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AIMA

Private credit and the trade finance opportunity

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TradeFlow Capital Management
Transforming Risk, Enabling Trade

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Foreword

The Alternative Credit Council (ACC) and Simmons & Simmons are delighted to introduce this research paper on the role of private credit in trade and commodities finance. Produced in partnership with TXF, this research provides investors with data and insights on the risk and return opportunities in the global trade finance market.

Global supply chains and international commerce are adapting to structural changes in the economy and financial system. One of the biggest drivers of change is the retrenchment and greater balance sheet management of traditional lenders, who have historically been the largest providers of trade finance and key facilitators of cross-border business. This happens at a time when demand for trade finance has significantly increased, with firms adjusting their practices in response to Covid-19 and renewed interest in and pressures on global trade patterns. This is contributing to a growing trade finance gap which some now estimate to be greater than $2 trillion.

During the past decade, private credit managers have helped address finance gaps in global credit markets. While direct lending to SMEs and mid-market businesses may be the most prominent example, the growth of asset-based lending, leasing and speciality finance providers gives testament to the increasing role of private credit in the financing of the real economy.

Trade finance offers a significant opportunity for investors seeking assets that offer a differentiated and competitive risk-adjusted return. It can also provide borrowers with the tailored and flexible finance solutions they need to thrive and innovate. For these reasons we expect private credit to become a larger part of the trade finance market, and for trade finance to be soon recognised as its own distinct subset of the burgeoning private credit universe.

Investing in the trade finance market requires a sophisticated approach to the credit and operational risks that exist. There is also evidence that the sector is evolving in response to challenges in the market through the incorporation of technology, ESG and more sophisticated risk management practices. Furthermore, there are increasingly more diverse ways to take exposure to the trade and supply chain finance opportunity throughout the capital structure. Our research demonstrates that the potential reward for investors who can be part of this evolution is significant.

This research provides an overview of the trends shaping the role of private credit in the trade finance market. It is our hope that it will help investors understand the potential of this market and how private credit can help fill the trade finance gap.

Jolyon Ellwood-Russell
Partner, Simmons & Simmons

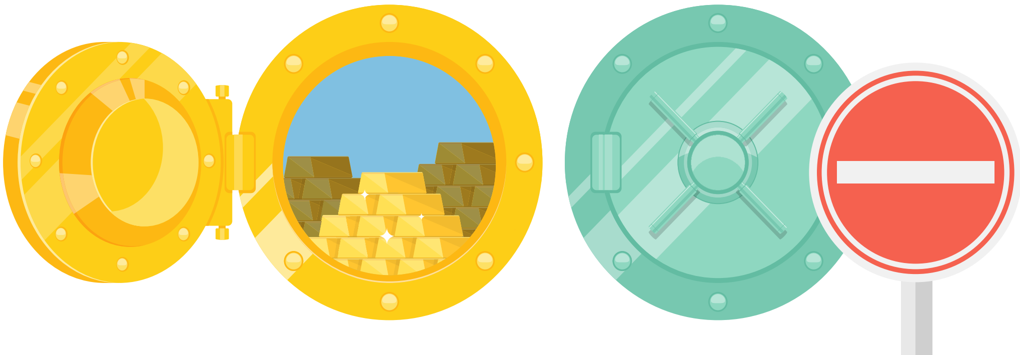
Jirí Król
Global Head, Alternative Credit Council

Executive summary

Shaken not stirred: Alternative asset managers (63%), banks (61%), and corporates (52%) are cautiously optimistic about the current state of the trade finance industry. Most of the corporates (90%), banks (83%), and alternative asset managers (81%) reported being in a healthy position moving forward in 2021 and beyond despite the turbulence of the previous 18 months.

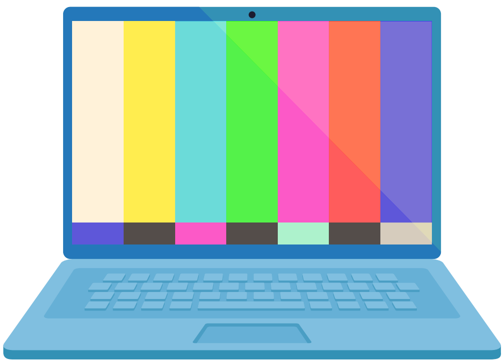
The commodity trade finance opportunity: Across respondents, alternative asset managers had the strongest knowledge of non-bank lending in commodity trade finance (4.6 out of five), followed by corporates who demonstrated a sound understanding (3.8 out of five) and banks (2.1 out of five). This data suggests that there is still a relative lack of understanding of non-bank lending within commodity trade finance across the market, which may prevent finance from reaching its potential with corporates.

Finding your perfect partner: Banks generally held a more negative perception of alternative asset managers prior to working with them (2.1 out of five) than after working with them (3.7 out of five). However, banks working with alternative asset managers also highlighted their different mandates (50%) and the need for asset managers to understand the operational and regulatory constraints of banks (both 43%) as key hurdles to developing stronger partnerships. Bridging the perception gap and acknowledging these constraints will be important for alternative asset managers looking to develop their relationships.



Filling the finance gap: Nearly half of the corporates surveyed chose to access private credit supplied by alternative asset managers because they have been unable to access bank financing. However, respondents also highlighted the attractive benefits of private credit as a key driver of their behaviour rather than the limitations of the banking sector. Faster execution times (48%), bespoke financing (43%), and strong relationships (38%) were the most popular benefits of private credit cited by our respondents.

ESG is now BAU (business as usual): Corporates cited ESG as very important to their outlook (4.4 out of five). Despite this, however, nearly 60% of the corporate respondents noted that alternative asset managers (AAMs) do not meet their ESG requirements, a finding that likely stems from corporates believing that AAMs can do more to demonstrate they understand fundamental ESG issues and challenges.



A tentative nod to tech: There were a range of different technology platforms used across the respondents, with Komgo, Bolero and essDOCS the most used for documentary trade, open account trade, and shipping and freight. However, the data suggests that use of digital technology in the sector is patchy with little certainty on when this may become commonplace across different trade finance activities.

The cost of capital remains a concern: Higher fees (46%) were the main reason for corporates who reported no current involvement with alternative asset managers or private credit. However, this cohort of borrowers also stated that they may do so in the future (3.1 out of five). This suggests that while the market will remain price-sensitive in broad terms, borrowers may increasingly consider non-price factors such as speed and flexibility, particularly as alterative asset managers' involvement in trade finance grows.

Introduction

Aims and objectives

The aim of this research is to present the latest market trends on the role of private credit in trade finance. To meet this aim, the following objectives were undertaken:

- A quantitative survey of banks, corporates, and private wealth managers/asset owners active within commodity trade finance, trade finance, and receivables finance.
- Qualitative interviews to explore in greater detail why the quantitative trends might have occurred.

Methodology

The data in this report were collected using a mixed methods design that included a quantitative component, an online survey, and a qualitative component, follow-up phone and email interviews. The data presented in the subsequent sections is an in-depth and detailed exploration of the trends in private credit across trade finance (the survey), contextualised with detailed insights on why these trends might have occurred (the interviews).

The survey

An online survey platform (SurveyMonkey) was used to collect the quantitative data across trade finance[1]. Specific questions were developed for each industry type with respondents only seeing questions that were relevant to their experiences.

Responses were collected between May and August 2021. To ensure the overarching aims of this research were met, the survey questions were tailored specifically for the different respondent types to respond to. No duplicate data from the same institution were included. If more than one respondent answered from the same institution, the scores were aggregated and then averaged. This approach ensured that every institution was weighted equally.

There are figures throughout the report where the percentages do not total 100%. The reason for this is because there were 'tick all that apply' style questions. Where applicable, a footnote has been included to aid understanding and interpretation.

A note on sample size

A total of 151 respondents completed the survey. It is important to note that data presented in this reported is from a sample that only represents a very small percentage of the respective industries. Moreover, the cross-sectional[2] nature of the data means that it is only representative of the industry at the time the data was collected.

However, these caveats are common across many pieces of research, and while they must be acknowledged, they do not detract from the conclusions drawn from the data. Moreover, because inferential statistical analysis was not conducted on the data, the sample of 151 respondents was large enough to conduct methodologically robust data analysis and, most importantly, for reliable trends and conclusions to be drawn.

Consequently, this report is not making any assumptions or providing definitive conclusions about the entire private credit landscape in trade finance. Instead, the data presented provides an insight into prevailing sentiments across the

[1] In the context of this research, 'trade finance' refers to commodity trade finance, 'traditional' trade finance solutions, and receivables financing.
[2] 'Cross sectional' data refers to data collected at a single point in time. Data collected over multiple time periods is known as longitudinal.

different cohorts of respondents on the role of private credit in trade finance - research which to date, does not exist in the industry.

The interviews

To explain the quantitative trends, semi-structured interviews were conducted via phone and email with eight consenting individuals. Participants were identified through a final question on the survey that asked if they wanted to be involved in a follow-up interview.

The topic guide for each respondent was based on their survey responses, ensuring that the interview remained focused. The interviews were conducted between July and August, 2021. Telephone interviews were audio recorded and email interviews were kept on an encrypted hard drive. To protect the identity of the respondents, all qualitative data has been anonymised throughout this report. The quotes used throughout the report are verbatim.

Understanding the interviews

The qualitative quotes used throughout the report are designed to provide additional context and insight to the quantitative trends. The quotes have been analysed against a rigorous framework that promotes transparency and detailed comparison across the interviewees.

This ensures that the quotes are not a collection of anecdotes or isolated views, but instead, an accurate representation across the interviewees. Where there are differing views, these are presented independently within the report.

However, it is important to also state that while the quotes are reflective of the overriding sentiment across all the interviews, they are not intended to be the defining view of the industry on a specific subject.

Demographics of the respondents

Of the 151 respondents, 39% identified as a corporate, 39% as a bank, and 22% as an alternative asset manager (hereafter AAM) (figure 1). Just over half of the sample reported to be a global head or director, with 37% operating in a senior position (figure 2). Asia-Pacific and Europe were the two most reported regions for company headquarters (figure 3). Nearly three-quarters of banks and just under two-thirds of the AAMs and corporates reported operating on a global scale (figure 4), with finance (27%), agri/softs (25%), and metals and mining (17%) the top three sectors of operation (figure 5).

Figure 1. Type of respondent

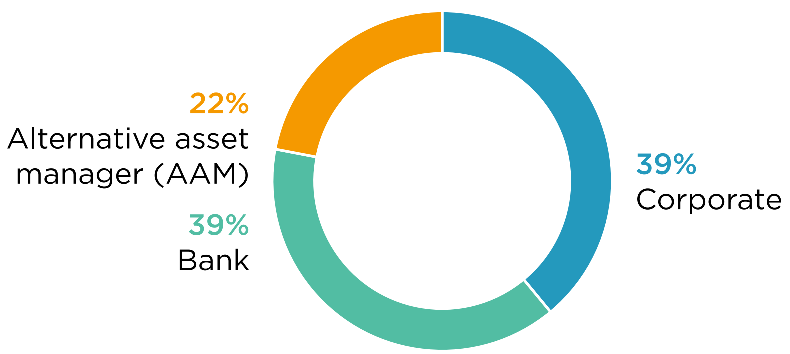


Figure 2. Seniority of the respondents' role

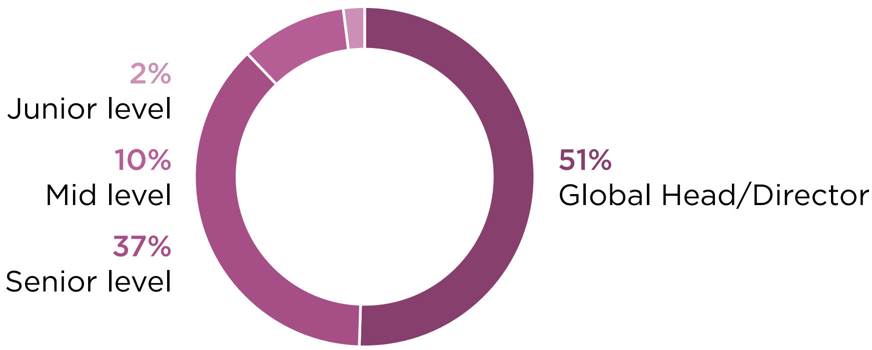
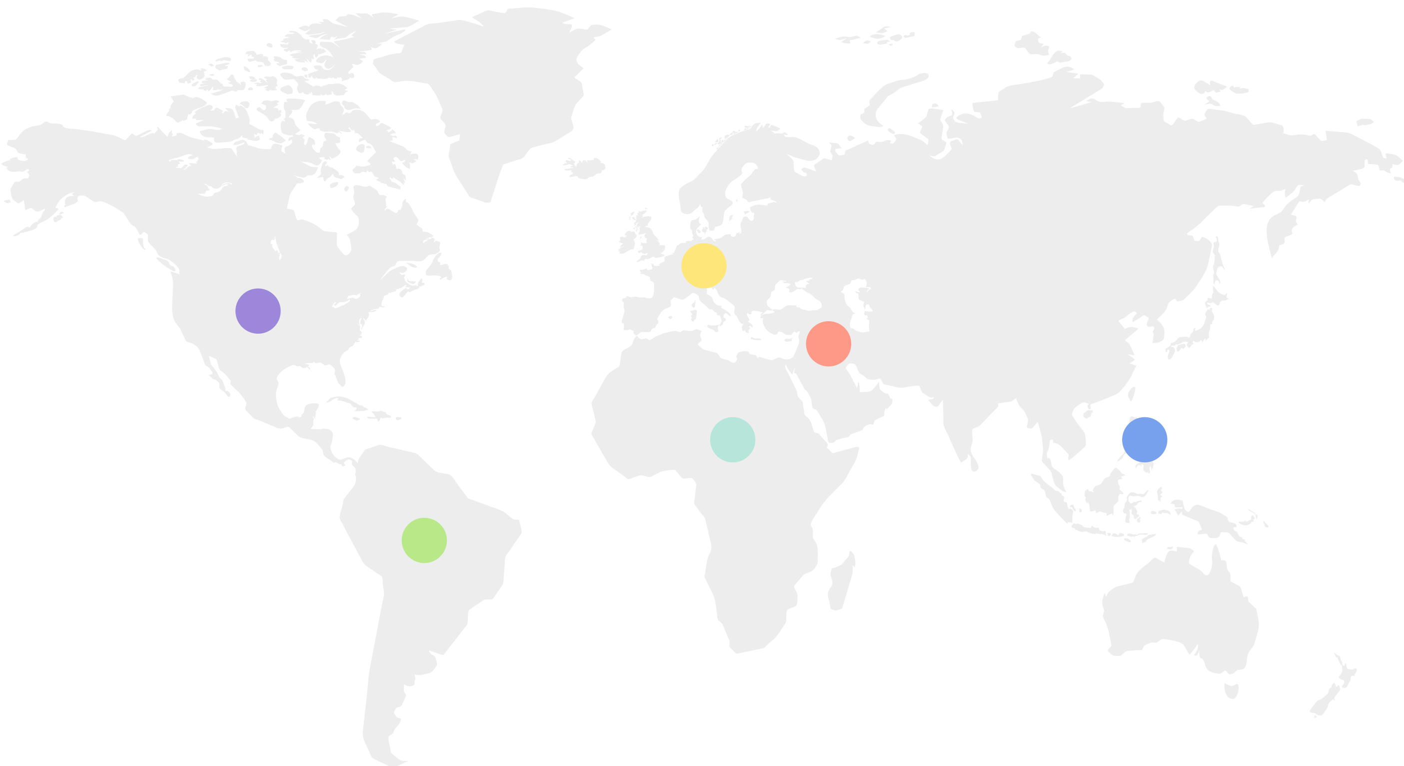


