

Wanted

Extra capacity for supply chain finance

Many banks are arranging syndicated deals to meet corporates' ever-growing supply chain finance requirements. But this tactic may not be enough, writes **Liz Salecka**.



Huge demand for supply chain finance over the last two years has caused many banks to start using the syndication market to support their provision of trade-related financing and to minimise their own risks and exposures.

Faced with balance sheet constraints and exposure limits, as well as concentration limits for any one corporate client, many of them are seeking to arrange syndicated deals to meet growing demand for ever-larger supply chain finance programmes. "Banks need an outlet for trade finance assets so that they can meet their clients' growing requirements, and the syndication market has proved to be the natural outlet," says Michael Goldenberg, trade sales manager, Bank of America Merrill Lynch, who points out that his bank considers the opportunity to take assets off its books as one of the biggest advantages of syndicated deals.

"We will continue to pursue syndications as like other banks we are gearing up for a major push in supply chain finance – and if that is the case we will need capital relief and liquidity relief. The only real way to grow your programmes is through the syndication market."

And Bob Kramer, vice-president of working capital solutions, PrimeRevenue, adds: "Individual banks don't have the balance sheet capacity to fund large supply chain

finance programmes, and the main driver for syndication is the capital constraints they face, rather than the need to mitigate risks. "Capital constraints are an issue for banks today, and look set to become even bigger issues tomorrow, given the implementation of Basel III, which will further limit banks' ability to finance large programmes."

Client-led

For many providers of supply chain finance, their initial approach to syndication has been driven by their own corporate clients, which have sought to involve their own relationship banks in the syndicates arranged for supply chain financings.

"We always initially went to the banks that our large corporate buyers favoured, and they were often also originators for that particular client themselves," says Goldenberg.

But he notes: "One constraint here is counterparty exposure. As a result, many originators are now looking for a larger basket of banks to get involved in syndicated deals." Although the syndication market was relatively flat in 2008, improvements in banks' liquidity positions and capital ratios have meant that there are now several players looking to invest in trade assets.

"We are moving away from having one to three banks involved in the financing of trade assets to using several banks," continues Goldenberg, pointing out that this

greater diversity means that more assets can be syndicated, and counterparty risks further reduced.

"There are a number of banks, which do not want to originate these trade assets, but want to invest in good quality assets, and we now speak to interested investors on a daily basis. "Our primary way of engaging in these facilities for our clients is via financial institutions, primarily banks. However, there is an emerging market of non-bank investors."

Basel III will drive needs

Deutsche Bank has recently started to make its own inroads into the syndication of trade finance assets, and although the bank has, and still is, conducting deals on a bilateral or club basis, it expects to do some of its first syndicated financial supply chain deals this year.

At its global transaction banking division, Donata Invernizzi, a member of the distribution and emerging market loan trading team in London, identifies the capital adequacy requirements of Basel III as a major driver.

"Most banks will have to start monitoring their capital and funding ratios, and are also expected to meet a framework of more stringent reserve requirements," she says. "By using syndication, they can introduce greater capital efficiency."

Deutsche Bank expects that its first trade

finance syndication deals will involve a group of banks as senior lenders, but that such deals will be subsequently offered to retail banks, which represent a new breed of investor here.

"The syndication of financial supply chain deals is still developing as a financing practice. We are just starting to see syndications and it seems that the parties involved are largely and primarily still international banks," says Invernizzi.

"Retail banks' involvement may be limited at first, but will grow as the market matures and as these banks get more familiar with syndicated financial supply chain deals."

Benefits for corporates

The movement towards syndicated supply chain financings brings benefits for not only banks, but also corporate buyers and their suppliers.

For banks, syndication enables them to take on an appropriate proportion of a supply chain financing and also share the risk involved with other players.

Corporates, meanwhile, benefit from reduced risks and greater scope to increase the scale of a financing. They can also use the syndication as an opportunity to enhance their relationships with house banks.

