MIT launches new collateral management software

MIT, the Swiss trade finance software vendor has just launched TRAC, a new collateral management software system for banks. **Jean-Luc Spinardi**, banking consultant at MIT explains why he believes TRAC fills a huge gap in the trade and commodity finance and structured trade finance arena.

One can observe three major schools of thought in terms of trade finance and commodities financing:

• Balance sheet-based financing. This type of "corporate financing" focuses mainly on companies with a stable and solid financial background, but requiring strong working capital to finance their core business. Such type of financing usually requires little control once the bank has decided to finance the company, and is based on the corporate's capacity to reimburse. In other words, balance sheet analysis is the cornerstone of such a financing method.

• Transactional-based financing methods that do not base themselves on a corporate's balance sheet, but rather on the goods financed. Indeed, one of the major characteristics of international trading companies, except for the large corporates around, is their relatively low capitalisation. With such method, the banks need to monitor the physical flow of goods since they represent their main collateral. Effectively, transactional-based financing requires a thorough evaluation of risks and an accurate follow-up of transactions financed.

• Structured trade finance is in fact a mix of the two financing methods explained above. This third method including balance sheet analysis and transactional-based financing is becoming more and more common, and represents the future in terms of trade and commodity finance. The purpose of such practice is that the banks can back their risks both on collaterals and on a financed company's balance sheet. This very interesting way of financing can be defined as a tailor-made solution for a corporate needing financing depending on the particularities of their activities and their cash-flows. The main difference with transactional-based financing is a stronger balance sheet allowing more complex and structured financing.

These second and third methods require a vast knowledge of commodities' markets and most of all of the customers seeking financing. In these cases, the risks will be limited in certain types of transactions due to the possession of the bill of lading (B/L). Nevertheless, the growing complexity of the financing structures and the increasing demands of the supply chain forces the banking community to design more complex financing schemes more adapted to customers' specific requests; the risks are higher but so are the perspectives of revenues for the bank.

However, a bank specialising in transactional and structured-based financing needs to consider several indicators in order to efficiently monitor this activity, more precisely the scrupulous respect of financing limits set for each customer, the level and type of commitments, the evaluation of its collaterals, and first and foremost a good comprehension of the different types of risks involved. A bank needs generally to look at the following risks:

• Customer Risk or KYC - Know your Customer: A bank's relationship manager must know his customer well, and identify whether the skills and professionalism of the latter represent a sufficient guarantee to finance a transaction.

• Country risk: Obviously, a risk is evaluated differently depending in which country the goods are located at a given time. The fact that goods may transit from one country to another, will have a strong impact on the risk calculation and evaluation.

• Market risk or price risk: Monitoring such risk is fundamental in the perspective. The goods being the only collateral for the bank, it becomes necessary to follow the price change

of commodities. The more volatile the price of a commodity is, the higher the risk becomes.

• Counterpart risk: The banks need to evaluate the risk on counterparts of transactions they are financing. Indeed, the second step of a transaction involves a counterpart to which the goods will be sold to, and whose payment will serve to reimburse the amount initially financed.

• Operational risk: The bank ought to put in place very strict internal procedures for this activity and make sure their employees follow them rigorously. Obviously, the set-up of such procedures are accompanied by the implementation of IT solutions designed to apply these procedures in a secure manner, but also to help the bankers make quick and rational decisions based on valid data updated in real time.

As a matter of fact, banks are currently evaluating whether their existing trade finance systems are still in phase with today's market standards and with the evolving prerequisites of auditors.

In today's current crisis climate, one major topic 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 the banks to look more in depth on how they evaluate their risks linked to trade finance, since it will have repercussions on capital requirements for this activity.

If 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 credits, guarantees and collections, it is not obviously the case for more complex financing and the monitoring of its allocated credit limits, and the management of collaterals. 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 committee, when deciding whether or not to finance. Despite its proven flexibility, a spreadsheet is not sufficiently secure as far as the reliability of the data presented is concerned. On the other hand, this information supports the decision-making process for financing amounts up to seven or eight digits.

> *As a matter of fact, banks are currently evaluating whether their existing trade finance systems are still in phase with today's' market standards and with the evolving prerequisites of auditors.*

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

About the company

MIT is an independent Swiss company that specialises in the development of trade finance software solutions for bankers.

MIT's CREDOC is installed in prestigious banks in Switzerland, the European market, and the Middle East. CREDOC is available on several platforms, and can be integrated in every type of organisation.

MIT recently launched a new product called TRAC (Trade Risk Active Control), a trade and commodity finance and structured trade finance customer portfolio management software for banks. The purpose of the software is to replace the Excel worksheet widely used in the trade commodity finance sector.

TRAC is a multi-entity browser-based system. Its flexible architecture allows an easy integration with any core banking solutions, or any other traditional trade finance systems including CREDOC.

For moreinformation, visit www.mitsa.ch.