Views

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Bringing Credit Intelligence into Trade Finance Operations

Credit and fraud risk have long been the Achilles' heel of trade finance. Technology has evolved for processing transactions, but platforms have often been less effective at recognising when the risk behind those transactions is changing.

Whilst the technology exists, many have failed to orchestrate credit management and transaction processing. Recent headlines involving a major corporate collapse, disputed receivables and allegations of fabricated invoices have once again highlighted the consequences when transaction processing and underlying risk assessment become disconnected. For years, we have argued that the two cannot be treated as separate disciplines. A platform may correctly process a transaction according to the information and rules available to it, but this does not necessarily mean that the underlying counterparty or portfolio continues to represent an acceptable risk.

This applies not only to receivables programs, where the credit risk lies within the portfolio of buyers that may fail to meet their payment obligations, but also to supply-chain finance or reverse-factoring programs. In these structures, although there is typically a single obligor responsible for repayment, it may still be important to monitor credit risk at the supplier level.

This is because, in programs involving financially weaker suppliers, those experiencing financial distress may be more vulnerable to pressure from buyers. Buyers may seek to exploit this position by delaying or withholding payments that would otherwise be due. This risk is particularly relevant where the buyer does not have a direct contractual obligation to make payment to the funder.

Finally, funders may choose to introduce some form of recourse to suppliers in such programs in order to strengthen the overall risk structure. In this case, credit risk would also sit directly with the suppliers, making the need for adequate supplier-level credit risk monitoring even more apparent.

This is where the combination of our Financial Management Tool (FMT) and Trade Programs Servicing platform (TPS) becomes particularly relevant. FMT provides the financial and credit intelligence, supporting financial spreading and analysis, customised credit rating methodologies, credit limit management and portfolio monitoring. TPS provides the transaction-processing intelligence and obligor behaviour generated by the program itself, including exposures, repayments and actual payment behaviour.

When integrated, TPS and FMT create a continuous link between what the credit analysis says should happen and what is happening within the program. A credit rating generated in FMT can be combined with actual payment behaviour captured in TPS to produce a hybrid rating. Rather than relying exclusively on periodic financial information, credit teams and operators can therefore assess the counterparty using both its financial condition and its observed behaviour. Changes can automatically trigger notifications and/or credit-hold actions. The same principle applies at portfolio level. In more complex receivables and payables programs, credit exposure, payment behaviour, insured and uninsured positions, and counterparty limits may change. These should not sit in separate systems waiting for an analyst or operator to connect the dots manually. They should form part of the same risk management environment. KS-TF has consistently taken the view that the more complex and rewarding trade finance products require precisely this combination of credit expertise, automation and scalable operating processes.

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Whilst technology cannot completely eliminate fraud or credit losses, and human judgement, proper structuring and strong credit controls remain essential, it can substantially reduce the blind spots. Deteriorating payment behaviour, changes in credit quality and movements in exposure can be identified earlier and considered together rather than in isolation.

We should therefore not accept major credit failures as an unavoidable feature of trade finance, nor should we analyse the warning signs only after a program has collapsed. The objective should be to identify those signals whilst the program is still operating and there is still time to act.

This is why we believe the next generation of trade finance technology must go beyond transaction processing. Credit intelligence, actual payment behaviour and transaction servicing need to work together. FMT and TPS were designed precisely with this objective in mind.

Kendall Stevens, President & CEO of KS-TF AG

After having built reputable and sustainable trade financing operations which became market leading, KS-TF AG, Switzerland based, was created as a consulting company. Today it consists of a team of professionals with expertise in the design and development of software, covering receivables/payables processing, credit and compliance. KS-TF AG software is licensed to specific clients in the relevant sector and can be customised.