Trade Finance Distribution 2.0 – Chimera for some?

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Trade finance distribution has been receiving exponentially more interest and investment over the last decade – driven by tighter regulations, narrowing credit appetite, liquidity, enhanced client demand driven by increase in trade and many more.

The pandemic brought to the fore the need to use technology already available to digitize trade and the distribution of trade. Platforms gained a greater member base; enhanced their product offerings and digitalization efforts gained speed and more support almost overnight from banks, suppliers and even policy makers keen to roll out infrastructure to digitalize negotiable instruments.

One can't help but wonder how far these initiatives have penetrated in the developing world. Despite rhetoric to the contrary, distribution and its myriad risk mitigation tools have been slow to gain strength in the emerging countries. It is only in the last few years (prior to the onset of the pandemic) that banks from these nations started incorporating the 'traditional' way of distribution or buying (& consequently selling) trade risk under Master Participation Agreement or partnering with larger or development banks under risk sharing arrangements or even portfolio based trade finance funds. However the need to evolve beyond the traditional method of distribution (which still offers tremendous advantages according to these banks current appetites) even if recognized, has not initiated a larger scale adoption of alternate methods and technologies by these regional banks. André Casterman, Founder, Casterman Advisory and Chair Fintech Committee, ITFA agrees "Whereas the inter-bank distribution practices (e.g. Master Participation Agreement) may be adopted by some institutional funders today, banks should not expect this to become the norm for that category of funders tomorrow."

There is a need for FI's in emerging economies to realize that the need of the hour is revolution not evolution and that perhaps the most efficient way to do this would be to partner with larger banks to gain insight and experience to alternate methods of financing trade and receivables; and to sync with fintechs offering ready solutions enhancing distribution networks & capabilities. As endorsed by André "Automation is critical to make trade receivables accessible and transparent for investors and banks alike. For instance, bank-originated receivables need to be bundled in portfolios of possibly thousands of individual assets, which revolve every 30 days. Bundling those assets offers simplicity and issuing notes increases accessibility to investors."

No reflection on 2020 would be possible without COVID'19 being mentioned. The onset of the pandemic revealed other traditional fault lines where smaller or regional banks rolled back appetite completely and the evaluation process became almost impossible to navigate. Although the nature of the current crises was completely unprecedented (US FED alone spent USD 75 Billion PER DAY at the peak of 2020 COVID-19 crisis on QE under stimulus packages vs. USD 30 Billion per month at the peak of 2008 crisis) in terms of predictability, scale of influence and time frame – there were traditional metrics for evaluation which supported continued appetite for trade finance risk both primary and secondary. The ICC Banking Commission Trade Register report released in early 2020, while taking into account COVID-19's potential to disrupt global trade and rising default rates, reiterates the 'importance for all stakeholders to take the low-risk nature of trade finance into account to ensure accessibility to all businesses around the world' – a large part of this is continued support for appetite under risk distribution. In order to sustain long term viability of trade portfolios and ably face unplanned financial pressure banks need to recognize the need to be steadfast (within reason) in the face of vulnerabilities.

Rahul Daswani, Financing Programs International, Microsoft states that "When discussing customer financing with corporates in the region, the traditional view has been that trade distribution is about banks distributing risk

to reduce their exposures. It has not been associated with the capacity of banks to help generate more credit appetite for the corporate. Thus trade distribution value for a corporate treasurer seems to have been more around creating efficient pricing mechanisms."

Rahul notes that more developments are needed for generating an efficient marketplace which includes bringing new providers of financing which effectively would help expand the credit availability for a corporate. He views that for such an efficient marketplace to function requires deeper integration with rating agencies such that, for solutions like customer financing for enterprises, credit profiles with predictable behaviours can serve as receivables asset classes for specific investors' appetite. Such developments would be of particular value in emerging markets where credit availability has been a subject of active interest.

As part of their development initiatives related to trade finance, the World Trade Organization (WTO), International Chamber of Commerce (ICC), and Business Twenty (B20) Saudi Arabia joined together to issue a statement this year on addressing "the diminishing availability of trade finance" – where interestingly two of the areas needing action mentioned were the need for sharing of risk and a rapid transition to paperless trading. Another urgent statistic mentioned in relation to the increased scale of the finance gap, as estimated by the ICC that projects a need for up to USD 5 trillion in financing required to support a rapid rebound in global trade flows. Tradeteq Ltd, a digital trade finance exchange estimates that in 2018 up to USD 400 billion was distributed between the banks themselves, and another USD 100 billion was sold to nonbank financial institutions. These volumes have been supported by entrance of alternative players & capital i.e., institutional investors, bank & trade finance fund collaborations, trade finance securitization initiatives. However, the exact quantum impact of COVID'19 on trade and distribution volumes will take time to materialize over the next few years.

The rhetoric has now evolved with more positive global sentiment, higher liquidity levels and a need to reverse negative returns in 2021 looming, supporting banks returning in force with appetite. However this resurgence of appetite and a dearth of transactions during a large part of 2020 has resulted in demand driving down pricing till the risk reward metrics are skewed once again. This, along with smaller players not being able to offset the diving premiums against other supporting revenue streams from a trade relationship is now, more than ever, one more factor locking smaller banks out of the distribution game.

There is a solution – from continued education and more acceptability of alternate mitigation techniques to utility of innovative solution providers streamlining and supporting credit appraisal and outreach methods – the need for collaboration between trade finance providers, their distribution partners and most importantly regulators is more pressing than ever. As is the need for more agility from the smaller trade finance players in order to sync with the chain of innovation and greater acceptability of alternate and pioneering technological solutions to support trade. Because if there's one thing we have learnt over the past decade and now in this one year the future is faster than you think.