Innovations in collateral management systems

Just two years ago, MIT the Lausanne based trade finance software vendor, launched a new system called Trade Risk Active Control (TRAC). To measure the product's success so far but to gain a better understanding of its capabilities beforehand,* Trade Finance Magazine *(TFM) spoke with Paul Cohen Dumani, General Manager of MIT.*

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TFM: ***Can you give us a brief overview of the Trade Risk Active Control (TRAC) system?***
Cohen Dumani: TRAC is a collateral management system enabling banks' front-office (relationship managers), middle-office (credit risk managers) and top managers to monitor their risks appropriately. It was designed to replace the frequently-used Excel spreadsheet in the trade commodity finance sector.

TFM: ***Why do you believe TRAC should be seen as an innovation for commodity financing?***
Cohen Dumani: It is true that banks nowadays are more or less well equipped with systems capable of supporting their back-office operations linked to financial instruments such as letters of credit, guarantees, and collections such as our own flagship product CREDOC, but it is not obviously the case for more complex financing, the monitoring of its allocated credit limits, and the management of collateral. In this case, the most frequently-used tool is an Excel spreadsheet.

The spreadsheet offers great flexibility for relationship managers to follow the evolution of their transactions, and establish the global economic position of a customer at a given time. The position is calculated on the spreadsheet by consolidating data manually coming from heterogeneous sources. The global economic position supports the decision-making process of a relationship manager or a credit comity, when deciding whether or not to finance.

Despite its proven flexibility, a spreadsheet has some limitations. It is not sufficiently secure as far as the reliability of the data presented is concerned. Spreadsheets also typically support the decision-making process for financing amounts up to seven or eight digits.

Therefore, market demand is increasing for innovative dashboard tools that can be easily integrated into a bank's IT infrastructure and are capable of automating the extraction of data coming from various systems in order to present a reliable, real-time view of a customer's global economic position.

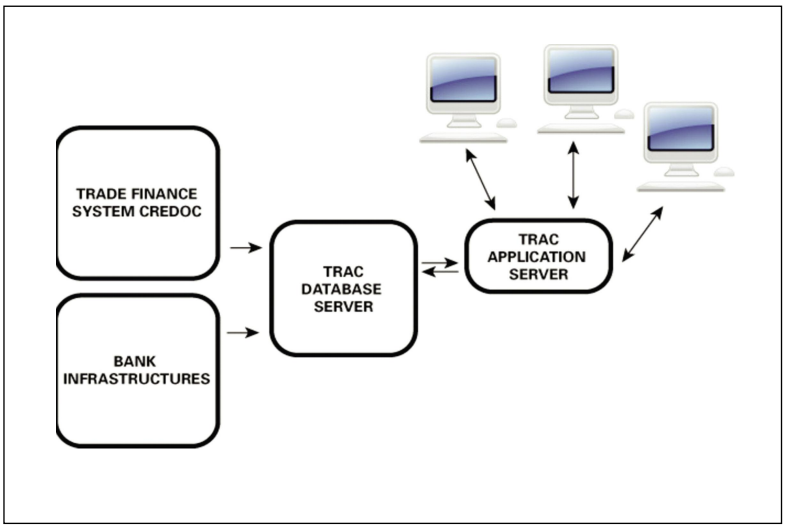
TFM: ***OK, but don't you think standard back-office systems already include notions of limits, risks, and collaterals?***
Cohen Dumani: Yes, they already do but bear in mind a trade finance back-office system or a loan system are designed to process, book, and follow up the financial instruments they automate, whether it is letters of credit, guarantees, collections, or loans. You already find notions of risks, limits, and collateral in such systems but only in the framework of one given operation.

I will propose here two notions: transaction and operation. A transaction being made of several operations of purchases and sales that can sometimes be linked to a documentary instrument such as an LC, but it is not always the case.

Nowadays, banks are engaged in more complicated financing transactions involving many operations of purchases and sales linked to LCs (import or export), open account, or even cash. Therefore, a traditional back-office system often cannot give you the complete view of a more complex financing scheme, especially in terms of monitoring collateral and the different risks involved under one transaction. For this reason, we designed TRAC, which is a complementary but autonomous software to our core product, CREDOC.

One must also bear in mind that the job tasks of a traditional back-office trade finance specialist are different from those of a front-office relationship manager. Indeed, the latter needs the appropriate tools to make decisions in terms of financing, while the former needs a tool to book and follow up its documentary business.