"Syndication reduces the risk of uncertain outcomes such as the possibility that the main relationship bank will be unable to reach the target amount of the facility," explains Invernizzi.

"The corporate can also give its relationship banks the opportunity to strengthen ties by participating in these deals."

Standard Chartered is one bank which regularly enters partnerships to provide supply chain financings which are above its 'portfolio risk perspective.'

Ashutosh Kumar, global head of local corporate products and receivables management, believes that corporates themselves have nothing to fear from syndicated deals, regardless of how many players get involved, because the operational changes required are minimal.

"As long as these types of structures do not impact the business of buyers and suppliers they will be fine with them," he says. "One lead bank will always do all the work, explain the conditions, and maintain relationships with other banks in the syndicate. Buyers and suppliers benefit

"One lead bank will always do all the work, explain the conditions and maintain relationships with other banks in the syndicate."

from the efficiency of talking to one person, as well as obtaining liquidity, without having to change much in the way that they operate."

However, one issue that often arises in syndicated deals is that corporate buyers can end up working in much more distant relationships with the funders of their supply chain finance programmes.

Kramer points out that corporate buyers should always seek to know who is financing their programmes as it has implications for the stability of their supply chains as well as their credit capacity with individual institutions.

"In particular, buyers want to ensure the sustainability of the supply chain finance funding sources from both a liquidity and a pricing perspective. They don't want short-term funders who may not provide financing when suppliers need it," he says. "Fortunately, most supply chain finance technology platforms, both open and proprietary, provide a good level of visibility around the funding sources to corporate buyers."

Invernizzi agrees, but notes that buyers' visibility into their supply chain finance providers may be compromised if there is a secondary syndication.

"Buyers can see who is participating in the primary syndication phase, but this may not be the case if there is a secondary syndication, which involves the risk being sold on," she says.

"This is why it is important that clients work with accredited banks, which are very selective in terms of the partner banks they sell their risk to on a secondary basis."

Is syndication enough?

However, despite the movement towards syndication, many industry players believe



Ashutosh Kumar

that global trade and demand for trade finance will grow to such a level, banks alone will be unable to meet demand.

"The level of trade finance required today still outstrips what syndications, that pull together all the banks, can achieve," says Kitt Carswell, senior offering manager at CGI Technology. "The pool is just not big enough in terms of the figures needed to support global trade."

"If you look at trade, and what it takes to finance trade, the numbers are staggering, and outstrip the capabilities of all the banks in the world."

And Kumar adds: "Just relying on bank syndications is fine in the short-term but not good enough in the long-term because you are relying purely on the banking community for trade finance, and banks are limited in number and face other risks."

"Trade is growing at a fast pace, and for this to continue, we need to ensure that the provision of trade finance can capture external interest and also that we can do different financing structures."

Kumar believes as Basel III's capital requirements may further restrict banks' provision of trade finance, there is a need for new non-bank investors, such as hedge funds or pension funds, to enter the market. For such investors, trade finance represents a viable new investment opportunity, meeting their risk and return requirements.

"In the world of global trade finance, for banks to be the sole investors is far too restrictive. The investor base can be expanded to include pension funds, which want a good return and a certain risk profile. Trade finance is the right product for them because it is low risk," he says.

"We have seen some interest from European pension funds, as the more diversified their portfolios are, the lower the risk. They

want to invest in multiple geographies, multiple products, and a large number of counterparties to create diversity.”

Kramer at PrimeRevenue also believes that the concept of securing non-bank financing to generate additional liquidity for the supply chain finance market carries significant merit, and identifies insurance companies, as well as funds, which source money from external investors, as the most likely participants.

“When it comes to just the financing aspect of supply chain finance programmes, we are likely to see a lot of innovation in terms of non-bank players getting involved, as well as new and different legal structures,” he says.

“Non-banks are starting to get involved in this product, depending on their own risk parameters and their return requirements. The ones, which are already familiar, are able

is phased in.

