', and 'credit duration', it proceeds to generate an invoice with proper tagged fields. The user only needs to fill the fields and save it in the file server. Moreover, since it is an intelligent system, its performance increases with repeated usage. Furthermore, it can be used along with a data mining framework to enhance classification of documents and better retrieval of data as and when required.

**V.** Blockchain being a distributed ledger technology, helps record digital transactions securely in data blocks. It is fast gaining traction and is acting as a boon as far as logistics is concerned. First of all it has increased the speed with which transactions used to occur. So for example, when a trader ships goods, he receives a paper bill of lading. Now this bill of lading needs to be sent to his bank via courier in order to obtain a letter of credit. But, this process is quite slow and can be fastened by using digital techniques such as Blockchain. Blockchain has the ability to create smart contracts that do not require any human intervention and can execute payments automatically. Another important thing that Blockchain has to offer is that it can drastically reduce regular cases of frauds in trade finance. Usually, many fraud cases occur due to paper-based processes. Moreover, it is not only the trader who incurs loss but also his bank even in an LC- covered transaction. Blockchain on the other hand has only one bill of lading for a shipment that can be verified by all the nodes present in the blockchain automatically. Moreover, banks need not invest a lot on increasing capacity for checking documents as it can all be done digitally and it will translate in a lower cost of LC's for traders. Blockchain also provides opportunities for efficient storage. In the 2008 Qingdao trade fraud case, multiple warehouse receipts were being used in multiple trade finance transactions that were withdrawing cash through inventory financing from banks. Blockchain serves a solution by restricting the quantity of issued warehouse receipts. As use of blockchain increases, analog and digital worlds will further collaborate and some day we will have digital keys to unlock a warehouse. This measure will ensure that access to digital keys is only with the person whose goods are present in the warehouse.



### 3. Handling of Compliance, Sanctions, Corruptions & Screening Vendors

Handling of compliance and sanctions related issues can deal a major blow to your company in the present trade environment. Many companies that are unable to meet the specifications often meet with huge fines, sometimes more than a billion US dollars. Compliance helps firms to achieve their original objective of doing business efficiently, reducing risk and helps to obtain their own standards of corporate social responsibility. Moreover, when a company's bank comes to know about the legitimacy of the company's trade partners and vendors and that they are not on any sanction lists, it provides a reassurance that the company can trade with confidence.

#### A. 2 Key Problems Associated With Compliance, Sanctions, Corruptions & Screening Vendors

I. Sanction risks in the recent past have exacerbated trade finance scenario. Banks are under constant pressure to improve their internal processes for vetting trade finance documentation. This is to ensure curbing of proliferation finance and financing of terrorism due to which there has been an increased focus on compliance by regulators all around the globe. These problems can be solved by bringing a capable screening process into action.

The Chinese Telecom & Mobile Manufacturer  
ZTE Has Been Fined A Hefty Fees of

**\$900 Mn**

For Violating U.S. Sanctions Against  
North Korea & Iran



#### That is screening for:

a. Dual-use and military goods: There are certain goods like Acetone Peroxide which can be used both in nail polish remover or for creating an explosive device. The basic problem is that many firms are good at screening the 'who' and 'where' of the trade but are not as capable at screening the goods. About 63% of banks routinely screen dual-use goods but they mostly rely on their staff to filter high-risk goods from low risk which is not an effective way. Some banks use software to check goods against the military list or their own list consisting of high risk goods. This can sometimes lead to false positive results which not only results in the wrong product being discarded but also tramples the bank's reputation.

b. Continually over the trade life cycle: In terms of both, time taken for the journey and the real time location of the ship, a typical trade is a long and complex journey. Sanctions change constantly. Its quite possible that you are protected at a particular instant but not throughout the journey, especially during transit. Informing clients about the real time location of the ship and whether it is sailing through a risky port is another challenge. Also, screening the original letter of credit and checking whether any changes have been introduced in it is itself a challenge. The agency needs to be proactive rather than being reactive which is a major problem area for them.

II. Effective screening of vendors: Selecting top-notch vendors is a must. A Vendor's experience in the industry needs to be checked. Ensuring that vendors are themselves not buried in debt, mired in litigation, and associated with any criminal activity is another challenge. Businesses should also check that vendors accurately and honestly record each and every kind of business information and comply with all the applicable laws regarding their accuracy and completion.





