Global head interview – Deutsche Bank

TXF talks to Deutsche Bank about the current state of the trade and supply chain finance market.

Michael Spiegel, global head of trade finance and cash management corporates, global transaction banking, Deutsche Bank AG

TXF: What state do you view the trade finance sector in at the present time – and how is your business developing?

Trade finance as a business was relatively unfashionable until the global financial crisis five years ago, at which point its comparative stability sparked a growing popularity. While we have seen no reversal in the trend for open account trade (as opposed to LC settlement), times of crisis highlight the importance of using instruments that help safeguard importers and exporters from payment and counterparty risk.

With regard to supply chain finance, companies are now more interested in the broader enterprise risk of their operations, rather than just counterparty risk. There is a need to take care of suppliers as well as distributors.

Another mega-trend is the rapid increase in South-South trade. Almost 50% of global trade now takes place between what we once called the emerging markets – and China counts in this context. While the BRIC countries remain very important, a new wave of up-and-coming economies is attracting focus, particularly the newly-termed 'MINT' group of Mexico, Indonesia, Nigeria and Turkey. While the focus on emerging markets is not restricted to such acronyms, there is, globally, a fundamental shift in the nature of FDI (foreign direct investment), which now looks at countries not just from a manufacturing perspective, but also from a consumer angle. There is considerable investment in manufacturing and natural resource development, but also a huge interest in the consumer growth potential.

In addition, there is increased interest in Africa – both in terms of development of its natural resources and as a consumer market. China, for example, is clearly investing in Africa, not just in resources but also in products – whether that is agricultural equipment or mobile handsets.

So, how do we fare in all of this? We enjoy a lot more attention, not only on the cash side but also the trade side. There are tremendous opportunities for us with our global footprint and in dealing with so many multinational companies. We enjoy the fact that trade finance has become fashionable again. We can also play a broader role in the mitigation of enterprise risk through the whole value chain, for our corporate clients and their customers.

TFX: During the GFC (global financial crisis) trade banks overall failed to provide finance to the market as they had done so in the past. Since then, many banks have

largely focused on core relationship business. Is this the new norm? What lessons have been learned?

The GFC caused a lot of changes, some also due to regulatory intervention. But globalisation continues. While in the past the average product would pass through, say, three countries, today that product would pass through eight – and this number will only grow. We, in turn, are supporting our clients from an end-to-end perspective. In essence, we have returned to our roots by servicing our global clients for their global needs. The end-to-end approach means we are also dealing with our clients' clients. Certainly, there is an opportunity for the more global providers to leverage their relatively broad global patterns in this respect.

The market will always consist of a combination of local, regional and global players, and the crisis meant that those who didn't have a global understanding had to focus on their local clients, and subsequently try to create a more regional presence over time. The fact that some of these players have now dropped out of the market goes to show they may not have been the best in the first place.

We have also seen many players working together to develop new and innovative solutions in a number of markets. At Deutsche Bank, we always seek ways to collaborate with our bank partners on a global scale in order to support the interests of the real economy in terms of trade finance and cash management, and as such, help to strengthen the transaction banking industry and the contribution it makes to society.

TFX: What do you see as the biggest hindrance to the provision of trade finance today, and what are you doing about it? Regulatory requirements have forced banks to re-examine their capital requirements and overall lending activities. How do you view your bank in this regard, and how do you think the trade banking sector is placed overall?

Clearly, the onset and continued impetus of regulatory change is to make the banking sector more stable, but this has often been viewed as burdensome, and the consequences – intentional and otherwise – somewhat misunderstood. Now, however, we can see improved regulatory developments when it comes to the trade finance sector – for instance, the maturity floor of one year has been lifted, and under Basel III, trade assets now being viewed more favourably than cash loans. Trade is now being seen as a relatively friendly product that supports the real economy.

Of course, increased regulation is clearly a challenge. The more global you are as a business, the greater understanding you need of the overall regulatory framework, as unfortunately the numerous regulations at play are not very well harmonised. If you look at Basel III, it is more of a capital requirement with the various leverage ratios.

But the way in which regulators address KYC (know-your-customer) and AML (anti-money laundering) requirements tends to be very fragmented, making them something of a specialist area. This, however, opens up opportunities for banks with both global and local awareness of the implications of these regulations to engage in dialogue with the regulators. In doing so, we can also help to navigate any unintended consequences and help the regulators achieve their desired aims.

In the case of trade finance we have seen a number of positive developments from the regulators already. Certainly, final interpretations will still need refinement – the Basel III leverage ratio and how to classify deposits with central banks etc. are an example. We also need to get down to a more granular level, so that we can avoid increased pressure being placed on those assets that actually support global trade flows.

