A Two-Part Series on Structured Trade Finance Transactions

Part Two

Risk Mitigation in Trade Finance

Structures and Third-Party Credit Support

Presented by Sam Fowler-Holmes, Partner, Natalie Lake, Associate and Maria Capocci, Associate, Sullivan & Worcester UK LLP

Thursday 20 April 2023

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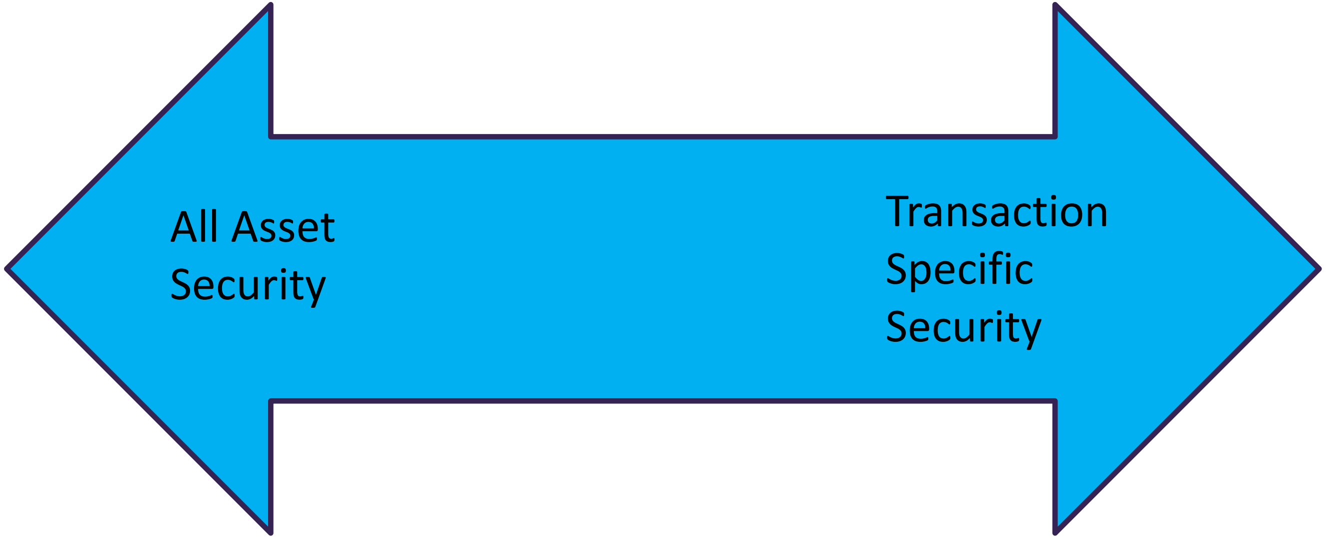
What this talk will cover

- Types of security that are typical in a trade finance transaction
- Preserving the value of the security
- Cross border issues
- Types of third-party credit support
  - Guarantees
  - Export Credit Agencies
  - Credit Insurance
- Legal and commercial issues

Character is key; the nature of trade finance

- Self Liquidating
  - Seller Performance Risk
  - Buyer Payment Risk
  - Insolvency Risk
- Risk Mitigation
  - It is not always about security, but it's a good place to start
  - STRUCTURING