Figure 3. Location of company headquarters



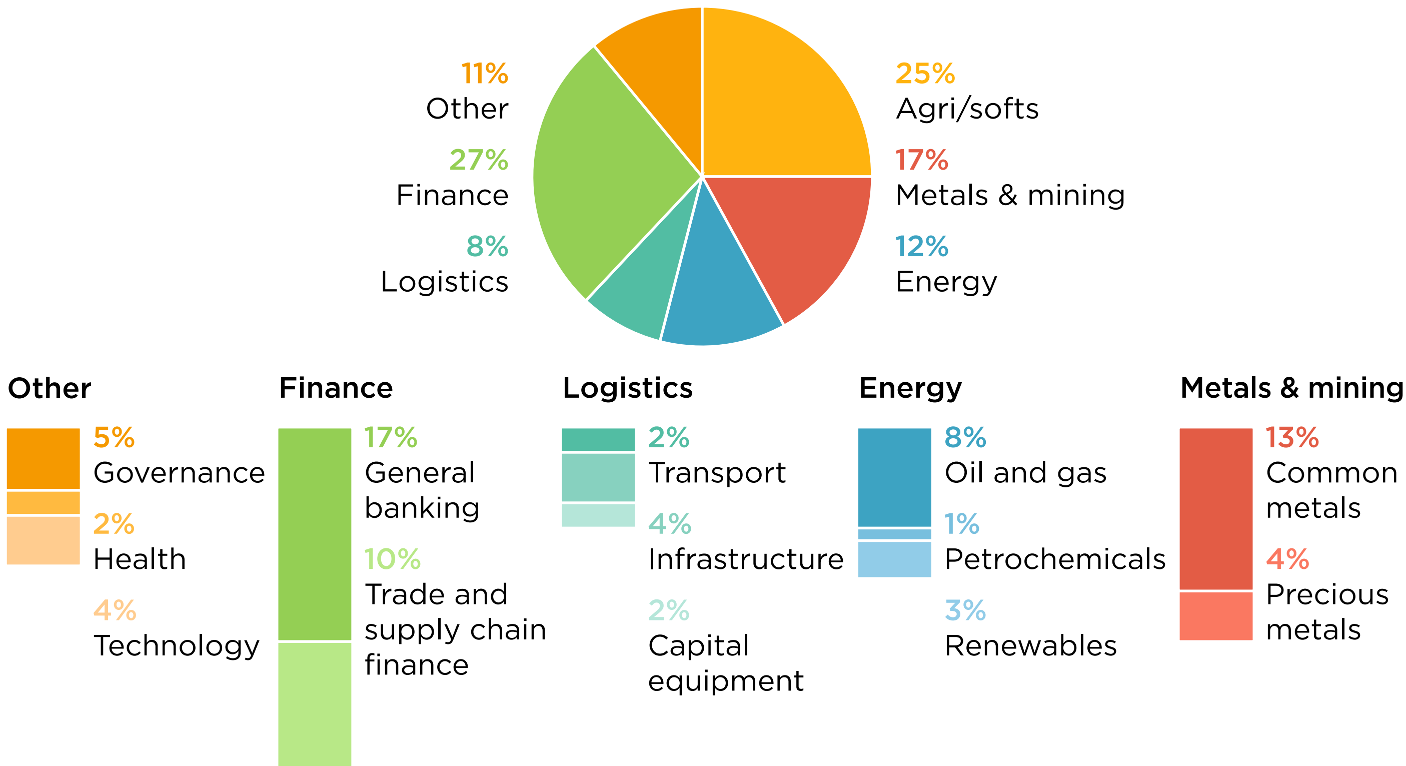
	AAM	Bank	Corporate
Africa	0%	2%	2%
Asia Pacific	41%	22%	23%
Central and South America	0%	2%	0%
Europe	37%	67%	52%
Middle East	4%	0%	6%
North America	19%	7%	17%

Figure 4: Scope of operations

	AAM	Bank	Corporate
Single jurisdiction	4%	2%	2%
Multiple jurisdiction (e.g. home country plus a few others)	15%	7%	15%
Regional (across the continent within which you are located e.g. Asia-Pacific, Europe, North America)	11%	4%	6%
Multi-regional (operating across more than one region)	7%	15%	15%
Global (operating across all regions)	63%	72%	63%

100% 75% 50% 25% 0%

Figure 5. Sector of focus



What is trade finance?

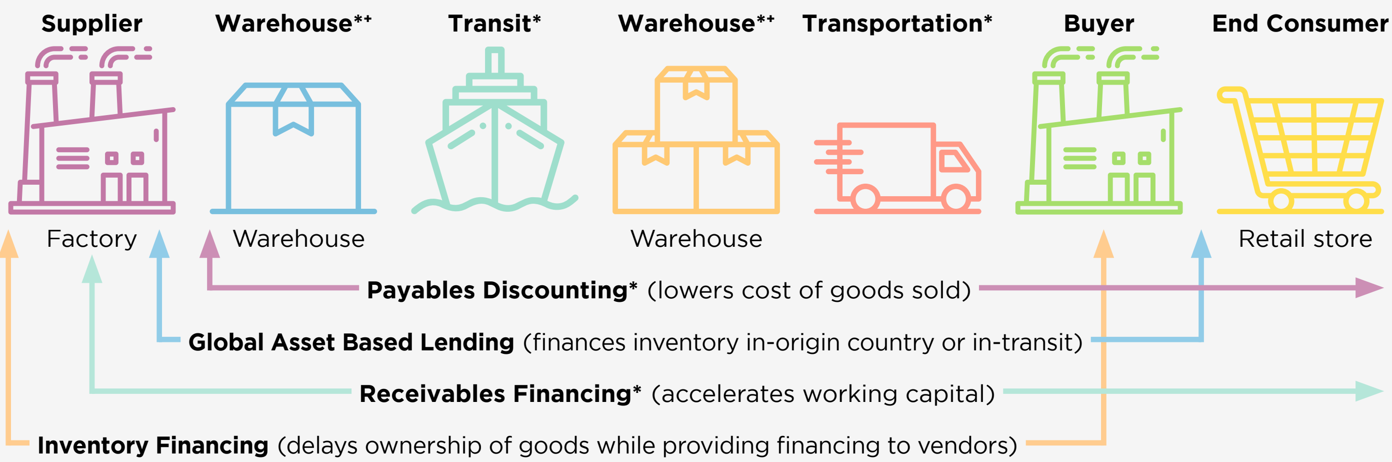
Trade finance is the financing of goods or services with financial instruments and products to facilitate international trade and commerce from a supplier through to the end buyer. It is estimated that trade finance underpins between 80-90% of global trade flows in one form or another.

Trade finance is an umbrella term covering many financial products. These can include: documentary letters of credit, back-to-back credit, standby letter of credit, purchase order finance, inventory finance, supply chain finance, receivables finance, invoice finance, working capital, bonds and guarantees, commodity trade finance, structured commodity finance, among many others. NB: In the context of this research, trade finance refers to, 'traditional' trade finance solutions, commodity trade finance and receivables financing.

The function of trade finance is to introduce a financier to transactions to remove the payment risk and the supply risk. Trade finance provides the exporter with receivables or payment according to the agreement while the importer might be extended credit to fulfil the trade order. In general trade finance loans are short-term and self-liquidating. They are often secured and offer healthy yields compared to other liquid credits. Simply put, trade finance underpins trade at every stage of the global supply chain.

According to the World trade Organisation (WTO), global merchandise trade was valued at $19.051 trillion in 2019 – which was 3% down from 2018. Much of that drop off was due to a fall in energy prices through that year. Global trade in commercial services for 2019 was valued at $5.898 trillion, up 2.1% from 2018. Unsurprisingly, global merchandise trade volume fell some 5.3% through 2020 largely due to the Covid pandemic-induced collapse which bottomed out in the second quarter of last year. In October 2021, the WTO revised its estimates and stated that merchandise global trade volume is expected to increase by 10.8% in 2021, with trade growth likely to slow to 4.7% in 2022.

Caption 1. A example of how trade finance works



* Owned, operated or managed by UPS
+ May or may not require warehousing

Source: UPS

The low default rate of trade finance

One key attraction of trade finance as an asset class has always been its low default rate. According to the International Chamber of Commerce (ICC) Trade Register 2019, which captured a full decade of data from 2008-2018, the default rates, weighted by the obligor, are low across all products and regions, averaging 0.36% for import letters of credit, 0.04% for export letters of credit, 0.73% for loans for import/export and 0.45% for performance guarantees. Where defaults do occur, the asset class is often characterised by high and fast recoveries.

And as noted in a 2020 ICC paper on unprecedented times for global trade: The unpredictable spread of Covid-19 has disrupted the world around us – and trade is no exception. In turn, it is important to acknowledge these figures – even more so during these uncertain times – confirming that relative to other banking products, trade finance instruments remain a low-risk asset class (Bischof, 2020).

The ICC Trade Register 2021 reports that in 2020 global documentary trade revenues fell 16%, trade loans and non-risk mitigating trade product revenues fell 13.5% and supply chain finance revenues fell 6%. It also noted slight rises in default rates for both import and export letters of credit, which the ICC noted were: "likely driven by the impact of the [Covid] pandemic." ICC results indicate that default rates from 2008-2018 are low across all products and regions, averaging 0.37% for import letters of credit (L/Cs), 0.05% for export L/Cs, 0.76% for loans for import/export, and 0.47% for performance guarantees (when weighted by obligors).

Critics of the Register argue that the data pool is not large enough to obtain a comprehensive overview of the true risks of trade finance related to defaults. However, in general the asset class is characterised by a lack of good publicly available statistics, although the ICC figures are widely regarded as the best available. Commenting on the Register for this year, Andrew Wilson, global policy director, ICC, said: "This year's ICC Trade Register provides substantial reassurance of the low-risk nature of trade as an asset class, while also demonstrating the immense value of a rich, data-driven and authoritative source at unprecedented times of uncertainty."

The global trade finance gap

One key issue over the provision of trade finance which has been heavily discussed over the last few years has been the size of the global trade finance gap. One market practitioner describes the trade finance gap as: the difference between how much trade finance is requested by businesses around the world so they can sell their goods and provide their services, and the actual amount of funding that banks are willing or able to provide. In other words, it's the difference between the supply of, and the demand for, trade finance (Behling, 2020).

Although part of this gap may be due to the poor credit quality of those applying for trade finance, or hampered by compliance or regulatory constraints within commercial banks as they become increasingly risk averse, there is a genuine need to bridge some of that gap for trade transactions. While developmental financial institutions in particular have risen to provide more trade finance and guarantees through the past two years in particular, there remains immense opportunities for other non-bank financiers to enter this space both individually and on a collaborative basis.

Up until last year many reports had quoted the figure of $1.5 trillion as the size of the global trade finance gap – a figure which had been released by the Asian Development Bank (ADB) in relation to its Trade Finance Gaps, Growth, and Jobs Survey of 2018. The gap represents the difference between requests and approvals for financing to support imports and exports. In October 2021, the ADB revised this figure to

$1.7 trillion for 2020, following its latest survey. The ADB says the survey is the world's leading barometer of trade finance health with data coming from 79 banks and 469 firms, covering all regions of the world.

ADB trade and supply chain finance head Steven Beck, commented: "The challenges of trading businesses may be even steeper than our survey indicates, as many of them were deterred by the economic uncertainty from even applying for trade finance. Higher prices for food and energy will exacerbate the gap, eating into country and counterparty finance limits in place to support trade. To close the gap, we need to bring trade fully into the digital world through greater coordination with the private sector as well as global agreement on common standards, practices, and legislation."

Other institutions have made further observations about the global trade finance gap. In a statement released by the WTO and ICC in July 2020 it noted the following: "Trade finance is a critical element in re-igniting worldwide growth in imports and exports. Since the need for trade finance is estimated to be between $2 trillion and $5 trillion, meeting this demand and addressing the shortfall will be challenging. There is serious concern that the growing gap between demand and supply will particularly affect micro, small and medium-sized enterprises and businesses in developing countries, with important implications for jobs and incomes."

WTO and ICC urged the private and public sectors to work together to bring about a rapid transition to paperless trading, including e-documents in the processing of trade finance transactions. In addition, the statement called for an exchange of views on how regulatory authorities can help ease constraints on the provision of trade finance. It also proposed increased risk sharing to support trade finance and the extension of development bank schemes to provide risk mitigation. If such changes do take place making transactions easier to carry out, track and process, it would naturally also be easier for alternative capital providers to enter the market and help narrow the gap.

A turbulent time for commodity trade finance

In December 2019 the most talked about news stories globally were: Brexit, the US presidential election result and the ongoing US-China trade war – and all three of which were causing volatility in global financial markets.

The very thought of a 'black swan' pandemic that would cause unprecedented disruption to global supply chains, soaring unemployment rates, extreme volatility across every financial market, and would disrupt global economic activity on a scale never seen, was limited to fantasy and fiction writers and film makers.

For those in trade finance – an industry that covers, among other financial products, short term trading of commodities, traditional trade finance solutions (for example, supply chain finance, letters of credit, trade loans, bonds, guarantees, and indemnities, and trade collections), and receivables financing (see caption 1) - the industry was about to experience much more pain.

In 2020, the high-profile collapse of commodity trading companies Hin Leong, Agritrade International, ZenRock Commodities, and Phoenix Commodities sent shockwaves through the industry. US crude oil prices also plummeted below $0 for the first time on record, and there was extreme volatility in the pricing of core commodities such as crude oil, agri/softs and metals, causing uncertainty and concern. In subsequent months the fallout was considerable in the commercial banking sector, with much of the focus on activity in Singapore. Largely as a result of this, ABN Amro pulled out of commodity finance, BNP Paribas significantly scaled back, SG closed its commodity finance operations in Singapore, and many other banks have scaled back in a so-called 'flight to quality'. As such opportunities have opened for non-bank lenders.

To compound matters for banks, the impending implementation of the latest risk-based Basel IV that will introduce reforms to credit, market and operational risk, the output floor, and the credit valuation adjustment, will increase the weighted average Tier 1 minimum risk-based capital requirement of global systemically important banks (G-SIBs) by 23% and 26%, respectively (KPMG, 2018). Under Basel IV, scheduled to be rolled out over the next five years, banks will be required to hold an additional $120 billion in capital, reducing the banking sector's return on equity by 0.6% (McKinsey & Company, 2017).

Moreover, global trade has long been operating against a turbulent backdrop of increasing cross-border sanctions, tariff hikes and the growth of non-tariff barriers. Such protectionist policies and other geopolitical tensions have added increased stress to global supply chains (Bell, 2020).

In addition, the recent revelations of Mercuria's 'painted stone slabs masquerading as copper blister', and around the operations of Greensill Capital, are stark reminders that trade finance is still experiencing turbulence (Bell, 2021).

