Going once, going twice

Competition in the world of auction-based online platforms has stepped up a notch as new and very different players continue to launch to market. Could this attempt towards standardisation and commoditisation of trade finance be the model of the future? *Shannon Manders* reports.

Auction-based online marketplaces are not a new phenomenon. For years, **GTR** has been tracking the success of platforms such as the UK's Platform Black and Sweden's Fakturabörsen, which offer online services through which invoices can be sold. The common denominator in many of these earlier models was the fact that they focused on the finance-starved SME market.

Fast forward a few years, and we're seeing more of these platforms enter the market, each with its own tailored offering. And while financial inclusion is still a driving force, these newer models are also attempting to solve issues relating to transactional efficiency – whether that be in terms of price or execution – technology and regulation: essentially addressing the needs of a changing environment. They are also increasingly seen as a viable method of managing portfolios and growing the asset class.

While some of the more traditional trade finance players still purport these offerings to represent only a small portion of the market, there's no denying that they are gaining market traction.

US-based Liquid X, which touts itself as the "largest electronic marketplace for trade finance assets" and is purely large-cap focused, has hosted in excess of US$10bn of traded volume and processed US$40bn of payments. Its volumes are growing by over 90% a year. "One of our biggest buyers is one of the big four British banks," says Glenn Kocher, the company's managing director. "This bank is just getting started in the US with its trade finance business and uses us in a very significant way to source its assets."

Swedish start-up Mitigram, which supports risk and finance pricing of instruments such as export letters of credit (LCs), standby LCs, international guarantees and avalised drafts, claims to have facilitated over US$1bn of trade finance in 69 countries in less than 16 months.

A relatively recent convert to these platforms is Lufthansa: a couple of years ago, when the German carrier sought a supply chain finance solution, it chose an auction system over a single-bank solution. In doing so, it became the pioneer customer of CRX Markets, a German start-up that had, at that point in time, not signed up any formal deals. The "competition approach" offered by the platform, Lufthansa head

of supply chain finance Alexander Pawellek said at a recent conference in Amsterdam, was in line with the company's business on all fronts. They completed their pilot project at the end of 2015, and have since done their first live supplier trade. The platform, which expands the multi-bank offering through an auction platform where banks and investors compete for securitised payable bundles, provided Lufthansa with the "perfect set-up", said Pawellek.

Niche players

Capital & Credit Risk Manager (CCRM) is one of the newest kids on the block: the platform is still being developed and is set to go live with its initial capabilities at the end of Q1 2017.

CCRM presents an entirely different model in that it is a distribution platform for bank and non-bank financial institutions: its focus is purely on the secondary market.

"It's a platform that supports banks to succeed by enabling syndication and distribution through technology," says CEO Ka-Kit Man, who runs the business together with fellow former banker Kah Chye Tan, out of Singapore.

As such, he explains, the platform helps banks buy and sell debt instruments to optimise their balance sheets for capital and credit relief and liquidity.

They are currently working with 17 institutions – buyers and sellers, spread across 13 countries and all continents – to co-create the platform.

"There is a natural need and understanding that the current distribution market needs to modernise," says Tan.

Although it has auction-type characteristics, CCRM is not designed as a bidding platform because, as Tan explains, there is still an "important relationship component" that exists when a bank is trying to sell an asset to another bank, insurance company, or fund manager. Sellers on the platform can choose who they would like to invite to provide them with a price for their asset.

The system is designed to make it more efficient to reach out to as many potential buyers as sellers choose, track in a visible and auditable way and compare the offers received on a transaction: essentially it circumvents the limitation of human capacity.

It's a cradle-to-grave approach to distribution, says Man. "When you sell an asset, that is not the end of the process – you need to manage paying the fees, releasing your investors: there are many additional steps after the sell. And this goes for when there's a non-payment situation too. The system keeps track of when the asset is sold, all the way to when it is paid – or even a default situation."

What's more, the platform addresses the non-standardised practices between – and even within – banks when it comes to managing the operational needs of the distribution process. With today's compliance and regulatory requirements, this is a process that requires a "major refresh", says Tan. "And that's what this platform brings to the table: much tighter regulatory standards."

Tallying the advantages

Of the many benefits that auction-based platforms bring is a structure for discovery of the true market price. "The auction process allows you to define prices for risks that are very difficult to determine," explains the product manager at one of the newer models – who asked not to be named. In fact, he says, the only possibility of achieving a fair and transparent price is through an auction – and one that has a good investor base. "If there are a number of interested parties, then the price should be good."

Many of the platforms in the market today downplay the effect of pricing transparency: for one, in most of the auctions, although bidders can monitor the price as the auction progresses, they are often not privy to the final fee.

Moreover, price compression is often not the end goal, as Liquid X's Kocher, also a former trade finance banker, explains: "If, during certain cycles, there is competition or compression around the asset, that's fine: this is reflected in our prices. We don't dictate the marketplace – we're not going to beat up funders over the next basis point."

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>
> **Kah Chye Tan**, CCRM

The fact is that many of these platform providers believe that human interaction remains key.