The all-asset debenture



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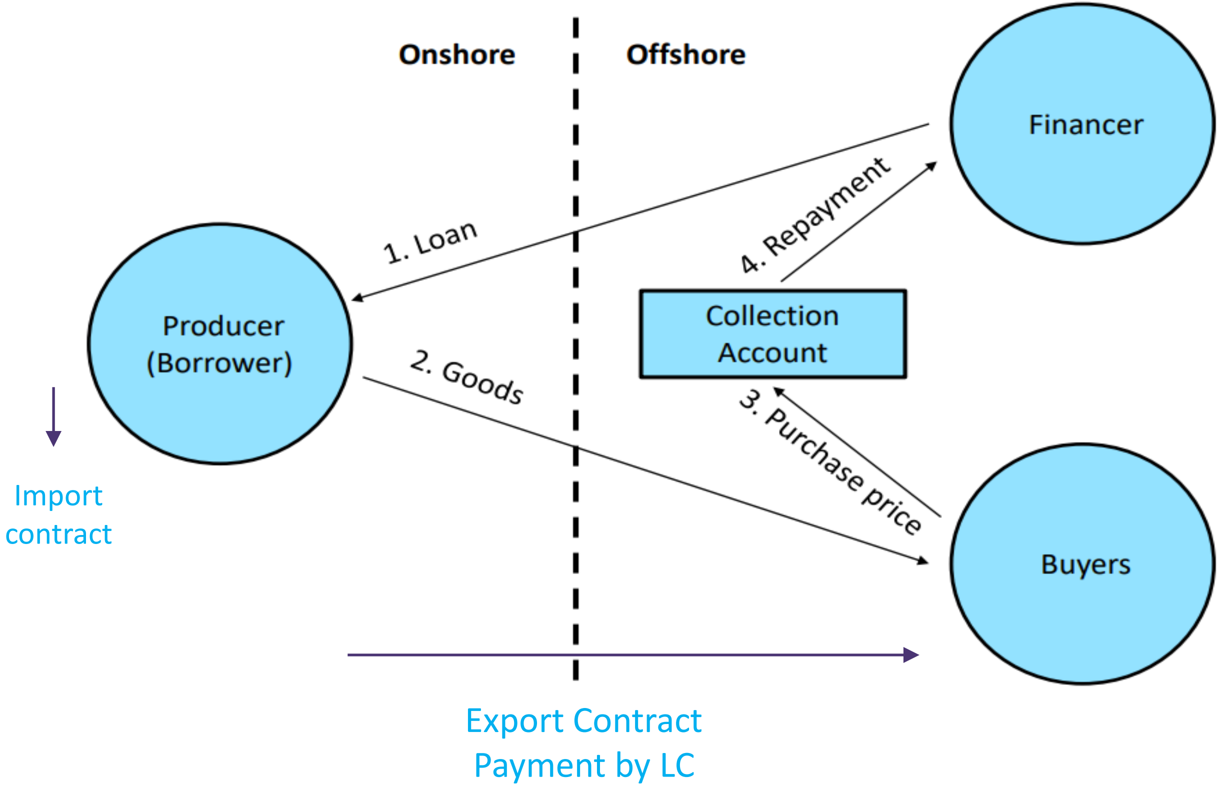
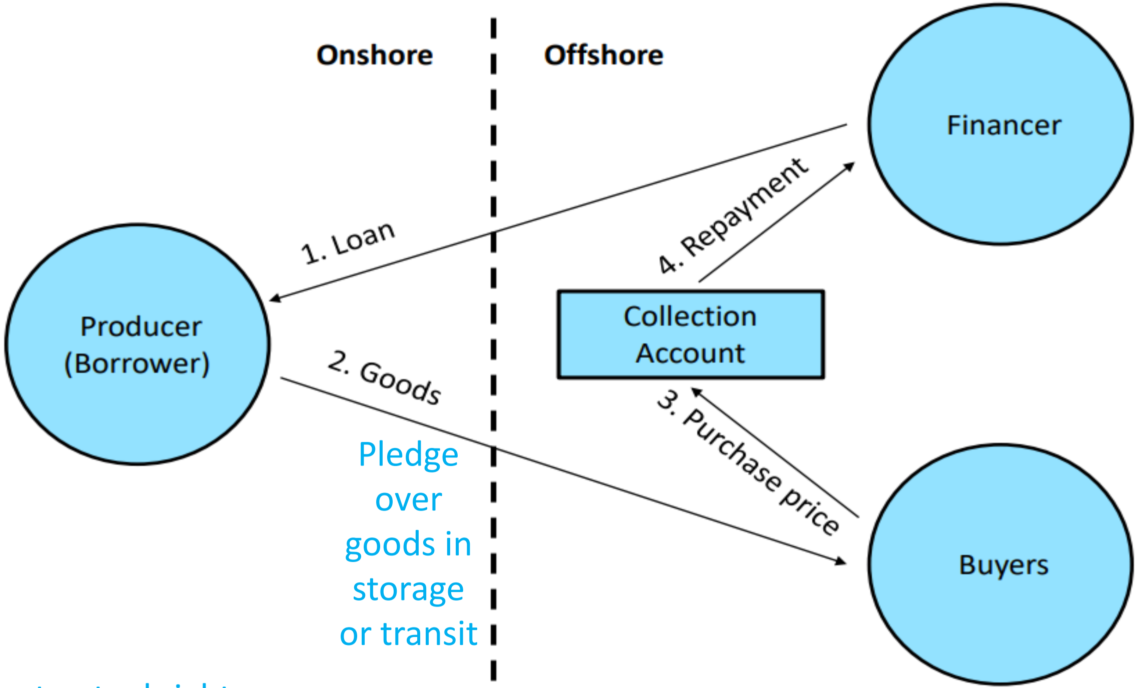
Typical financing structure



Legal speak: Assignment

- An assignment by way of security
- Transfer of ownership – Power of sale
- Legal v Equitable Assignment
- Notice to perfect

