WHITE PAPER

HOW CAN YOUR ETRM / CTRM SOLUTION HELP WITH CREDIT?

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INTRODUCTION

Current market conditions are forcing many firms exposed to commodities to perform a re-evaluation of their credit risk systems and business processes.

As most commodity prices are extremely volatile and progressively rising through time due to issues like shortages, supply chain disruptions of various types including most importantly, political sanctions, increased demand and so on, default by a counterparty is seen as increasingly likely. Indeed, were it not for Government intervention, a few high-profile firms would already have defaulted. However, the need to manage cash more effectively is also driving an enhanced focus on credit risk as many commodity firms face huge margin calls from various exchanges and increased scrutiny by lenders. Importantly, the rapid emergence of regulations around ESG and carbon, whether planned or actual, are also having a huge impact on counterparty credit worthiness. As firms review their credit solutions, they are scrutinizing their ETRM / CTRM solutions and their role in managing credit risk as well.

CREDIT RISK BACK IN FOCUS

Credit risk is a risk that often only gets the focus it deserves when something goes wrong. A supplier or other counterparty goes bankrupt or runs into difficulty or, an entire segment of the industry looks threatened like energy retailers in the UK earlier this year when more than 30 retailers went insolvent for example, and suddenly credit risk is an area of increased focus. It is getting laser-like focus and a great deal of attention again because of current difficult market conditions in which prices are extremely volatile. Current market conditions include not just extreme volatility in many commodities, but also generally rising prices and inflation rates not seen in over 70-years.

The perfect storm facing commodities includes shortages, bottlenecks, and increased demand. Recovery post the COVID lockdowns had already seen demand surge for many raw materials, but geopolitical events like the Russia-Ukraine war have accentuated those supply/demand issues. Disruptions to supply chains due to lockdowns, vaccination mandates and sanctions, and political action have only served to further aggravate the situation. Rising costs and inflation, and focus on ESG and net zero, along with the energy transition, have also enhanced the impact of many of these issues. The result has been huge volatility and rapid rises in energy and other commodity costs. This has in turn led to massive margin calls and other liquidity issues for companies in commodities and recently Norway's Equinor ASA has said that European energy trading risks collapsing under the weight of margin calls amounting to at least US$1.5 trillion[1]. Meanwhile, Uniper, Germany's largest gas importer, was only saved from bankruptcy after it made an urgent request to the German Government for help. Likewise, the Finnish utility Fortum Oyj received 2.35 billion euros (US$2.3 billion) of bridge funding and Switzerland provided Axpo a credit line of up to 4 billion francs (US$4.1 billion). More of the same can be expected. Inflationary pressures are adding fuel as central banks increase interest rates creating FX volatility and increasing the cost of credit in the process.

Credit risk is also under renewed scrutiny because of the various ESG, and carbon regulations planned or enacted across various jurisdictions globally. With an emphasis on net zero, carbon footprints, carbon/ESG disclosures, and audits are clearly on the radar. These will necessitate looking at counterparties in terms of their ESG compliance and carbon footprints/offsetting profiles as well as their creditworthiness. This will impact Know Your Customer (KYC) and credit rating assessments going forward as well as potentially other aspects of counterparty management. Furthermore, outside stakeholders are increasingly politically active. They demand ESG/Carbon footprint action as conditions in return for capital and loans.

[1] https://www.reuters.com/business/energy/wide-demand-reduction-only-feasible-solution-europe-energy-crisis-equinor-2022-09-06/

All of this adds up to increased and renewed emphasis on counterparty and credit risks and the systems and processes in place to manage and support those activities. While this is driving sales of true credit solutions that manage everything from rating assessments through exposure management and collateral management, it is also forcing firms to look at other systems with a credit lens. That includes ETRM / CTRM software.

THE ROLE OF ETRM / CTRM SOFTWARE IN CREDIT RISK

While there are wide ranging and highly focused credit solutions on the market, they do tend to be procured by only the larger firms and sporadically at best.

