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The Aftermath of Greensill Failure: Negative Rates Take a Grisly Toll on Japan and Switzerland

UK "Fintech" Leader Implosion Casts a Dark Shadow

Greensill Capital's bankruptcy opens an albeit small window into much that is wrong with present monetary radicalism. Paradoxically, perhaps, the spotlight is on an "underbelly" of financial weakness in two safe-haven currency countries – Switzerland and Japan.

The purpose here is not to retell the saga but to pick out the salient facts which fit a broader diagnosis missing from much of the blow-by-blow account seeping through the financial media.

According to its sales pitch, Greensill has been a pioneer in two respects. First, it turned a new financial product, supplier chain finance, into a new asset class. Second, it has been a leader in "fintech", developing a "new platform" that could handle a much lower cost than otherwise the complicated relationships across the chain.

Both claims have turned out to be bogus – and in ways which drew in some big players as apparent dupes or else possibly as well compensated operatives for turning a blind eye.

Take the innovation that was not an innovation – supplier finance, otherwise described as reverse factoring. This has been around for a decade or more and, in general, regarded as an unexciting low earner.

Greensill may have been successful in getting higher earnings than usual with its early history of inserting itself (under the Administration of PM Cameron) between the British National Health Service (NHS) on one side (the buyer) and independent pharmacists (the supplier) on the other. The crony links here are subjects for other publications – including the knighthood bestowed by Prince Charles on Greenhill's founder and the fees from Greensill to ex-PM Cameron as an advisor.

Credit Suisse opened the door to the new asset class by marketing funds to investors, based explicitly on the supplier finance operations of Greensill. Those investors were desperate for yield amidst the income famine created by central banks, mainly the Swiss National Bank, with its negative interest rates. In their desperation, they failed to study the hoary details (more below).

Greensill described itself as a fintech pioneer, the largest in the UK. But that has not been the case. It had a partnership with a US-based fintech firm, Taulia. In 2019 Taulia announced that it was breaking its exclusive arrangement with

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Greensill and, in April 2020, declared that it was entering into a strategic alliance with JP Morgan Chase.

That announcement should have been a red flag to all about Greensill's business prospects, including the buyers of its notes from Credit Suisse, who through 2019 poured more and more into them (growing from an estimated $2bn to $9bn). In Japan, it seems that Softbank was also not seeing the red flag when it took two equity participations in Greensill in 2020, attracted it appears to its vaunted leadership position as the UK's fintech firm.

Softbank was not the only Japanese player with apparently impaired judgement. We should consider the role of Tokyo Marine Insurance. Having suffered in consequence of claims inside Japan primarily related to the Triple disasters of 2011, this firm had embarked on an overseas buying spree. This spree was driven by the notion and backed by the equity market swollen by virulent asset inflation that growth would be faster outside Japan, not least because of the negative rates and the demographic decline there.

And so in 2019, Tokyo Marine had bought an Australian insurance company (same nationality as the founder of Greensill), Bond and Credit Company, from its parent (also Australian, IAG). It seems that Tokyo Marine was not aware at this stage of any potential issue with BCC's credit insurance concerning Greensill. Notably, BCC had insured massive amounts of Greensill lending under its supplier insurance agreements. Whether IAG knew about potential issues remains part of the unanswered story, we should note that its share price slumped as the saga unfolded.

Hence the involvement of these two Japanese players in the Greensill saga, Tokyo Marine Insurance and Softbank, was driven directly by the madness of Japan's negative rate policies and the related desperation there for yield and growth. The implication is that usual rational-sober scepticism was missing in action.

We don't know at what stage the Softbank top command became aware of issues. Still, through 2020 there were revelations about how this bank was also buying units in the Credit Suisse fund whilst simultaneously one of Softbank Venture Fund's companies, Oyo hotels, was a borrower from that fund. Undoubtedly, Oyo's financial situation was indeed made worse by the pandemic.

Back to Tokyo Marine. It became aware last year at some stage about the risky exposure of its recently purchased Australian unit to Greensill, blaming this on the unauthorized breaking of limits by an employed underwriter. This lousy behaviour could well have been happening before the take-over by Tokyo Marine. It is still unknown what lay behind this, whether insurers were desperate to get returns in a world of interest famine, criminality, or both. y. In any case, Tokyo Marine, based on this revelation, announced that it would be suspending insurance of Greensill loans from early 2021, if not before.

Meanwhile, we can only guess the downhill fortunes of the underlying business of Greensill. There must have been knowledge at the top about how Taula took its core business from under its feet along to its new outside partner, JP Morgan Chase. The implication is that Greensill's revenues would become even more dependent on shaky foundations, exposed by a possible predatory battle for its business from a US financial giant with monopoly power. No wonder that

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Greensill seems to have become growingly dependent for published revenues (actual and forecast) on specifically growingly dubious borrowers (including the biggest British steel group).

Greensill Capital, the UK based business of Greensill, borrowed in these circumstances from its German bank associated company, Greensill Bank, an action which is now under criminal scrutiny. In turn, the German bank had been funding itself growingly via accepting deposits from German municipalities, which responded to Greensill Bank's deposits not being subject to negative interest rates. Apparent cynicism about why Greensill Bank would be paying above-market rates seems to have been missing from these public servants' calculations, desperate to protect their accumulated sums for priority disbursements.

Back to Credit Suisse. Here we have a financial institution whose performance had been held back by Switzerland's decline as a haven for global funds in the wake of the end of bank secrecy in the last decade - and where internal political battles had failed to resolve, let alone produce a path for new opportunities. Amidst its woes, the SNB has forsaken all idea of sustaining the franc as a safe-haven currency. Swiss banks, amongst others, could have gained and instead of swimming with the tide of the 2 per cent inflation standard and currency manipulation.

The top brass at JP Morgan Chase is putting out the word in the financial media that Greensill will not be the catalyst to a global financial crisis. This smacks of the arrogance of the big bank monopolist turning its nose up at the tribulations and misdeeds of its small competitors, laid low in part by its alleged predatory behaviour.

One big picture question does subsist despite JP Morgan Chase's relaxed (and satisfied) posture. Could all the sordid details of the "Greensill affair", albeit so far only about a "small operation", be the catalyst that opens many eyes to just what lies behind the surface in the brave new world of financial innovation, including fintech. There has to be a small risk of this, albeit not the central scenario. But history does suggest that scandals such as this can be part of the beginning of the end.

More substantially perhaps, will any of the significant player central banks take note that their policies, most of all of negative rates, but more generally of virulent asset price inflation, are producing a very nasty and dangerous financial world around us? The short answer, at least if we study comments from the central bankers, is no.

For now, the Swiss franc and the Japanese yen may be the victims in the currency markets of the Greensill failure – but that is not likely to last long if this broadens out into a more significant crisis. The snapshot the Greensill affair offers on the grimy world of asset-inflation, and negative-interest rate induced market signal corruption and related sordidness may just remain that. But it could be an eye-opener in a broader sense. And as investors, we should all take note of these significant errors of the judgement under present monetary conditions by big players – in this case, in Switzerland and Japan. These big players can move markets for some time – but they can also fall through the floor. We should think of those massive flows into Sterling bonds or high-yield European bonds coming in recent months from Japan as a topic for another day.

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