Global supply chains and trade finance in a post COVID-19 world

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Building a better working world

Now

Next

Beyond

COVID-19 will force banks to accelerate trade transformation initiatives.

- In the face of the current crisis, banks are running contingency plans as they strive to maintain business continuity:
  - The unprecedented and global nature of the crisis has left some players struggling to maintain basic business operations.
  - Their tactical handling of operational, fraud, credit and client engagement change is resulting in provisional solutions that may be institutionalized post-crisis.
- There are no signs that the end of this period of trade and market turmoil is near; banks must boost resilience and futureproof their business:
  - Certain processes and operations will rapidly digitalize both from a banking and an industry perspective.
  - Data will be enabled to drive improved insights across trade finance processes, and to boost transparency and trust among clients.
- Some banks will use the current crisis as an opportunity to increase their share-of-wallet by transforming their organizations.

Now, banks are ensuring business continuity amid unprecedented disruption and changing demand patterns

Challenge

Operational resilience

Back end processing centres

- Remote working including connectivity limitations in developing markets and limited availability of laptops/scanners.
- Staff unable to access physical sites impacting call centres, operations and third parties unable to provide services.
- Limitations to remote logins to corporate networks due to firewalls or limited capacity.
- Spikes in activity volumes due to market developments.
- Reduced availability of key staff due to illness or caring duties.

Paper-based transactions

- Presentation of original documents under letters of credit.
- Endorsement of bills of lading by banks for clients to take delivery of goods.
- Documents are either not correctly signed/endorsed or are incomplete.
- Dependency on courier services for forwarding and receiving trade-related documents.
- Authorized signatories are working from home and unable to sign documents (draw-down request, bills of lading).
- Additional challenge when dual authorized signatories are working from different locations.

Controls

Potential fraud

- Potential exposure to fraud due to dilution of controls.
- Increased exposure to financial crime when banks make internal deviations to process transactions:
  - Single signatory to siphon off funds;
  - Change in account details to access cash;
  - Potential duplicate financing presentation of copies of documents.

Financial resilience

Credit monitoring

- Weakened demand for non-essential goods, drives increased credit risk for Small Medium Enterprises (SMEs) and mid-corporates which feeds through to banks' P&L.
- Foreign exchange (FX) rates and commodity prices may erode borrower's profitability.
- Rising defaults could trigger a systemic reaction.
- Monitoring of collateral.
- Government backed intervention to support business impacts risk monitoring, limits and decisioning.

Client engagement

Interfaces

- Client interactions have increased, particularly in relation to document processing and the time critical nature of several steps in the customer journey.
- This has constrained existing client service models as origination, sales and relationship teams hand-hold clients through transactions.
- Clients' channel of choice may not be available due to the impact of the crisis on branches and front office staff.
- There may be insufficient operational staff available to complete manual activities. Digital channels, where they exist, may not be able to handle increased traffic.

Immediate actions

Back end processing centres

- Review contingency plans.
- Re-balance offshore work.
- Expediate transaction processing by splitting high resolution and other workflows.
- Ship safe-cards to BPO employees.
- Expediate RPA/tactical automation.

Paper-based transactions

- Bank guarantees to shipping liners to release goods.
- Clients directly endorse bills of lading to the buyers to take delivery of goods.
- Electronic documents and signatures.
- Email indemnities and telephone confirmation from clients before disbursement of trade financing.
- Centralized document management, upload and retention accessible by clients and staff.

Potential fraud

- Send regular reports to clients listing all transactions processed with deviations.
- Relationship managers should provide client call-backs to reconfirm all deviations when processing transactions.
- Strengthen controls around internal deviation process.
- Additional data analytics to identify suspicious activities.

Credit monitoring

- Review credit risk models and provisions.
- Rapid portfolio review (RPR) of trade finance exposures with credit risk team.
- Review risk decisioning, collateral policy and processes to determine how to meet changing policy demands.

Interfaces

- Boost client service models to maintain transparency regarding the status of transactions.
- Proactively communicate with customers to set expectations, reduce inbound queries and gain an early understanding of their changing financing needs.
- Turn off non-critical services where there are support constraints to ensure most critical services and operations are robust as the system is stressed.

