World Supply Chain Finance

Report 2019

Expert views and opinions on today's global supply chain finance market

Edited by Michael Bickers

Published by
BCR

Contents

Investing in supply chain finance as an asset class

Jolyon Ellwood-Russell
Partner
Simmons & Simmons

For the typical asset backed investor in a rapidly expanding market with strong growth, opportunities in the supply chain finance market should be plentiful, however, they remain relatively untapped as an investment asset class.

The potential of SCF is significant and well documented: SCF opens up US$2tn in financeable highly secure payables globally and a potential revenue pool of US$20bn.[1] But the way to access that potential pool as a specific financial investment remains, at best, opaque and at worse, totally out of reach for the growing and willing investor base. From large institutional private debt funds to high net worth individuals, and from fintech platforms to traditional family offices, there is an increasing enquiry into understanding the potential of SCF as an investable asset class. As efforts are made to break down the obstacles to greater uptake, and traditional bank funding continues to decline - or at least greater pressure on banks to originate then distribute - investors are increasingly turning to SCF as an asset class. Accelerating this trend is the marriage of fintech's superior reliance on data with the traditional asset backed instruments being offered digitally, meaning SCF, as an asset class, now has a wider investor base than at any time.

> SCF opens up US$2tn in financeable highly secure payables globally and a potential revenue pool of US$20bn.

Investing in SCF as an asset class often comes in a variety of forms and can include SCF platform providers issuing dynamic notes linked to the receivables they have purchased from the supplier or the promise to pay from the debtor. This can be linked to different classes or profiles of underlying debtors, invoice quality or other variables. They can then market these to investors interested in subscribing, on account of the advantages of SCF set out below, thereby broadening the investor base.

By way of an example, a SCF platform provider can issue a series of notes linked to specific supplier/debtor programmes or relationships, or even linked to classes of buyers and sellers. An alternative structure is for a SCF platform provider to issue a note linked to a specific receivable based on, for example, the profiles of terms of the underlying contracts of sale (e.g. 60 days or 90 days) or credit support profile (e.g. receivables covered by insurance). The structure to be taken by a SCF platform provider, and therefore the constitution of classes and determination of the eligible criterion, depends mainly on the profile and data available for a SCF platform provider to slice, tag and categorise the receivables and underlying debtors.