The result for banks has been the soaring cost of debt, increasingly stringent and resource-intensive anti-money laundering (AML), KYC and KYCC procedures (all of which increases the administrative costs to banks), and the retrenchment of many banks from key sectors such as commodity trade finance.

For borrowers, as explained above, this has left a seismic $3.4 trillion gap in needed trade finance, most severely felt by small and medium-sized enterprises (SMEs) and those in emerging markets (Standard Chartered, 2020).

Trade finance and the private credit opportunity

While not new to the financial world, private credit offers opportunities for both banks and borrowers. The Alternative Credit Council (ACC) defines private credit as: "an umbrella term used to describe the provision of credit to businesses by lenders other than banks. Most commonly, these lenders are regulated asset management firms pooling investor money into funds that are then used to finance respective businesses. The term private credit is also often used interchangeably with phrases such as 'private debt', 'direct lending', 'alternative lending' or 'non-bank lending".

Private credit is an established but growing sector within the alternative investment market. It can be differentiated from other types of lending activity and investment strategies in various ways, including:

- Bilateral relationships: private credit lenders will often have a direct rather than an intermediated relationship with the businesses they are lending to
- Buy and hold: private credit assets – usually loans - are generally not intended to be traded and will be held to maturity by the original lender.
- A flexible approach: Core features of a credit agreement such as repayment terms or covenants will typically be structured to match the unique needs of the borrower.

Private credit is part of the alternative asset management sector, a cohort of investors that are typically defined by three key drivers: i) a desire to achieve a positive return regardless of whether markets are rising or falling; ii) freedom to trade all asset classes and a wide range of financial instruments while employing a variety of investment styles, strategies and techniques in diverse markets; and, iii) reliance on the investment manager's skill and application of a clear investment process to exploit market inefficiencies and opportunities with identifiable and understandable causes and origins (AIMA, 2021).

Private credit, which encompasses a wide range of strategies, including senior direct lending, mezzanine debt, opportunistic/distressed credit, and various niche or specialty finance undertakings, has seen a meteoric rise as an asset class over the last decade. As of June 2020, private credit held assets under management (AUM) were estimated to total $887 billion globally (Preqin, 2020). Today, only a small proportion of this capital is allocated specifically to trade finance. However, dedicated trade finance strategies are finding increasing acceptance among institutional private credit investors – a dynamic which is not surprising given that trade finance directly addresses at least two of the key drivers identified by AIMA, namely a lack of correlation with other markets, and readily understandable causes behind the market opportunity.

A recent report - *Private Credit in Asia* - by ACC, Simmons & Simmons, and EY (2020) also highlights the growing importance of private credit in the economic fightback from Covid-19 in the Asia-Pacific region, a finding that will likely hold resonance for other regions too.

The rise of alternative asset managers such as hedge funds, private equity funds, real estate funds, pensions funds, and insurance companies, are also increasingly acknowledged as a major driver behind global economic growth (Hale, 2019).

What attracts private capital to trade finance?

One of the misconceptions of the market, particularly from corporates (borrowers) as well as other stakeholders, is around why trade finance funds/asset managers exist.

While the trade finance gap and retrenchment/rationalisation of banks has aided the emergence of trade finance funds, one must consider funds from an investment strategy perspective within the private credit segment to uncover what is attracting private capital to trade finance and what characteristics trade finance has as an asset class. Only when one observes trade finance through such a lens will they understand why private funds exist and the role they can play in the ecosystem.

At a high level, some of the key characteristics driving the emergence of private credit funds (across the credit quality spectrum) in trade finance are:

Risk

• The ICC Trade Register 2019, highlights the low-risk nature of trade finance – as noted above.

• Whilst defaults and high-profile fraud cases grab the headlines, it is important to keep in context the overall macro situation as per the above data points and seek to understand the underlying reasons for potential and actual losses.

Maturity

• Trade finance transactions are typically short term, under 180 days – when compared to other credit opportunities, these are few and far between (treasuries, short duration / short residual maturity commercial paper, corporate bonds etc.), and even more sparse in the private credit segment.

• To investors this represents greater liquidity (although trade finance is semi-liquid in nature) as well as the ability to reprice more efficiently if credit conditions or base rate situations change.

Diversification

• Trade finance offers diversification opportunities on several fronts – not only from a private credit segment perspective, but also from a sector, geography and obligor perspective, particularly for SMEs who do not have the ability to tap the traditional capital markets.

Low correlation

• Trade finance has demonstrated limited to no correlation to traditional equity, fixed income or commodities markets.

Return

• Depending on the nature of the trade finance fund, its source of capital and its investment strategy, trade finance can offer a compelling return profile for private capital investors (Odedra, 2021).

> **"The characteristics of trade finance as an asset class is why private credit funds and investors exist."** (Odedra, 2021)

Unanswered questions ...

The growing importance of private credit in trade finance raises several questions. Why do some banks engage and work with alternative asset managers and others choose not to? What are the benefits for banks working with alternative asset managers and what are the main challenges? And how can technology improve, if at all, operational inefficiencies that currently exist with the financial markets?

For corporates, what are the reasons for some choosing to access private capital compared to those that do not access it? What do corporates think of the cost of private capital compared to bank debt? What do corporates think of how well (or not) alternative asset managers understand ESG? And will private capital be a feature of corporate debt in the future?

For alternative asset managers that currently invest private capital – why do they do so and how long have they been investing in this form of financing? Which vehicles do they use to invest? And which sectors do they invest in?

Findings

1. Introduction
    a. Cautious optimism about the current state of trade finance
    b. The need for education
    c. A 21st century asset class with 20th century technology
    d. Trade finance and ESG
2. The banks: In focus
    a. Negative perception becomes a reality
    b. Complimentary vs. alternative finance
    c. Banks and alternative asset managers: Complimentary partners
3. The corporates: In focus
    a. The importance of relationships cannot be underestimated
    b. The cost of capital
    c. Realising the opportunity
4. Asset managers: In focus
    a. Direct exposure leads the way
    b. Increasing private credit fund participation in the trade finance market

Cautious optimism about the current state of trade finance

AAMs (63%), banks (61%), and corporates (52%) mostly held a cautious optimism about the current state of trade finance (figure 6), a sentiment that reflected the turbulent nature of the industry over the past 18 months.

For corporates, cautious optimism stemmed from the uncertainty that has unfolded over the past 18 months:

"We saw some large defaults happening for corporates and finance providers, aka Greensill. We have been hearing that the banks have become cautious in their approach to extending credit for commodity traders. This results in greater counterparty risks and sustainable supply risk. Failing to deliver as agreed could lead to back-to-back defaults for buyers, or a delay in fresh procurement. It could also result in higher replacement cost. Add to this that counterparty KYC (know your client) and risk management is becoming increasingly important." **(Corporate; Asia-Pacific)**

However, the corporate goes on to say:

"There has been quite a movement in commodity prices. For large traders with strong origination and distribution capability it is a very positive opportunity."

For banks and AAMs, cautious optimism stemmed more from the clarity that is beginning to appear now the worst of the pandemic is over:

"The last 18 months have been pretty relentless for us. Not just because of Covid-19 but the wave of fraud cases too... but we are starting to see some stability come back in which allows us to better predict what is going to happen. This gives us more certainty to lend." **(Bank; Europe)**

"We have been positioning ourselves to take advantage of the massive trade finance gap that exists and the growing appetite from borrowers for private credit. We are mindful of what has happened but excited about the future." **(AAM, Europe)**

Figure 6: Prevailing sentiment on the current trade finance industry

	AAM	Bank	Corporate
Bullish	22%	35%	27%
Cautiously optimistic	63%	61%	52%
Defensive	11%	4%	17%
Bearish	4%	0%	4%

However, despite the turbulence of the past 18 months, most of the corporates (90%), banks (83%), and AAMs (81%) reported being in a healthy position moving forward in 2021 and beyond (figure 7). The driving reason across all the respondents for this healthy position was because of the strong relationships that they each held within their respective industries:

"We have very strong relationships with our banks, something that has helped us be in a strong position now. Over the next couple of years, we need to make a choice on the quality of the banks that we do business with. We will not take a fickle approach where they bank with wrong people just because of their name... strong relationships are fundamental to this process." **(Corporate; Asia-Pacific)**

Figure 7: Overall sentiment on the current state of respondents' company

	AAM	Bank	Corporate
We are in a healthy position to move forward in 2021	81%	83%	90%
We are damaged but will survive	11%	9%	10%
Unclear as we are still assessing the damage caused by Covid-19	7%	7%	0%
I am not sure we will survive much longer	0%	2%	0%

AAMs, banks, and corporates cited several reasons why they invest in trade finance. All three cohorts' primary reason was that it is seen as relatively lower risk because of its short-term nature (figure 8). More than half of the banks also referenced the liquidity of trade finance as an asset class, and 50% of the AAMs reported that investing in trade finance has more favourable pricing than longer forms of investing.

Figure 8: Most attractive features of investing in trade and receivables financing[3]

	AAM	Bank	Corporate
Relatively low risk as it is short term	65%	73%	64%
Trade finance is a liquid asset class	46%	51%	47%
Attractive returns	31%	44%	43%
More favourable pricing than longer forms of investing	50%	40%	36%
It is a safe asset class to invest in because of its transparency	38%	31%	36%
Other	7%	13%	4%

100%
75%
50%
25%
0%

[3] Tick all that apply.

The need for education

Across respondents, alternative asset managers had the strongest knowledge of non-bank lending in commodity trade finance (4.6 out of five), followed by corporates who demonstrated a sound understanding (3.8 out of five) and banks (2.1 out of five) (figure 9).

The qualitative data suggests that there is still a relative lack of understanding of trade finance. This may prevent trade finance from reaching its potential with corporates and investors. As one corporate noted:

"Trade finance needs to be understood in simple terms. It is creating liquidity to enable a buyer and seller to execute trade and exchange payment and goods with each other... it does get more complicated, but a lot of people overlook what its core function is." **(Corporate; Asia-Pacific)**

It is perhaps unsurprising therefore, that a lack of understanding and a perceived ambiguity between the different types of trade finance products were two of the most cited challenges across all the AAMs, banks, and corporates (figure 10) – both of which can be ameliorated by more education on the asset class, as several interviewees noted:

"Education, education, education. Investors need to fully understand what they are getting involved with before they will invest." **(Bank; Europe)**

"The global nature of trade finance can be daunting, especially to new investors... it is paramount that effective training courses are provided to all players involved in trade finance... without it... mistakes will be made." **(AAM; Europe)**

A recent whitepaper conducted by the Asian Development Bank Institute concluded that away from the main routes of trade, in countries and regions that have the greatest opportunity for trade expansion (for example, emerging markets), trade finance shortfalls are sharply exacerbated by education gaps. This was found to detrimentally impact the ability of SMEs to benefit from trade finance and the reallocation of production and investment within global supply chains (Auboin & DiCaprio, 2017).

Figure 9: Reported knowledge of non-bank lending in commodity trade finance

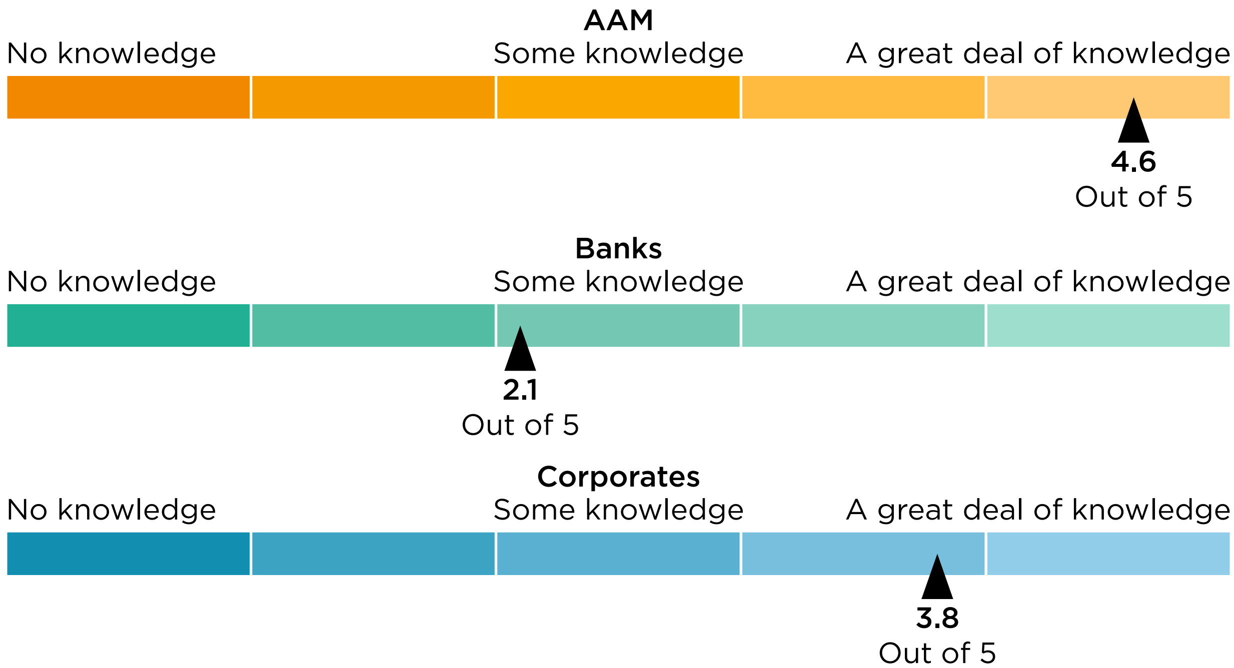


Figure 10: Greatest challenges to investing in trade and receivables financing[4]

	AAM	Bank	Corporate
There continues to be a lack of understanding about what trade finance is	56%	63%	58%
There is too much ambiguity between the different types of trade finance products (e.g. structured commodity trade finance)	67%	46%	60%
Increasing regulation makes it difficult to enter trade finance fully	37%	57%	42%
It is too niche as an asset class	41%	35%	29%
It is too costly	22%	24%	29%
It is too risky	22%	17%	27%
Other	13%	14%	15%

A 21st century asset class with 20th century technology

Much discussion regarding the role of technology in the trade finance sector over the past decade has been dominated by blockchain technology – a digital ledger of economic transactions that is fully public, continually updated by users across the globe, and considered impossible to corrupt.

Since then, the discussion has not moved on that much, although over the last couple of years there has been some significant momentum with the development of the digital platforms/ networks Covantis and Komgo (Bell, 20210)). And for Komgo, the involvement of its trade finance blockchain platform as digital agent in the $500 million sustainability-linked borrowing base financing for Sucafina in 2020 is something of a landmark in the commodity sector (Howse, 2021).

Figure 11 suggests a similar story with very limited use of digital platforms across the respondents. While the qualitative data suggested a more optimistic picture, with all the interviewees citing digitisation as, *"one of the fundamental cornerstones of trade finance for decades to come"* **(Bank, Europe)**, all the interviewees were uncertain on when the use of digital platforms might become commonplace within trade finance.

What is certain, however, is the need for vastly improved IT infrastructure and digital platforms to improve the operational efficiencies of trade finance. It is estimated that approximately four trillion documents are produced globally a year in trade finance, the vast majority of which are still printed out documents sent via fax machine.