"Let's be realistic: everyone's shopping around their relationship banks," says Marcus Wade, founder and owner of Trade Asset Exchange (TAEX), a platform that has been around for a couple of years and currently counts more than 100 multinational corporate and large bank users from around the globe. But, he says, if banks clock their clients engaging on a platform and they have not been able to win any of that business, it would be an incentive for banks to pick up the phone and find out why this is the case.

The TAEX platform covers the full range of trade finance services, from the more traditional products such as LC issuance and discounting, through to supply chain finance, including receivables purchase facilities, as well as an option for bidding for deposits, the real-time issuance of term sheets, and more. It's what Wade describes as a "virtual meeting room" in that it is a bidding platform, but does not extend all the way through to the execution of transactions. It is currently in the beta testing stage.

The portal "globalises trade finance in a way that hasn't been done before", Wade says: banks without a global platform, but with an appetite for risk, can use the portal to access clients all over the world. In turn, it brings about better access to finance for reliable corporates. "It's also a very efficient way to get your one transaction out to multiple banks at the same time."

At what cost?

But how much are users willing to pay for access to a more efficient way of engaging in trade finance? Most of the platforms that **GTR** spoke to for the purposes of this article make their money by charging a transactional fee on successful conclusion of a bid – except TAEX, which is currently running a promotion and available for free.

"The whole idea is to make it much more efficient for people to get involved. And if you're paying more for your platforms than for your relationship managers, it doesn't make sense," says Wade.

However, he says that a "competitive" annual fee, dependent on the size of the institution, will be introduced in the future, after the beta testing phase has been completed. For corporates, it could be as little as €1,000.

Many bankers feel that, aside from the transactional or sign-up fee, the cost implications of joining these platforms are excessive. "You have to do a lot of episodic underwriting, unlike in relationship banking, where you underwrite on a periodic – once a year, or every six months – basis," says Paul Johnson, managing director and senior product manager, trade and supply chain finance at Bank of America Merrill Lynch (BofAML).

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Coupled with this, he explains, are the costs associated with compliance and regulation. "If you have to do one-off KYC, AML, etc, and you're not sure of all the participants in the chain, the economics cease to be attractive." This is the reason, he says, why a lot of the participants in these marketplaces are non-regulated banks: asset managers and private equity players do not face the same regulatory challenges that banks do.

Costs aside, for banks, the discussions around these platforms tend to boil down to a more fundamental debate on the merits of transaction finance vs relationship banking.

"Some clients are comfortable on any given day wanting the transparency on price – which they can get on these platforms. The problem is that on any given day, you can't be sure that what you need is going to be available. So for most – not all – clients, they value relationship banking: the comfort of knowing there is a line of credit available and that pricing is set," explains Johnson.

The idea that predictability is a missing factor for these platforms is echoed by some of the providers themselves – although, for platforms, a "buy it now" price is also available.

"The point is, you can't have it all," says our unnamed source. "Everything has its price," he says: you can't have maximum flexibility and also the certainty that you can sell – at any given time – everything that you have on your books. "If a client wants this security, then an auction-based platform is not the right choice."

The highest bidder

As competition becomes even more fierce, platforms are doing a lot to differentiate themselves from their rivals. The introduction of insurance is one of the tools that they are looking to add to their kit.

Liquid X, for one, looks at correlating services: things that people who operate in the asset class will do, say, three minutes before or after they make a trade, says Kocher. It is in the process of developing a trade credit insurance capability that will enable users of the marketplace to request competitive quotes for a credit insurance policy at the same time.

"That applies to traditional funders, but also corporates who may be, on one hand, selling receivables from their book and, on the other, looking to insure pieces of that book and using the platform to source the trade credit insurance," he explains.

GTR understands that Liquid X is currently working with a broker in the US to introduce a few of the monoline underwriters. It's a move targeted for the first half of this year.

TAEX is also looking to open its portal up to insurance companies, multilateral development banks and export credit agencies. "Then the financial institution buyers can bid for these insurance-covered transactions as well," says Wade.

The big question is, as with all third-party platforms, with various models springing up and all trying to offer the most superior services, how do potential users find the best fit? And, as there's no clear leader of the pack – yet – will buyers and sellers interested in engaging with these marketplaces want to sign up to, and monitor, a handful of different platforms?

The more niche players are called one-trick ponies, and the platforms that offer a wide range of services are accused of trying to boil the ocean. And while we may soon witness the launch of a "super" platform that will usurp all of today's offerings, consolidation is not yet on the horizon. "We are not at that stage," says CCRM's Tan. "The market is sufficiently large – we are far away even from scratching the surface." Until then, we are likely to see more and more platforms enter the market, mimicking their more successful predecessors and developing nuanced approaches that set them apart.

As these providers compete for users, and buyers and sellers, like Lufthansa, shop around for the option that suits them best, what must not be forgotten is that the platforms are but a tool for companies to support their core business – and not the fundamental business itself. When, for example, a buyer needs to move out their days payable outstanding in a meaningful way, technology is an important factor, but it is only one component; likewise, the funding is an important factor, but it too is only one cog in the wheel. GTR