“Growth in the number of securitisations may reflect an unintended consequence of Basel III, which will encourage a movement into an area that is less well-regulated.”

“Syndicated deals represent a big step, and beyond syndication, securitising trade finance assets has major traction,” adds Carswell at CGI Technology, pointing out that many third party providers are also supportive of the movement towards securitisation, and plan to introduce the infrastructure required for their solutions to support this type of financing too.

“If this type of financing grows, it will outstrip what all banks can offer. It has got to evolve into something that is mass market.”

Although a small number of trade finance banks have already taken advantage of

disbenefit of “locking users into a proprietary platform.”

“I think it’s a good development for both Citi’s clients and the supply chain finance market. But Citi’s approach here is still a proprietary platform, operated by Citi, and while it has the potential to provide greater liquidity than Citi’s balance sheet can offer by itself, this approach still suffers from the disadvantages of any proprietary bank platform,” he says.

“All of the supply chain finance programme parameters are still controlled by Citi and there will be no competition for best practices among the participating liquidity providers.”

Kumar at Standard Chartered anticipates huge growth in both the number and scale of trade asset securitisations, but points out that this movement will not necessarily be spearheaded by the availability of multi-bank securitisation platforms.

Standard Chartered itself, he explains, has been a pioneer in the use of securitisation structures to support its trade and supply chain activities, and the bank broke new ground in 2007 by carrying out its first US\$3bn synthetic securitisation of a range of trade finance products.

“Since then we have carried out further trade finance securitisations/collateralised

loan obligations (CLOs) - in 2008 and 2010 - and we found strong interest in these securities from hedge funds, pension funds and private equity funds,” explains Kumar.

“One advantage that we have is that our assets are diversified enough to attract non-bank investor interest.”

He adds that his bank has continued to pursue this route to meet the strong demand it has experienced for trade finance.

“We wanted to build capacity so that we could meet this demand, and so in 2008, we continued doing securitisations, and in 2009 we were the first bank to enter the global trade liquidity programme with the IFC. The whole purpose was to keep trade finance flowing at the height of the crisis. We started lending to other banks so that they could offer more trade finance to their clients.”

Deutsche is also looking at the benefits of securitisation. “Securitisation, considered in the context of a portfolio of risk mitigating solutions, enables banks to benefit from more efficient balance sheet management,” Invernizzi notes. **GTR**

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Donata Invernizzi

to acknowledge and leverage the benefits, adds Invernizzi at Deutsche, pointing out that in future non-banks are expected to participate in secondary market syndications. “The secondary market will develop for this type of facility as players sell on to banks and non-bank investors.”

Is securitisation the answer?

The securitisation of trade finance assets is currently being heralded as another important step towards enabling banks to generate the funds needed to support more, and larger, supply chain finance programmes. Moreover, banks’ use of this particular financing mechanism looks set to be driven forward all the more by the capital adequacy requirements of Basel III.

“Basel III may have unintended consequences on the provision of trade finance so we need to see what other solutions can be created,” says Standard Chartered’s Kumar, pointing out that as securitisation structures take assets off a bank’s balance sheet, removing the need for them to hold capital against those assets, they will grow in popularity as Basel III

securitisation, Citibank has taken this opportunity one step further by launching a multi-bank global trade platform towards the end of 2010, which enables participating banks to pool together their trade finance assets for securitisation.

A key rationale behind the multi-bank approach is that it will create a more diversified, and hence lower-risk, pool of trade finance assets for market distribution. Banks will also benefit from a more efficient mechanism by which to securitise their trade finance assets.

Carswell believes that Citi’s new multi-bank global trade platform, or similar mechanisms, will be used by trade banks in future to secure the level of funds they need to support growing demand for trade finance.

“It’s a positive step in the right direction, and offers a valuable mechanism to support trade,” he says, but notes that Citi’s platform may ‘kick-start’ other banks into launching similar initiatives.

Kramer at PrimeRevenue points out that although the new global platform will help trade banks source funds, it brings with it the