If private credit is to fill the trade finance gap, digital platforms to improve operational efficiency must be at the centre of this movement.

[4] Tick all that apply.

Figure 11: Digital platform currently used by respondents[5]

	Service	Bolero	essDOC	Voltron	Marco Polo	CargoX	Komgo	Trade Information Network	We.trade	E-Trade Connect
AAM	Documentary trade	14%	0%	14%	0%	43%	29%	0%	0%	0%
	Open account trade	14%	0%	14%	0%	43%	29%	0%	0%	0%
	Shipping and freight	14%	0%	14%	0%	43%	29%	0%	0%	0%
Bank	Documentary trade	13%	13%	0%	13%	0%	50%	13%	0%	0%
	Open account trade	17%	0%	0%	17%	0%	33%	17%	17%	0%
	Shipping and freight	25%	0%	25%	0%	0%	50%	0%	0%	0%
Corporate	Documentary trade	-	0%	0%	0%	0%	50%	0%	0%	50%
	Open account trade	-	0%	0%	0%	0%	100%	0%	0%	0%
	Shipping and freight	50%	0%	0%	0%	50%	0%	0%	0%	0%

Trade finance and ESG

ESG and the role of the financial sector in tackling climate change is now central to any discussion of the economy and increasingly important for investors, corporates and asset managers when considering their investments.

For corporates in this survey, ESG was cited as very important to their outlook (4.4 out of five) (figure 12). Despite this, however, nearly 60% of the corporate respondents noted that some AAMs do not meet their ESG requirements (figure 13), and a finding that likely stems from corporates believing that AAMs can do more to demonstrate they understand fundamental ESG issues and challenges (figure 14).

While these data do not paint a positive picture for current providers of private credit, the qualitative data suggested that this outlook could be a legacy of AAM mandates from the past, as one corporate noted:

"Private credit and asset managers still have a long way to go when it comes to ESG... but I do see positive change. Historically, fund managers were focused on one thing - to achieve a positive return on investment whatever the costs... Nowadays, ESG is definitely more front and centre in their decision making." **(Corporate; North America)**

A recent report by PRI (2019) affirms this narrative and demonstrates the fundamental role that private credit can play in responsible ESG-related investing, a rapidly growing movement that is matched by consumers and corporates becoming ever more focused on ESG and corporate and social responsibility (CSR) in trade finance (Condon & Cavalletto, 2019).

Developments are taking place fast, and significant attention is now being placed on the key issue of ESG by many in the asset management sector. Today there is a strong and growing trend by many asset managers to adopt and incorporate principles of responsible investment, operating principles of impact management and compliance with EU Taxonomy, among others.

A recent report by ACC, Simmons & Simmons, and EY (2020) on private credit in Asia also concluded that:

[5] Tick all that apply.

- ESG is now central to how investors are allocating capital in the asset management sector.
- Many aspects of ESG are still nascent (for example, how ESG is defined, the availability of credible data, and benchmarking).
- That each sector requires a relatively bespoke approach.
- Investors, AMs, and corporates need to communicate more to raise understanding and address common challenges to ensure good ESG outcomes alongside returns (and not a trade-off).

While this is encouraging, ESG issues need to be evaluated carefully, particularly as the subject gathers greater momentum.

A recent meta-analysis by NYU Stern and Rockefeller Asset Management of 250 studies published between 2015 and 2020 found that ESG investing in trade finance is reaching maturity and could become a victim of its own success. The report suggests that this could see companies that invest in ESG-focused portfolios incur higher costs and lower profits (Whelan et al., 2019).

This begs the question: If ESG-investments are costing more and yielding less, will private credit still be attracted to these types of investments? To compound matters further, trade finance lacks a unified definition of sustainability, and the focus to date, is heavily on the E, and less on the S and G (Morton, 2021).

Figure 12: Importance of ESG to corporates

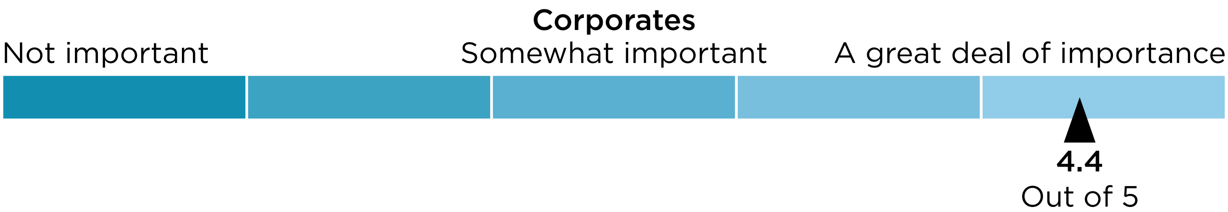


Figure 13. Corporates' view on whether alternative asset managers meet their ESG requirements

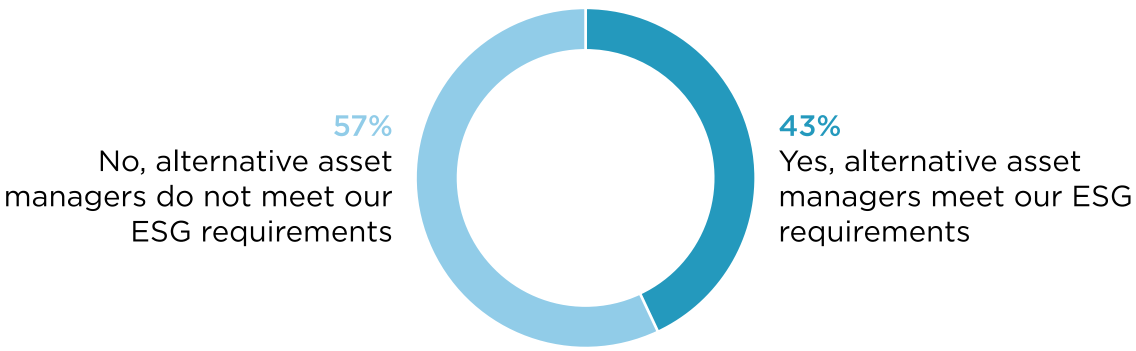
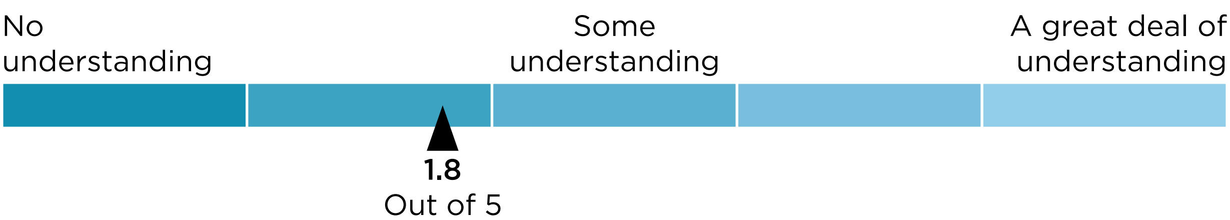


Figure 14: Perception of how well corporates think alternative asset managers understand ESG



From an alternative asset manager's perspective, ESG continues to become central to their investment process. Investors who provide capital to asset managers are constantly seeking to allocate to funds following a rigorous ESG approach as part of their investment process and activities.

Morningstar data shows that global sustainable funds attracted a record inflow of $185.3 billion in the opening three months of 2021, a 17% bump in new cash being invested, compared with the prior quarter (Bioy, 2021), hence asset managers are very well incentivised to be at the forefront of ESG integration.

ESG fund inflows have been some of the greatest and fastest since 2019 but the integration of ESG into the investment process is near ubiquitous across the sector.

Approaches to ESG are increasing sophisticatedly and investors are applying more scrutiny when it comes to how to integrate ESG factors for trade finance transactions – where does the focus lie and where is a line drawn? At a corporate level, and at a trade flow level, how detailed should your assessment of the buyer and supplier be? Must you also evaluate the shipping/transport company, and the fuel used by the transport method etc? While asset managers are applying an iterative approach to these questions and evolving their processes accordingly it is generally accepted that activities which are not properly understood or being adequately managed when it comes to ESG have a material impact on the success of the strategy.

"As an asset manager, one cannot not consider ESG, or not be constantly seeking to improve one's understanding and integration of ESG across its activities. As the market develops and knowledge increases across stakeholders, the different interpretations and accordingly expectations of ESG should align." (Odedra, 2021)

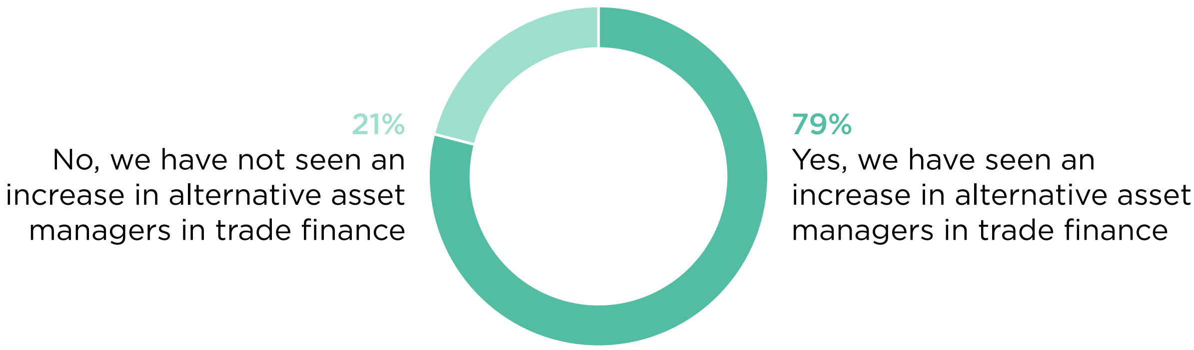
Banks: In focus

Negative perception becomes a positive reality[6]

Nearly 80% of bank respondents have seen an increase in AAM activity in trade finance over the past 12 months (figure 15), a finding that supports the view that banks are retrenching from the lower end of the middle market (Taylor, 2021).

A recent review by *The Financial Times* also reported that 520 private credit funds were available to investors in October 2020, up from 436 at the beginning of that year and just under 400 in January 2019. Average fund sizes also grew, with the combined fundraising target of $292 billion, up from $192 billion in January 2020 (Mackenzie & Platt, 2020).

Figure 15. Perception on whether banks have noticed an increase in the presence of AAMs in trade finance over the past 12 months



[6] Other than figure 15 which is based on the total sample of banking respondents, this section is based on data from banks that do engage and work with alternative asset managers.

Nearly one-third of bank respondents stated that they work with AAMs (figure 16). Of those that do currently work with AAMs, there has been a shift in their perception of how complementary AAMs are to trade finance.

Prior to working with AAMs, banks generally had a more negative perception of AAMs (2.1 out of five), a sentiment which turned more positive after engaging and working with them (3.7 out of five) (figure 17). The reason for this, one banker explained, was because they shared goals:

"We share similar goals... and that is to try and generate a return on investment... there are some sticking points, namely around the speed of operation and that they are not bound by such stringent regulation, but there were more points of commonality there than we initially thought." **(Bank; Europe)**

For the relationship to be successful, however, clear communication was key:

"We understand them [AAMs] and they understand us... we have always been open when operating with each other and I definitely think that has helped forge a better relationship... there are still challenges but the key is that none of these challenges are hidden... it is all out in the open." **(Bank; Asia-Pacific)**

Figure 16. Banks that work with private credit and alternative asset managers

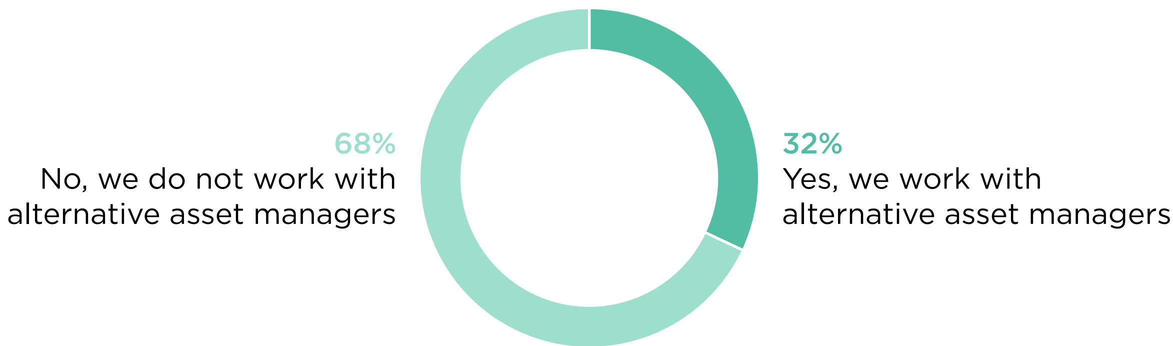
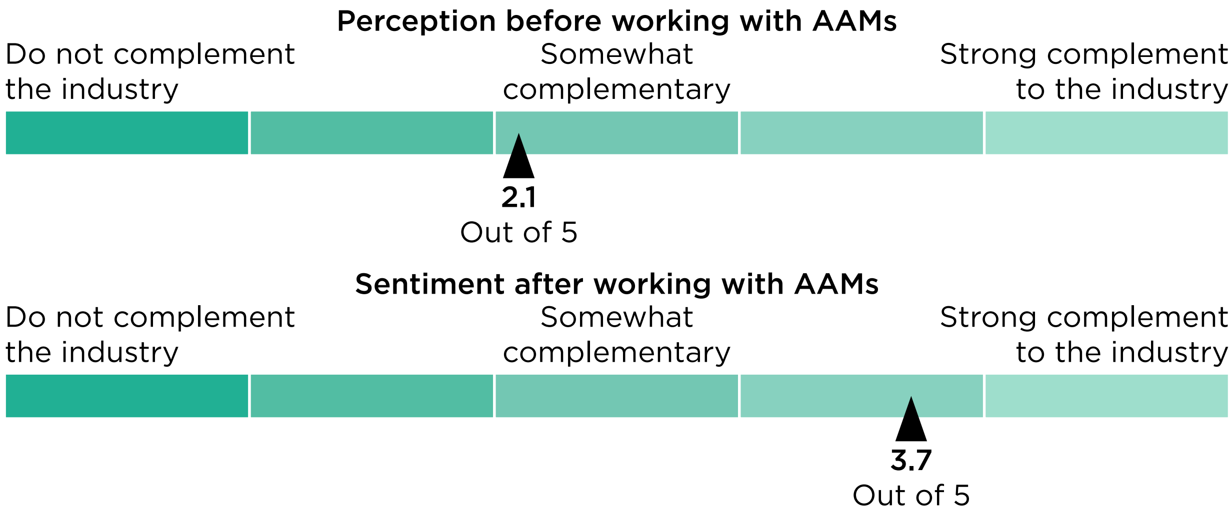


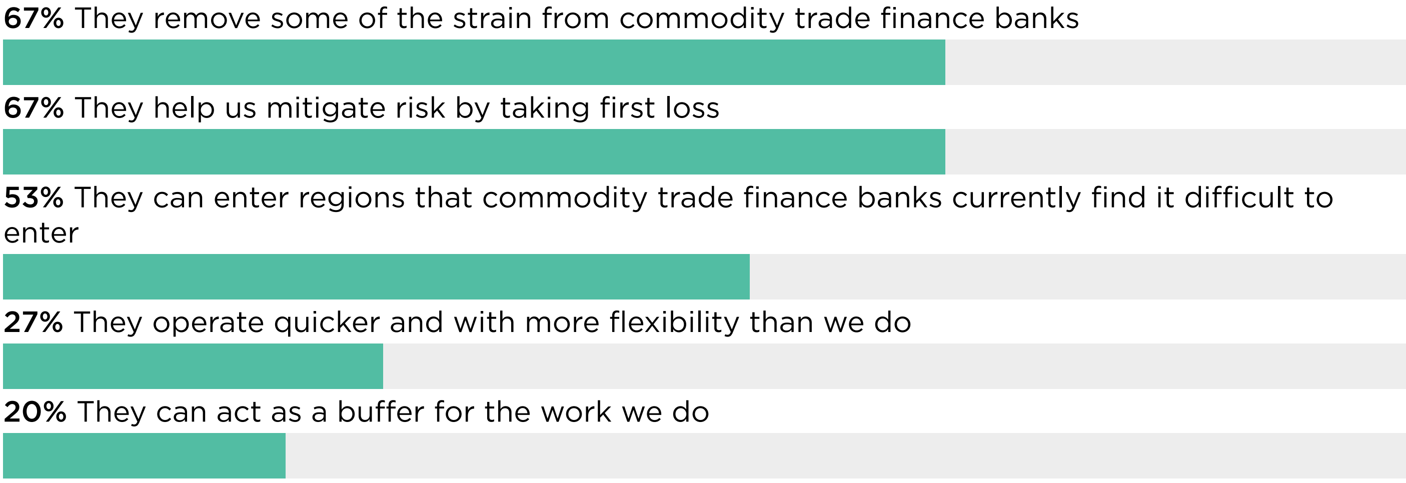
Figure 17: Banks perception on how well private credit providers complement the trade and receivables industry (specifically banks that actively work with AAMs)



Mitigating risk, ameliorating strain (both 67%), and the ability of AAMs to enter regions where banks currently find it difficult (53%) were the top three reasons why banks currently engage with AAMs (figure 18).

