A Two-Part Series on Structured Trade Finance Transactions

Part One

Structured trade finance transactions, including PXF, prepayment financing, borrowing base and others.

Presentation by Sam Fowler-Holmes, Partner & Dyna Yates, Associate, Sullivan & Worcester UK LLP

Thursday 23 March 2023

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What this talk will cover

- Why is structuring important?
- Typical trade finance structures
  - PXF
  - Prepayment
  - Borrowing base
  - Warehouse financing
  - Typical documentation
- Holistic trade financing
- Ownership structures
- Part Two

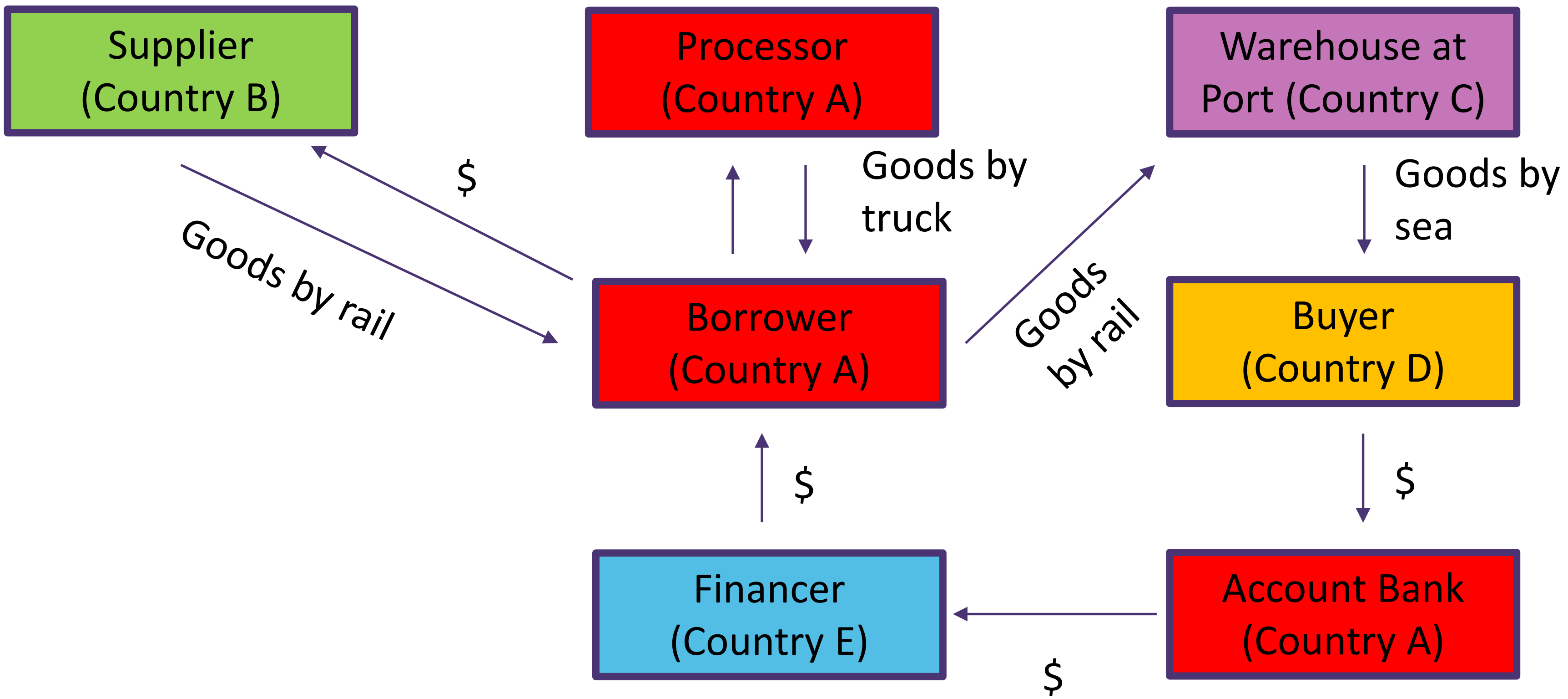
Why is structuring important?