Many firms, especially smaller ones, instead rely on a combination of manual business processes, home grown solutions, spreadsheets and rudimentary ETRM / CTRM system functionality to manage counterparty and credit risk. As a result, operations like KYC and credit scoring are performed by reference to third-party credit ratings and analysis of financial statements. And the resulting credit limit is maintained in the ETRM / CTRM solution. It is also in that system that much of the exposure management is performed and compared against the limits. Other areas like collateral management may be performed in other solutions along with more advanced risk metrics, if utilized.

The problem with this approach however is when the ETRM / CTRM lacks the capabilities needed. For example, it does not properly calculate exposures, or it doesn't update the exposures in real-time. It may not factor in collateral or specific types of collateral and so presents a flawed view of exposure levels. Other issues include the ability to view exposures by various filters such as country, trader, and so on, and unable to drill into changes in exposures for explanations. In short, most ETRM / CTRM solutions are providing vastly inadequate credit risk functionality while their lack of integration may mean that they also provide an incomplete view of credit risk as they do not have access to all the data needed. This is where homegrown solutions, bolt-ons and spreadsheets are used.

Under current markets conditions when there is a focus on liquidity, credit and counterparty risks the best solution is always going to be a fit for purpose credit solution. However, many firms simply cannot afford the cost of such a solution nor the implementation process that goes along with it and therefore look to construct something workable that utilizes their ETRM / CTRM solution(s). This means that the credit functionality of that solution becomes a critical piece of the puzzle.

ENUIT'S ENTRADE – ROBUST CREDIT FUNCTIONALITY IN AN ETRM / CTRM SOLUTION

Enuit noted that most ETRM / CTRM solutions are lacking on basic credit functionality and have worked to ensure that its solution – Entrade – incorporates solid functionality. It has an integrated credit system that pulls from the risk and other data and helps users manage basic credit risk.

The solution tracks exposures and limits and includes collateral in its approach. It can provide several views on this information and can include items like forward months mark to market, notional values, billed but unpaid, overdue, and so on. For international cargo markets the solution goes further to include bill of lading dates, prepayments, and other important functionality. In short, it calculates many types of credit exposure incorporating collateral and compares that to limits issuing alerts for breaches and near breaches. Much of this is user configured via benchmarks and alerting. Other important reports like country risk and concentration can also be provided via the solution.

In essence, Enuit's Entrade is an ETRM / CTRM solution that incorporates robust basic credit functionality ensuring that users gain an accurate idea of exposures and can set up and manage limits, collateral, and alerts. It also allows credit ratings calculated outside the solution to be entered and stored thus providing users with increased confidence in credit risk. Enuit's solution goes further that most of its competitors by offering robust basic coverage to its users often eliminating the need for additional spreadsheets and off-system calculations and in today's market conditions, this is what users should expect from their ETRM / CTRM.

ABOUT ENUIT LLC

Enuit was founded in 2008 with a single goal in mind: To bring to market affordable, functional trade management software. ENTRADE® is all of this and more. And, it really works. It can help your company track its transactions through the entire deal life cycle: From done deal through to sent bill.

ENTRADE® supports Every commodity, every feature, and every user in one place.
There's no Third Party or Legacy System to integrate. Enuit calls it One Platform.

Whatever you trade, wherever you trade. Its universal deal manager and risk engine ensure that all of your trading activities can be well managed within one system, with one architecture, on one trade management platform. ENTRADE® also provides industry and market segment-specific logistics management forms and reports, which take into account the nuances of the specific logistical requirements of each commodity.

Enuit gives their customers complete visibility, insights, control and management over their business operations helping them to have peace of mind to make quick and informed decisions that affect the bottom line.

Enuit, LLC is headquartered in Houston, Texas, USA, with offices located in Beijing, China, London, Singapore, India and Tokyo to serve markets in China, Asia-Pacific, Middle East, Europe, and North America

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ABOUT

Commodity **Tech**nology **Advisory LLC**

Commodity Technology Advisory is the leading analyst organization covering the ETRM and CTRM markets. We provide the invaluable insights into the issues and trends affecting the users and providers of the technologies that are crucial for success in the constantly evolving global commodities markets.

Patrick Reames and Gary Vasey head our team, whose combined 60-plus years in the energy and commodities markets, provides depth of understanding of the market and its issues that is unmatched and unrivaled by any analyst group.

For more information, please visit:
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