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# HOW TECHNOLOGY CAN UNLOCK TRADE FINANCE'S CONTRIBUTION TO SMES

MARKET ANALYSIS THOUGHT

By **Thomas Frossard**
Head of Innovation
**Tinubu**

Thomas Frossard, Head of Innovation at Tinubu, discusses the evolution of banking and insurance regulations and their relationship to SME financing, outlines the role technology can play in facilitating mutual understating, and how it can help unlock available liquidity.

Trade and infrastructure finance gaps are hitting all-time highs once again. Even though the gaps were clearly identified – particularly their impact on SME financing and economic development – they continue to widen, and the immense amount of available liquidity fails to reach those who need it the most.

Should we be blaming a low appetite for risk? Not really. Studies converge and demonstrate that financing SMEs – especially for their trade business – is one of the less risky financing areas. Yet, compliance and operations costs are incredibly high for this market segment compared to the revenues earned.

It would be easy to blame SMEs for not understanding how they should present themselves to be eligible for financing. Still, communication challenges exist between banks and private and public insurers, and it is critical to address them.

## Basel, Solvency II and their impact on finance executives' culture

Financial regulations have considerably evolved over the past 20 years, with two main frameworks now well known by finance executives: Basel II and III for banks and Solvency II for insurers.

Our industry –from trade finance to credit insurance – was not necessarily under the spotlight, yet this evolution has deeply impacted it.

Executives who were used to monitoring their operating ratio in banking and their combined ratio in insurance have been asked to steer their business according to return on equity and have been familiar with PD, LGD, EAD, and EVA concepts. In a risk-averse culture where change and disruption are certainly not wanted, new regulations have required executives to allocate their liquidity to the economy in a completely new way.

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Banks have developed assets and liability management teams tasked to steer business operations by optimizing balance sheet strengths through capital allocation. Insurers have developed their actuarial teams to adapt to the need to define internal models within the Solvency regulation framework. Nevertheless, while defending their value proposition, they have failed to some extent to seize the opportunity to serve some of their customer segments better.

As outlined by Henry d'Ambrières in his article, banks and credit insurers do not understand each other well enough. Therefore, they fail to identify synergies that could allow them to explore new territories and provide more financial services to specific customer segments suffering from trade and infrastructure finance gaps.

Stakeholders cannot work in silos anymore but must perceive themselves as taking part in an extended ecosystem. Technology might not be THE answer to these challenges, but it can most certainly be used to overcome some of the difficulties identified.

## Messaging in the finance industry

Large companies who are either building strategic Large companies either building strategic infrastructures or controlling global supply chains can optimize the financing of their operations thanks to their mastery of debt structuration and insurance coverage. They understand the mechanics of loan securitization and reinsurance.

However, for the vast majority of companies around the world, accessing banking and insurance services remain a relationship challenge that can significantly depend on their ability to pick the right account manager. They are unaware of what is happening behind the scenes, nor can they influence it. They would nonetheless benefit highly from better cooperation between banks and insurers.

However, cooperation can only be sustainable based on mutual understanding. From this perspective, SWIFT has significantly facilitated bank-to-bank operations, especially in international trade. The insurance and reinsurance industry has developed a similar initiative with the creation of ACORD standards and the too little-known Ruschlikon initiative aiming at connecting the insured with the insurer, the insurer with the reinsurer.

Ultimately, all these initiatives rely on one technology: financial messaging.

Banks have achieved a very satisfying level of communication, even if interoperability with the emerging blockchain platforms still has significant room for improvement. Insurers and reinsurers are still on their way to moving away from bordereaux and Excel, although recent improvements must be recognized.

On the one hand, given this situation, one could state that further cooperation between both industries to develop new cross-industry messaging standards would require lengthy discussions and would be pretty unrealizable. On the other, such a statement ignores the opportunities provided by technological advancements to have both bank and insurance messaging solutions communicate with each other instead.

From a technology standpoint, it is all about XML messaging: both bank intercommunication, insurance and reinsurance communication, and corporate to financial institution communication. Our duty as service providers is not to fight for technological advantage from proprietary standards but to seek interoperability.

