
# SPECIALTY FINANCING PLATFORMS: CONNECTING BORROWERS AND LENDERS GLOBALLY

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The importance of specialty financing platforms continues to grow, connecting debtors and funders across the globe at increasing pace and scale. In this article, we explore how speciality financing platforms deploy different legal techniques to create sophisticated and robust investment opportunities for varied markets, facilitating previously untapped lending opportunities and helping to significantly narrow the existing trade finance gap.

### Key Issues

- Varied speciality financing platforms continue to play an important role in the market, including plugging the USD 1.7 trillion trade finance gap.
- Platforms deploy different legal techniques to create sophisticated and robust investment opportunities to (often) untapped markets.
- Opportunities to interpose financing solutions into the global supply chain (using embedded finance, digitalisation and automation) continue to advance at pace.
- Borrowers and investors (as lenders) can be “matched” through speciality financing platforms.

## INTRODUCTION

Over the course of the last five to ten years, a large variety of specialty financing platforms have taken a foothold in the market. These platforms provide financing for a wide range of product and asset classes – including trade receivables, corporate loans and consumer loans/leasing. They therefore attract a large and varied borrower base (principally consumers and small and medium-sized enterprises) and a diverse set of investors. The investors range from traditional banks to private equity investors, asset managers, funds and insurance companies. At the same time, peer-to-peer lending (“**P2P**”) is becoming increasingly popular, enabling consumers to obtain financing directly from other consumers thereby removing banks and financial institutions as the linchpin – although many of the leading fintech platforms that initially raised funding via the P2P model now also raise funds via the capital markets, often using structured finance techniques (whether securitisations, originator trust structures or similar arrangements). The emergence of these platforms streamlines the process of obtaining finance across jurisdictions. They allow for global growth by connecting potential borrowers to investors and enabling the production and delivery of goods and services across the globe, which, in turn, catalyses economic growth.

## Wide Variety of Specialty Financing Platforms

Specialty financing platforms have evolved significantly over the course of the last decade. Some players started out with less complex financing arrangements and then increased the complexity and jurisdictional reach of their platforms to achieve further efficiencies, scalability and a wider investor base. One common feature of speciality financing platforms is that they are often thinly capitalised. The platforms do not necessarily have the capital nor the desire to fund the acquisition of assets on their own balance sheet. Instead, raising capital from third party investors (often allowing investors to gain an exposure to the underlying assets on a "pass through" basis) is commonplace. The legal solutions employed to ensure that investments made using these platforms have an acceptable level of "legal security" are sophisticated and varied.

Some platforms use a sophisticated factoring (or reverse factoring) model. Borrowers (in the context of loans) and debtors and/or suppliers (in the context of trade receivables) sign up to the relevant platform dependent on passing thorough know-your-customer checks done by the platform. Stand-alone independent payment undertakings are also sometimes granted by the borrowers/debtors as part of the onboarding process. In those undertakings, they agree (either via a supplemental arrangement or through a modification to the terms of the underlying loan/receivables contract) that they owe the debt directly to the investor. That debt may be acquired by (i) the investor, directly onto its balance sheet or (ii) a special purpose vehicle, which, in turn, is financed by the investor or a syndicate of investors. In the latter case, the debt would normally be wholly secured in favour of the investor(s), who would sometimes also share in the upside of any excess cashflows.

An alternative to these (reverse) factoring structures are originator trust structures. Originator trusts have recently been deployed through financing platforms focussed on providing financing in the context of consumer loans, the Coronavirus Business Interruption Loan Scheme ("**CBILS**") and the Recovery Loan Scheme ("**RLS**"). Originator trust structures are typically used where there are concerns around the assignability of assets – or the assignability of the benefit of a guarantee, as was the case in respect of the UK government guarantee issued in the context of CBILS and RLS.

Alternatively, some speciality finance platforms effectively "match" borrowers with investors (as lenders). In these cases, the platform typically charges a fee for origination and servicing activities.

The variety on the asset side is matched by a variety of investment types. Investments in platforms can take the form of loans, notes, loan notes or New Yorkstyle participation agreements, and can be structured as securitisations (for EU, UK and/or US regulatory purposes) or structured not to be a securitisation, as needed. The variety of financing platforms in the market deploying different funding models means there is increasing flexibility for borrowers, debtors, suppliers and investors in terms of borrowing and investor funding methods, and the related platform's structures and features.

## Trade Finance Platforms and the Opportunity to Narrow the Trade Finance Gap

The trade finance gap is the excess of demand over supply for trade finance. The Asian Development Bank estimated that in 2020, the "*value of trade finance transactions supported by major global banks was (…) around USD 9 trillion*"[1] with the "*trade finance gap (…) [being] at an all-time high, having reached $1.7 trillion (…)*."[2] Specialty finance platforms are well-placed to narrow this gap – especially given the plethora of models available. While

[1] Asian Development Bank: https://blogs.adb.org/blog/your-questions-answered-what-trade-finance-gap-and-why-does-it-matter and see also: https://www.adb.org/sites/default/files/publication/739286/adb-brief-192-trade-finance-gaps-jobs-survey.pdf

[2] S&P Global: https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/banks-risk-widening-trade-finance-gap-as-they-push-for-greenlabel-72221977

trade finance has traditionally been supported by banks, platforms with a wide variety of investors are moving into this space to provide finance where banks historically haven't and bridge the trade finance gap.

