

## Trade finance in today's regulatory environment

Three decades ago, trade practitioners only had to focus on the issue of the International Chamber of Commerce (ICC), rules which govern the business of documentary credits.

Now it is not only the recently revised documentary credit rules, ICC publication No. 600, it is the International Standard Banking Practice for the Examination of Documents (ICC Publication No. 681E) — which is a checklist of procedures for document examiners to follow when examining documents under letters of credit and a whole host of U.S. and international regulatory concerns, some of which have always been mandated but in today's environment are looked at more vigorously.

The August 2007 modifications to the Federal Financial Institution Examination Council (FFIEC) manual, specific to trade finance, will certainly test the resolve and skills of trade practitioners and compliance organizations. Such entities need to conduct a full trade finance vulnerability assessment, deal with under/overpricing of goods and services, as well as insert 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. We know now that regulators focus on these issues and have added 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**  
Essentially, you MUST know who the customer is, what their business is and where they are going as a company. Thus, a steel company that starts dealing with paper goods may be viewed as inconsistent.
- **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 overpricing of goods**  
You need to recognize that the cost of a tractor would not equal \$100 dollars, and conversely, the cost of pencils would not be \$10,000 dollars. This is certainly challenging to monitor.
- **Obvious misrepresentation of the quantity or type of goods imported or exported**  
Again, this requires reviewing the transactions closely 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, thus presenting another challenge.

- **Additional red flags that must be investigated include overly complex transactions, significantly amended letters of credit, shipment locations or description of goods not consistent with the terms of the letter of credit and, misrepresentation of quantity or type of goods imported or exported.**

We must recognize that 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. Lately, customers are flocking back to the simplicity and transparency of trade finance. Trade finance continues to be the easiest, cost-effective and most collateralized form of credit. It is in these difficult times, trade finance shows itself to be a tried and tested method of financing.

What does all this mean to trade finance organizations? Simply put, it means 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. Without the correct advice, direction and technology, these tasks could be overwhelming. In order to meet these requirements, we recommend a review of a banks' trade clients, to ascertain their associated risks, the scope of regulatory training for trade practitioners and the inclusion of technology — where possible, to detect any abnormalities.

Our customers 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.

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