Michael Spiegel at Deutsche Bank in London

Specifically regarding Basel III, concerns remain on both the trade and the cash side – on the trade side around the credit conversion factor, and on the cash side, how the leverage ratios will work. The impact Basel III will have on the cost of trade finance products is still unknown, and this is why we are continuing to work with both clients and regulators – to try and mitigate that cost to the extent that it is tangible, because we want to ensure a secure and stable environment.

In addition, the definition of deposits will have an impact on leverage ratio. Is it operational? Is it non-operational? What kind of liquidity reserves do we need to hold? These are all areas we are still looking to fine-tune, to improve the overall risk framework and isolate high risk areas while leaving low-risk areas moderately untouched.

Overall, there is room for further improvement to minimise the potential impact on the real economy.

TFX: With global supply chains ever-more complex, are the supply chain finance solutions available, and the provision of those, sufficient to meet the demands of corporate treasurers? What additional tools are you employing to assess corporate risk?

As further trade corridors and trade flows develop, how can you as a bank help all the parties involved in the flow of goods? How do you see involvement of MFIs (multilateral financial institutions) in this space and are you able and willing to partner with them in such schemes?

If we look at the flow of goods, first of all, it is important to understand the end-to-end value chain. The financial supply chain is indeed becoming increasingly complex, and traditional trade finance products only cover a small proportion of the overall supply chain. To better support clients, we must understand how the whole supply chain operates and interlinks in order to provide the most appropriate financial solutions – from the sourcing of basic resources, right through to delivering the final goods to the distributors or end users.

The benefits of being a global supply chain finance bank or global trade finance house is that we have access to a better data pool and knowledge of companies that have a large global spread of both suppliers and customers. Both of these are essential from a corporate risk perspective, as clients increasingly need to manage counterparty risk while simultaneously ensuring the stability – and liquidity – of their suppliers. In order to facilitate this, we work with the likes of credit insurers to constantly improve our knowledge base on the counterparties and their financials, as well as the underlying business flows

In the past trade finance required heavy manual reconciliation, largely due to the amount of traditional, documentary forms of settlement. However, with the growing use of technology, you clearly see the changes now in the payment process,

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especially with supplier financing on the payables side.

Today, we can use technology to not only onboard clients, but to also track the performance of their transactions, offering increased transparency and security, and thereby helping suppliers with their clients to ensure they receive their payments on time or perhaps earlier by discounting. Through our technology and electronic platforms, we have been able to develop a more integrated, end-to-end supply chain automation offering. In fact, we have just launched a supply chain manager app for our Autobahn app market product.

The increased focus on the supply chain is offering a fresh approach to looking at working capital management and financing liquidity generation – it's a model that supports buyers and sellers in their trading partnerships. And with this comes a renewed focus on operational efficiency to a) reduce costs and b) to increase transparency – both of which will ultimately help companies to successfully assess and manage their risk profiles.

We work with a number of multilateral financial institutions (MFIs) to see how we can encourage the smoother flow of both goods and finance. But we also work closely with private risk insurance companies. Risk insurance and the trade industry has almost become a business in its own right. The insurers hold a lot of data, and this is a prime resource for us and our clients – particularly where we may not know the counterparties in a transaction. Indeed, this certainly happens in many South-South trade flows.

Where a track-record has not been established, it is imperative to work with MFIs and insurers to facilitate the best solutions for our clients. And of course, our documentary products are still relevant in this context – and continue to offer strong risk mitigation properties. Moreover, as a bank

we also work with export credit agencies (ECAs) both on short-term transactions into certain markets, but particularly on the longer-term transactions in our export credit product area. Indeed, the ECA role has become a lot more sophisticated as importers will go to an ECA to see how they can get longer tenors for a pool of imported goods and thereby obtain an alternative form of funding.

TFX: What other initiatives are you taking to customise your trade finance offering for multinational corporates?

Interfacing with the client to provide the right data set is probably one of the most important aspects, as well as integrating currency hedging into that. Our clients want us to provide the right solutions for them, and look closely at how to execute payments and collections in the context of the settlement of their flows of goods and services being bought or sold. But, at the most basic level, this is our business, so I'm not sure to what extent it is a customisation.

We do go a level deeper than the normal trade flows, and look more closely at understanding the operational challenges that companies may have. Then again, because of the growing importance and complexity of the supply chain, we have to have a better understanding of the challenges facing our clients' clients. From this perspective, we are able to use the right technology and/or structure the right type of sequence, which would package the right products into a truly compatible solution.

