The Future of Corporate Lending in APAC

Paving the way to a more efficient loan market

iLex

Corporate loan markets are hot in the press. From the risks associated with the USD 1-trillion leveraged loans market in the US to the spectacular growth of CLO and Private Debt funds, the demand for corporate loan assets from institutional investors has reached unprecedented levels, offering more stable risk-return and investor protection than equities and bonds in times of market uncertainty and volatility.

With global outstandings estimated at USD 40 trillion, the loan market is the second source of funding for corporates, and hence a vital avenue for the sustainable growth of the global economy. Contrary to equities and bonds, it has remained a relatively bespoke and confidential market without embracing other capital markets' trends of electronic trading and digitization. Reasons for this range from the traditional role of corporate lending in cementing client relationships in commercial banking, the risks associated with the disclosure of non-public information, and the relative complexity of loan documentation and settlement process.

Confronted with the erosion of corporate lending ROEs, increased regulatory pressure, and direct competition from non-bank lenders, commercial banks are progressively shifting their business model to more advisory and originate-to-distribute businesses. This opens a new age of opportunities to further enhance the efficiency, transparency and liquidity of the corporate loan market.

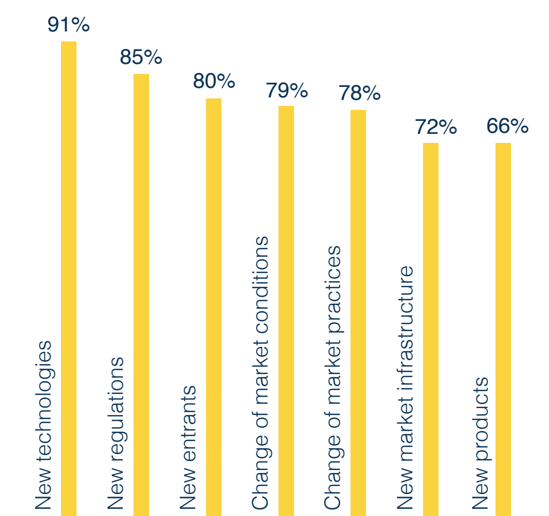
Will market practices converge with the equity and bond markets? How long may this change take? Who will be the leaders of tomorrow? This white paper discusses the outlook for the APAC corporate loan market infrastructure in the next five years and beyond.

Is the APAC loan market set for a major change?

The market seems to think so with 78% of respondents in our survey predicting major changes in the industry over the next five years in APAC.

Historically, APAC has been lagging behind the US and EU regions for the adoption of structural market changes. This is notably the case for the transition to institutional and non-bank lending, and the development of a broader and more standardized market, even if private debt fundraising was up 192% in Asia in 2017, more than in any other region.

Areas of change



Source: APLMA survey (% of positive responses)

Key market figures

FY18	North America	Europe	Asia-Pacific
Size of syndicated loan market	USD3,180bn	USD915bn	USD747bn
% non-bank lending in loan market	77%	61%	5%
Pension funds allocation to Private Debt	6%	2.5%	<1%
# of Private Debt funds in the Top 100	70	25	5

Source: Thomson Reuters, Preqin

The reasons underpinning this situation are well known:

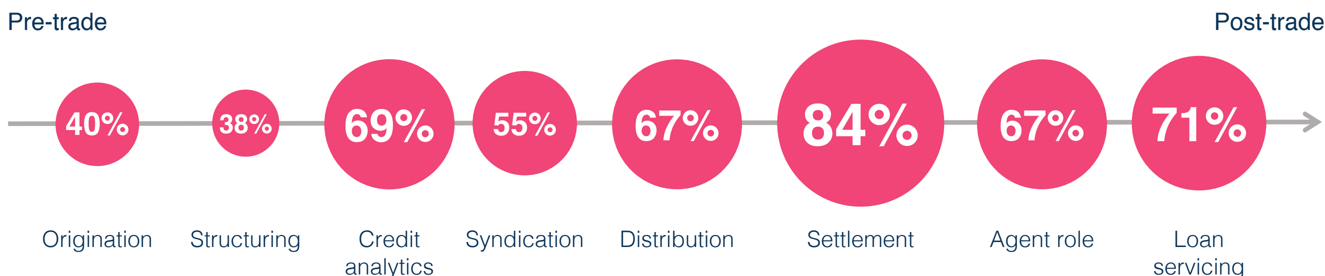
- Cheaper cost of funds and operations for banks not yet subject to international standards (CRDIV directive and MIFID 2) or backed by governments.
- Capital controls restricting lending and foreign direct investments in some countries.
- Complex and heterogeneous regulatory and legal frameworks across the region.