- Structuring is all about risks
  - Identify
  - Evaluate
  - Eliminate or reduce / mitigate?
  - Allocate
- A question of balance?
- Self-liquidating rather than balance sheet
- Holistic Due Diligence
  - KYC - ongoing
  - KYT - ongoing
  - Track record
  - Commercial
  - Legal

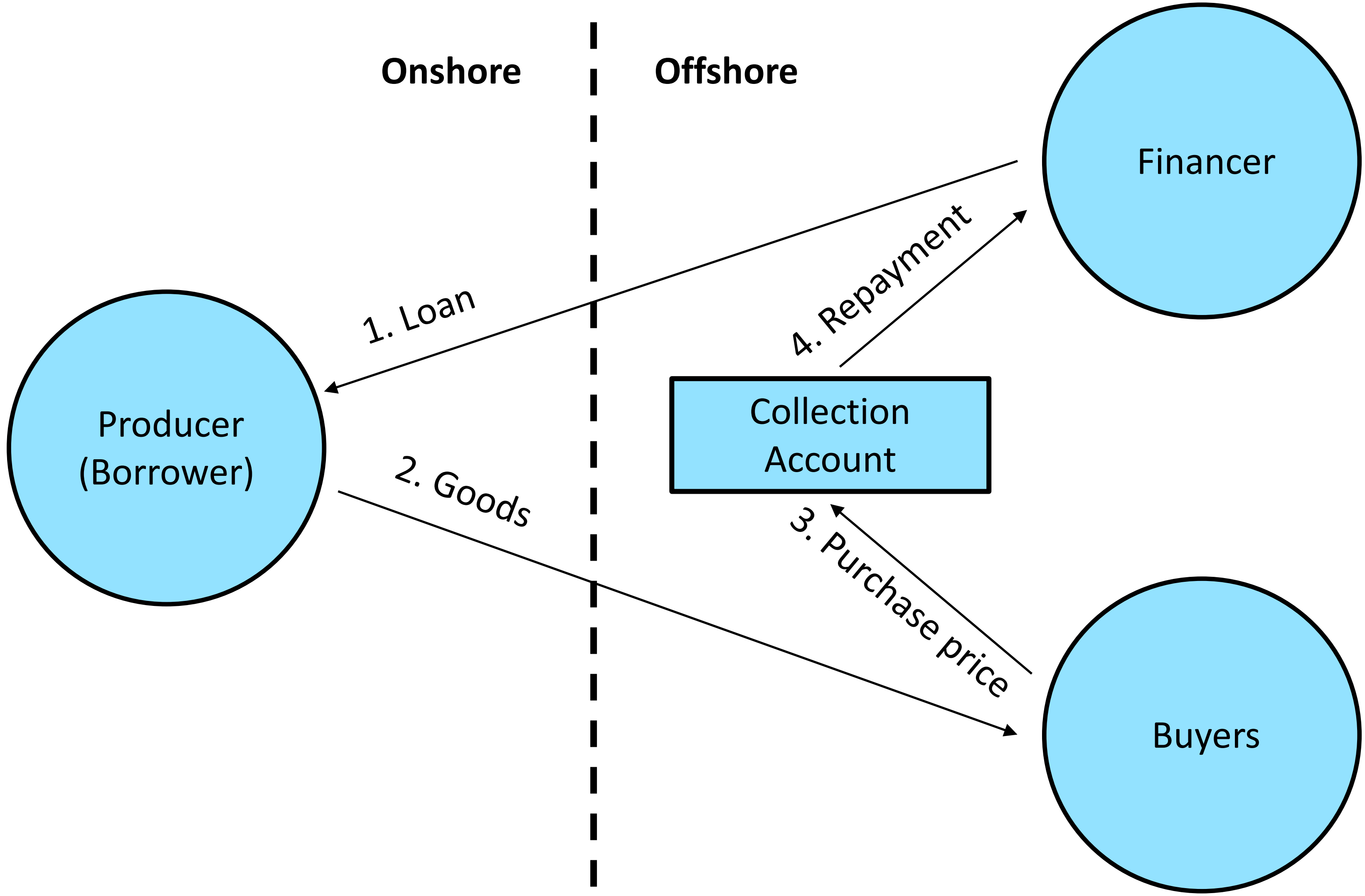
Some types of risks

- There are a range of risks that can arise in trade transactions:
  - Payment risk (including liquidity risk)
  - Performance risk (including force majeure)
  - Legal risk
  - Third party risk
  - Fraud risk
  - Regulatory and compliance risk
  - Perfection risk and cost implications
- Can “good” structuring rescue a “bad” deal?

