# Institutional investors committed to the trade finance investment class

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Data sharing, digitisation, and harmonisation of SME credit insurance practices are key ingredients to attract more funding to the trade asset class. These were the conclusions shared by the representatives of Trafaltin, NN Investment Partners and Channel Capital Advisors during our recent investor-centric **TFD Initiative** webinar. The talk demonstrated that institutional investors are committed to the trade investment class and are seeking to build new long-term partnerships with trade banks.

The banking industry has demonstrated since about a decade that trade is an attractive asset class for institutional investors, and it seems it was heard loud and clear.

In October, we focused on the growing importance of credit insurance and institutional funding to **banks' revenue business model**. In November, we expanded on how TFD Initiative is enabling banks to engage with institutional investors through new multi-bank market practices to **make trade assets accessible to such non-bank liquidity providers**.

During the session of December, I invited three representatives of the investor space to debate their views and expectations of the on-going market transformation:

- **Stef Merckx**, Chief Commercial Officer, **Trafaltin** which is a new player in the institutional space and setting up the trade finance activity. Trafaltin creates access to trade finance for institutional investors.
- **Walter Gontarek**, Chairman and CEO, **Channel Capital Advisors** which has processed 6 billion USD of trade finance cumulatively and demonstrates 10 years of successful operations.
- **Suresh Hegde**, Head of Structured Private Debt, **NN Investment Partners** (NN IP) which is a Dutch insurance asset management company operating since 150+ years and managing 300 billion EUR of assets with 71% of those integrating ESG requirements. NN IP has recently launched the NN (L) Flex Trade Finance fund to offer credit investors exposure to a globally diversified portfolio of assets that finance the physical trade of commodities and simple goods.

## Part 1 - Rationale: is trade finance becoming an attractive asset class for institutional investors?

- Trade finance is a scalable and repetitive market as assets are replenished on continuous basis (i.e., corporates and SMEs need funding on a repetitive basis).
- Trade finance is an uncorrelated asset class with low defaults and low credit risks - this contributes to its attractiveness too.
- The short duration of granular trade transactions is a key attribute of this asset class, as well as the self-liquidating nature - both characteristics make trade assets compelling for institutional investors.

*"For insurance asset management companies, trade finance offers an interesting return on capital in addition to being a diversified and scalable investment class.", **Suresh Hegde, NN Investment Partners***

- Institutional investors operate in a very low-yield environment. About 40-50% of accessible investment-grade quality paper offers between 0 and 0.40% yield. This puts a tremendous pressure on insurance companies which need to generate investment returns to cover expenses and protect claims. Examples

of today's country yields in traditional asset classes are f.i. Austria issued a 100-year bond at 3%; Portugal issued a 10-year bond at 0%.
- Standard Chartered Bank estimates the trade finance gap to have increased to **3.4 trillion USD**. This means banks have more corporate demand to deal with whilst still being confronted with balance sheet constraints. By moving to the originate-and-distribute model, banks are able to increase the velocity of their balance sheet. This requires banks to rely on committed institutional funding.
- Transparency and communication about the new asset class is key to establish it further in the non-bank community - the financing of specific trades is safer for investors, rather than lending to corporates. The characteristics of trade finance need to be highlighted as they enable investors to target specific flows.
- We may expect disruptions in the credit market in 2021 and 2022 which will impact trade finance. This is why institutional investors are increasing risk governance on transactions and using new tools such as AI to improve risk mitigation.

The panel agreed that more investors will engage with more banks in the future. Both sides are seeking for certainty in the new bank-investor relationships. Investors will want to partner with multiple originators which will contribute to supply risk mitigation and investment diversification. Long-term partnerships are therefore expected to be sealed between banks and institutional investors.

### Part 2 - Expectations: which priorities stand out on the asset management side?

- On the buy-side side, "ESG" has become a top priority. This is a very positive contributor to help trade finance become an increasingly attractive asset class to them. The use of "big data" and "AI" also offer key opportunities for investors to run their business as trade finance assets include the required information to make ESG-compliant investments. Not all institutional investors will be 100% focused on ESG.
- ESG scores are becoming as critical as credit scores, people risk scores, ...
- Regulatory arbitrage could create an obstacle as regulators are not aligned. The compliance standards on the institutional investors should be similar to those on the banking side.

*"Bank and insurance regulators need to align as requirements on trade originators should be recognised on the insurance side.",* ***Stef Merckx, Trafaltin***

### Part 3 - Growth: how can distribution flows scale?

- Banks are the largest and best originators, and, as a consequence, they have gathered a wealth of data that institutional investors could use to drive funding decision-making algorithms.
- Institutional investors do not represent a new competition for banks, but want to become real partners in the originate-and-distribute model. This should ease to establish data sharing agreements.
- Transparency - through data sharing - on assets such as credit risks, regulatory compliance (e.g., AML) and ESG need to be continuously enhanced to scale the market.

*"ESG is a top priority for institutional investors which is why a new dedicated function was recently created and reporting straight to me as CEO.",* ***Walter Gontarek, Channel Capital Advisors***

- Unfunded instruments such as guarantees and L/Cs (except if discounted) are not ideal for institutional investors.
- Platforms offering securitisation-as-a-service introduce semi-standardisation of the operational processes around the asset class. They contribute to operational efficiency and, sometimes also, to risk transparency.

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- The **AnaCredit** which stands for *"analytical credit datasets"* and which is operated by the ECB is a key tool that the industry should tap into. *Note*: AnaCredit is a dataset containing detailed information on individual bank loans in the euro area, harmonised across all Member States.

### Part 4 - Calls to action

- The sharing of data on trade assets between banks and investors need to increase to improve transparency and risk appetite. Increased digitisation through digitisation and possibly also through tokenisation of trade transactions is critical too as trade finance is a document-heavy activity.
- There is a need for more consistency amongst credit insurers as this is critical for institutional investors on the SME side.
- Patience will pay off as more institutional investors are looking into trade finance. More established institutional investors are looking at trade as an alternative asset class.