In Australia, Singapore or Hong Kong where banks are increasingly facing similar constraints to their US/EU peers, and where the institutional investor community is concurrently looking for diversification opportunities, one can see early signs of market transformation with new technologies, regulations and the emergence of new entrants acting as primary change drivers according to survey respondents.

Market practices are set to evolve as well. In particular, the highly manual and relatively complex deal settlement, loan servicing and agency processes are considered the most likely to be impacted.

The industry will benefit from innovation in ancillary areas such as credit analytics, client onboarding and secondary trade execution. The core corporate banking businesses of origination, structuring, syndication and distribution are viewed as more immune to change.

Impact of innovation on the value chain



Source: APLMA survey (% of positive responses)

An inevitable marriage of bank and non-bank lenders' interests

For banks, most transformation investments are currently geared towards process efficiency and operational excellence in order to reduce costs and risks, enforcing a more open mindset for the adoption of innovative solutions.

In addition, successive rounds of business portfolio reviews since 2008 have increased pressure on capital-intensive businesses, reducing banks' ability and appetite to lend over longer tenors or into riskier assets, thereby leading to an increased focus on originate-to-distribute strategies.

Main drivers for change adoption

Source: APLMA survey

But developments on the buy-side also play an active role in supporting change. Similar to the US in the mid-90's and the EU post-GFC, banks' lower credit risk appetites and their withdrawal from certain lending businesses opens the door to alternative lenders and institutional investors, working either hand-in-hand with banks or directly with corporates to fill the void.

Other more domestic factors can also be at play. Recently in Australia, some political leaders have called for a greater involvement of the AUD 2.6 trillion superannuation funds industry in the long-term financing of large Australian corporates to sustain economic growth and reduce their dependency on global capital markets.

In addition, the growth of PE-sponsored LBOs and Structured Finance volumes in the region attracts more and more liquidity from institutional investors in both the investment grade and leveraged loan markets. For example, last year saw non-bank participation in Singapore's Grab Holdings SGD800m syndicated asset-backed facility, and several unitranche facilities and Term Loan B issuances have taken place in Australia.

To become sustainable and prevalent, this shift to institutional lending calls for a structural revamp of the corporate loan market products and infrastructure. The needs of institutional investors differ from those of traditional corporate banks – they prefer bullets, cov-lite structures, and a certain degree of liquidity. They want to see loans converging with securities standards in terms of price discovery mechanisms, best execution capabilities, and multilateral trading venues, but without the compliance hassle of publicly traded securities.

Big data and blockchain-enabled smart contracts driving the transition to alternative digital trading venues

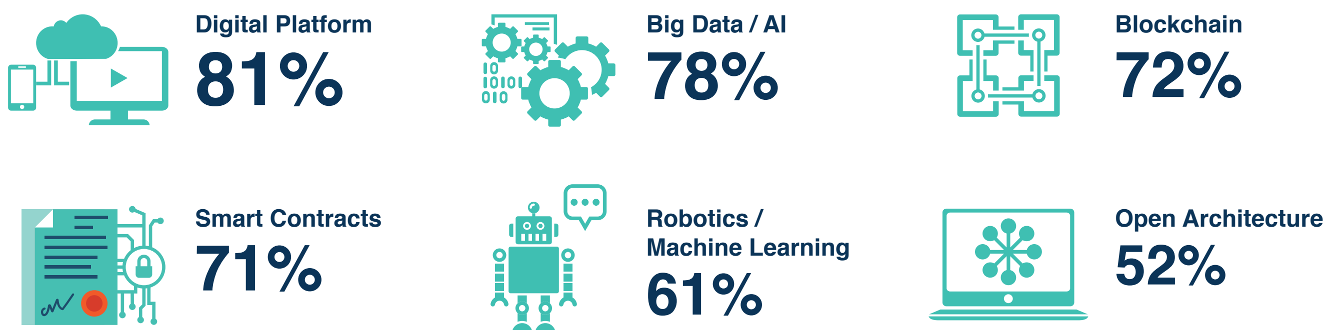
The increasingly fast adoption of new technologies in the Financial Services industry creates opportunities to make change happen sooner than later. The US market is already experiencing the emergence of next generation trading venues:

- "Instinct Loans" from BAML offers a fully electronic venue to trade large-size syndicated loans in the secondary market.
- Debt X and LEO have developed multi-dealer marketplaces and streamlined platforms for mid-size corporate loans syndication.