Message buses and message interpretation technologies could allow every actor to do so if we are willing to make suitable investments. Surety bonds and bank guarantees are an area that should be studied from this perspective. Banks and insurance carriers are used to sharing risks on these products at the operation and portfolio level. Corporates use banks or insurers to purchase coverage and rely on platforms that allow them to consume capacity from both industries. Bank guarantees have been covered for decades by insurers either through coinsurance schemes or counter guarantees.

Such operations incur costs that could be significantly reduced should all institutions invest in XML messaging capabilities – which are not far from their reach. This approach would democratize capacity sharing between banks and insurers, all for the benefit of their customers, including those SMEs in need of financing.

## Can we be sure? Yes, we can!

Another essential aspect introduced by the Basel and Solvency regulations is the equivalence of provisions compared to the quality of exposure borne by financial institutions and their ability to recover from their claimed assets.

> *The trust demonstrated by the banking industry in the value proposition of credit insurance should now be extended to the whole turnover and the retail sector for the benefit of SMEs.*

Although credit insurers have significantly developed their business with banks over the last 20 years, they still need to improve their credibility as a collateral provider despite their proven capacity to provide sustainable coverage.

Corporates are used to seeking credit insurance cover to protect their trade finance credit lines. However, regulators seem to be still doubtful of the value of this coverage for banks according to the recent position of the EBA on CRR.

All these challenges and obstacles boil down to one aspect of credit insurance: how can corporates or banks be sure that the insurance policy will cover the potential trade loss?

Indeed, cumbersome policy wordings and debates around the on-demand nature of surety bond wording have damaged the reputation of these coverages. Insurers have nevertheless proven to be reliable partners, relying on solid balance sheet foundations, and have supported the economy both in pro-and counter-cyclical circumstances.

Single risk named buyer and bank guarantee cover have constantly increased in the last two decades, demonstrating the trust of the banking industry in the value proposition of credit insurance. This cooperation between banks and insurers must now be extended to the whole turnover and the retail sector for the benefit of SMEs.

It is a lot more complicated to underwrite the buyers of an SME with the same level of detail compared to a single risk limit deal involving two listed multinational corporations.

Yet, thanks to technology, credit insurers have demonstrated for two decades that the underwriting discipline can be maintained in retail industry segments.

Being able to cross the next frontier resides in the capacity to provide certainty of cover on operations that must be analysed at a highly granular level. By giving access to businesses' accounting software – and thanks to regulations such as PSD2 – technology is allowing credit insurers to grant their customers – whether they be banks or corporates – the certainty that an individual operation will be covered according to their policy Terms & Conditions. Open APIs combined with AI allow credit insurers to provide retail businesses with sophisticated services that were until now only available to large deals.

## It's all about democratization

Capital is available, and underwriting capability is proven. Ultimately, it has everything to do with making sophistication affordable for smaller deals. Recent technological developments in financial messaging targeting greater interoperability and advancements in AI to grant certainty of coverage should make it possible to provide SMEs an equivalent level of support to the one we can provide to significant or government-supported investments.

**Our industry needs to demonstrate its ability to renew itself so that it can lessen the widely known financing gap and contribute to the achievement of SDGs.**

## About Tinubu

Tinubu is the business facilitator and exchange enabler that delivers fluidity and simplicity to the insurance industry by using the strength of collective performance.

Our company is an alliance of technology software and insurance expertise offering the best combination to its clients. It covers the entire value chain of credit insurance & surety with one end-to-end platform, connecting every part of your business with one digital highway.

Established in 2000 and headquartered in Paris, France, Tinubu is an independent software provider and employs 170 people, located in Paris, London, New York, Orlando, Singapore, and Montreal. Its clients represent 30 of the top 60 Credit & Surety underwriters worldwide.

## About the Authors

**Thomas Frossard**
Head of Innovation
**at Tinubu**

Thomas and his team are developing outside-the-box solutions to tackle the industry pain points, and are augmenting Tinubu's competence in advanced technologies (blockchain, AI, quantum computing).

He has built an expertise in trade finance and balance sheet management as an advisor for financial institutions at CSC Peat Marwick and lead the European business analysis team dedicated to surety bonding at Atradius.

Contact Us

contact@tinubu.com
+33 (0)1 74 31 20 70 (EMEA)
+1 (213) 290-9628 (USA)
tinubu.com

tinubu

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