The larger the company, the more important it is to understand their challenges. Indeed, as their trade flows globalise, they may get suppliers from a remote location where we don't have a branch, so we then have to think about how we can avail payment streams, how we can use our partners and their knowledge and how we can deal with certain exotic currencies.

The same holds true for looking into receivables solutions. If you look at the renminbi, this is a good example of how we have customised solutions for our clients by looking at their trade patterns and helping them to structure their flows of goods, services and payments by reducing the conversion and optimising their portfolio. This may only save them a few basis points, but the tying together of our understanding of the local regulatory environment and constraints is highly important, not only for the benefit of the bank, but also for the protection and benefit of the client. This is a de-

rivative of the trade finance activity.

Our clients will be selling in certain markets where we need to be able to understand and provide for a) the trade finance side b) the cash management side. These all have specific requirements where we can customise specific elements or solutions for our clients.

TFX: How much is technology/tech innovation helping the provision of trade and supply chain finance? Have tech innovations delivered? What further opportunities do you see to improve efficiency and your offering to clients?

There has been a kind of convergence. Some 'legacy' trade finance instruments became a type of cash management instrument within open account payment. Because of this, we have benefitted from having corporate cash and trade under one roof, and we also closely collaborate with our colleagues on the foreign exchange side. Such collaboration ensures that we can provide solutions which are technology-based or technology-supported, and these help our clients to operate more cost efficiently and deal with the challenges they face more effectively – particularly in the supply of international goods and services and the resultant payments – whether this is under the receivables or the payables side.

Through our technological platforms, companies can get better data and use better solutions to mitigate their risk positions. Indeed, the App Market we have introduced is clearly a prime example of this, and now with the introduction of the Financial Supply Chain Manager App, clients are able to gain greater oversight of their financial supply chains than before. While the solution itself is still fairly traditional, the innovative part is the way it is presented (online) and the ease of use for the client. Furthermore, the use of technology is giving us much more transparency in this space and this is what the market has been crying out for. Trade in a much more modern, and technology-supported way has now become the norm.

Apart from increasing efficiency for the corporate, technology also makes things more efficient from a data reconciliation point of view. Trade is growing and trade payments are increasing too, largely because of the number of suppliers and buyers involved across all aspects of the supply chain. There is so much data going round that needs to be stored and analysed – investment in technology and innovation is essential to help increase the transparency of all this information.

At Deutsche Bank, we are clearly committed to improving access and transparency and within a short time period have already developed some 60 applications across the Autobahn App Market.

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This has been driven primarily by our global markets business, but we are catching up on the transaction banking side where we now have some 20 apps, including liquidity management apps. Through solutions such as this, we are moving in the direction where technology makes ease of use for corporates, and perhaps more importantly, where they have real-time access to data and information, which in turn will help their own businesses.

TFX: How do you view the future of the availability of, cost of and provision of trade and supply chain finance in the near to medium term?

The volumes will continue growing to such an extent that we will need to attract new investors. The regulatory impact will also have an influence on the overall availability of credit. With trade moving so fast, we will continue to see further movement into open account settlement. It's a wonderful opportunity, but clearly we will also need to broaden the investor base in trade finance.

The more sophisticated you are, then the more you will have a role to play in that space. And certainly, there will be a growing facilitator role to play in the provision of trade finance. It doesn't matter where the actual cash comes from; what matters is the experience, knowledge, understanding and sophistication in order to avail that liquidity to our clients.

I think we will see new investors through multiple instruments – for example, the club trade finance or asset class is pretty alien to most investors outside the banking space. We've seen a few CLOs (collateralised loan obligations), as well as securitisations; and we have also seen interest from hedge funds and pension funds. Trade finance provides a wonderful instrument on a portfolio basis – as we can see from the ICC Registry – but it will have to be diversified for longer-term investors.

Indeed, we need to educate and make trade a more attractive prospect for outside investors, and get more investment into supply chain and working capital on the back of trade. This, in turn, will provide liquidity to the real economy from the movement of real goods and services.

In terms of cost, it will trend upwards in the medium term. The question is: By how much? And how do you compare that to current levels? In fact, it may not actually be more expensive than current levels; it just depends on how you look at its suitability. After all, it has to be cost that makes sense in the end to the entire system. We will continue to look at ways to optimise the reduction of cost structures, and how to make the system as efficient as possible. Undoubtedly, though, there will be some costs incurred that will have to be passed on to clients, both from a liquidity and a regulatory perspective. And while it is likely that cost will trend up, we will do our utmost to keep that in check as much as possible.

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