These use cases may still be at an infant stage but the momentum is there, with huge prospects when considering the yearly USD 3-trillion new US syndicated loans proceeds.

Big data and artificial intelligence are other technologies which will bring substantial benefits in areas such as asset sourcing, trading, price discovery, and credit portfolio management. In Italy, Axyon fintech start-up currently develops a deep learning algorithm to help syndication desks identify the best possible co-lenders for any new deal, based on historical market data and insights on market participants' past behaviors.

Key new technologies



Source: APLMA survey (% of positive responses)

Finally, no tech picture would be complete without a mention of blockchain. Several initiatives are taking place to define and test potential applications for the industry:

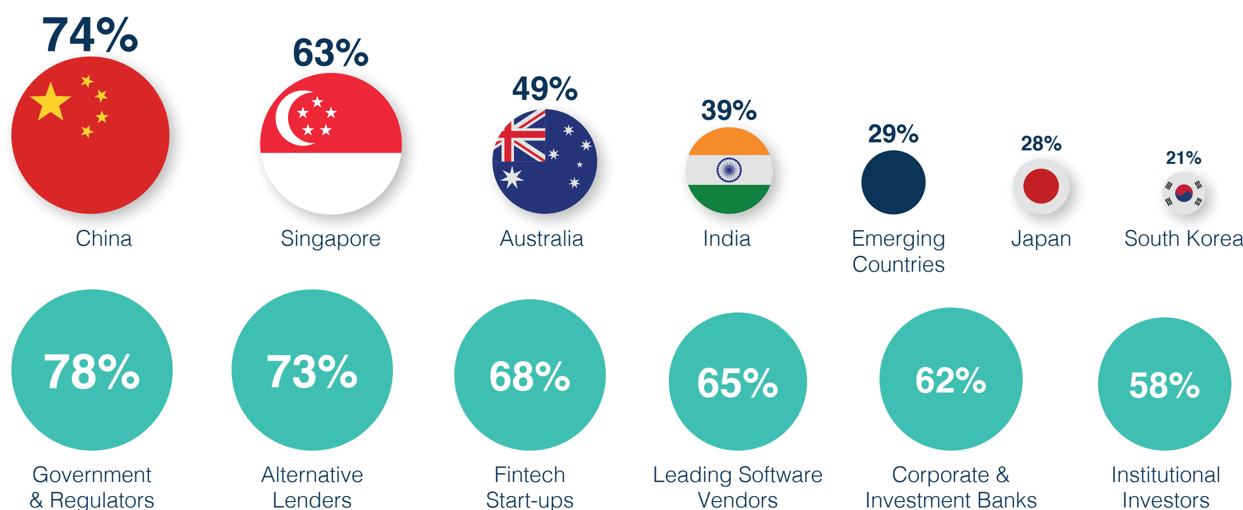
- Synaps, a joint-venture between Symbiont and Ipreo (IHS Markit) is trying to solve one the the industry's major pain point on loan settlement by leveraging Symbiont technology and ClearPar know-how in loan processing.
- LenderComm, a bank-consortium led by Finastra and underpinned by R3 Corda DLT technology, has developed a platform between bank participants to streamline the agent-lender communication and reduce loan servicing costs.

Some of the success of these new platforms will hinge on the adoption by lenders and borrowers of digital assets, tokens and smart contracts that are meant to standardize loan data sets and improve asset comparability and tradability in the secondary markets, a condition for the development of alternative trading venues.

Tokens are digital assets that replicate a financial product's key characteristics, and allow to trade and track ownership of the asset on an immutable and secured blockchain network. Standard trade characteristics and trading rules can be embedded into a smart contract. They allow to buy a fraction or an aggregated participation in illiquid assets in a more efficient way than traditional securitization and at a much lower cost. Similar to cryptocurrencies, the tokenization of assets is still under scrutiny to determine under which regulatory and legal frameworks they will be governed. Several ventures are working on making the technology available for loans, that could lead to a quantum leap change in the way loans are structured and traded in the future.

Trend-setters in APAC

Change of this magnitude will not happen in isolation. While all parties will undoubtedly have their role to play, APLMA respondents identified governments and regulators, followed by alternative lenders and fintech startups, as change leaders in shaping the future of the industry, with China / Hong Kong, Singapore and Australia leading the way.