Typical financing structure



(a) Assignment of contractual rights

Legal Speak: Pledge

- Possessory Security
  - A right to possess the goods and a power of sale in the event of default
- Transfer of possession to perfect
  - Delivery of the asset
- Actual v constructive possession

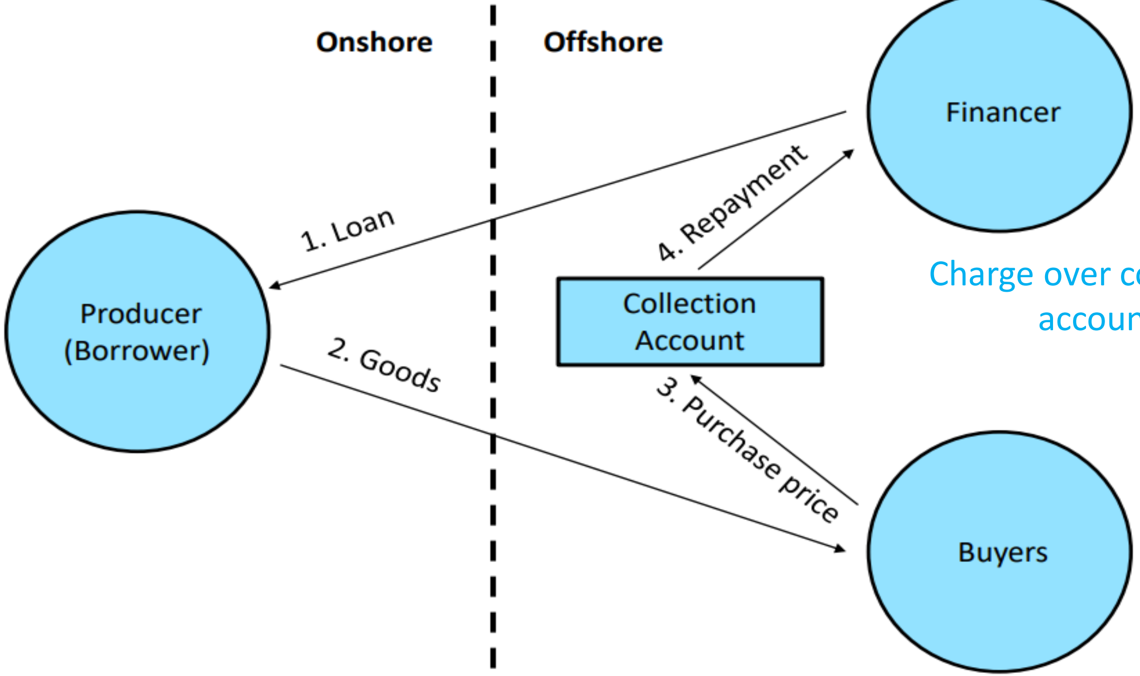
Pledge over goods in warehouses

- Attornment
  - 1. The pledgor instructs a warehouse to issue warehouse receipts in the name of the lender
  - 2. The warehouse issues such warehouse receipts
  - 3. The warehouse confirms in writing that it is holding the goods to the order of the lender
- Warehouse receipts
  - May or may not be documents of title
  - May or may not be transferable
  - May or may not be negotiable
  - Recourse by way of power of sale
  - Delivery
- Commingling
  - Change of commodity

Pledge over goods in transit

- Bills of Lading
  - Documents of title?
  - Pledge and endorsed bill of lading
  - Do you need to take security over goods in transit? Consider when ownership passes.
- Retention of title
  - Due diligence on the underlying export contract
  - Does the security document allow for return of goods to the borrower
    - Trust Receipts

Typical financing structure



Charge over collection account

(a) Assignment of contractual rights
(b) Pledge over goods in storage or transit

Legal speak: Charge

- A proprietary interest - right for secured creditor to appropriate an asset toward discharge of outstanding indebtedness
- Registration to perfect
- Floating charge – Crystallisation
- Fixed Charge – Control
- Triple cocktail:
  - Charge
  - Set-off
  - Block

Protecting the security

- Why are you taking security? To ensure you are able to recover amounts owed to you if something goes wrong.
- How:
  - Insurance
  - Monitoring
  - Fraud Risk

Protecting the security: Insurance

- Loss payee
- Assignment of insurance proceeds
- Insurance policy is valuable as long as the Borrower abides by the terms

Protecting the security: Monitoring

- Stock Monitoring
- Collateral Management
  - Constructive possession
- Liens
  - Fees as part of the secured liabilities
  - Right to pay the fees as lender on behalf of borrower and recover by way of indemnity