However, figure 18 demonstrates that banks primarily engage private credit providers as they can reduce the financial, operational, and strategic burden for the banks, largely imposed on them by the Basel accords.

Figure 18. Reasons for banks working with alternative asset managers[7]



Banks working with alternative asset managers highlighted how their different mandates (50%) and the need for asset managers to understand the operational and regulatory constraints of banks (both 43%) as a key hurdle to developing stronger partnerships (figure 19). One banker explained the implication of this:

"We [banks] do slow the process down but it is important to note that this is not deliberately. We have many more hoops to jump through from a regulatory and financial standpoint that funds do not… this can make things more difficult but they [funds] know this going in and they still want to work with us." **(Bank; Asia-Pacific)**

Despite these challenges, all the banks that currently work with AAMs plan to continue working with them in the future (figure 20), a sign that the challenges are not insurmountable. Bridging the perception gap and acknowledging these constraints will be important for asset managers looking to develop their relationships.

[7] Tick all that apply.

Figure 19. Banks' perception on the challenges of working with alternative asset managers[8]

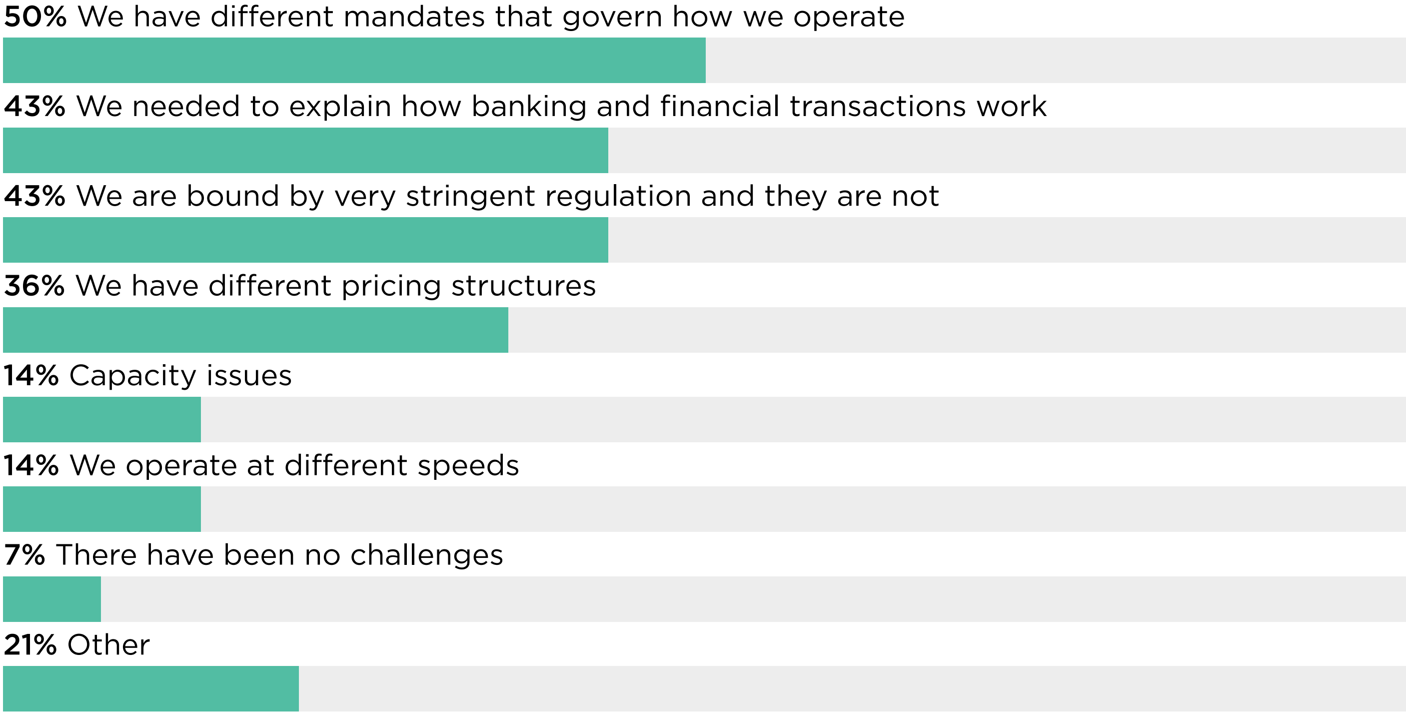
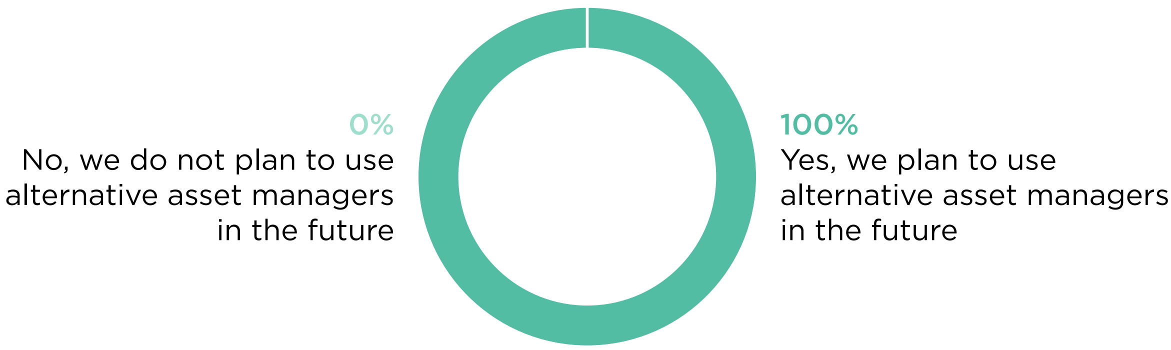


Figure 20. Banks' use of alternative asset managers in the future



Complementary vs. alternative finance

Private credit funds in trade finance have often been called 'alternative lenders. This has resulted in some confusion and misalignment of expectations in the market. Whilst trade finance investing might be classed as an 'alternative investment', it is very much a traditional lending product and one which many are already familiar with.

One area of difference is the cost of capital and the returns investors in private credit are seeking. This can come as quite a shock to corporates who have previously become accustomed to lower pricing.

However, with the increasing number and variety of private credit participants in trade finance, the market has evolved in recent years, with certain investment strategies competing with the banking and factoring market. From a borrower's

[8] Tick all that apply.

perspective, trade finance funds can be a useful provider of liquidity, having the ability to be more creative than banks when it comes to structuring facilities, the speed, risk appetite etc. which has been noted in this survey's findings.

Additionally, along with the complementary nature of direct lending funds, we have seen examples in the market where banks and private funds have successfully partnered together, with the fund taking the riskier portion in a trade which is aligned to its investment strategy and a bank focusing on a segment of a trade flow which is aligned to its appetite.

A public example of this is Czarnikow's collaboration with Kimura Capital where Tanya Epshteyn, head of structured finance at Czarnikow, said: "There is no need for one form of finance to replace another. There is a pronounced need and space in the market for the risk takers and the capital providers to work together in a safe, collaborative way that includes all facets of the supply chain and fully supports the real economy, rather than singling out the elements which match the high yield curve or fit the traditional collateral valuation boxes." (Odedra, 2021).

"In the conventional and high-yield loan market we have seen how commercial banks and private credit funds can provide solutions that the market requires by working competitively and collaboratively. Trade finance funds should be seen no differently, there is no reason as to why commercial banks and trade finance funds cannot co-exist. The market is a better place with both." (Odedra, 2021)

Banks and alternative asset managers: Complementary partners

As noted above, for some time there has been a general misconception that AAMs and banks are competing in the same market place. While they may operate in the same general spheres, for the most part they act as complementary and even collaborative partners within trade and commodity finance in a number of ways. And given that bank financing has become more risk averse in the last two years, particularly within commodity trade finance, the need for AAMs to be there as an alternative and to complement the sector is obvious.

"We don't see ourselves as competing with any bank, nor would we expect a bank to think that we are in competition with them – our relative costs of capital are just too far apart that we cannot practically compete for the same borrowers. We are either chasing different credits entirely or cooperating with each other by taking different slices of risk from the same credit." **(AAM, South-East Asia)**

Banks benefit from AAMs acting as a strong counterparty risk partner that can take a 'first loss' position on their investments. This helps banks reduce their exposure to credit risk and improves their capital position. They also benefit from AAMs being able to provide a substantial portion of the capital required for a deal. AAMs benefit from the banks' long-standing relationships with borrowers, gain improved visibility to deal flow, and may be able to leverage their bank partners' lower cost of capital to offer borrowers a cheaper financing solution on the whole than they would be able to on their own.

As one AAM points out: *"AAMs that have direct borrower relationships can perform an important origination role for their bank partners, many of whom have reduced headcount in recent years and thus cannot invest heavily in business development. Additionally, AAMs may have expertise in certain markets that exceeds the bank's own knowledge base and therefore working together may improve joint underwriting and administration of a deal. Finally, AAMs can serve as valuable partners to banks in a workout scenario (e.g., by taking over collateral that banks do not want to have to take onto their own balance sheet)."* **(Colin Sheldon, Drumlin Capital Management, LLC)**

In conclusion, some important points need to be emphasised:

• While it may seem that banks and AAMs are competing for the same borrowers, the reality is quite different because of the significant difference in cost of capital. In fact, banks and AAMs have complementary skills and capabilities that can allow them to work together synergistically.

• There are plenty of examples in other 'traditional' finance markets where banks and AAMs not only co-exist but also cooperate successfully. The market for trade finance is moving in this direction but is very far behind. Ideally, the trade finance space will likewise gravitate towards a situation in which banks and AAMs collaborate on many of the same deals, with each taking only the risks that they are willing to bear, at the prices they are willing to accept.

• AAMs may actually be better at pricing risk in this market – they have an incentive to ensure that the return they are generating fully compensates for the risk of the transaction. Banks have different incentives, such as generating revenue from ancillary business lines, such that trade finance becomes a 'loss leader'.

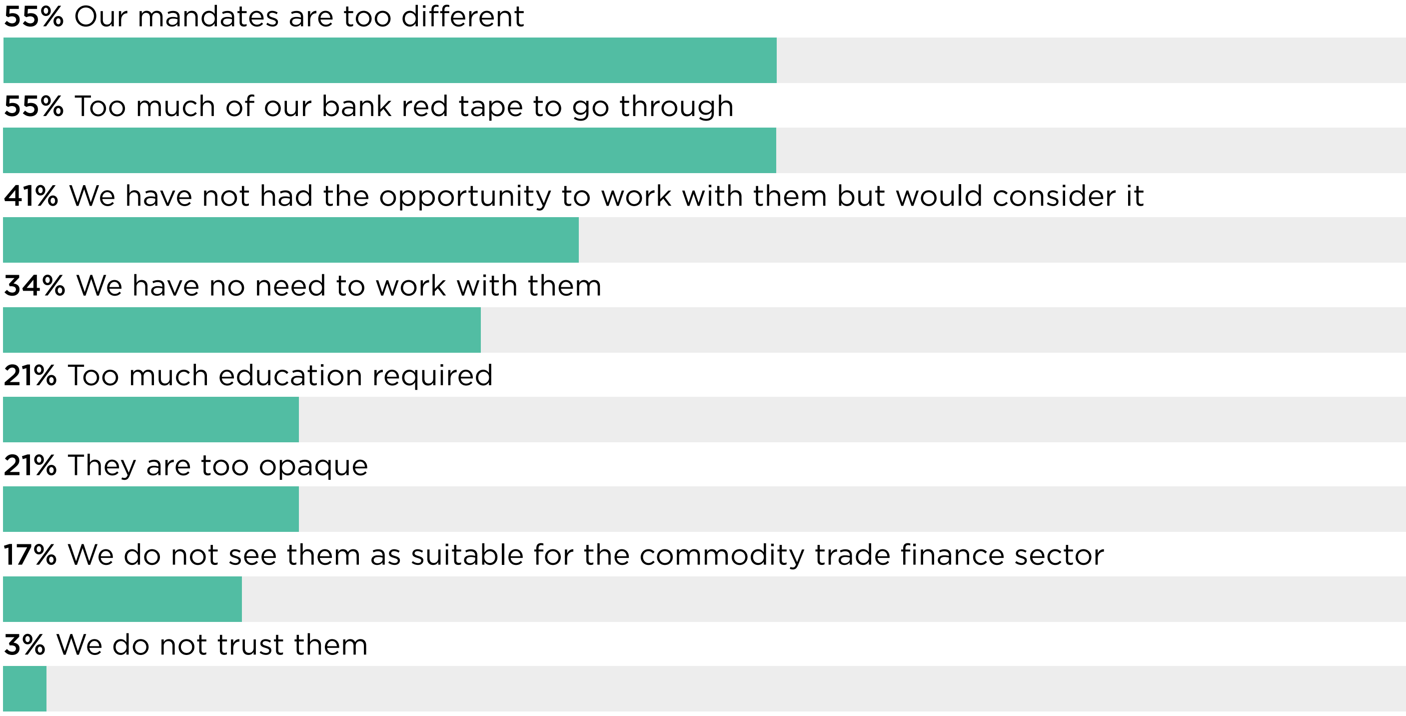
• From a public policy perspective, it is a positive systemic development that AAMs are participating to a greater extent in trade finance, either on their own or by providing risk transference for banks. If a traditional money centre bank collapses because of missteps in trade finance (e.g., the 2019-2020 events in Asia and the Middle East on a bigger scale), it is depositor money – and ultimately taxpayer money in the bank's home jurisdiction that pays the price. AAMs on the other hand are typically (depending on their jurisdiction) restricted to sourcing capital from institutional or 'accredited' investors. These sophisticated investors are presumably better aware of the risks to trade finance lending, and better situated to bear the risk of any loss that results.