Example trade transaction



Structure of a pre-export financing



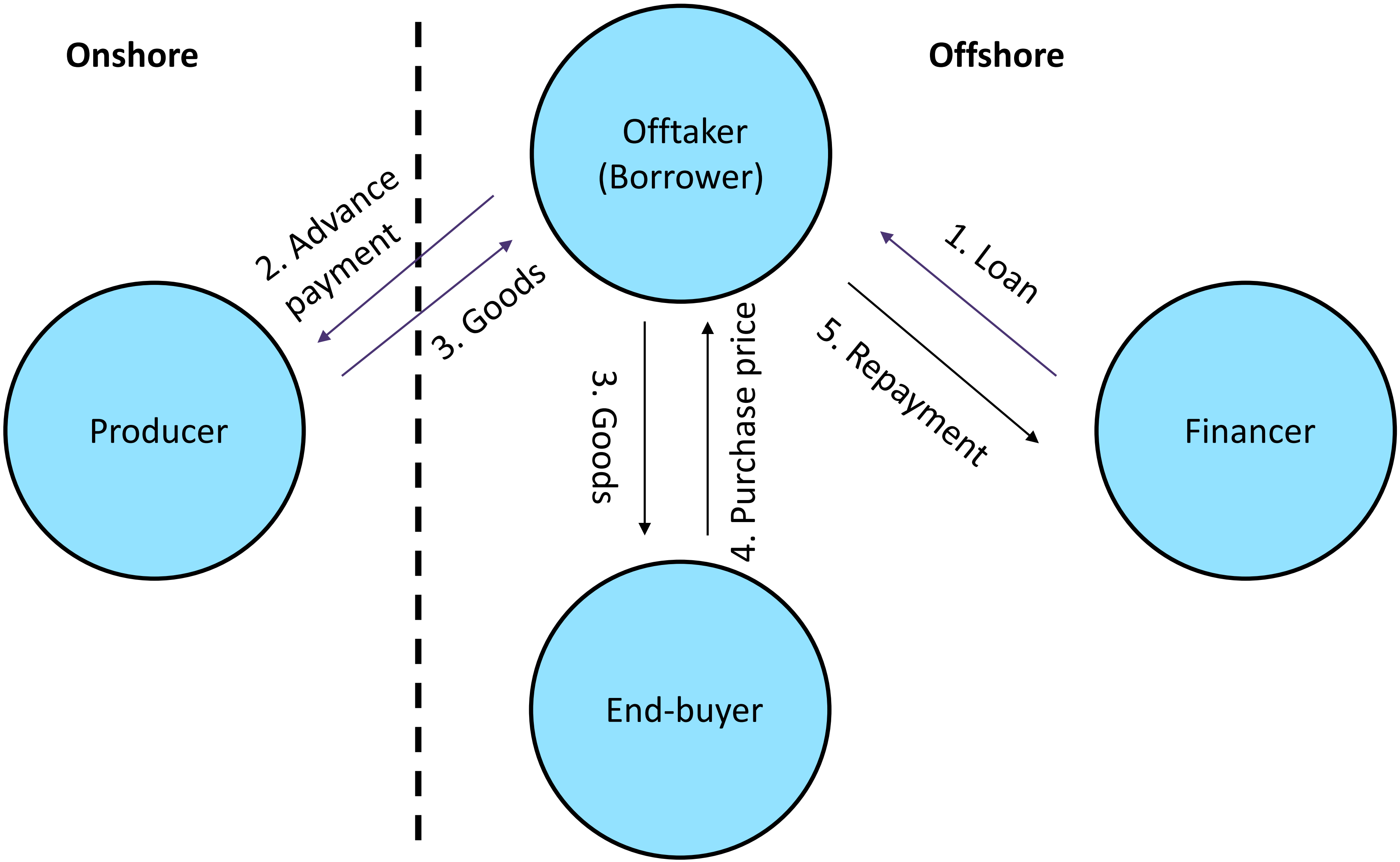
Overview of a pre-export financing structure

- The structure
  - Sale of goods generates receivables
  - Seller performance risk and buyer credit risk
  - May have security over the goods
  - Variations e.g. goods delivered in series of shipment with repayments to match or loan drawn in instalments to finance stages of production

Pre-export financing - documents

- Export contract between producer of goods and buyer
- Facility agreement - advance from financer direct to producer
  - Focus is on the ability of the producer to produce the goods
  - Financer’s rights
    - Repayment
    - Step in rights
- Excess funds in collection account can be paid to producer
- Security:
  - assignment of rights in the export contract
  - charge over money in collection account
  - security over goods?