EY solutions

Trade transformation

Target operating model	Digitalization	Risk & control	Portfolio management	Digitalization

EY supports clients to mitigate the fallout of a global downturn, delivering trade finance transformation in challenging conditions

Next, banks will re-evaluate and digitalize business and operations to promote resilience

Challenge

Operational resilience		Controls	Financial resilience	Client engagement
Back end processing centres	**Paper based transactions**	**Potential fraud**	**Credit monitoring**	**Interfaces**
In a competitive market with tight margins, banks must redefine their target operating model to rebalance their costs and client delivery methods and to do so effectively they must operate from a robust and agile technology stack.	The paper-intensive nature of trade finance is rapidly changing as banks digitize client documentation in order to maintain some semblance of business as usual; the industry as a whole will now likely digitalize more rapidly.	As banks digitalize, they are subject to new and increasing levels of risk such as third-party risk, data risk and systemic risk due to cloud adoption.	The current crisis reveals a potential disconnect between the trade credit facilities made available to a client by their bank and their actual working capital needs. Moving forward, this should be linked via robust modelling and forecasting to enable greater resilience.	Client service models are rapidly digitalizing; as engagement digitalizes client expectations will shift and moving forward, they will demand increased levels of digital interaction.

Recommended actions

Back end processing centres

- Develop a contingency system of alternating suppliers to better tackle similar situations in the future.
- Distribute BPO centres across low-cost near-shore and offshore locations
- Rebuild onshore skills such as letters of credit checking and trade documentation processing that have dwindled as offshoring of low value-add tasks increased.
- Enable staff to work remotely by provision of infrastructure, bandwidth, firewalls and laptops.
- Undertake a data management audit to maintain appropriate offsite access to and handling of physical documents.

Paper based transactions

- Digitalize underlying trade documentation by:
  - Using tools such as DocuSign or digital channels to accelerate legal contracts between banks and clients.
  - Extracting data from documents such as insurance policies, bills of lading using technologies such as optical character recognition.
- Extract and digitize data to accelerate RPA implementation

Potential fraud

- Develop and set up robust governance processes for deviations that include root cause analysis, elimination, monitoring and escalation and use of single sign documents.
- Invest in and embed a culture of external data sharing to crosscheck that underlying transactions do not have duplicate financing.
- Automate KYC and other financial crime checks at a transactional level.

Credit monitoring

- Engage governments and development financial institutions (DFIs) to hedge difficult credits.
- Unlock capital and liquidity using risk mitigation legal structures such as master risk participation agreements (MRPA), true sale securitization and insurance.
- Use advanced analytics and modelling to support an advanced internal ratings based (IRB) approach to optimize risk weighted assets (RWA) and capital without impacting clients and revenues via asset sales.
- Automate and scale volumes for small ticket transactions, supply chain financing and trade receivables financing, which are normally booked by thousands of transactions at invoice level.

Interfaces

- Provide clients transparency regarding the status of their trade transactions.
- Drive adoption of digital channels for applications, servicing and other activities which have an established digital solution.
- Increase the number of digital channels available to clients and invest to push their uptake among clients.
- Customize client solutions for emerging trade finance requirements via active engagement by sales and relationship teams.
- Develop contingency solutions for critical clients and for various client segments.

EY solutions

Trade transformation

Target operating model	Digitalization	KYC – EY Digital Passport	Portfolio management	Digitalization
Automation	Robotics	FinCrime – EY TRACK	Automation	Data and analytics
Data and analytics		Governance model	Data & analytics	Contingency planning

EY supports clients to mitigate the fallout of a global downturn, delivering trade finance transformation in challenging conditions

Beyond, trade finance will embrace an agile business environment by transforming

Operational resilience

- The "people" element is changed for banks; they must adapt to managing a cloud-based, distributed, always-on, remote workforce, including reducing key person risk and attracting suitable talent
- As the operating environment changes, new checks and controls including monitoring and evaluation systems are needed
- The current upheaval is giving rise to change that banks can embed, such as rapidly digitalized manual and paper based processes