## B. Solutions to the above listed problems

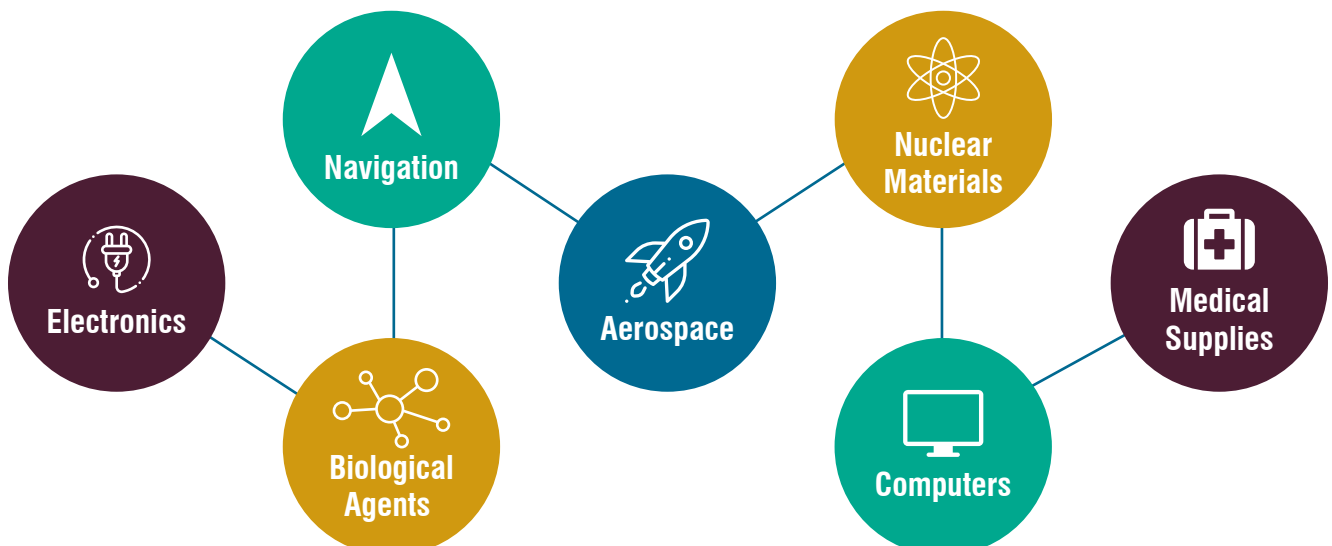
I. Terrorist financing involves collection and receipt of funds for carrying out brutal acts of violence that lead to mass deaths or serious bodily injuries or for benefiting a terrorist group. The Criminal Justice (Terrorist Offences) Act, 2005 enforced the 1999 United Nations Convention for preventing funding of Terrorism. This inserted a scheme through which An Garda Síochána can confiscate funds that are used for financing terrorism. Also, in the Criminal Justice Act (CJA) of 2010, the financial and credit institutions are obliged to take preventive measures against financing of terrorism such as monitoring and reporting of suspicious transactions, customer due-diligence etc. Countries have also accepted various targeted financial sanctions both at supranational level (EU) and at international level (UN). Once an entity or a person has been identified as a terrorist by any of the above organizations, its funds and all types of other assets are frozen without any delay and are not made available to it either directly or indirectly. Financial institutions are supposed to file a Suspicious transaction Report (STR) immediately if they spot a customer who is matched either to the UN terrorist list or the EU terrorist list and do not provide any transaction or service to that account until the report has been made. Banks and other agencies must use improved technologies such as behavioural profile technologies and complex matching algorithms in order to achieve this feat and help to create a safe, secure, and an illegal financing free environment and to reduce heavy losses in International trade.

**The UNODC (United Nations Office on Drugs & Crime) Report Suggests That All Criminal Proceeds, Excluding Tax Evasion Would Amount to Some**