Structure of a prepayment



Overview of a prepayment structure

- The structure
  - Sale of goods generates receivables
  - Advance is discharged by delivery of goods by the producer
  - Producer performance risk and off-taker and end-buyer credit risk
  - May have security over the goods
  - Market price of goods impacts ability to reimburse advance payment
  - Often revolving, may have a run-off period
  - Variations e.g. advances could be made to multiple producers or there could be sales to more than one end-buyer

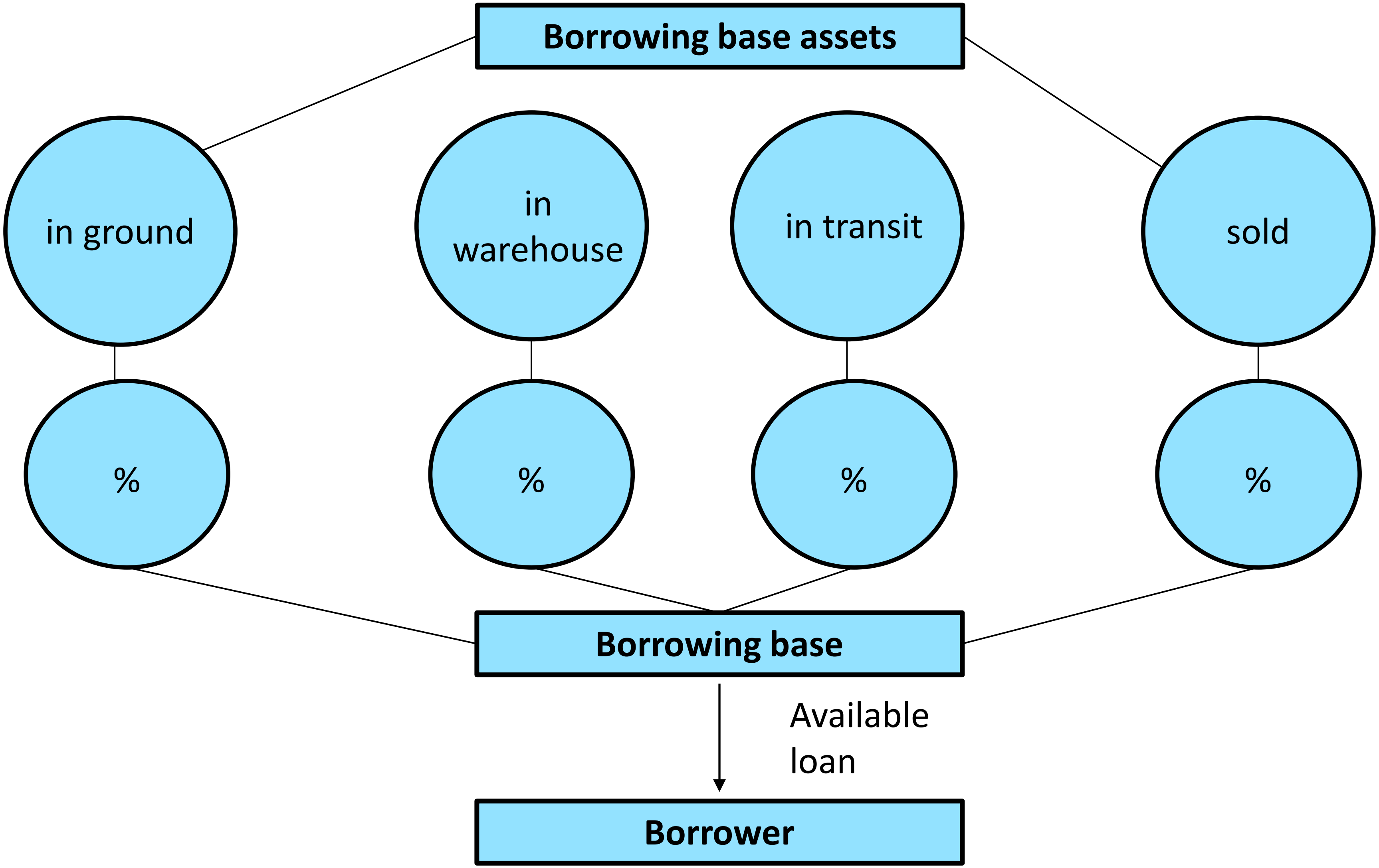
Prepayment – documents

- Export contract or a prepayment agreement
  - No loan to producer, funds advanced to offtaker (borrower)
  - Commercial arrangement between offtaker and producer

