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Thought leadership

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Rethinking Trade Finance Contracts: Built Better by Blockchain

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Decentralization and lack-of digitalization have made trade finance particularly susceptible to financial crime, where fraudsters can use collateral, such as an invoice, more than once to receive repeat payments. Recent regulatory actions against major global banks indicate that trade finance controls will be scrutinized more closely to prevent financial crimes through trade products.

With the exception of Asian banks with a large volume of trade finance business, very few banks have made good progress in combatting trade finance fraud by using a distributed ledger pilot to minimize the risk of duplicate-invoice fraud. While a successful pilot, testing 60 mock invoices and working with the Infocomm Development Authority of Singapore, these early projects are far from achieving global scale.

In order to expand on the success of early trade finance projects, tier one banks and intermediaries need to get on the blockchain train and agree to a common framework for how it will be used across businesses. When doing so, they should consider these three criteria:

- **Get Smart** - Smart contracts can be used to digitize parties' information, order underlying documents, include terms and link payments to the contract. When developing smart contracts, make sure to be clear on regulatory aspects including audit requirements, risk controls and Know Your Customer (KYC) requirements which could all impact where, how and why you make this information accessible in the future.
- **Ask Permission** - Trade finance needs permission-based access, so that information can be accessible to authenticated participants only. While organizations like SWIFT might be disintermediated by a trade finance blockchain, AML and credit rating functions should remain third-party and anonymous and keep banks' information confidential via a restricted view. This way the same blockchain can be used with differing permissions based on the accessing organization or individual's function. As alluded to above, regulators or KYC vendors or logistics providers could alternatively need access or restricted access.
- **Scale** - Given the global volumes for trade finance, a trade finance blockchain should be consortium based to scale to global and regional needs. The path forward for banks would include looking to form a small consortium of three or four banks as shaping agencies to create the ecosystem, select the platform and service partners to involve and work toward a pilot. When forming consortiums, banks should look to attract the attention of blockchain gurus to bring in the best applications and building blocks for this technology.

Blockchain is a transformative digital technology with the potential to truly change financial markets, and we've found it is most actionable and affective when addressing challenges and operations involving digital payments, distributed ledgers and smart contracts. Trade finance involves all three. A trade finance blockchain would provide a common platform for businesses to consolidate workflows and generate smart contracts and payments. This would lead to increased accuracy due to less manual intervention, low execution risk, fewer intermediaries and reduced transaction costs. First-movers will define the trade finance blockchain and fast forward that world into existence.

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