**\$2.1 Trillion** which is **3.6%** of **Global GDP as of 2009**

II. Dual use goods are one of the most important aspect of international trade as on one side they strengthen economic ties but on the other hand they also promote the proliferation of WMD's (Weapons of Mass Destruction). An export control regime should be in place to regulate dual-use of goods. Standardized controls measures must be adopted by all the countries and they must fulfil their obligations under the Biological Weapons Convention and Chemical Weapons Convention. Countries must tighten the regulations further by proscribing certain dual-use goods and must allow them to be exported out of the jurisdiction area only after prior licensing/authorization. Governments across the world must produce Product Control Lists by segregating different materials into various categories such as navigation, nuclear materials, electronics, aerospace, medical supplies, biological agents, and computers and must keep a close vigilance of export and import of such materials from and into the country respectively. Furthermore, an effective compliance program must be brought into action that should reflect the risk assessment of the company, should be flexible enough to tweak its regulations, standardized procedures and export control laws, must make suitable use of upcoming technology including Machine Learning and Artificial Intelligence, and should have warning systems and modus operandi pre-installed so as to get hold of potential issues and screen them without much delay. One must always remember that advice from government, directions from regulators, counselling by professional advisors and independent bodies is a must and should be interacted more often for smooth functioning of trade of dual use goods. As far as financial institutions are concerned, they must be under constant surveillance as they are the ones who issue letter of credit, trust receipts, bank accounts, and provide import/export loans, pre-shipping facilities, documentary collections, bank guarantees and FX conversions. All the above steps will help to import/export dual goods in a relatively safe, secure and controlled environment.

**Governments Should Produce Product Control Lists to Segregate The Following Materials to Maintain A Close Vigilance:**



**III.** Sanctions are ensued by countries over an individual, or group of people, companies or other countries itself so as to refashion the strategic decisions of the non-state actors that challenge their interests or contravene international norms of behaviour. Most importantly after 9/11, smart sanctions have been issued such as travel bans, embargoes, foreign aid, and trade restrictions. Businesses and organizations have to plan out well in advance to deal effectively with sanctions without breaching them. They must have a compliance programme built around a robust policy on sanctions including multidisciplinary systems to execute the policy effectively. In order to avoid breaching sanctions, businesses which import or export from overseas should have in place a compliance programme based around a robust policy on sanctions and comprehensive systems to implement the policy effectively. They should enable customer and transaction due diligence programs and should filter out those entities who are not to be entertained by financial sanctions target lists including the Iran List, OFAC's SDN List, HM Treasury's Consolidated List etc. Also, they must ensure that all the mandatory licenses for export purposes are available and products and equipment are present in the export control lists such as UK's Strategic Export Control List. One of the most important verifications that need to be done is to check whether the imported goods are restricted in any way. Thus, companies must maintain a list of those countries and individuals whom goods and services cannot/should not be transported via a third party vendor or by any other means unless there is an exception in the sanction. Furthermore, companies also need to be well aware of contractual controls that includes warranties, sanctions and exclusions and also need to efficiently and methodically monitor transactions and constantly train their employees about new policies and procedures.



**IV.** Screening potential vendors is one of the most important tasks that needs to be done. First of all companies need to check whether the vendor shares the same experience in delivering services in your trade. This can be verified by cautiously checking the vendor's past projects and clients. Also, if the contract is a long one, it is a good idea to check the qualifications and expertise areas of the project manager and the team members. Moreover, it is a good practice to interact with the client's references so as to gain a deep understanding of the quality of services, customer support, turnaround time, and client management practices as exercised by the vendor. Checking about the probable challenges and finding out innovative and out of the box ways beforehand is necessary so as to avoid any problem that creeps up later on. One needs to note that the vendor may not be able to deliver each and everything owing to the confidentiality of terms and conditions with other clients. So, it's better to acknowledge such agreements and rather ask for samples/prototypes instead. Various other important things that need to be considered are whether the vendor works in the same time zone as you. Suppose you outsource your work to a foreign vendor, then practically speaking, a 100% overlap is not guaranteed. So both the parties, after a mutual understanding, must find out a common ground where they can interact more often. Successful interaction is only possible if reliable communication channels are available. Thus, organizations must check whether the vendors speak a common language, such as English, and are available on standard channels like phone, email, and VOIP. The icing on the cake is the time taken to respond to queries - the faster, the better. Ascertaining the vendors financial position and determining whether they have adequate capital is crucial and last but not the least, companies must never forget to check the IT infrastructure and provisions for data security that the vendor has undertaken as there is no nightmare as fearsome for a company as data theft in the present time.

#### **What companies need to check?**



**Vendor Shares The Same Experience  
In Delivering Services In Your Trade**



**If The Contract Is A Long One Companies  
Should Check The Qualifications &  
Expertise Areas of The Project Manager  
& The Team Members**



**Interact With The Client's References**

Thus, in **Part 1 of International Trade Finance**, we understood the importance of **Payment Risk Management Practices, Reduction of Transaction Time, & Handling of Compliance, Sanctions & Screening Vendors.**