How can banks tackle the trade finance gap in Asia Pacific?

Why industry-wide collaboration and the innovative use of new technology are crucial to reduce the trade finance gap in Asia Pacific, though analysts caution against quick fixes

By Holger Frank and Siow Chin Yeo

Despite contributing 60% of the world's economic growth in 2017, Asia has a lot left to give – if only it could find the funds. A recent Asian Development Bank (ADB) survey estimated that approximately USD 600 billion worth of trade in Asia Pacific was failing to secure the financing it needed. SMEs are the worst hit, accounting for 74%of total rejections in 2017.

The problem is multi-faceted. Rising costs of finance provision, arduous compliance processes, credit risk exposure limits and a lack of transparency as to the credit-worthiness of smaller clients all make it difficult for banks to extend finance to SMEs.

There is no quick fix for these issues, but a growing culture of industry-wide collaboration, combined with innovative uses of new technology, is helping to redress the shortfall.

Tackling the compliance burden

According to research undertaken by the Asian Development Bank in 2016, the trade finance gap has, in part, been fuelled by compliance pressures on banks – in particular know-your-customer (KYC), anti-money-laundering (AML) and sanctions screening requirements. Implementing effective due diligence can prove costly and time-consuming, which in turn limits a bank's credit capacity.

Growing compliance costs have had a particular impact on the correspondent banking model. Many small domestic banks in Asia have struggled to find correspondents either because of their size, or because of issues with their KYC and AML. Indeed, according to a survey published by the IFC in September 2017, 85% of correspondent banks identified regulatory challenges and/or costs as one of the biggest barriers to growth for their bank.

The onus is on banks to draw on their combined strengths and harness new technology to share the load. For example, SWIFT has developed a secure global utility – the KYC Registry – which banks can use to "share and consume" KYC data among themselves.

Now accessible to all financial institutions, the KYC registry enables correspondent banks to demonstrate transparency, align themselves with global best practices, and reduce due diligence costs for their counterparts.

Support from governments and regulators

Beyond compliance, there are further applications for shared information registries. Governments and regulators have a part to play in reducing Asia's trade finance gap here – by providing shared repositories of credit information on the underserved SME sector, or encouraging such an initiative in the private sector.

There is a lot of call for governments to provide guarantees for banks when lending to SMEs, but even something as simple as access to a prospective borrower's payment history, for example, would enable banks to make more informed decisions and give them the confidence they need to extend finance to otherwise risky clients.

A number of private-sector credit reference agencies are already up and running to this effect in Hong Kong. Similar agencies in other major Asian financial hubs would go a long way to reducing the barriers to finance for SMEs in the region.

There is also scope for fintech companies to play a role here - by exploiting their technological expertise, to collect historical payment data and make it available to banks at a low cost.

Harnessing the power of blockchain

Blockchain technology, underpinned by distributed ledger technology (DLT), could prove a truly transformational technology for trade finance – and not just in terms of eliminating the compliance burden.

By harnessing blockchain technology, and substituting large numbers of proprietary, centralised databases with one open-source, relatively simple protocol, trade finance could be made accessible to a far greater number of companies. Where payables finance is mainly accessible to the largest suppliers in a buyer's supply chain, a blockchain-enabled system that eliminates paper-based processes and creates transparency across the end-to-end trading process, would help to reduce supplier on-boarding costs, and allow for new efficiencies through innovations such as "smart contracts".

Developing and implementing such technology hinges on collaboration and dialogue between the various participants in the trade finance ecosystem. Recognising this, in January 2017, UniCredit joined eight other international banks in signing a collaborative agreement to develop and commercialise we.trade – a new cross-border trade finance platform for SMEs, based on distributed-ledger technology. While focused initially on SMEs in Europe, we.trade is planned to branch out into Asia**,** bringing greater speed, transparency and convenience for SMEs.

Pooling resources – adding a multi-funder dimension

While corporates looking for smaller funding packages have found themselves turned away due to compliance costs, there are also barriers to larger deals. The increasing popularity of supply chain finance, for instance, has stoked rising demand for jumbo payables finance programmes that threaten to breach individual banks' limits for exposure to a given company, industry or geography.

To create capacity for these programmes, leading banks are now partnering with other banks in order to execute the programme as a syndicate. This enables banks to lend beyond their own credit risk limits, while clients can continue to participate in a single programme, eliminating the need to work with five different bank systems.

Moving forward, further financing capacity can be created through new linkages with the capital markets and the development of a deep secondary market for trade finance assets. By selling trade assets, banks could optimise their capital allocation and increase their origination capacity for trade finance lending.

To catalyse the creation of a formal secondary market for trade finance assets in Asia, UniCredit has participated in CCRManager, a digital trade finance platform launched in 2017, designed to facilitate the distribution and sale of trade and supply chain finance assets to banks and other institutional investors.

Collaborative efforts such as CCRManager, we.trade, the KYC Registry, and syndicated payables programmes represent effective ways of narrowing Asia Pacific's trade finance gap. We must continue to nurture them as an industry – while staying on the lookout for other opportunities for collaboration and innovation.

Holger Frank, is head of global transaction banking and financial institutions group, Asia Pacific, and Siow Chin Yeo, head of trade finance, Asia Pacific, at UniCredit