Treasury Services

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# Trade Finance and Supply Chain Update

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# Trade Finance: What is it?

Trade Finance is a business that manages:

- The movement of **goods** from point A to point B, and
- The movement of **cash** from point B to point A.
- **Ideally** in a way that optimizes working capital for the trading parties
  - Getting funds in the hands of the supplier more quickly
  - Providing extended payment terms to the buyer.

Trade Finance consists of two components:

- Processing
- Financing/Settlement.

How you manage these is a question of your comfort with the risks of the business, your capabilities and the capabilities of your bank or non-bank Trade service providers.

# Dynamics in Letters of Credit and Open Account

Trade growth has resumed but the mix is once again changing

- -12% growth in global Trade in 2009; 14% 2010; 6% in 2011; 7% in 2012; 4% in 2013
- ~2-3% annual growth in LCs forecast
  - LCs are **not** dead, contrary to rumor! A $2-3 **trillion** market is far from dead!

**BUT –**

There is a growing focus on open account.

- Seismic shifts in how Trade is managed and what clients are looking for
- 80%+ of all Trade now managed via Open Account. What is Open Account? Pretty much any Trade transaction managed by something other than a commercial LC.
  - Funds transfer
  - Collections
  - Standby LC
- BUT, it's not as though 20 years ago, Open Account was at zero! Quite the contrary.

The issue today is the increasing difference in growth rates between LC and Open Account.

# The Situation for Trade Banks Today

Open Account service providers are facing a dilemma. Clients are moving to Open Account processing which has traditionally been undertaken without bank involvement.

To retain this business, banks and other service providers either adapt, with expectation of lower returns, or risk losing the client.

- Lower revenues are better than zero revenues but they limit your investment flexibility and may force a re-assessment of how you deliver your product.
- The "Betamax vs. VHS Conundrum": How much will you be allowed to invest and what happens if you buy the wrong thing?
- Trade bankers must now become documentary, regulatory and credit experts.
- We must be consultative salespeople.
- We must maximize automation in a business that is still heavily manual.

# Banks: Struggling to Add Value

Clients' shift away from LC to Open Account can be threatening

- Shift either means lost business or reduced revenues.....or both
- What do service providers need to do to retain this business?

Why have clients shifted to Open Account to begin with?

- Costs
- Ease of processing
- View that market risk has decreased

Where can banks potentially add value?

- Information Management
- "One-Stop" shopping
- Financing
- Risk Intermediation

**Areas of "natural advantage" for banks**

# Banks: Struggling to Add Value

To be competitive, banks must develop a “holistic” approach to Open Account, combining data and financing in ways that the corporates themselves and third party service providers cannot if they expect to add value, retain valuable clients and grow their Trade market share

- Systems issues / Technology
- Data feeds / Interfaces / Information
- Financing
- Viewing Trade as one integrated component of a complete treasury services offering
- Managing all of this AND ensuring their business remains profitable so they will have the flexibility to move with the market

# Open Account Overview

- Major Shift to Open Account
- Increasing technology requirements being demanded by clients
- Many, not all, market players considering technology upgrades
- Need to become more efficient; Need to "wring-out" additional profitability from a low-growth, manual processing, people-intensive business

***Open Account Finance is a "must-have" business, but it's getting harder and harder to justify needed investment and development. Revenue growth and new client identification is critical.***