While 68% of the bank respondents stated that they do not currently work with AAMs (see figure 16), 41% stated that they have never had the opportunity to do so but would consider a potential partnership in the future (figure 21).

As figure 10 suggests, education has a vital role to play as it could break down any potential barriers that may be in place between banks and AAMs – something which this report has found.

The adage *'where there is a will, there is a way'* comes to mind, as most challenges that seem insurmountable, often have a solution. If banks and AAMs are committed to working together, it is likely that the challenges highlighted in figure 22 can be overcome.

Figure 21. Reasons why banks do not currently work with alternative asset managers[9]



Corporates: In focus

The importance of relationships cannot be underestimated

Across the total sample of corporate respondents, 53% stated that they **do not** currently have any involvement with AAMs or private credit (figure 22).

Of those corporate respondents who **do** have partnerships with AAMs, almost all did so via direct relationship with a specific AAM (96%) (figure 23), a point reinforced by all the corporate interviewees who receive financing from AAMs:

"It is all about relationships. With the sums of capital involved, we must be absolutely certain in the person we deal with. In the past, we have been known to move banks if our trusted contact moved… we would do the same in the non-bank financing world." **(Corporate; Europe)**

For those corporates who do not currently engage with AAMs, they also reinforced the importance of developing a trusting relationship:

"Relationships are everything to us and it is how we choose our banks. Finding the right person, within the right [alternative asset manager] organisation would be a top priority for us… it is part of the reason why we have not engaged them [an alternative asset manager] so far." **(Corporate; Asia-Pacific)**

[9] Tick all that apply.

Figure 22. Corporate partnerships with alternative asset managers

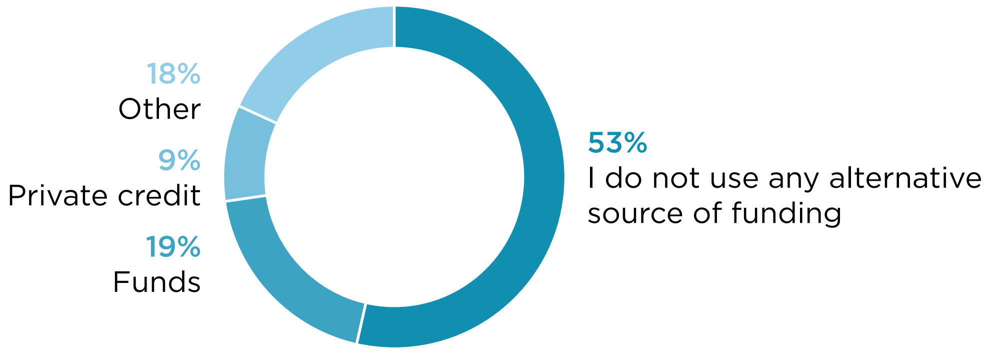
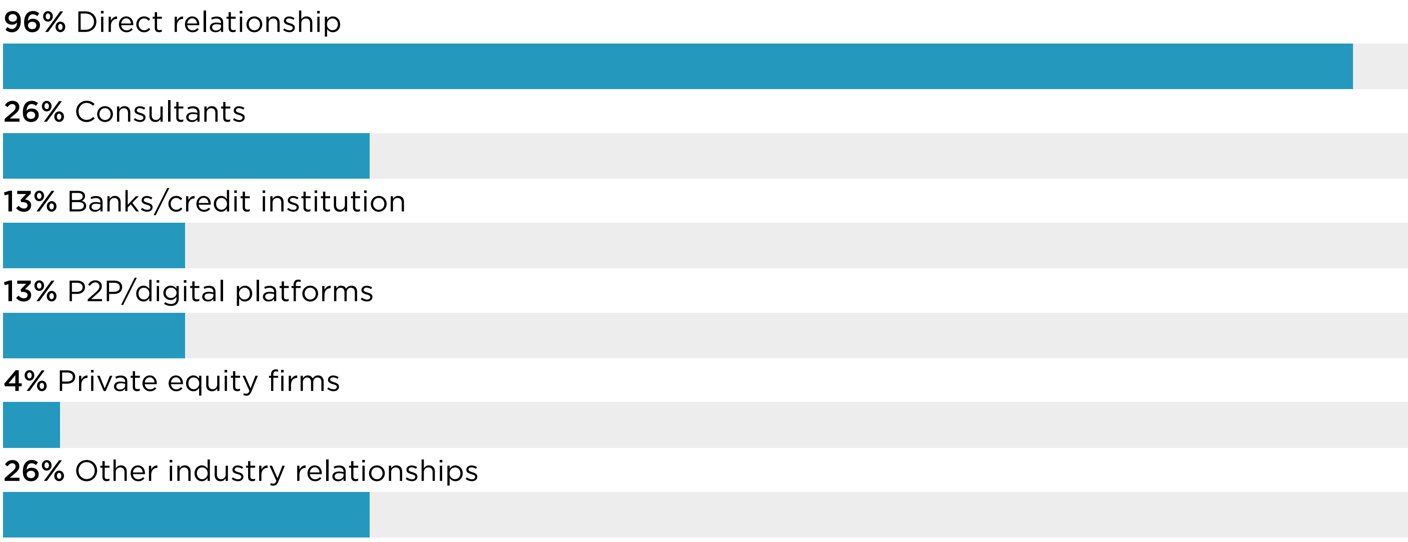


Figure 23. Mode of communication that corporates use to establish relationships with alternative asset managers



The inability to gain bank funding (48%) was the main reason given by corporates choosing to access private credit (figure 24). However, beyond this, the reasons for accessing private credit were due to the benefits of private credit rather than because of the limitations of the banking sector. For instance, fast execution times (48%), bespoke financing (43%), and strong relationships (38%) were also commonly reported reasons for accessing private credit, as one corporate noted:

"It is a well-known fact that banks simply cannot finance certain deals... more often than not, private credit is able to plug this gap." **(Corporate; North America)**

This is likely why corporates noted speed of decision making (71%), flexibility (57%), and the ability to carry out complex deals structures as additional benefits to the private credit market (figure 25).

Figure 24. Reasons for accessing private credit[11]

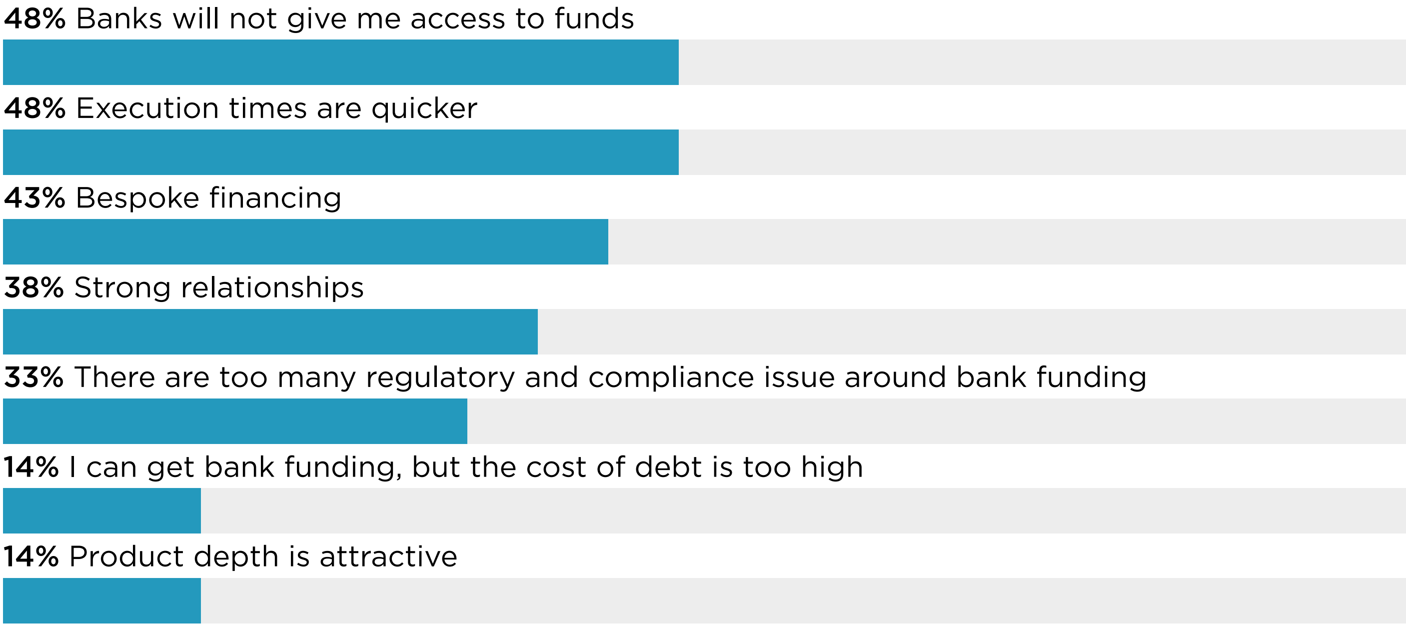
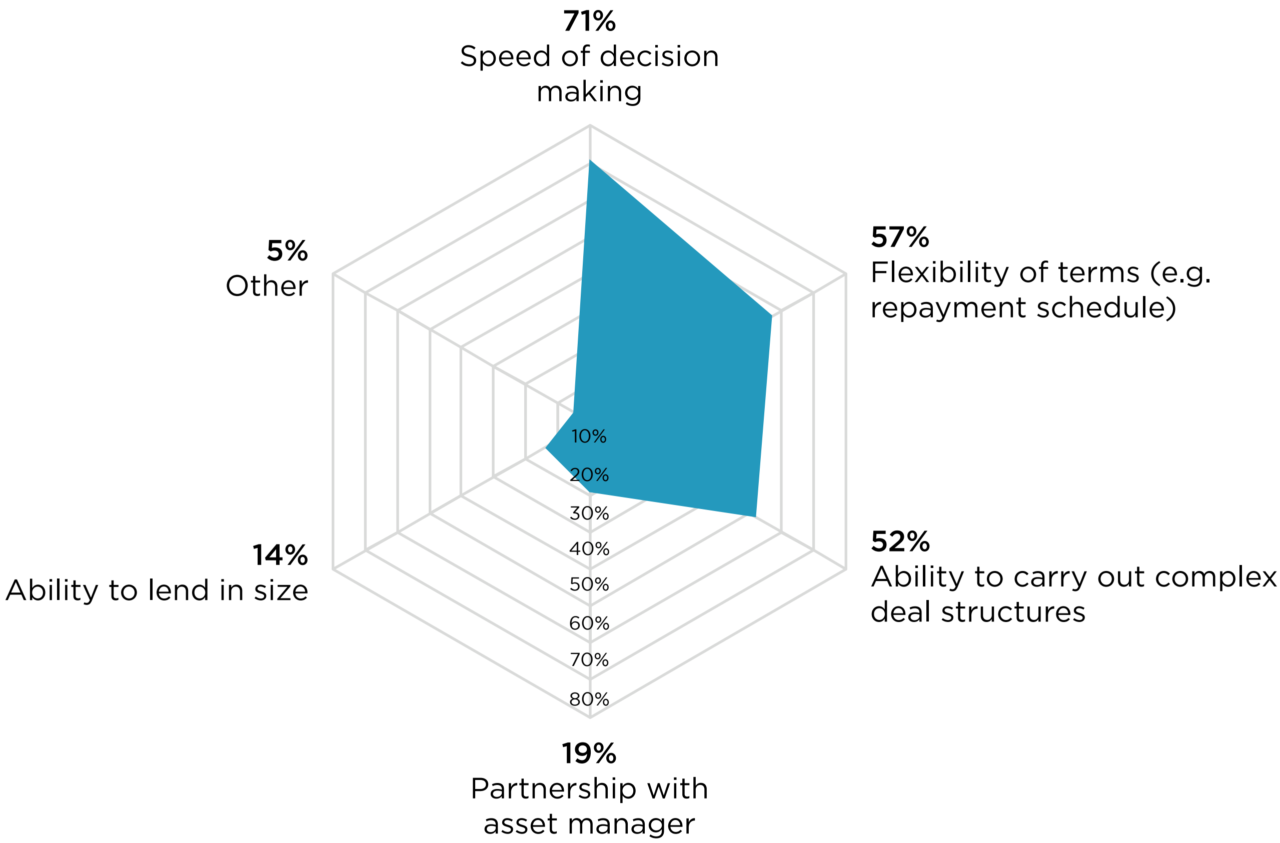


Figure 25. Benefits to corporates working with alternative asset managers[12]



[11] Tick all that apply.
[12] Tick all that apply.

The cost of capital

Across the sample of corporates who were actively engaged with AAMs, the average cost of debt for private credit was 8.9%, with seven to nine percent the modal class (figure 26). This, the corporates noted, was significantly more than the cost of debt provided by commercial banks (figure 27).

Figure 26: Corporates expectations on pricing margin for private credit

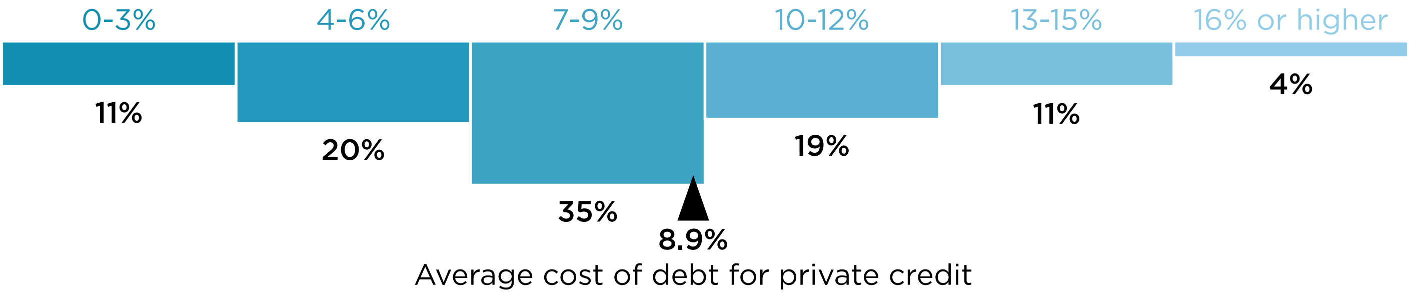
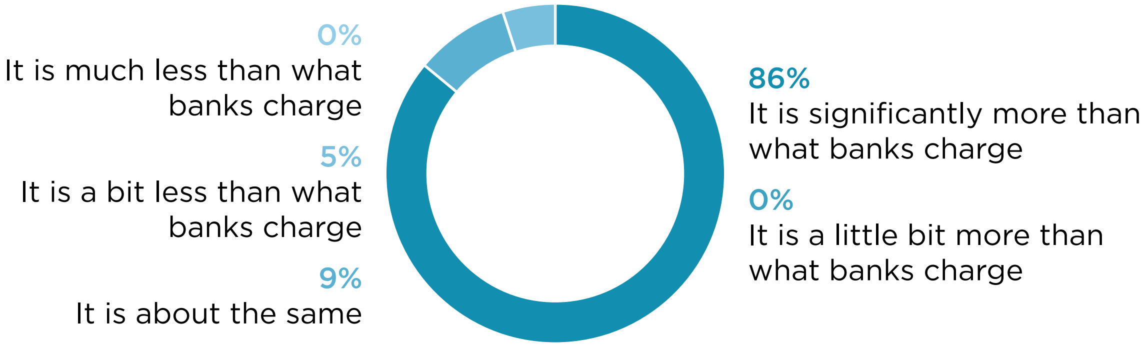


Figure 27. Corporates perception on private credit cost of debt compared to commercial bank loans



However, despite this cost, a finding that was of no surprise to all the interviewees, several of the corporate interviewees noted that price is only one consideration when accessing private capital:

"It is no secret that private capital is expensive… everyone who has done their homework knows this going in… but you need to consider what you get for the price… much greater flexibility [compared to banks], much quicker deal flow [referring to the speed of deal execution], and an ability to access bespoke financing that the banks just cannot offer… the cost of debt is a fair reflection of what you get for your buck." **(Corporate; Europe)**

While some corporates were more circumspect about the cost of private capital, they all agreed that private capital solutions have several advantages that banks cannot compete with. This is likely why 41% of the corporates accessing private credit felt that price reflected their expectations (figure 28), and why a combined 86% plan to use either the same, or more, private capital in the future (figure 29).