- Offtaker will want to monitor the producer via tests which trigger:
  - top-up requirement to protect against price fluctuations; or
  - obligation to repay outstandings if deliveries are insufficient

- What about recourse?
  - Limited recourse between offtaker and financer but financer will want the offtaker to maintain a vested interest and share in the production risk
- Financer takes credit risk on offtaker and end-buyer

Structure of a borrowing base



Overview of a borrowing base structure

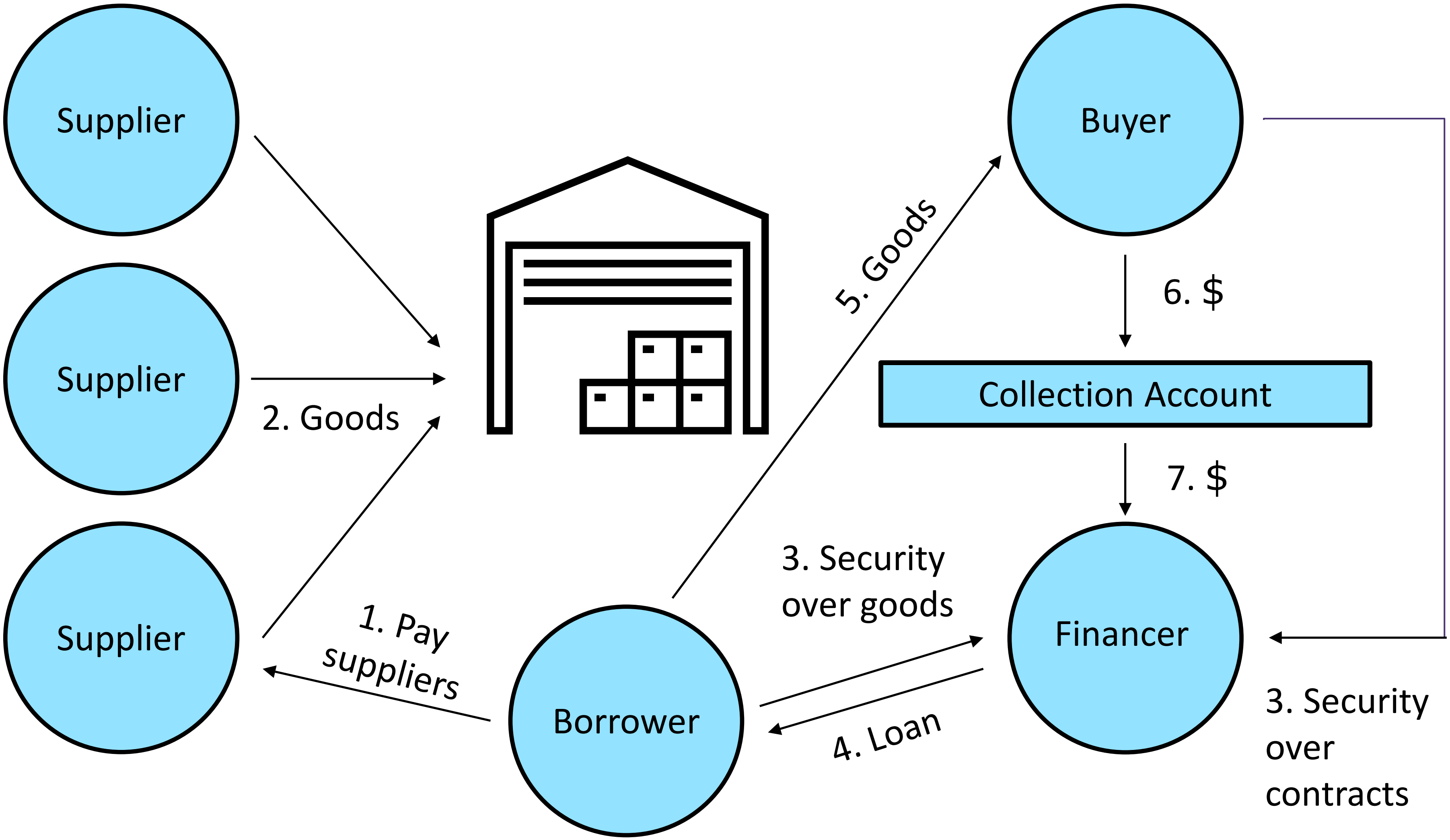
- The structure
  - Covers changing goods in the borrowing base
  - Value attributed to the goods is impacted by time, risk, cost of conversion to cash
    - Lending levels under the facility are in turn set as a percentage of fluctuating value of the goods
  - Producer performance risk and buyer credit risk
  - Security over goods
    - Pledge
      - Control and possession
    - Trust receipts and attornment
  - Assignment over receivables, sales contracts and insurance
  - Security over bank accounts
- The parties
  - In addition to the borrower and financer, third parties including:

