NFTs in Treasury?

Establishing Use Cases in Trade Finance and Beyond

By **Ben Poole**, Columnist

The world's first trade finance-based non-fungible token transaction in 2021 highlights the need for treasurers to understand the technology behind tokenisation and the practical implications that it could have for corporate finance.

Non-fungible tokens (NFTs) have gained quite the reputation in the past year. Collins Dictionary has even gone so far as to name the abbreviation as its Word of the Year 2021, following an 11,273% rise in usage in the past 12 months.[1] A type of unique token minted in a blockchain

and using smart contract technology as a framework, NFTs have taken the art world particularly by storm. While the debate has raged over just how unique a digital image that can be easily captured in a screenshot can be, art-based NFTs can sell for big money. This was highlighted in March 2021, when artist Beeple's digital NFT-based *Everydays: The First 5000 Days* image sold for just over $69m at Christie's.[2]

Jean-Baptiste Gaudemet, Senior Vice President Data & Analytics, Kyriba, says that beyond the art world, there is an even bigger potential for this technology that corporate treasurers need to be monitoring, particularly in trade finance. "An NFT can represent any kind of digital object, and that obviously includes validated purchase orders and validated invoices," Gaudemet says.

"You can represent an invoice as an NFT in the blockchain in such a way that you can prove that you own this invoice. Therefore, the invoice becomes a tradable asset, which is a game-changer for activities such as trade finance, supply chain finance [SCF], or factoring. The NFT can carry a smart contract describing the terms and conditions of the invoice. In trade finance, you have a lot of conditions to trigger payments, such as the shipment of the goods and passing the border, for example. This could all be encoded within the smart contract in such a way that the invoice becomes self-payable, avoiding a lot of the cost and effort of reconciliation."

In order to 'tokenise,' either as a supplier or as a buyer, a number of fintech platforms offer corporates a service to register either a validated invoice or payment guarantee on the blockchain as a token. And as Thierry Cairus, Regional Treasurer, Asia Pacific, JTI, points out, tokenisation of trade finance documents on a blockchain offers corporates enhanced traceability and security over their supply chain processes.

"In today's world, trade finance often lacks transparency and efficiency," Cairus says. "Some pain points could be addressed with blockchain technology, which offers transparency, speed and increased efficiency in the financing process. Automation with smart contracts could unlock value and reduce risk. With all the documentation and invoices accessible in a single place, we can have real-time review, such as AML [anti money-laundering], and quicker access to financing, which could also be done through a decentralised financing platform. With ESG gaining a lot of traction, controls and robust audit trails that cannot be tampered with are required. Blockchain enables this and can increase trust and traceability."

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Resolving existing trade finance issues

Research by the Asian Development Bank published in October 2021 found that the global trade finance gap – the amount that demand for trade finance from corporates outstripped supply – had widened to $1.7tr. in 2020.[3] This lack of funding, and the complexity that prevents suppliers further down the chain from accessing SCF programmes, means smaller businesses in particular are being squeezed. The tokenisation of invoices has the potential to change this scenario, according to Gaudemet.

"By tokenising the invoice, you transform it into a tradable asset, which means you can very easily put it on an exchange and then it can be bought by a pension fund, insurance, or wealth manager very efficiently," Gaudemet explains. "You're opening the door to a much bigger pool of financing beyond the balance sheet of a bank. You may still need to go through some securitisation process, but the tokenisation

THE WORLD'S FIRST TRADE FINANCE-BASED NFT TRANSACTION

September 2021 saw the first complete end-to-end transaction following a unique set of regulatory guidelines and trade finance standards, following a partnership between Tradeteq and eXchange inFinite (XinFin).

"We are convinced that trade finance is a very exciting asset class for these asset-based lending tokens," comments Christoph Gugelmann, Tradeteq CEO. "There are these very large stablecoins and similar types of offerings where, in a way, the whole reserve pool management is still very centralised. We think that trade finance is a fantastic way to keep crypto assets stable. It's global, short term, somewhat inflation-protected, it attracts the value of the underlying goods, and it's usually dollar based. It can also be very decentralised if you want because you can make it an open platform with multiple originators contributing towards its reserve pool."

Tradeteq recently partnered with Singapore-based eXchange inFinite (XinFin) to offer tokenised trade finance products. Gugelmann describes the natural fit between the two parties that enabled them to work together. "We were looking for a business that had DNA in the trade finance space and the XinFin network is very focused on trade finance, it has made its smart contract protocols available for full trade finance for quite some time," he explains. "We decided to partner up and were overwhelmed by the interest from originators and also from the quite large institutional and high-net-worth investment demand. It was logical to then proceed and do the first transaction with Dublin-based Accelerated Payments. We now have acquired a good pipeline for carrying out further transactions, but we also want to scale as quickly as we can and offer it to a much wider set of partners."

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greatly facilitates the circulation of the ownership of the invoice."

Additionally, if a validated invoice or a validated purchase order can be tokenised, the supplier can use the token as a medium of exchange to pay their own suppliers. Therefore, the token can be seen moving down the chain all the way through to the smallest businesses sitting very deep in the chain.

"It is a way to diffuse an SCF programme put in place by a large buyer across the entire chain of suppliers because it becomes very easy to use the payment guarantee as a medium of exchange at each step of the supply chain," Gaudemet adds. "In the current context of supply chain difficulty, where buyers are bidding between each other to secure their supply chain, this becomes a huge competitive advantage to be able to put in place a financing facility deep into the chain."