Source: APLMA survey (% of positive responses)

In an industry where compliance, regulations and data privacy are of upmost importance, evolution will only happen with the blessing from regulators and the support of trade associations such as APLMA to promote new business standards towards more market transparency, efficiency and liquidity. Conscious of the opportunity, several APAC countries have taken actions to promote an innovative and collaborative environment and position themselves as international fintech hubs. Regulatory sandboxes providing a controlled environment for testing innovative solutions and business models can now be found in virtually all large APAC economies, with the notable exception of China (for now). Other government incentives have been set up for work visas, talent recruitment, financial grants, and tax.

From an origination perspective, non-bank lenders are likely to drive Term Loan B and unitranche volumes up, and take a bigger market share in capital-intensive sectors such as Infrastructure and Real Estate where banks need to deleverage their loan books. Borrowers will also have their say, especially in an environment where more and more deals are being self-arranged, and they will be especially wary of potentially losing the relationship with their banking group and the control on their debt ownership.

On their side, with a leaner and more agile setup and the absence of legacy, fintech start-ups can offer tailored products and services with fast go-to-market. This had led to a revolution in Payment Services with APAC seeing its fair share of fintech leaders, think Paytm, Ant Financial. Bond markets and Trade Finance have also developed a more vivid innovation ecosystem with flagship investments such as SGX stake in Trumid bond trading platform or the R3 Corda-enabled Voltron project led by BNP and HSBC to digitize trade finance documents. However, only 1% of fintech companies globally are focused on the large corporate lending segment, and little to nothing has been achieved yet in this space in APAC. Lending-oriented fintechs in the region have focused first on underserved markets and more disruptive peer-to-peer lending and invoice financing platforms for retail and SME customers. This is mostly evident in China and emerging countries where SME's access to capital is a major economic challenge. While these solutions are slowly becoming credible alternatives to fill the SME funding gap left by the GFC, they are not likely to transform the corporate lending markets, which have much larger funding requirements and greater transactional complexities. Instead, change will take the shape of B2B solutions focused on streamlining market infrastructure, connecting institutional investors to bank originating capabilities, and supporting commercial banks in their business and operating model transformation.

This is what iLEX, a Singapore-based fintech, is trying to achieve by developing the first multi-dealer marketplace for institutional investors and banks to trade loans in the primary and secondary markets. iLEX platform will be powered by advanced credit analytics and will offer added value ancillary services with the objective to accelerate the convergence with EU/US standards.

So what's next?

This exciting path ahead is not without roadblocks. The survey clearly sets the bar for new ventures: going beyond the reluctance to change of market participants swamped with new regulatory requirements, and working with regulators to adapt policies to new entrants and market practices, are all key challenges to transform a well-established market. It took more than 20 years for equities; it may take the same for corporate loans. Success will likely revolve around execution. But probably better than ever before, all the conditions are met for the corporate loan market to come out into the open and catch up with other capital markets.

About APLMA

The Asia Pacific Loan Market Association (APLMA) is the only pan-Asian association that is dedicated to promoting growth and liquidity in the primary and secondary loan markets of the Asia-Pacific region.

The APLMA's mission is to increase liquidity, efficiency and transparency in the primary and secondary syndicated loan markets in the Asia Pacific region. The APLMA advocates best practices in the syndicated loan market, promulgates standard loan documentation and seeks to promote the syndicated loan as one of the key debt products available to borrowers across the region.

About iLEX

iLEX is the first APAC multi-dealer platform providing an alternative trading venue for loan markets participants, banks and non-bank lenders alike.

Combining superior matching engines, data & analytics and integrated pre- and post-trade loan services, it delivers a one-stop gateway for both primary syndications and secondary trading across all corporate lending products. Bringing higher transparency, efficiency and liquidity to the market, iLEX bridges the gap between banks and institutional investors, and streamlines origination, syndication and distribution capabilities. iLEX is an independent fintech based in Singapore.

About this white paper

This white paper discusses the findings of a survey conducted with APLMA in April 2019 (138 responses from APLMA members) with the objective of identifying innovation trends in the APAC loan markets over the next five years, and presents the latest technological developments in the loan market for pre-trade, post-trade and trading solutions. You can find an electronic version of this paper on www.ilex.sg or www.aplma.com websites.

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