TFM: ***You said TRAC is complementary but autonomous to CREDOC? Can you explain that?***
Cohen Dumani: As already mentioned, the goal of TRAC is to calculate the global economic position of a customer at a given time. This can be done by aggregating data coming from a traditional trade finance back-end system such as CREDOC (eg, data on an import LC) and from a core banking system that supplies information on customers' account balances.



The industry of back-end trade finance software is quite mature, so our initial thinking was to design a system that could exchange information with CREDOC as well as with other trade finance software in the market so we could assist banks that already have a back-office system in place other than CREDOC. This gives us different options in the market. We can offer CREDOC without TRAC, TRAC without CREDOC, or both as an integrated solution.

TFM: ***Do you already come across competition for TRAC?***
Cohen Dumani: We've seen banks very interested in TRAC that have examined whether their own loan systems' providers could cover the missing parts, such as transactional-based financing (multiple purchase and sales) and collateral management that are usually not covered by traditional loan systems. On the other hand, there are many collateral management systems in the market but very few designed specifically for banks' trade commodity finance and structured trade finance activities. So, we believe that with CREDOC and TRAC, we have now a very unique and strong offering. At present, we can say that we are the only software vendor in the market that can provide both back and true middle/front-end systems in regards to trade finance.

TFM: ***Do you think there is a strong demand in the market for a tool such as TRAC?***
Cohen Dumani: In today's current crisis climate, a major area of concern remains on the lips of bankers and software vendors: "How can we improve risk management?". Trade finance and commodities financing do not escape from such debate.

Furthermore, Basel II regulations oblige banks to look more in-depth into how they evaluate their risks linked to trade finance, since it will have repercussions on capital requirements for this activity.

For these reasons, and according to our own research, we believe there is a huge demand for tools such as TRAC, because reliance on an Excel spreadsheet increases operational risk and is no longer an acceptable solution for auditors.

On top of that, we are seeing more and more financial institutions wanting to enter and compete in the commodity finance space, especially Asian and American banks that do not face a shortage of liquidity when it comes to lending in US dollars, and also do not face high exposure on sovereign debts. These banks want to take market share from some European banks, historically the key players in this activity.

TFM: ***You mentioned Basel II, in what sense TRAC will help banks make sure they comply with such regulation?***
Cohen Dumani: Basel II has already set strict guidelines in terms of capital requirements for trade finance. There will be even more constraints with Basel III. Therefore, a collateral management system for trade finance needs to give a clear view to trade finance managers of the necessary capital required for this activity at any given time, and also where savings could be made to allocate more financing to increasingly demanding customers.

Precisely, TRAC enables the follow up of collaterals with an evaluation on a mark to market basis, which is already a prerequisite for Basel II. It also enables to create specific statistics for Basel II and III calculations. The Basel module in fact enables to calculate the amount of capital required in the frame of Basel II requirements. Furthermore, the system handles features such as hedge, stock financing, as well as counterparty, country, and commodity limits that are paramount notions for monitoring trade risks in the frame of Basel II and III guidelines.

TFM: ***TRAC is a fairly new system. Are you satisfied with the response from the market so far?***
Cohen Dumani: We've been working actively for more than five years now on the issue of trade commodity finance automation because customers and prospects were pressing us to do something in this area.

In 2011, Banque Cantonale de Genève, one of the key players in commodity finance in Geneva and the first taker of TRAC, went live with the system. They reaped the benefit of having TRAC and CREDOC working as an integrated solution for their trade commodity finance activity.

Last year also, TRAC was selected by French bank Natixis, to support its commodity finance teams around the world. Natixis Paris already went live with the system at the end of June, and Asian branches (such as Singapore, Hong Kong, and Shanghai) are due to be connected to TRAC before the end of this year. Natixis New York should also roll out the system in 2013.

Finally, we are expecting one to two more sales of TRAC before the end of 2012. ■

*MIT (Micro Informatique & Technologies SA) is an independent Swiss company specialized in the development of trade finance software solutions for bankers, such as the famous CREDOC used by more than 50 banks in Switzerland, the European market, and the Middle East. MIT recently launched a new product called TRAC (Trade Risk Active Control), a Trade Commodity Finance & Structured Trade Finance Collateral Management software for Banks (more information on www.mitsa.ch)