    warehouse operators / collateral managers / stock monitors / borrowing base inspector / logistics providers / tollers

Borrowing base – documents

- Usually a revolving loan facility
  - Might be multi-currency
  - Could be syndicated or bilateral
- Key characteristic of borrowing base is the monitoring and valuation of the goods – reporting obligations on borrower
  - **Borrowing base certificate** *confirms values of assets as at testing date and how much the borrowing base exceeds the value of the then outstanding loan*
  - **Borrowing base reports** *detail the assets set out in the borrowing base certificate*
  - **Shortfall remedy notice** – prepayment or withdraw positive funds from collection account
  - **Regular audit of borrowing base** – covering the assets in the then most recent borrowing base report and the procedures used by to identify and calculate the borrowing base

Structure of a warehouse financing



Overview of a warehouse financing

- Financing the storage period
  - Financing is on a revolving basis and against collateral in warehouse
  - This allows the borrower (an exporter) to build up sufficient volume of goods for shipment
- Consider the storage requirements for the goods
  - Depends on the type of goods – e.g. are they perishable?
  - Consider whether the warehouse is equipped to store the goods
    - Segregation
    - Labelling
    - Sole access or use of warehouse or a designated area

Warehouse financing – documents

- Warehouse receipts – issued by storage provider as proof or evidence of the existence of goods
  - Is it a document of title / negotiable / transferable – check the local law
  - If it is a document of title helps to establish control and possession
- Holding certificates - mark to market price
- Financer's rights e.g. blocks on drawdown and/or sale of goods following a default under the facility
- Pledge or debenture over the warehouse receipts (representing the goods) or the goods themselves
  - Perfection requirements: filing, delivery of notice, stamp duty, “club” level rules
  - Can future goods be covered by the security?
- Tripartite agreement between warehouse operator, borrower and financer
  - Specify required services / duties / fees / waiver of lien / indemnity