One of the market-leading UK trade finance platforms seeking to narrow this gap is Stenn. In 2019, Stenn established a multi-jurisdictional trade receivables securitisation platform backed by trade receivables and wrapped by credit insurance with advice being provided by, among others, Clifford Chance. Stenn acquires these trade receivables as part of their own invoice financing and factoring business from suppliers or other third party factoring companies (and owed by debtors) across the globe. This transaction was unique by virtue of Stenn itself being a factoring company. It therefore requires simultaneous funding via the securitisation to match its origination. This meant using a dynamic pre-funding mechanic and the ability to sell receivables to the issuing SPV daily, thereby providing Stenn with frequent cashflows to facilitate efficient origination through its own acquisition of the relevant receivables immediately prior to on-selling to the SPV. Stenn's trade receivables programme is truly global with obligors, suppliers and intermediary factors located in more than fifty jurisdictions. Detailed legal, insolvency and tax analysis has been undertaken in almost half of the jurisdictions to date.

The US enterprise resource and working capital management specialist Taulia LLC has also established a number of trade finance programmes to narrow the trade finance gap. Using versatile special purpose entities in Europe and the United States, Taulia established first a supply chain finance programme with the capacity to form segregated series from time to time to acquire receivables and payment undertakings from sellers and obligors who participate in Taulia's SCF Program. Those supply chain finance programmes were subsequently augmented by account receivable purchase facilities. While the European programme is a traditional Luxembourg-based securitisation vehicle issuing single-tranche asset-backed securities to investors, investors in Taulia's US trade finance programmes acquire participation interests in the receivables and payment undertakings owned by the US vehicle. Taulia's trade finance platform is scalable both by virtue of its structure and its link to the Taulia technological platform, while achieving optimal funding efficiency without the issuance of securities. Clifford Chance is pleased to be involved as counsel to Taulia on the establishment and ongoing development of its US trade finance programme.

## Financing Platforms – what's next?

Credit insurance has been, and continues to be, a hot topic and we expect to see credit insurers continuing to underwrite debtor default risk in financing platforms. This offers credit enhancement and broadens the pool of potential financiers.

This is because some financiers require credit insurance recourse for investment and/or regulatory capital purposes.

In the United Kingdom, the Electronic Trade Documents Bill is currently being considered in the House of Commons which, if passed into law, will allow for the legal recognition of electronic trade documents such as bills of lading and bills of exchange. This would likely enable financing to be raised at an earlier stage (and ultimately with more legal certainty) than is currently the case during the supply chain life cycle, to the benefit of all interested parties.

Given continued focus on environmental, social and governance ("**ESG**") objectives and the exposure of some of these financing platforms to the bond market, financing platforms may be well-positioned to drive ESG objectives by requiring the underlying borrowers, debtors and/or suppliers to meet certain ESG minimum requirements when borrowers, debtors and suppliers sign up to the platforms. However, given the uncertainty surrounding standardisation of ESG criteria, we expect more time is needed before the precise role financing platforms can play becomes clear. For more information, see the article entitled "*ESG Securitisation: weathering the storm?*" earlier in this volume.

Regulators, including the Financial Conduct Authority in the UK, have also highlighted heightened fraud risk in the trade finance business and have encouraged market participants to conduct detailed know-your-customer checks. Market participants note, however, that no seismic shift has taken place following these announcements by regulators, which is likely because significant borrower and debtor due diligence has always been a key focus of sophisticated platforms and the funders financing them.

Despite the demise of Greensill, trade finance platforms have continued to be popular with other players in the market seemingly picking up market share, including UK-based Stenn, San Francisco-based Taulia (both mentioned above), New York-based LiquidX and Missouri-based C2FO, with some market participants observing that given the wide variety and number of platforms, consolidation is expected over the coming years.

Given that financing platforms can effectively provide a direct liquidity line to underlying corporates, there will naturally be a continued evolution and integration of the offerings of financing platforms. This is part of the current broader movement towards further embedded finance solutions, directly and seamlessly connecting origination, invoicing and payment systems within a corporate to an immediate funding source through the financing platform.

C L I F F O R D
C H A N C E

# CONTACTS

**Andrew Bryan**
Knowledge Director, London

T +44 20 7006 2829
E andrew.bryan@cliffordchance.com

**Simon Connor**
Senior Associate, London

T +44 20 7006 5304
E simon.connor@cliffordchance.com

**Jacklyn Hoffman**
Associate, New York

T +1 212 878 8058
E jacklyn.hoffman@cliffordchance.com

**Anna-Lena Marx**
Senior Associate, London

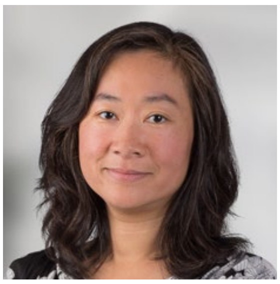
T +44 20 7006 5542
E annalena.marx@cliffordchance.com

**Gareth Old**
Partner, New York

T +1 212 878 8539
E gareth.old@cliffordchance.com

**Simeon Radcliff**
Partner, London

T +44 20 7006 2786
E simeon.radcliff@cliffordchance.com



**Maggie Zhao**
Partner, London

T +44 20 7006 2939
E maggie.zhao@cliffordchance.com