It is important to note too, that the cost of commercial bank debt is also increasing to offset the changes in the regulatory and financial landscape. For instance, the impending increase of the output floor to 72.5% within Basel IV means that banks will face a significant increase in capital requirements that will place greater strain on their lending capacity. Collateral management costs, a paid for service by the banks to verify collateral transactions to reduce credit risk, have also recently increased. To compound matters, the backdrop of Covid-19 and recent cases of fraud have also shaken some assumptions about the sector.

The net result of these factors is that banks are increasing their cost of debt and making borrowers reconsider the relative merits of this compared to the potential benefits of private credit.

Figure 28. Corporates expectations on the cost of debt for private capital

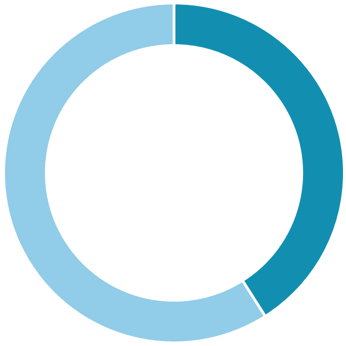
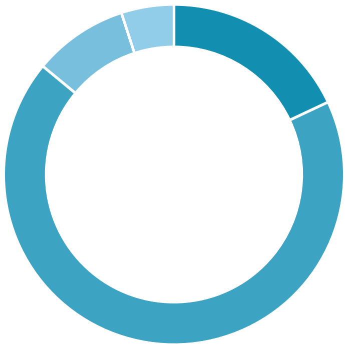


Figure 29. Corporates views on future use of private capital



Realising the opportunity[13]

For those corporates who reported no current involvement with AAMs or private credit, high fees (46%) was the main reason for doing so (figure 30). However, as the qualitative data shows, a positive experience and better understanding of the benefits of private credit are also important in shaping views.

Figure 30 also shows that 42% of the sample have not yet accessed private credit because they have not yet needed to. The interview data suggested several reasons for this:

i. No added benefit

"Borrowing is a function of ease of availability and commercials. As a corporate, we are able to get the required financing from our bankers and at commercially viable rates hence there has not been any requirement for non-bank lending for trade finance." **(Corporate; Asia-Pacific)**

ii. Pricing and tenor don't meet expectations

"We can issue a bond at a cheaper cost to us than accessing funding from AAMs … and with the bond, we get a much longer tenor." **(Corporate; Asia-Pacific)**

[13] This section is based on data collected from corporates who do not currently have any involvement with private credit or AAMs.

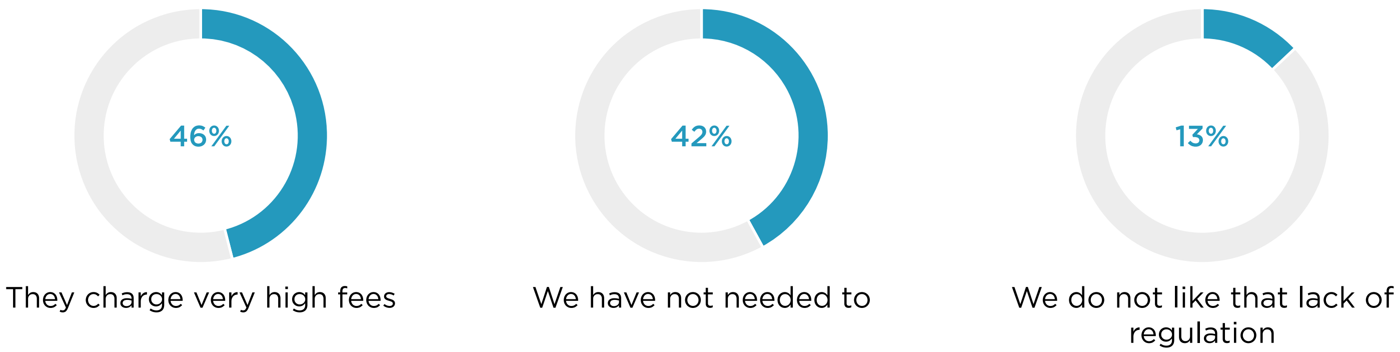
iii. Level of commitment

"Non-bank lenders can walk away at any stage, primarily because trade finance is an asset that is easy to walk away from. We want commitment and banks have a track record of demonstrating that." **(Corporate; Europe)**

iv. Uncertainty around liquidity

"Banks always have deep pockets and are required to demonstrate this... and as we saw with Greensill, it is very easy to mask the strength of their liquidity... we don't believe that asset managers have genuine 'skin in the game' like banks." **(Corporate; North America)**

Figure 30. Reasons for not accessing private credit



The last two comments above suggest that there is a fundamental lack of understanding of AAM lending by some corporates. This again underscores the need for greater education about AAMs throughout the borrower market.

In response to some of the comments above, on the 'level of commitment' one fund manager remarked: *"Ironically, the vast majority of bank funding in trade finance is done on an uncommitted basis. AAMs with closed end funds that have long enough fund life are actually more likely to lend with a legal funding commitment than are most banks."* **(AAM,Europe)**

And on the subject of 'uncertainty around liquidity' another fund manager stated: *"Most fund managers put a meaningful portion of their personal net worth into the funds that they manage – something that virtually no commercial banker, other than those working for private banks that still have a partnership model, does. When it comes to 'skin in the game' we, and other funds, most certainly have that in abundance!* **(AAM, North America)**

Encouragingly, however, there is a reasonable likelihood that this cohort of borrowers may do so in the future (figure 31), and if they do so, it will most likely be through funds (52%) (figure 32). The main reasons that they may consider accessing private credit in the future is if they cannot access bank financing (26%) or if the cost of bank debt gets too high (17%) (figure 33).

Figure 31: Likelihood of corporates accessing private credit in the future

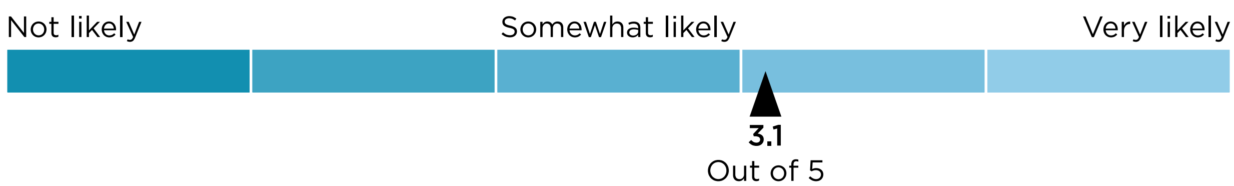


Figure 32. Planned use of alternative asset managers in the future[14]

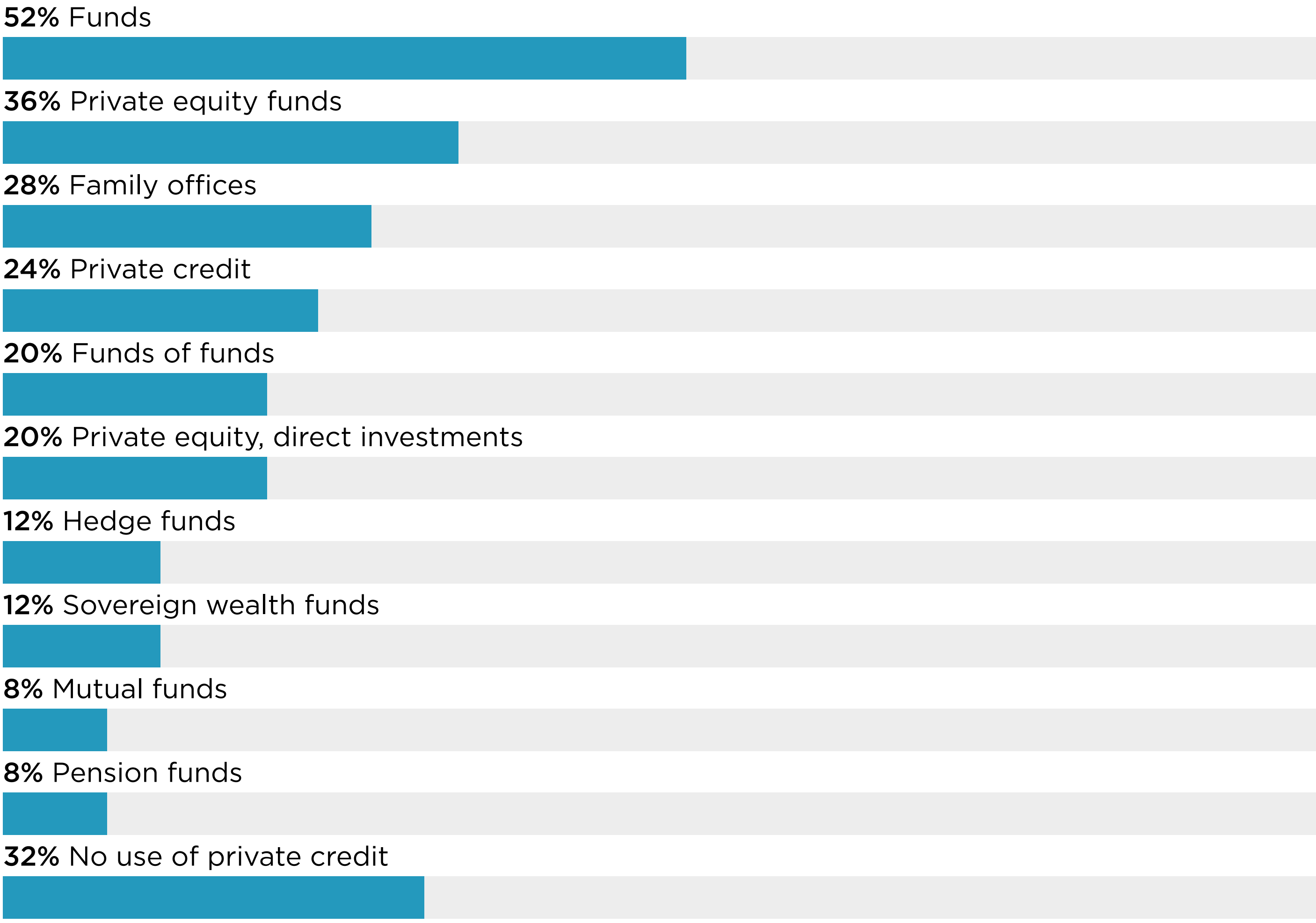
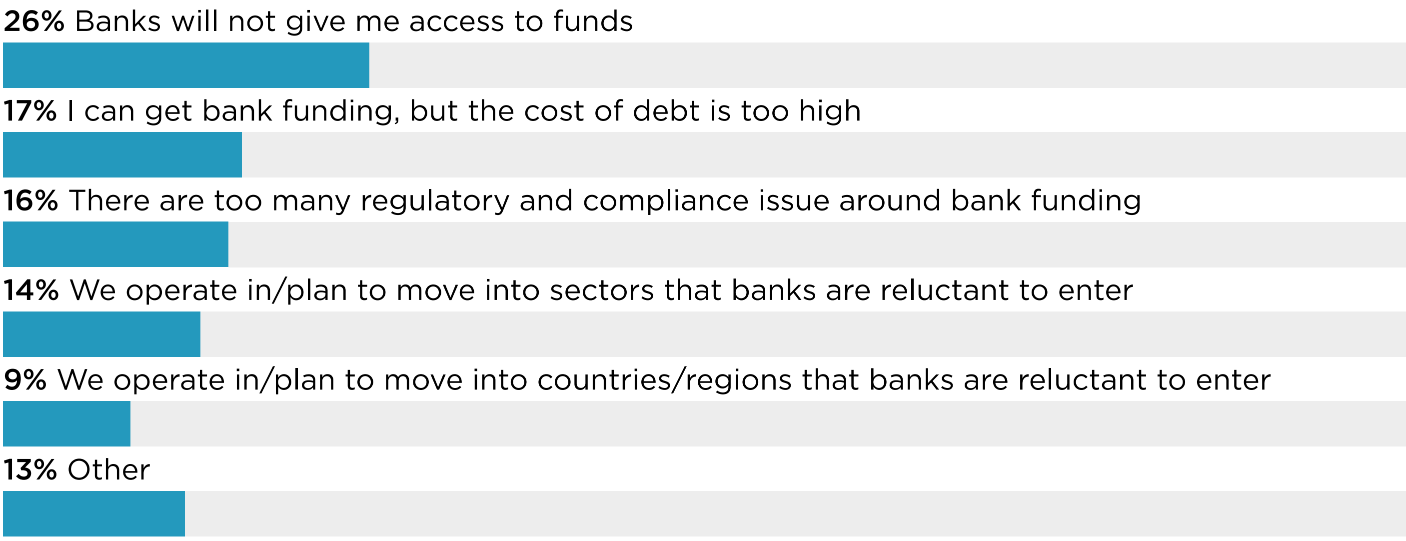


Figure 33. Reasons for accessing private credit in the future



[14] Tick all that apply.

