ORIGINATING AND DISTRIBUTING TRADE ASSETS IN THE EMERGING MARKETS By Deepesh Patel, Trade Finance Global (TFG) – March 2020

For where two or three are gathered together, there shall be performed the Parrot Sketch" instructs Monty Python. If the same rule of inevitability applied to trade finance conferences, the role of the parrot would be played by the perennial figure of the $ 1.5 trillion trade gap as measured by the Asian Development Bank. A considerable part of the gap, which translates to unmet demand for trade finance, resides within MSMEs in the emerging markets. Given the search for higher-yielding trade assets to entice the fabled NBFIs (Non-Bank Financial Investors) into financing trade, are emerging markets an El Dorado for these investors or are there structural and other factors preventing liquidity from soaking up these assets and solving the MSME's dilemma?

No investor can make a decision without information: leaps of faith only cover so much ground. In the emerging markets, marketable information can be hard to find particularly at scale and with ease. Some multilaterals and international utilities have tried to plug this gap by creating registries. Afreximbank has created a KYC/AML registry called Mansa covering corporates in all its members countries whilst a similar, but more global, registry has been created by SWIFT. The latter now contains information not just on banks but also on corporates. Governments have also made some efforts to create transparency by building financial information databases. In Senegal, a government agency, ADEPME, has created a rating system for local MSMEs to which these companies are encouraged, by carrot or stick, to contribute with several local banks requiring certification as a pre-condition of lending. And so we could go on, but comprehensive coverage is still elusive. Some private sector providers such as Coriolis Technologies with its Multilateral platform, Conpend and Quantexa are able to provide macro- and micro-level data drawn from a variety of sources including customs, ports and some credit reference agency data. Such data can be both descriptive and predictive. Banks themselves often possess more data than they are aware of. "Data-scrapers" such as Intix can often open the key to these hidden treasures and organise the revealed data rationally and usefully.

But if some progress is being made here, understanding the form and underlying structure of the intended financing can be challenging when obligors are unfamiliar with the language of investors. This is partly an issue of description and taxonomy, attaching familiar labels, such as pre- or post-shipment, buyer- and supplier-centric, to potential deals which are nevertheless meaningful creating recognisable form and substance, and thereby marketable deals. In the emerging markets, bringing light to what sometimes seems like unfathomable chaos is one of the most important responsibilities of any originating bank. Producing bankable paper is not the preserve of Western financial institutions, however.

At the recent ITFA annual conference in Budapest, Banka për Biznes (BPB), a Kosovan bank, explained how, when dealing with micro segment clients, data analytics overcame one of the main barriers for growth being an inability to create scale in their supply. BPB created the "Supplier's Club". In essence, BPB has "married" suppliers and buyers in specific industries using its understanding of trade flows and credit profiles in a way which would have been unachievable for such small firms and cementing these relationships by providing finance through a technology light platform easily useable by all the parties. The platform empowers BPB to link suppliers with the buyers. Invoices are settled by BPB acting as an intermediary in financing working capital in a fast and efficient process flow. The platform works using SMS messages. The platform is free in terms of service and transaction fees, and has an in-built waiting period of time without interest for settlement. BPB has already introduced targeted Suppliers Clubs for industries where it has the greatest critical mass of suppliers and buyers. One such recent club will be underpinning supplies for more than 100 clients where the bank has approved limits. So was born a transparent and data-rich payable (considered safer than receivables in general terms) asset in an emerging market. Any takers?

Many originators and investors also consider the economics of a credit enhancement when looking at the emerging markets. Credit risk insurance (CRI) has been the star kid on the block here. With its genesis in political risk insurance, CRI is not a stranger to the emerging markets and is able to understand and price risk effectively. Specialist insurers, such as ATI in Africa, have perfected this know-how and expanded capacity. CRI capacity between 2008 and 2019 grew by around 150% according to Willis Towers Watson. Much of this is in the emerging markets. CRI comes at a cost however, sometimes as much as 80% of the margin. Whilst many banks have used CRI to increase final take and hold participations, for investors this can represent excessive dilution of their profit. One solution is finer pricing from insurers. Another may be use of trade facilitation and trade enhancement offered by certain multilaterals and ECAs normally tied to trade in real goods and services as opposed to the provision of corporate debt. Banks make widespread use of these but the possibility of making these guarantees available to third-party investors is not a subject that has not yet been broached – most documentation requires the consent of the multilateral or ECA to an assignment. There may be a fear that proliferating such guarantees into broader credit markets less interested in the social purposes and ethics of trade facilitation may be undesirable. The delicate argument revolves around the way in which these credit enhancements could increase liquidity and capacity so achieving beneficial medium to long-term benefits not possible without private markets. These chickens and egg scenarios are always difficult to kick-start; it is surely worth making a stab at it.

Some investors are more handson than others. A number of these have been described as alternative financiers or altfins. One such is Channel Capital Advisors which, whilst also using CRI, also does its own clever structuring to derive the safest possible position for itself without sacrificing profit. To finance commodities in Asia, volatile products in volatile markets, for example, it will match payables and receivables as well as taking transactional security. Such involvement requires experienced and savvy staff.

NBFIs, especially those less able to get up close and personal to the underlying trade, have been used to slick and standardised processing, settlement and documentation. The plumbing for emerging market investments is not currently as well developed. Can the market put the necessary rails in place? Fintechs such as Tradeteq have established slimmed-down securitisation vehicles to enable the repackaging of trade debt into more recognisable debt obligations. This allows messy payment obligations to be transformed and, using cutting - edge AI technology, rated and scored. Settlement and clearing uses the same infrastructure as for bonds e.g. Euroclear, DTC etc. Presentation and packaging are critical to ensure that operational costs do not kick this asset class out of touch. Of course, the box, however shiny, can't be empty and these NBFIs still need to understand structures and counterparties. A harmonised taxonomy and better data can help tremendously here. The Trade Finance Distribution Initiative (TFDI), supported by ITFA, is striving to do just this as well as educate investors.

This short article merely touches on the possibilities of this new asset class. Enormous efforts and progress have been made only equalled by the effort that still needs to be put in before we can talk of a revolution in trade finance. The future seems tantalisingly near though…