Gugelmann notes that as well as opening up trade finance to investors outside of banks, tokenisation also has the power to enhance banks' balance sheets. "Trade finance is the only asset class that has not found its way into capital markets," says Gugelmann. "Banks need the ability to distribute trade finance to all the parties, whether this is retail, high-net-worth or institutional investors, regardless of the delivery mechanism. If this happens, banks will have more liquidity and will be able to service their customers better. The banks will create more net interest income, but crucially they will be able to make more liquidity available to corporates. This is the big game-changer, and we now have the technology to do it."

Other use cases for treasurers

Tokenisation of trade finance is part of the puzzle to increase liquidity flowing from capital markets, through banks and non-bank originators, into corporates. That is an obvious benefit for treasurers, and it is not the only one, according to Gugelmann.

"Another benefit is that it can potentially be an attractive investment opportunity, so corporate treasurers should start thinking about the crypto space," he suggests. "Not necessarily Bitcoin, which can be quite volatile, but stable assets. Large corporates have all the access in the world through central securities depositories, but for smaller firms this might not be the case. If they have excess liquidity, then that actually might make sense to park it in something stable, which is inflation-protected, and which you understand, because trade finance is at the heart of most companies. So it can be of benefit on two sides."

Other use cases for tokenisation being explored by startups should also be on the radar for corporate treasurers, one of which is around cross-border payments. "Cross-border payments are a massive pain for the industry today," notes Gaudemet. "They are extremely costly and they take a lot of time, particularly when you want to pay in exotic countries when it can become costly and slow. NFTs can help to streamline the transaction across the correspondent banking network. Basically, it's an alternative to the SWIFT network."

Another use case that could also prove to be interesting for treasurers is using NFTs for in-house banking and intercompany loans. This is a private financial system with a ledger to ensure there is no inappropriate tax optimisation across the group. "All intercompany loans must be properly recorded with market appropriate interest rates," Gaudemet explains. "Today, all of that is registered on a centralised ledger, but moving forward, we might see the emergence of recording this type of in-house banking ledger through a decentralised ledger."

For corporates, there could also be capital markets and funding implications for using this technology.

"Tokenisation of assets doesn't really have any limits," JTI's Cairus says. "Anything from company shares to bonds or commercial papers could be represented by tokens in small fractions to allow as many investors as possible to participate. These tokens could then be tradable or transferred to and from centralised or decentralised trading platforms with 24/7 liquidity and real-time settlement, without counterparty risk."

CBDCs offer hope on the horizon

The potential for NFTs to be used in trade and supply chain finance exists today, but this could really be unlocked by the development of central bank digital currencies (CBDCs). Gaudemet makes the point that CBDCs have the potential to leverage the power of smart contracts, meaning the invoice itself could activate the supplier's payment.

"A payment through a CBDC could be triggered by the smart contract carried within the NFT – therefore, you no longer have any reconciliation required between the cash ledger sitting on one side and asset ledger sitting on the other," Gaudemet explains. "Most of the financial industry is spending its time doing reconciliation. The promise of CBDC and tokenised assets is to avoid this reconciliation because the asset itself becomes the trigger of the payment. This is available today if you write an invoice in Bitcoin or in Ethereum, but these private cryptocurrencies are rarely used in supply chains to pay for goods and services. It is really the development of CBDCs that will unlock the power of invoice smart contracts."

In areas such as AML, fraud, and monetary policy, CBDCs have the potential to offer corporates a safer cryptocurrency to work with as they are effectively fiat currencies. "It will be seamless to write the terms and conditions of your invoice on the smart contract with a payment in CBDC to be exactly equivalent to a payment in cash or by card," Gaudemet explains. "CBDCs will unlock the power of tokenisation of invoices, creating benefits such as access to more funding and the ability to transfer payment guarantees across your entire supply chain."

What treasurers can do today

Clearly, the financial world is changing at a rapid pace, and treasurers may wish to look beyond the basic services offered by their banks and examine the already mature technology around factoring and SCF. Gaudemet states: "SCF is super-important today in the context of buyer competition for suppliers. CFOs and treasurers need to look at what's available today on the market, as solutions are evolving very quickly. It is key to be forward-thinking and look at what new technologies such as NFTs, tokenisation, and CBDCs will bring in the future. The ability to finance working capital and the supply chain is increasingly a strategic resource and a competitive advantage."

For Gugelmann, it is important that corporates put pressure on their banks to move their business model from an 'originate-to -hold' to an 'originate-to-distribute' model. "Banks always make sure they're not too exposed to a market before it reaches a critical size," he explains. "Some banks are being incredibly proactive, moving ahead and making investments in this space, but others are still observing, seeing what the others do. But if their corporate customers knocked on the door and said, for example, 'I'm asking you for half a million in financing, you're giving me only 200,000 of financing, I'm underserved by 300,000', they could then make the point to the bank that they should be able to receive the full financing because the liquidity is there. The banks just need to distribute the financial instruments, as they do it for any commercial debt but trade finance. That's all that is needed. I think that very soon this is going to be a much more common occurrence."

Meanwhile, Cairus concludes: "Treasurers need to keep an eye on this space and stay informed, because it's clearly the future and could revolutionise the world just like the internet did. Digital finance is not only about Bitcoin and cryptocurrencies, but blockchain as an enabler and a more efficient technology solution."

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Notes

1 https://corporate.harpercollins.co.uk/press-releases/nft-is-collins-word-of-the-year-2021/
2 https://www.christies.com/about-us/press-archive/details?PressReleaseID=9970&lid=1
3 https://www.adb.org/news/global-trade-finance-gap-widened-17-trillion-2020

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