Asset managers: In focus[15]

Direct exposure leads the way

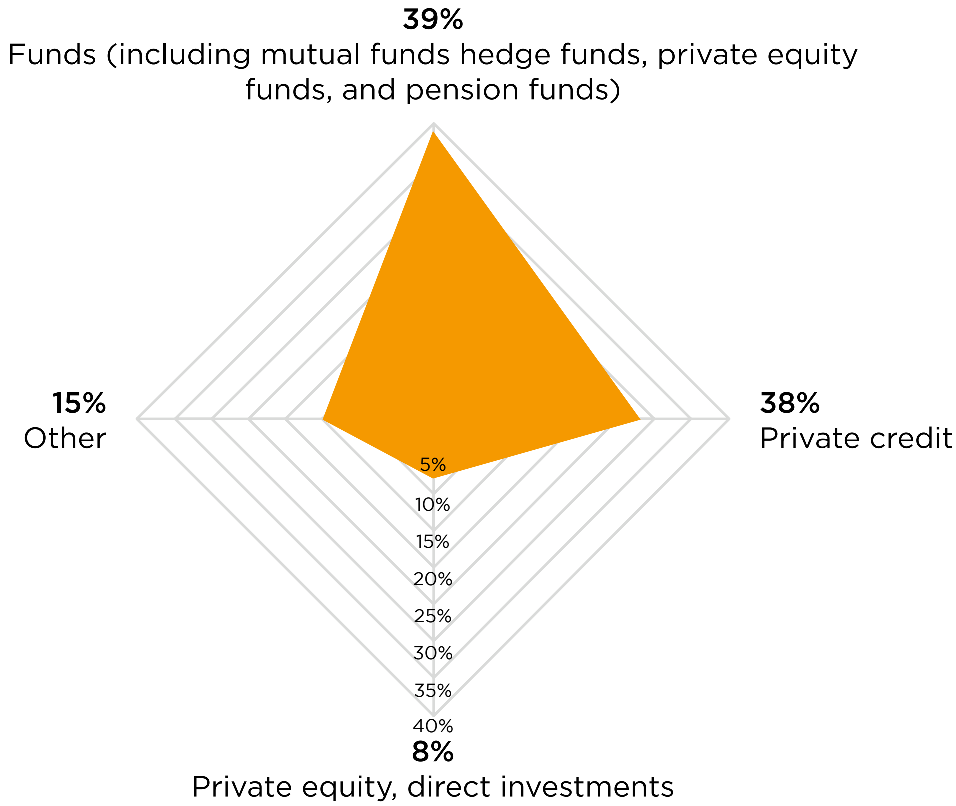
The average AUM of the AAMs surveyed was $871 million (figure 34). The two most common types of asset manager surveyed were those in funds (39%) or private credit (38%) (figure 35).

"This is where the opportunity for an investor lies. Given the supply/demand imbalance, especially the departure of larger players in the market, we see the non-bank entities as posing the biggest space to get attractive exposure to the trade finance market." **(Asset manager; Europe)**

Figure 34: Alternative asset managers' AUM

$871 million

Figure 35. Type of alternative asset manager



Nearly half of the asset managers reported that they had direct exposure to trade finance, with a further 47% having both direct and indirect exposure (figure 36). Asset managers interviewed for this research both had direct exposure to trade finance activity, which they described as increasing the likelihood of achieving higher returns for their investors:

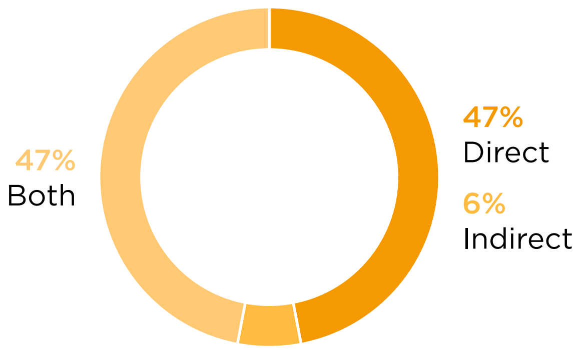
"Direct exposure tends to generate better yields as the "skimming" of the margins by other counterparties under indirect exposure can prove challenging for investor yields" **(Asset manager; Europe)**

However, the asset manager goes on to say:

[15] All of the asset managers surveyed were actively involved in private credit investments.

"Direct exposure causes more headaches in case of sorting out all sorts of problems, ranging from waivers to defaults to full work-out situations." **(Asset manager; Europe)**

Figure 36. Direct or indirect exposure trade finance activity



The importance of direct relationships is a theme across private credit markets. This supports the development of tailored finance solutions that more readily match the needs of the borrower and the interests of the lender. As noted earlier, there is significant attraction for borrowers or banks when working with an AAM. Having a more direct relationship, and by implication more ability to control outcomes or mitigate downside risks, is also valued by investors and part of what can drive any premium private credit managers may seek when it comes to their fees and remuneration.

For these reasons the proportion of private credit managers in trade finance with direct exposure is likely to grow as this type of finance becomes more prevalent.

Increasing private credit fund participation in the trade finance market

Increasingly, trade finance has been attracting private capital across the credit spectrum and in a range of participation formats. However, there are several factors which have hampered its development as a mainstream subset of private credit.

Putting aside credit and fraud events (which are also present in equities, fixed income, term debt, and other asset classes), the major challenge for trade to attract private capital at a large scale has been around standardisation and investor understanding of the risks involved in an activity that is still heavily reliant on paper documents and human skill and experience.

In a bid to tackle this, there have been many great initiatives from the creation of e-documentation, blockchain based solution, platforms etc. However, for the time being it seems that the optimal approach for private capital to access the asset class is to work with specialist firms – banks and trade finance funds who can originate, structure, monitor and manage trade finance risk. Although investors need to emphasise their due diligence on both the originators as well as the underlying asset class.

To attract further capital in an efficient manner, all stakeholders in the market need to work together towards greater standardisation and increase efforts which help to educate private capital.

Where next for private credit in trade finance?

The aim of this research was to explore the landscape of private credit in trade finance. Using a mixed methodology that combined 151 quantitative survey responses with detailed qualitative insights from eight consenting individuals, this report concludes:

Private credit is in good shape and is rapidly growing as a viable financing solution for trade finance. The ever-expanding trade finance gap is a concern for borrowers, particularly SMEs which find it increasingly difficult to finance their operations. This finance gap has been exacerbated by the Covid-19 pandemic, the rising cost of bank debt, and continued retrenchment of banks from the trade finance space. Private credit is well placed to meet this growing demand with fast, bespoke financing options that are increasingly providing a lifeline for SMEs. Realising this potential will require the sector to address the general lack of understanding about the intricacies and nuances of trade finance as an asset class – a key barrier for both banks and corporates. Disseminating knowledge about the differences between trade finance products, how they can support interested parties, and the main challenges to consider will be key to growing the sector's share of the trade finance market.

ESG continues to be an important consideration for corporates. Across trade finance, ESG is increasingly a salient consideration in investment decision making, a shift affecting the entire asset management sector and one that lenders must acknowledge. While strides have been made across private credit over the past few years to better understand the nuances of ESG, more can be done. Technology offers one solution as it will reduce the over-reliance on paper-based solutions. Letters of credit are a prime example of where digitalisation can reduce the impact on the environment while also simultaneously boosting operational efficiency. Improved digitalisation across supply chains will reduce barriers to entry and co-ordination problems for both lenders and borrowers. Making trade finance more accessible will help to close the persistent finance gap. Moreover, technology will improve business continuity by keeping the flow of goods moving, improve accessibility and connectivity across the entire supply chain.

The banks' perception of private credit is positive, particularly for those that actively work with alternative asset managers. After working with AAMs, bank sentiment towards private credit becomes much more positive. While there were challenges, the qualitative data suggest that if there is clear communication and understanding, the difficulties are not insurmountable. The report also found that for those banks that <u>are not</u> currently working with alternative asset managers, more than 40% said that they would consider doing so if the right opportunity presented itself. The benefits of collaboration are starting to become more widely understood but knowledge sharing and education are still needed to break down remaining barriers.

It is not just about price. The cost of private capital is naturally an important consideration for corporates and many believe that this is currently too high for their operations. However, as the qualitative data suggest, non-price factors are becoming more influential in the decision-making process. The benefits that come with the higher cost are many – bespoke financing, the ability to enter regions and industry sectors where banks are unwilling to venture, increased operational flexibility, and speed of deal execution – all of which offer corporates a potential source of competitive advantage. This is likely why more than 40% of respondents stated that costs met their expectations and that there was a desire to continue receiving financing from the private credit market. This report also found that there are banks and corporates who are prepared to access private credit if the price and conditions are right, but the onus remains on AAMs to create these conditions.

The future for private credit in trade is becoming clearer. The current trade finance gap is estimated at $3.4 trillion (Standard Chartered, 2020). This gap is also believed to be growing rather than shrinking. While the banks still have a significant role to play in filling this gap, there is also a need to continue cultivate alternative sources of credit. This is particularly true for SMEs and those active in emerging markets which are in most need of support and likely to remain unattractive to banks because of increased financial and operational costs of serving these customers. Many of the attractive features of private credit - speed, flexibility and less constrained appetite for risk - make it well suited to these markets and businesses.

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TXF Intelligence is made up of two proprietary sources of information: Data and research.

The data tool presents the latest closed deal information within the commodity trade finance, and export finance sectors. The data has been specially structured to capture all the relevant and unique characteristics of these sectors and has become the go-to resource for benchmarking, business development, trend analysis and secondary market loan distribution.

The research tool presents the latest market sentiment across commodity trade finance, and export finance. Using an in-depth and robust methodology that combines quantitative trends with thought provoking qualitative insights, contextualised with closed deal market information and outside literature from reputable sources, the research reports present a unique and proprietary analysis of the latest trends across these markets.

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As both the Asset Management/ Investment Funds and financial Institutions sectors are key areas of focus for our firm, whether we are acting for a lender, borrower or any party or service provider in the fund structure, we are able to deliver an efficient and high calibre service. Key to this is our access to leading lawyers in the areas of complex structuring for private debt and direct lending strategies coupled with funds formation, funds regulatory and tax, on an international level through our network of offices across Europe, the Middle East and Asia or with relationship firms in other jurisdictions.

Our international trade & commodity finance practice consist of experienced specialists lawyers from a multi-disciplined base who advise on the whole range of trade & commodity finance products. We have extensive experience of transactions involving all major commodities and traded goods and understand the infrastructure that is in place to store, process and transport them. We use that experience to give our clients practical advice as to how to structure trade & commodity finance transactions to achieve operational ease whilst ensuring that they are properly protected and collateralised. We have been pioneering in advising clients on origination or funding of trade receivables transactions, either on balance sheet or via structured securitisation finance.

Our immersion in the sector enables us to go beyond technical legal guidance, delivering rounded, actionable strategic advice. It's also informed the development of innovations such as Structures & Solutions in Trade Finance, Trade Finance Data Extraction, navigator, all online services that provides information on global cross-border trade and receivables structures, regulation, lending, distribution of funds, portfolio management and tax to subscribers.

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About The Alternative Credit Council

The Alternative Credit Council (ACC) is a global body that represents asset management firms in the private credit and direct lending space. It currently represents over 200 members that manage over $450 billion of private credit assets.

The ACC is an affiliate of AIMA and is governed by its own board which ultimately reports to the AIMA Council.

ACC members provide an important source of funding to the economy. They provide finance to mid-market corporates, SMEs, commercial and residential real estate developments, infrastructure as well the trade and receivables business.

The ACC's core objectives are to provide guidance on policy and regulatory matters, support wider advocacy and educational efforts and generate industry research with the view to strengthening the sector's sustainability and wider economic and financial benefits.

Alternative credit, private debt or direct lending funds have grown substantially in recent years and are becoming a key segment of the asset management industry. The ACC seeks to explain the value of private credit by highlighting the sector's wider economic and financial stability benefits.

About The Alternative Investment Management Association

The Alternative Investment Management Association (AIMA) is the global representative of the alternative investment industry, with around 2,000 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than $2 trillion in hedge fund and private credit assets.

AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. AIMA works to raise media and public awareness of the value of the industry.

AIMA set up the Alternative Credit Council (ACC) to help firms focused in the private credit and direct lending space. The ACC currently represents over 200 members that manage $450 billion of private credit assets globally.

AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialised educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors).

About Drumlin Capital Management

Drumlin Capital Management, LLC (Drumlin) is a specialty finance advisor and asset manager that provides alternative capital to traders, producers, and processors of commodities globally. Drumlin focuses on providing bespoke structured trade finance solutions to market participants across the metals & mining, energy, agricultural, and environmental commodity sectors. These solutions include secured direct loans, ownership based financings, and risk participations in partnership with both traditional and other alternative capital providers. Drumlin's team has extensive experience originating, underwriting, and administering billions of dollars in financial and physical commodity transactions at leading international institutions. Drumlin was founded in 2016 and is headquartered in Westport, Connecticut, USA.

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About Horizon Capital Management

Horizon Capital AG is the investment management arm of SCCF SA (Structured Commodities and Corporate Finance). We are experts in financing and managing companies in the essential commodities industry.

Horizon Capital AG is headquartered in Switzerland with additional offices in Singapore and the US. Horizon Capital is your Swiss partner to invest in private debt strategies globally through its unique approach to generate uncorrelated returns by financing the real economy. Horizon Capital AG is a predominately short-duration, absolute return fund specialising in senior secured lending and advisory services to SMEs located mainly in Europe, Asia and North America.

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INOKS Capital is a Swiss asset manager prudentially regulated by FINMA, providing customised financing solutions, via collective investment schemes or segregated mandates, to companies active non-speculatively in mainly the Agriculture/Food sector. INOKS aims to be the market leader in capital access in the real economy while applying its proprietary Impact framework.

INOKS Impact Framework - INOKS deploys a two-fold investment strategy consisting of investing its capital (i) responsibly by mitigating negative effects according to ESG criteria and (ii) impactfully by contributing to address specific sustainability challenges and generating positive impact according to INOKS's 4 Impact Themes.

Resilient returns for investors - INOKS' managed funds have been achieving positive returns for more than ten years now with a low correlation to traditional asset classes offering resilience to investors. The food sector is an essential economic sector with inelastic demand pattern as witnessed during the Covid pandemic.

About Qbera Capital

Qbera Capital, headquartered in London, is an independent advisory and asset management firm, facilitating and providing debt and equity solutions for real economy assets and companies specialising in the energy (including renewables), metals, agricultural sectors.

Qbera's team has over 150 years of collective experience, and have successfully originated and executed over US$53 billion in transactions across various jurisdictions across their careers to date.

For more details, please visit: https://www.qberacapital.com/

About TradeFlow Capital Management

TradeFlow is the world's first fintech powered commodity trade Fund management business focused on enabling international commodity imports and exports for SMEs.

TradeFlow consists of a diverse team of experts with the focused mission of addressing the increasing trade finance gap faced by global SMEs operating as producers/traders/end-users in the bulk commodity trading space.

By performing an enabling role in international trade and globalisation, TradeFlow creates growth opportunities for businesses whilst delivering investment grade products for investors wishing to gain access to the low risk and diversifying asset class of import/export trade.

To date, TradeFlow has successfully invested in more than US$750 million of physical commodity trade through 1000's of transactions across 15+ countries and 26+ commodity types, with more than 800 SME counterpart entities KYC reviewed.

In July 2021, Tradeflow was acquired by Supply@ME Capital, the innovative fintech platform that provides the Inventory Monetisation© service to manufacturing and trading companies, and which is listed on the London Stock Exchange. The combined strengths of both entities further TradeFlow's ability to fulfil its mission of enabling trade for SMEs worldwide, and in doing so, support the UN SDGs.

www.tradeflow.capital

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