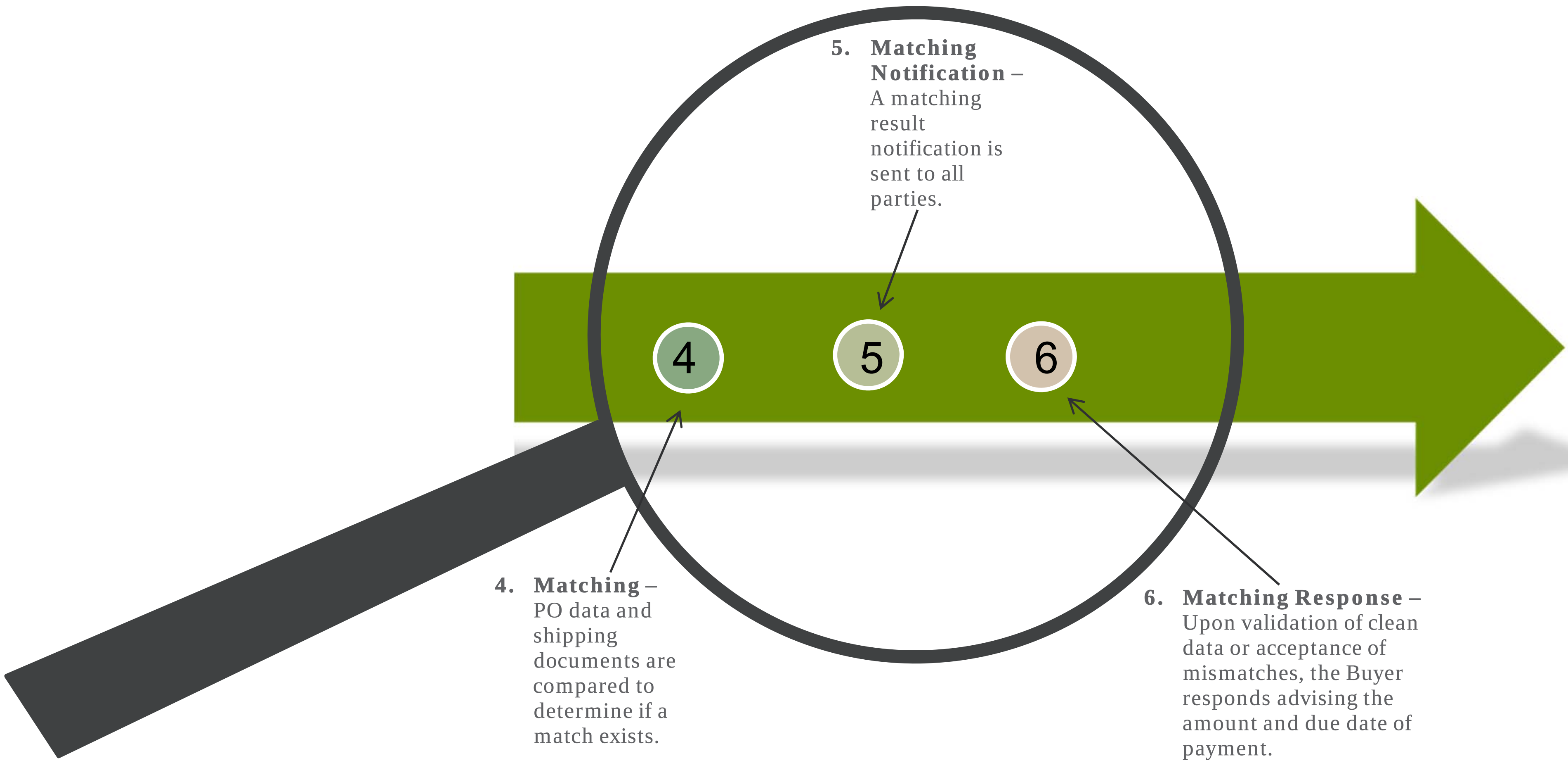
# "Open Account" Trade & Supply Chain Transaction Lifecycle

Processing | Settlement/Financing

1. **Purchase Order Delivery** – Purchase order data is sent to a service provider via secured means in the agreed format.
2. **Purchase Order Notification** – Notification that purchase order is available for viewing is sent to the appropriate parties.
3. **Shipment Data** – Invoice/shipment data and other required shipping documents are received from the Supplier.
4. **Matching** – PO data and shipping documents are compared to determine if a match exists.
5. **Matching Notification** – A matching result notification is sent to all parties.
6. **Matching Response** – Upon validation of clean data or acceptance of mismatches, the Buyer responds advising the amount and due date of payment.
7. **Payment to Supplier /Financing**– Payment is made or financing arranged .
8. **Reporting** – Transaction history data is made available to all parties.

# "Open Account" Trade & Supply Chain Transaction Lifecycle

Processing



# Sales and Implementation Issues

Sales to and implementation of **Letter of Credit** clients follow well-established procedures.

- UCP and other rules bodies make this a near-automatic process.

***But –***

Selling to and setting up clients for **Open Account** is a case-by-case process that can be very time consuming if not managed correctly.

- Extremely consultative process
- Each Buyer : Seller relationship is different.
- Delivery and document examination issues
- Data: Information and Systems
- Pricing
- Specific country requirements
- Determining which suppliers are "strategic," and which are less strategic. Cost of on-boarding goes up as strategic importance drops.

