



Trading Loyalty Point-Backed Securities electronically

By the second half of 2018, institutional investors will be able to create and trade securities based on loyalty point currencies such as frequent flyer, credit card points and other reward programmes, unlocking a new asset class worth over \$1 trillion.

New York-based Affinity Capital Exchange (ACE) in collaboration with Nasdaq plans to launch an exchange that will allow airlines, banks and financial sponsors to electronically trade loyalty points that are packaged into Point-Backed Securities (PBS).

Over the past year ACE has been working side by side with Nasdaq to create a customized matching engine for PBS as part of an end-to-end trading services suite. According to the five-year technology and commercial partnership agreement between ACE and Nasdaq, market launch of the exchange is slated for mid-2018.

"Everything is on track on the technology side, which means our focus has shifted to the regulatory and commercial preparations for launch," says ACE's chief executive officer, Atanas Christov.

Christov says loyalty points represent close to \$100 billion-worth of balance sheet value for airlines. "This is a conservative figure: the actual market value of airlines' loyalty points is several times higher, especially including points value as collateral for airline and fleet financing".

"We will focus on supporting issuances of loyalty points, packaged into tradable contracts



Banks can use loyalty point bonuses to stimulate demand for new credit cards, and create brand new banking and card products

Atanas Christov, Chief executive officer, ACE

for commercial partners and institutional investors, leaving the marketing side of the loyalty programs untouched," adds Christov.

Banks buy points sold by loyalty programmes such as frequent flyer programmes as part of co-branded credit card portfolio deals.

Christov says point sales by airline exceed \$50 billion a year, which come at a significant profit to the issuer, exceeding many fold operating profitability of the core business.

"Given that they control the redemption side and also the terms and conditions of the programme, it is an element of their books that can fetch 80% of

pure profit, sometimes more."

Airlines use the revenue for different purposes. Some have pledged points, or even loyalty program itself as collateral for raising operating funds and financing fleet overhaul.

"We have seen examples where the loyalty programme is used as in-house financing for many airlines. Because they are able to generate revenues and profits at a significantly increased rate than they will normally get, multiple airlines have resorted to supplementing their revenues via loyalty programme," he adds.

Although some airlines have sold parts of their loyalty programme, Christov views an equity sale as giving up a "very valuable asset" which rarely makes sense in the long run.

"This is where ACE comes in. We are trying to help airlines monetise their loyalty currency without giving up equity ownership, giving issuers full leverage over an unencumbered asset while avoiding the long-term implication of equity stake sale," he explains.

ACE aims to provide a vehicle for institutional investors to gain exposure to the points market while expanding the market for issuers, says Christov.

Banks and credit card issuers are the biggest customers for loyalty point sales by airlines; credit cards benefit from unique motivational value of loyalty points, directly increasing customer lifetime value for the issuers.

"Banks can use loyalty point bonuses to stimulate

demand for new credit cards, increase the spend of credit cards customers and create brand new banking and card products."

ACE will support initial offerings and secondary trading of PBS to authorised institutional buyers, utilising primary and secondary market venues to attract liquidity providers and new investors.

The exchange is also working on developing a blockchain application to eliminate post-trade inefficiencies and enhance the strategic value of the asset.

For hedge funds and private equity firms, the loyalty points backed security trading could form part of their diversification, hedging and quantitative strategy because of the risk element and the stable and uncorrelated nature between loyalty points and their parent programmes.

"It can become an element which they can arbitrage when comparing with multiple instruments across asset classes, sectors and geographies," says Christov.

He is confident that ACE will improve pricing of the assets and bringing it closer in the line with economic value - and at a time when traditional sources of liquidity are subject to regulatory and cyclical changes for the industry. ACE will enable new and existing liquidity providers to gain exposure to a valuable and currently untapped asset and help issuers unlock the economic value of loyalty currencies.