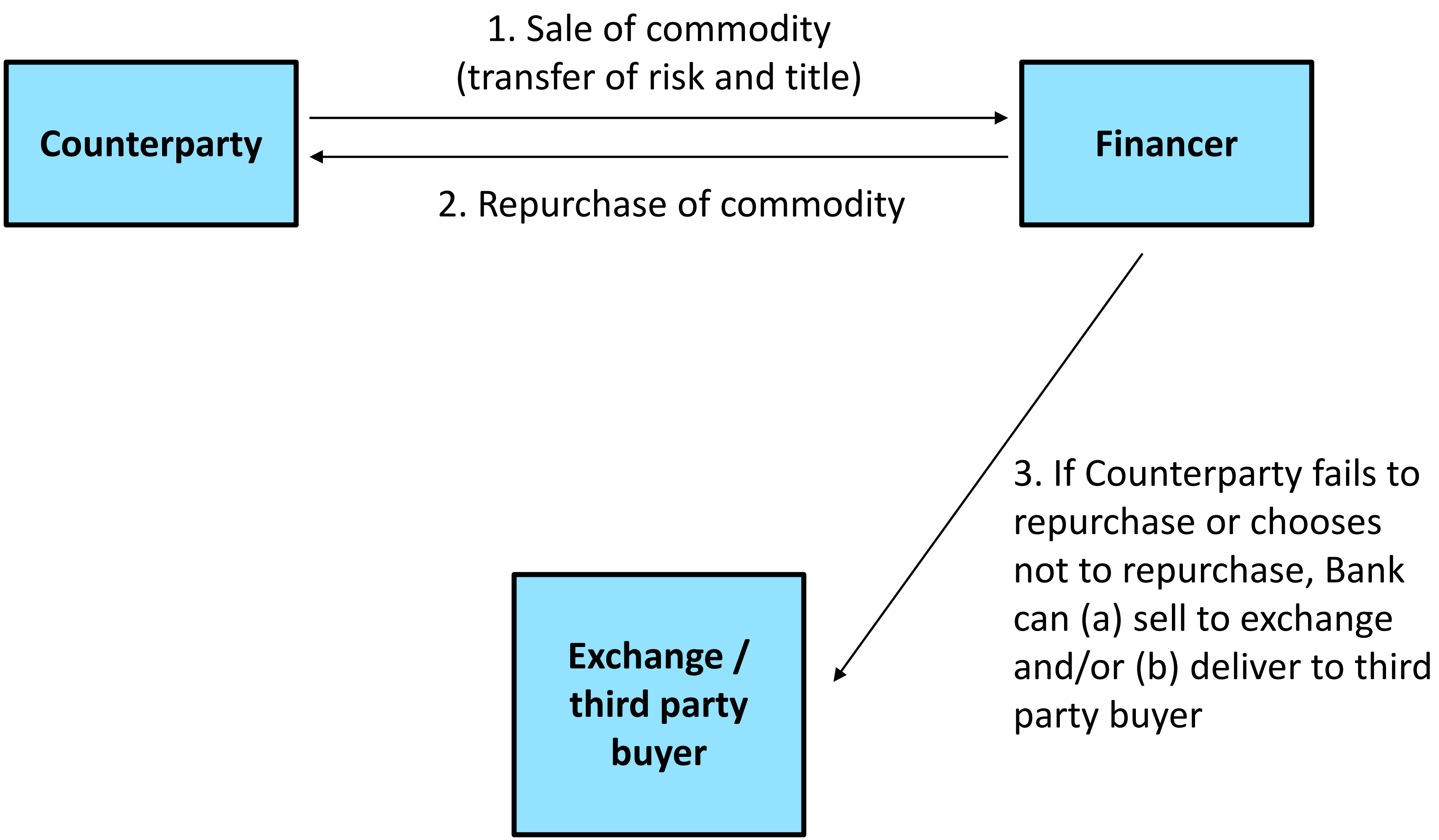
Holistic trade financing

- Looking at the supply chain as a whole - import to export cycle – are there gaps?
- Different roles financers might take:
  - Import LC issuance
  - Standby or demand guarantee issuance
  - Refinancing reimbursement obligation to a short-term advance (deemed loan)
  - Confirmation and/or discounting of export LC
  - LOIs
  - Purchasing of offtake receivables
- What other financing is in place that may have an impact?