# Processing Issues

Each Buyer: Seller relationship will be different. Need to carefully define things like:

- How are purchase orders advised?
- How are documents delivered? To whom? Physically or electronically?
- How and by whom are documents examined? To what degree are documents scrutinized?
- How are discrepancies identified, communicated and resolved?
- Is the buyer willing to commit to make payment? When?
- When will transactions settle via sight payment? When will financing be arranged?

# Credit and Financing Issues

Without the well-recognized credit backing provided by the LC, trade bankers must now become corporate credit specialists.

- The challenge of providing pre-export financing
- Post-shipment finance; receivables purchases
- Can you get a buyer commitment to pay? When? Impact to the Buyer and Supplier?
- Different standards in different markets. Potentially **very** different standards.
- “Trade” finance vs. “Corporate” finance
- The challenge of perfecting security interests on receivables sales in unfamiliar markets
- The challenge of obtaining “true sale” of receivables
- How available is financing in the market? Can your provider meet 100% of your need? Do you need to work with more than one bank or provider?

# Legal and Regulatory Issues

Without the well-established and time-honored backing of UCP 600 and other regulatory frameworks, Trade bankers must now become much more focused on underlying documentation to protect themselves

- Open Account is a "legally driven" product vs. traditional Trade, which is largely "rules" driven
- Separate documentation for each Buyer : Seller relationship; each party must contract with the bank or other party providing the service
- Differing terms and conditions
- Governing Law and Jurisdiction issues
- How do you resolve disputes?
- Payment and financing conditions
- Reps & Warranties; Positive and Negative covenants
- "Trade" finance vs. "Corporate" finance

# Systems, Tech and Operations Issues

How a bank manages the following key issues largely determines whether their Open Account effort will be successful (i.e., profitable) or not:

- How much ***can*** you invest and remain profitable?
- How much staff do you add? Where?
- Trade is a traditionally labor-intensive, "people" business. Can it successfully be automated? To what degree?
- SWIFT TSU offers an opportunity for standardization. Are there others? When will we know? Is there a risk of market paralysis until we **do** know?
- Need for multiple systems vs. development of a "multi-bank" platform? Data aggregation is an important, and growing, issue.

# What Can Go Wrong?

- Lack of commitment from service provider or client to focus on the process
- Unwillingness of suppliers to participate
- Security conflict-Receivables might be pledged elsewhere
- Challenges/conflicts in arranging needed security for receivables purchases
- Changing technology. What happens when the market discovers the “standard” technology for Open Account?
- Capacity challenges from buyers of receivables
- Fragmented service providers; how do you get consolidated data when dealing with potentially many counterparties?

## New Open Account Strategies

It's increasingly important that banks address the growing Open Account needs of their corporate clients.

Many global banks have yet to fully address this challenge.

What do you build or buy? How much can you spend and remain profitable?

Biggest issue might be the lack of a market standard technology or process around Open Account? Can you afford to build or buy the wrong thing?

**Partner Bank Solution: private-label an end-to-end Open Account solution that will provide you with access to global Open Account processing capabilities.**

# Advantages of Partner Bank Solution

- Allows you to immediately start providing Open Account services to your corporate clients AND start generating revenues from this activity
- Quick implementation and extremely low cost
- Gives you time to consider your options and make the right decision re process and technology

# Important Features of an Open Account **Solution**

BNY Mellon's Trade Workstation – Open Account end-to-end solution

- Modular suite of supply chain process management products
- Tailored to *your* needs, whether a Corporate or a Bank
- Undertake processing to facilitate financing
- Web-based portal to facilitates all letter of credit and Open Account transactions via a single platform
- Features include : PO File Integration, Matching and Payment Notification, PO data files, Images of ship Docs, and Reporting
- Capabilities use *existing* technology

# Trade and Supply Chain Product Solutions

***Simple***

- Traditional Correspondent Trade & Supply Chain products
- LC issuance, advising and open account services
- Risk Mitigation for exporters
- Document Examination Services

***Moderate***

- LC issuance and open account with direct interfaces
- LC Relay services
- LC Re-issuance or TSL
- Private Label Front End systems
- Back End systems with Standard Interfaces

***Complex***

- Full Outsourcing with Multiple Customized System Interfaces
- ASP options

BNY MELLON