Fig.1

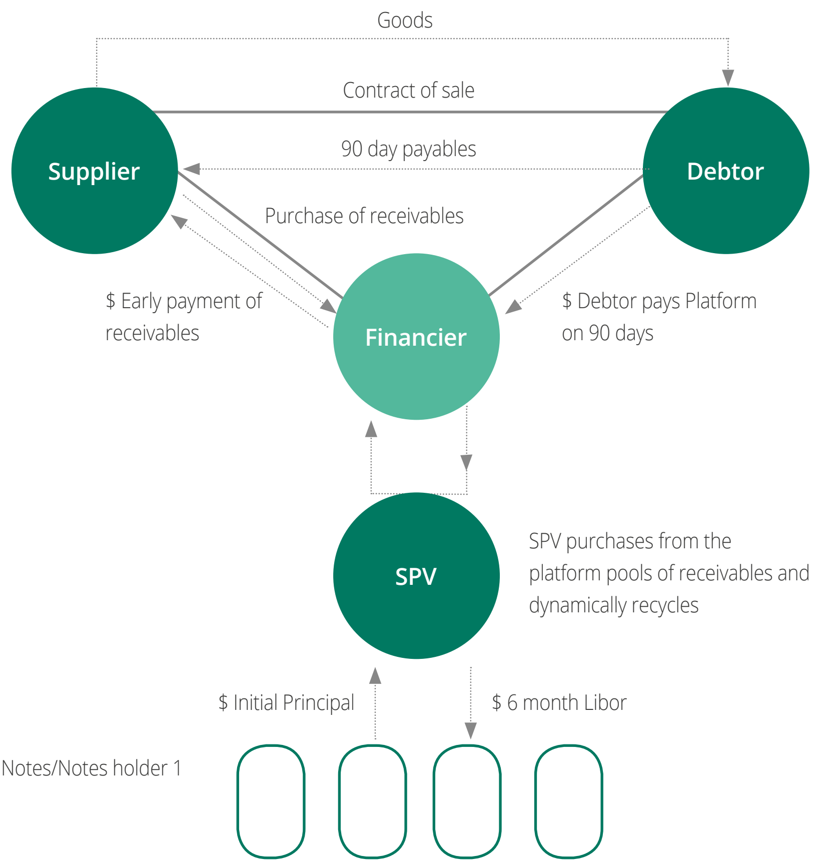
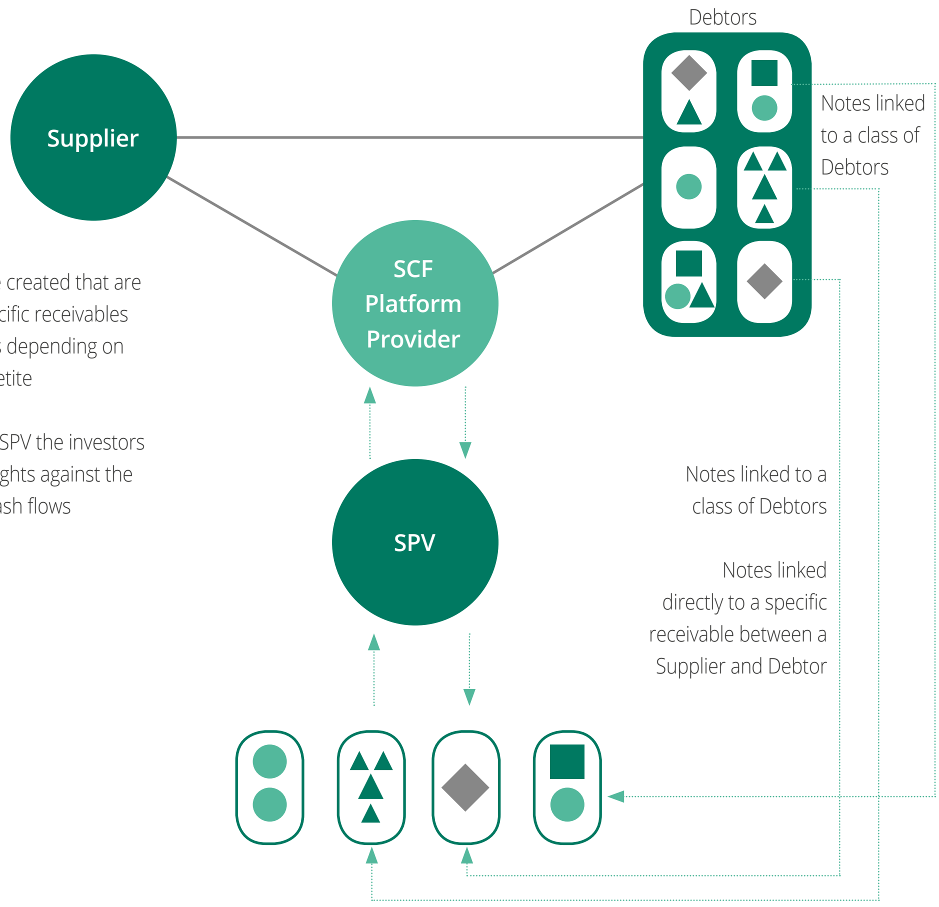


Fig.2



- Notes can be created that are linked to specific receivables and payables depending on investor appetite
- Through the SPV the investors have direct rights against the underlying cash flows

> SCF offers long-term relationships with the entities involved together with dependable payment and buying characteristics.

Advantages for investors

Investors are becoming increasingly aware of the advantages of the core characteristics of SCF as an asset class.

The financial structure is self-liquidating. This, coupled with the short-term nature of the receivables (typically 90 days from delivery to payment) which are uncorrelated to other financial assets, makes SCF inherently low risk and highly attractive for investors. According to the 2017 ICC Trade Register report, default rates for a range of trade and export finance products ranged from 0.03% to 0.24%[2]. Furthermore, the report found that the average time for recovery for trade finance products is 120 days, compared to 437 days for other asset classes.[3]

While each receivable is short term, SCF offers long-term relationships with the entities involved together with dependable payment and buying characteristics. Therefore, when packaged into longer term programmes, it becomes of additional interest to investors who like the individual receivable but have a lengthier investment horizon.

The SCF market is vast and can span numerous industries, including capital goods, energy, automobiles, tech hardware and equipment. In addition, with widely available and fairly inexpensive trade credit insurance, investors are able to mitigate their exposure with an insurer whilst still making a good return.

