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Le dernier mot

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Jean-François Lambert explores the practical consequences of technology for commodity trade finance, following on from his curtain-raiser on how technology would affect the future of trade in TFR April 2017

If you were to think of a particularly innovative sector, commodity trade finance may not immediately spring to mind. Moving raw materials from one place to the other, documenting sales and purchases, and buying risk protection are indeed some of the most traditional and conventional activities and have not really changed for decades.

Make no mistake though, this is about to change in a big way. This, both for traders themselves but also for banks to the point where trade finance as we know it may soon be history. All this because of the combination of new technologies. Most notably, artificial intelligence (AI), internet of things (IoT) and blockchain technology will provide more certainty about trade flows. Let me explain.

Risk and opportunity stem from knowledge. A trader, aware of a potential need, or disruption in the market, will endeavour to bridge the gap to their advantage. A bank, when it has a clear picture of ownership, origin, and destination is in the best position to finance a trade. Information is everything and this is exactly what is about to happen - information will become more certain, more precise and more widely available.

Information about positioning, quality and quantity will improve thanks to IoT. So too will information about origin and destination, thanks to sophisticated modelling and algorithms. Immediate information on ownership will also improve through dematerialisation of documents and the use of blockchain technology. Two major trading houses have already channelled shipping invoicing and ownership information digitally, so documents are available at the port of destination well before the cargo arrives.

As the amount and quality of information readily available to all market participants grows, it will be more difficult to differentiate and be ahead of the market, hence trading will need to get more sophisticated. This is akin to what banks experienced when trading currencies or other assets in large, efficient electronic markets.

However, it is the way trades are financed that is going to be the subject of the most outright transformation. Documentary credits, shipping guarantees (or letters of indemnity) will no longer be of use. The former because document validity will be immediately ascertained, the latter because documents will no longer lag goods delivery. Commodity trade financing will take the form of a string of short term advances predicated on events (shipment, changes of ownership, delivery), combined with outright counterparty guarantees as precise information on who owns what and where will be available in real time and in an undisputed fashion; stocks in transit will no longer be off-limit. Security over goods will be extremely easy to perform.

Some will argue I am getting ahead of myself. Indeed, they may be right

today. Digitised documents are more the exception than the norm. Trade finance becoming mainly on-balance sheet, how is this going to work in a Basel III environment? How would regulators react to such a paradigm shift? Are they going to need another seven years of data to evidence the rate of default to ascertain the new trade finance patterns? How will the legal system adapt and treat blockchain technology and digitised documents of ownership?

All are valid points. But the current alignment of planets fostered by the combination of fast-maturing technologies are quickly creating new patterns and requirements for the world's most strategic supply chains. Global trade finance banks should embrace these changes. This is a considerable challenge for them as the dynamics of their trade finance activities are likely to be significantly altered. With fewer documents to deal with and fee revenues under pressure, they will face the need to restructure their back offices. Transactional management units, performing qualitative controls on the trade flows banks finance, may also need to be overhauled thanks to more systematic use of AI and system integration.

If commodity trade finance evolves into paperless counterparty risk taking, using an open-source yet highly secured environment, what prevents a non-banking financier stepping in and providing risk protection to sellers? Trade finance banks must become proactive now or they risk being disintermediated by more nimble competitors.

Granted, regulation and legal frameworks will need to adapt, but who is better placed than global banks to pilot this dialogue, either directly or collectively through the ICC or with the help of multilateral bodies such as the WTO? Major trade centres such as Singapore will also be keen to play an active role as they see these incoming changes as an opportunity to consolidate their influence on trade flows. To paraphrase Winston Churchill, "If you don't take change by the hand, it will take you by the throat". Well, now is the time.

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