Protecting the security: Fraud Risk

- Fraud Risk
  - Hand in hand with monitoring
  - Difficulties with documenting against fraud risk
  - Due diligence
    - Ensure the monitoring is documented properly and carried out properly

Due Diligence

- English law or local law?
  - Formalities
  - Cost
  - Operational viability
  - Is it possible to take the security you wish to take in that jurisdiction?
    - Pledge over future assets
  - Enforcement
- Counterparty
- Transaction
- Third parties

Third-Party Credit Support

- Types of third-party credit support
- Legal and commercial issues

Guarantees – corporate entities

- Parent Company guaranteeing the obligations of their subsidiary in the underlying contract/financing
- Guaranteeing the same obligations as the principal obligor

Guarantees – where is the Guarantor?

- What jurisdiction is the guaranteeing entity incorporated in?
- Should you engage in using local counsel?

Guarantees – formalities

- What is the consideration being given?
  - Financial health of the corporate group
- Would signing as a deed be more straightforward?
  - Limitation period
- Directors' duties
  - Commercial benefit
  - Board meeting or shareholder resolution
- Guarantees **<u>must</u>** be in writing and signed by the Guarantor

Guarantees – commercial considerations

- Guaranteeing what?
  - Principal amount?
  - Interest?
  - Other fees?

- Would a termination clause be required?
- The obligations being covered – are you being specific enough?

Export Credit Agencies – what are they?

- Rising in popularity and use
- Created by governments
- Support export financing
- OECD Arrangement

ECA - Services and Support

- Innovative
- Buyer Credit Facilities → directly to Buyer
- Direct Lending:
  - Fixed interest
  - Long term borrowing
- Export facilities → Flexibility

Export Credit Agencies – a new era

- Growing competition between ECAs

- Climate awareness

- Supporting SMEs and Supply Chain Finance

Export Credit Agencies – Eligibility Criteria

(1) Location of the exporter

(2) Value of the export contract (maximum/minimum)

(3) Content – is it purely domestic, foreign?

(4) Is there a need for local currency?

(5) What minimum down payment requirements are there?

(6) Country limits in respect of the borrower

(7) Is the borrower or lender acceptable to the ECA?

(8) Anti-bribery/environmental assessments

(9) Term

Insurance – a different approach

Credit Insurance:

- Financer is the primary insured/policy holder
- Contract between the Insurer and the Insured
- Independent contract

Credit Insurance – considerations

- Premium Cost – how much?
- Policy terms – inclusions and exclusions
- Disclosure to the Obligor of the underlying contract – when should you do this?
- Due Diligence

Recap – a quick summary

- Guarantees – given by corporates
  - Upstream or downstream
  - Time to arrange and organise
- Export Credit Agencies
  - Increased variety of services and cover depending on your role
  - Eligibility Criteria
- Credit Insurance
  - Negotiate
  - Cost and finance margin

Suggestions for future topics and webinar dates

Please feel free to send any suggestions for future topics to London Events (londonevents@sullivanlaw.com)

Webinar dates for 2023

- Thursday 18 May
- Thursday 22 June

Sam Fowler-Holmes

Sam advises a broad spectrum of traditional and alternative financial institutions and corporate clients on a range of traditional and innovative trade and export finance products, including pre-export and prepayment finance, letter of credit and payment instrument facilities, as well as working capital and borrowing base financings.

Sam advises extensively on receivables and supply chain finance transactions, encompassing both traditional and bespoke structures. His practice also focuses on the digitalisation of trade, acting for both electronic platform providers and platform participants for a range of digital financing solutions.

He regularly advises on risk distribution techniques, including funded and unfunded participations, standby letters of credit and demand guarantees, and on insurance-related issues. Sam acts on matters in relation to jurisdictions across mainland Europe, CIS, Africa, Asia and the Americas and on a wide range of commodities including oil, gas, metals and softs.

Sam is a regular speaker at Sullivan’s trade and export finance webinars and has presented at events organized by GTR and the International Trade and Forfaiting Association (ITFA)’s Emerging Leaders Committee, having been a member of the ITFA Emerging Leaders Committee since January 2020.

In Chambers UK, 2023, Sam is included as an "Up and Coming" lawyer and in the UK Legal 500, 2023 he is recognised as a "Next Generation Partner.“

Sullivan & Worcester UK LLP
Tower 42
25 Old Broad Street
London EC2N 1HQ

T +44 (0)20 7448 1006
sfowlerholmes@sullivanlaw.com

Natalie Lake

Natalie has experience of a wide variety of banking and finance transactions including structured and unstructured trade finance, having advised both financiers and borrowers in oil, gas, metals and soft commodities, on a range of financing products (bilateral and syndicated), including pre-export financing, prepayment financing, borrowing bases and transactional trade finance.