Whilst banks continue to face increases in regulation, high compliance costs and low interest rates contributing to the scarcity and cost of capital, SCF offers investors short-term floating rate assets with limited exposure while generating competitive return.

Most importantly, SCF offers investors the advantage of heightened visibility and connectivity. Data can be used to predict demand and calculate the finance the supplier will need to meet that demand, meaning SCF can be triggered readily when an order is placed. Such data can be harnessed to provide a credit history of the buyer, allowing potential investors to assess the buyer's credit risk based on their transaction history. This gives the investor better buying visibility power which has in turn been driving demand for more specific and granular linked notes.

Ongoing challenges

The full development of SCF as an asset class for investors is at a comparatively early stage as various factors have historically hampered its progress.

A lack of publicly available information and awareness among the investor community has stunted uptake. Banks' use of different names and definitions for various SCF services has made it difficult for investors to compare offerings.

According to one Trade Finance Manager at a MENA Fund, regulation both external (i.e. imposed by governments) and internal (banks' responses to such regulation, such as compliance procedures) is still hindering investments in SCF.[4] SCF's insufficient track record and investors' focus on other asset classes have been cited as other major barriers to investment.[5]

Non-bank, third-party investors (asset managers, private equity and hedge funds) are increasingly taking the lead in investment in SCF. They find themselves better equipped to finance the range of complex, cross-border programmes owing to their greater agility and flexibility. They are therefore open to dealing with non-investment grade participants which SCF frequently involves. These non-bank investors are only accountable to their own investors and the mandate of the fund. The return is linked only to the prescribed strategy and not necessarily to any Basel III requirements or balance sheet reliance of a credit committee.

A bright future

Despite the obstacles, recent developments show a number of firms are paving the way in opening up the SFC market to new investment, transforming receivables into financial products. By way of example:

- Greensill Capital is the leading non-bank provider of SCF, providing investors with the opportunity to purchase capital market notes backed by specific payment obligations in its system.
- Orbian is a long-established firm in the SCF industry with a platform selling SCF notes to investors, focusing on the largest corporate buyers and their most important strategic vendors.
- Seabury TFX is a platform harnessing the power of data-tracking and validation technology to produce credit information generated on buyers and sellers during supply chain activities. The credit information is easily understandable to participating funders and are packaged into simple or dynamic notes.

It is clear that fintech and blockchain technology will play a substantial role in the development of SCF going forward. In whatever form this takes, the opportunity for investors to participate in SCF is becoming easier thanks to the rapid technology advances.

- For example, Tradeteq is a finance distribution platform founded in the UK in 2016 using machine learning and broader data collection to deliver advanced credit analytics and reporting. In this way, it increases the transparency and scalability of trade finance asset investment and facilitates efficient transacting between trade finance originators and institutional investors.
- LiqEase is using blockchain technology to digitise invoices, creating a functional token and smart contract which are listed on an invoice marketplace which investors can access and through which invoices can be discounted at the supplier's request. The platform enables the efficient sale of a receivables portfolio by a supplier.

> It is clear that fintech and blockchain technology will play a substantial role in the development of SCF going forward.

Final thoughts

Encouragingly, the obstacles facing SCF are not linked to the asset class's innate characteristics. As the technology to assist SCF continues to develop and an improved provision of information encourages investor confidence, we should see the full potential unlocked across multiple industries and geographies. This will be achieved through more sophisticated dynamic receivable and payable instruments and single receivables linked notes. Meanwhile, increased transparency for investors and the reduction of fees to establish SCF programmes are also seeing a greater uptake in SCF as an asset class.

---

[1] *Capital IQ: McKinsey analysis and expert interviews.*

[2] *Stephen Lloyd, New ICC report confirms trade & export finance are not risky business, ICC – International Chamber of Commerce, https://iccwbo.org/media-wall/news-speeches/new-icc-report-confirms-trade-export-finance-not-risky-business/ [accessed 9 Nov 2018].*

[3] *Confirms trade & export finance are not risky business, ICC – International Chamber of Commerce, https://iccwbo.org/media-wall/news-speeches/new-icc-report-confirms-trade-export-finance-not-risky-business/ [accessed 9 Nov 2018].*

[4] *EFA Group, TXF & EFA Group Market Report: Investing in Trade Finance Assets (February 2018).*

[5] *EFA Group, TXF & EFA Group Market Report: Investing in Trade Finance Assets (February 2018).*