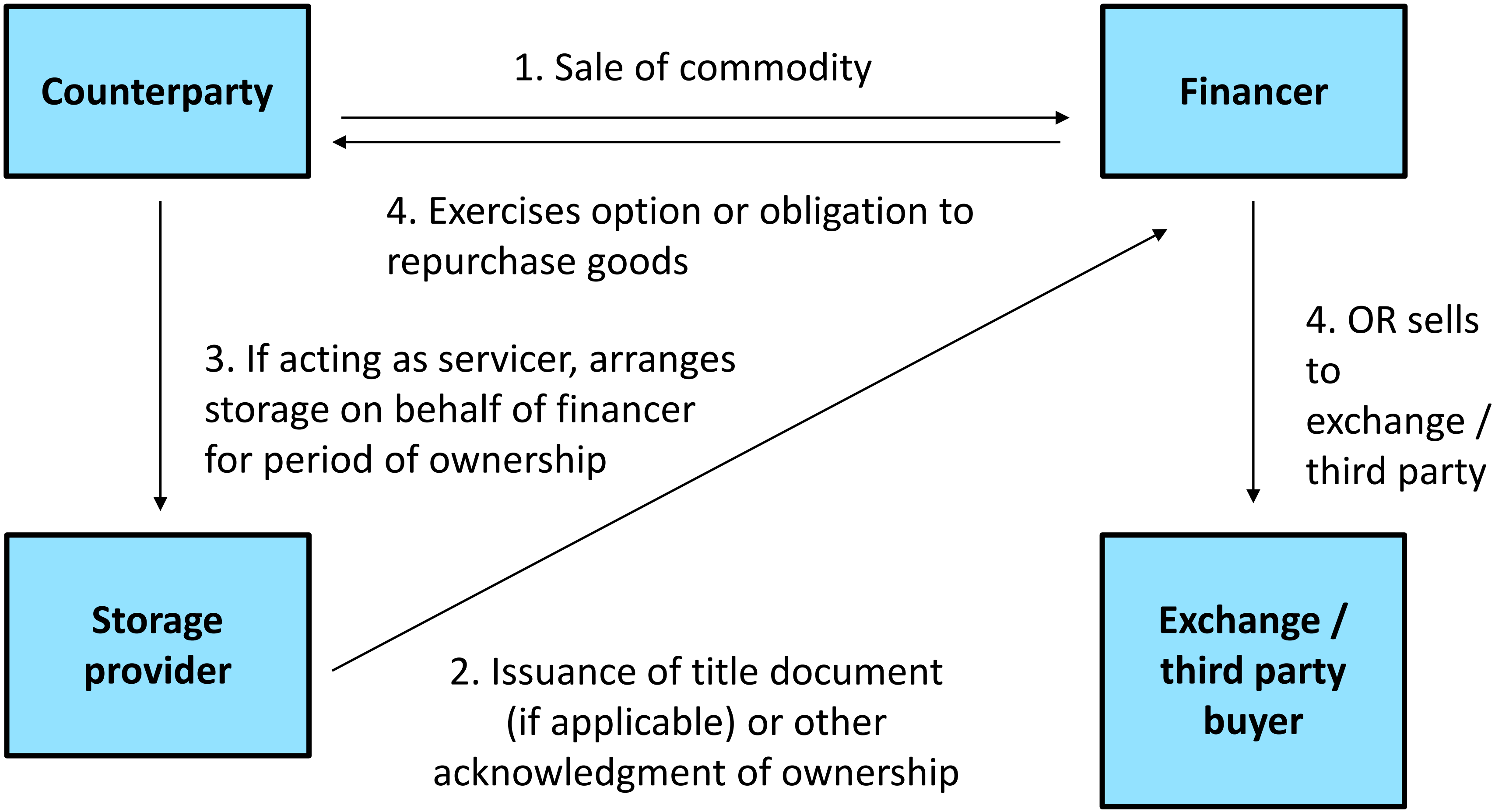
How do these structures compare to ownership structures?

- Repo structures
  - Sale and purchase of goods with a counterparty
  - Counterparty transfers title to the financer
- What purpose do they serve?
  - Method of ‘financing’, often when others are not available
    - Structural
    - Internal borrowing limits
  - Off-balance sheet treatment for counterparty
- Key distinction between seller/purchaser and debtor/creditor
  - Ownership may be more respected in certain jurisdictions
    - Better treatment on insolvency
    - Easier ‘enforcement’ rights

Basic structure of a repurchase transaction



Structure of a repurchase transaction – where goods in warehouse



Challenges with ownership structures

- Ownership
  - Financer owns the goods and takes on risks of ownership:
    - Price fluctuation
    - Delivery/storage costs
    - Insurance obligations
    - Third party claims (e.g. oil spillage/environmental)
- But these risks can be mitigated in the way any owner of goods protects itself:
  - Hedge price
  - Collateral manager
  - Servicing arrangements
  - Pass through costs
- Is it a true sale?

Next session…

Part two – 20 April 2023

- Focus on "self-liquidating" aspect of structured financings
- Taking security cross-border
- Third party credit support techniques
- Drafting considerations

…and more

Questions?

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 20 April
- Thursday 25 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."

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Dyna Yates

Dyna is experienced in trade, structured trade and commodity finance. She has advised clients on a wide range of cross-border trade finance transactions in a variety of jurisdictions across mainland Europe, CIS, Africa and Asia, with an emphasis on emerging markets.

Dyna acts for leading banks advising on secured commodity financings, letter of credit and guarantee issuance facilities, commodity repo structures, trade instruments and receivables financings, including supply chain finance on a wide range of commodities including oil, gas, metals and softs. She also regularly advises banks on risk sharing techniques, including the drafting of sub-participations.

Her experience also includes advising on the impact of regulatory changes in respect of trade finance. More recently Dyna has advised banks and corporates on the use of technology in their financings and has advised on some bespoke structures.

Dyna spent nine months on secondment to the London-based trade finance legal team of a leading multinational bank.

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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

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