Natalie has experience in risk-mitigation, including participations, standby letters of credit and demand guarantees, as well as advising on collateral management agreements and stock monitoring agreements. She is familiar with sustainability linked financing and digitisation issues affecting traders, having advised on a transaction that won 2022 Overall Commodity Finance Deal of the Year Award at TXF's Perfect 10 Deals of the Year Awards in Commodity Finance for, inter alia its focus on sustainability and the appointment of a digital agent to digitise a significant portion of the borrowing base reporting obligations. She has more recently advised on international sanctions in relation to trade finance products and also assisted clients on English company law issues.

Prior to joining the firm, Natalie worked in Switzerland advising banks and a variety of traders on the financing of their trading operations in various regions globally. She also lectured at Fribourg University on guarantees, indemnities and on demand guarantees on the LLM Trade Finance course.

Sullivan & Worcester UK LLP
Tower 42
25 Old Broad Street
London EC2N 1HQ

T +44 (0)20 7448 1006
nlake@sullivanlaw.com

Maria Capocci

Maria advises on a range of cross-border trade finance transactions in a variety of jurisdictions, including syndicated and bilateral pre-export commodity financings, letter of credit facilities, commodity repo structures, receivables financings, including supply chain finance, structured trade and commodity finance.

Maria also advises clients in relation to sanctions matters connected to trade and export finance, together with other regulatory and compliance issues and in relation to professional negligence and commercial litigation matters.

Sullivan & Worcester UK LLP
Tower 42
25 Old Broad Street
London EC2N 1HQ

T +44 (0)20 7448 1006
mcapocci@sullivanlaw.com

Awards & Recognition

The Legal 500 UK, 2023
Sullivan ranked in Tier 1 for Trade Finance by *The Legal 500 UK, 2023* for the ninth year running
Partner Geoffrey Wynne is included as a Leading Individual for Trade Finance in the "Hall of Fame"
Simon Cook and Mark Norris are recognised as Leading Individuals
Sam Fowler-Holmes is recognised as a Next Generation Partner and Hannah Fearn as a Rising Star

Chambers UK, 2023
Chambers UK, 2023 ranked Sullivan for Commodities: Trade Finance (UK-wide)
Geoffrey Wynne and Simon Cook are both ranked in Tier 1 and Mark Norris in Tier 3
Sam Fowler-Holmes is recognised as an "Up and Coming" lawyer

IFLR1000 Banking and Finance Guide, 2023 (32nd edition)
Sullivan recognised for Banking Lending - Lender Side, United Kingdom, in *IFLR1000's Banking and Finance Guide, 2023*
Partner Geoffrey Wynne is ranked as a Leading Lawyer – Highly Regarded in the United Kingdom

***Global Trade Review (GTR)* "Best Trade or Supply Chain Finance Law Firm", 2022**
GTR named Sullivan "Best Trade or Supply Chain Finance Law Firm" at the GTR Leaders in Trade Awards in 2022

***Trade Finance Global* "Best Trade Finance Law Firm" 2022**
Sullivan named "Best Trade Finance Law Firm" 2022 by *Trade Finance Global* (in connection with BAFT) at its International Trade Awards, 2022

In 2021, 2020 and 2019, GTR named Sullivan
The firm was named "Law Firm of the Year" in the category "Leaders in Trade for Innovation" at the 2021 GTR Leaders in Trade Awards and "Best Trade Finance Law Firm" at the GTR Leaders in Trade Awards in 2020 and 2019

2021 Lexology "Client Choice" award for Banking, United Kingdom
Geoffrey Wynne named a recipient of the Lexology "Client Choice" Award 2021 for Banking, United Kingdom

***Trade Finance Global* "Best Trade Finance Law Firm" 2019**
Sullivan named "Best Trade Finance Law Firm" 2019 by *Trade Finance Global* at its International Trade Finance Awards, 2019

What's Your Next?

Boston
One Post Office Square
Boston, MA 02109
+1 (617) 338-2800

Washington, DC
1666 K Street, NW
Washington, DC 20006
+1 (202) 775-1200

London
Tower 42
25 Old Broad Street
London EC2N 1HQ
+44 (0)20 7448 1000

Tel Aviv
28 HaArba'a Street, HaArba'a Towers
North Tower, 35th Floor
Tel Aviv 6473925
+972 74 7580480

New York
1633 Broadway
New York, NY 10019
+1 (212) 660-3000

sullivanlaw.com

@sullivanlaw

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