Financial resilience

- Revenue models will shift; they may become fee-based or end-to-end processing may supersede product-based pricing
- Cost transformation will be digitally led to reduce physical channels and automate and redesign processes to drive efficiency
- Credit portfolio management will be guided by data and analytics to improve stress-testing and better model the impact of inflation and interest rate changes. While industry data sharing would allow for credit checks
- Returns can be shaped by managing risk weighted assets and as regulations change business models will evolve

Client engagement

- Some client service channels have rapidly digitalized; banks must decide how to sustain these and which areas of client engagement they want to focus on
- Client demand is changing; banks must identify the direction of change and transform to meet the demand. Clients will increasingly need services that help them manage their current credit position and their businesses in a challenging environment rather than credit facilities
- As corporates nearshore, their supply chains they will need localized product solutions

In our experience, banks can outperform in challenging conditions and uncertainty should not delay transformation. Due to the groundwork laid over the past decade, banks are better placed today to manage an economic downturn and should not miss this opportunity to transform.

Amid weak profitability, some banks still report strong growth. Their success hinges on three common traits – focus on resilience, cost and customer – which other banks can replicate to boost profitability and enable investment in transformation.

- Banks can strengthen their resilience by taking a comprehensive approach to risk mitigation to protect the business and boost returns. They can proactively tighten prudential credit risk management and continually assess assets to reduce risk and bolster capital strength.
- Banks can control costs and free up capital to invest, by building highly efficient and agile processes which will enable them to quickly change to shifts in the market, by investing in an organizational mindset of cost management and continuous improvement and by constantly assessing their cost base.
- Banks can stay relevant as client preferences change by identifying a clear client segment and planning their strategy around understanding and meeting the needs of these target clients; by developing high quality, hyper relevant services and experiences for target customers, rather than pushing products through traditional sales and markets. Successful banks continuously create new offerings that better meet the needs of customers while regularly assessing service quality to enable exceptional client experiences.

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Appendix

Overview of potential credit deterioration across different trade products

Risk will materialize differentially across trade products, depending where they sit in the supply chain, while the risk impact will vary across time with SMEs and corporates taking a harder hit.

Trade product category	Timeframe	Risk description	Risk counterparty	Investment grade counterparty risk	Non-investment grade counterparty risk
Planning	Next	Recovering funds from buyers when issuing, banks need to pay at maturity the beneficiary upon presentation of documents may become increasingly difficult	Buyers (i.e., applicant of letters of credit)	●	◕
Export letters of credit	Next	Banks discount and pay net proceeds to seller upon shipment of goods and wait to receive funds from LC issuing bank at maturity	Letters of credit issuing bank	●	●
Document collection	Now	Banks are acting as “collection” agents with a limited role to play in documentary collections	N/A	●	●
Bank guarantees	Beyond	Non-performance of undertakings that are described in guarantees could lead to increased claims as banks recover funds from applicants	Applicant	●	◑
Trade loans	Beyond	Banks extend working capital loans to borrowers i.e., buyers or suppliers to finance their trade flows (import loans or export pre-shipment and post-shipment loans)	Borrowers (either buyers or suppliers)	●	◕
Supply chain finance (SCF)	Now	Banks are discounting accounts payables in favor of suppliers based upon unconditional and irrevocable acceptance by buyers to pay at maturity.	Buyers (usually investment grade)	●	◕
Trade receivables finance (TRF)	Now	Banks discounting trade receivables could be exposed to higher dilution risks due to credit deterioration among dealers and distributors as sales decline	Buyers	●	◑
PNs / BoEs – corporate risk*	Next	Banks discount negotiable instruments (like bills of exchange or promissory notes) and take the credit risk of corporate buyers	Corporate buyers	●	◑
PNs / BoEs – bank risk*	Next	Credit risk of discounting negotiable instruments is reduced through avalizaton by buyer’s relationship bank	Banks	●	◕

* Negotiable Instruments like bills of exchange (BoE) or promissory notes (PN)

Key: High risk ○ ◔ ◑ ◕ ● Low risk

Key: Now Next Beyond