

Trade Finance

What is going on in the digital world and elsewhere for trade finance in 2023?

Presentation by Geoffrey Wynne, Partner,

Thursday 15 December 2022



What we are covering today

- Going digital in trade
 - Where are we now?
- A start with MLETR
 - Electronic Trade Documents Act
- URDTT and digitalisation of a trade transaction
 - Digital payment obligation
- URTEPO
- What holds us back?
 - LEI a solution?
- Issues in the Receivable space
 - Payable financing, disclosure and FASB/IASB
- Developments in Basel III
- 2023 and beyond - some thoughts on ESG and trade finance in emerging markets

Digitising Trade

- Drivers to moving forward
- Getting there but slowly
- Model Law on Electronic Transferrable Records (MLETR)
 - › Promulgated some 6 years ago
 - › Seen prominence as a result of the pandemic (and fraud)
- Adopted by countries like Singapore (and others)
 - › Development of local laws to transfer certain electronic records
 - › Ultimately aim is to permit title transfer of a digital asset by digital means

Electronic Trade Documents Act (ETDA)

Focus of Electronic Trade Documents Act (ETDA)

- A number of key trade documents
 - Bills of Lading and Warehouse Receipts
- Payment obligations under the Bills of Exchange Act 1882
 - Promissory notes
 - Bills of exchange
- Can then be digital
- Can be “possessed” – where the electronic record provides exclusive control
- Determination using “reliable system”
 - So we are back full circle
- Law will then be ahead of the technology
 - When will it happen?

URDTT-a solution?

- Background to URDTT (Uniform Rules for Digital Trade Transactions)
- Digitalisation of trade but not yet...?
- Still need to document and perform the trade transaction
- Published and became effective on 1 October, 2021
- Part of the move towards digitalisation

URDTT and a trade transaction

How will URDTT be used?

- Focus is on use of Electronic Records to evidence the digital trade transaction
- Sets out Rules to create a Payment Obligation of the Buyer and (where agreed) of a Financial Services Provider
- Fits with URTEPO

Documenting with URDTT in mind

- Parties still sign commercial contract
- Agree to evidence performance by Electronic Records
- Incorporate URDTT into that agreement
- On Data Match Payment Obligation arises
- Payment Obligation can be undertaken by one or more FSPs
- Provisions cover responsibility for Electronic Record, corruption of data and force majeure
- Parties can agree method by which data is provided

Uniform Rules for Transferable Electronic Payment Obligations

- Launched by ITFA in December 2022
- Why have URTEPO?
- What is the difference between URTEPO and URF800?
- How does URTEPO fit with URF800?
- How could URTEPO be used by market participants?

Uniform Rules for Transferable Electronic Payment Obligations

- Relationship with other ICC Rules like URDTT, eUCP?
- What legal points do you need to reflect in transitioning to transferring a digital payment obligation but also reflecting there may continue to be paper documents?

Uniform Rules for Transferable Electronic Payment Obligations

- Thoughts on the way forward from a legal point of view
- You need a digital payment obligation
- You can document the transfer by electronic records or paper or a bit of both – examination of both is key to the buyer of the TEPO
- Needs a good transfer document with a governing law etc.
 - › Incorporate URTEPO

Uniform Rules for Transferable Electronic Payment Obligations

So what do the Rules contain?

- Definitions reflective of a digital payment obligation
 - › but not its creation
- The requirement for and contents of a Transfer Agreement
- Without recourse BUT.....
- Conditions to effect a Transfer
 - › Digital v paper?

Uniform Rules for Transferable Electronic Payment Obligations

- Satisfaction of conditions
 - › Satisfactory
- Liabilities of the Parties
 - › Reflective of knowledge and involvement
- Making payments
- Data Matching
- Other provisions

Uniform Rules for Transferable Electronic Payment Obligations

So what is key outside the Rules?

- That leaves how to effect the transfer
- That needs a technology solution
- The magic will be the “reliable system” where the payment obligation resides and can be securely transferred
- How do the Rules fit in with what else is happening on the “legal side”?

Uniform Rules for Transferable Electronic Payment Obligations

Where do we go from here with URTEPO?

- Up to all of you
- Can be used from now
 - For example with ITFA's ePU under the DNI initiative
- Idea is to save drafting (and negotiating) time
- Another step on the road to facilitating the transfer of digital payment obligation
- Use it now under English law or any law that allows for a digital payment obligation

Thoughts on obstacles and solutions to moving to digitisation

- The market remains happy with the paper world for trade
- Is it the cost of investment into technology solutions that holds parties back?
- Changes in law facilitate the move BUT what holds it back
- Regulators still not embracing technology solutions
- Interoperability of systems a key issue?
- How about verifying identities to facilitate KYC etc?

LEI: Key to Digital Trade (1)

- Legal Entity Identifiers (LEIs) have been used in financial markets for some time.
- ICC in its report with MonetaGo '***Shutting fraudsters out of trade***' Oct 2022 supports the use of LEIs and smart technology in trade and trade finance.
- **Unique identifier of a legal entity** endorsed by G20 with FSB establishing the Global Legal Entity Identifier Foundation in 2014 and development of the Global LEI System.
- Know who you are dealing with.
- Simple, cheap and easily accessible online with annual renewals.
- Registering requires a lot of data but will help with KYC and tackle fraud in trade and trade finance...*"requires businesses, banks, governments, regulators and trade associations to work together to ensure that the global trade system continues to be a multi-trillion dollar engine moving humanity forward"* (ICC report).
- In 2021 only 4% of UK trading companies were registered to use an LEI (ICC source).

LEI: Key to Digital Trade (2)

- LEIs plus Electronic Trade Documents Bill, once passed, will open up the digitalisation of trade internationally.
- Much more efficient, less paper based.
- Savings could be vast, says ICC. ICC and its Centre for Digital Trade & Innovation expect the Bill to generate savings of £225 billion, £25 billion in SME trade growth and £1 billion in new trade finance.
- See DSI-WTO Standards Toolkit for Cross-border Paperless Trade via ICC website.
- National campaign with Global Legal Identifier Foundation to promote LEI adoption to speed up due diligence, reduce fraud and track secure transactions in goods and finance.
- Using a LEI for corporate digital identity verification will reduce risks and costs in trade and trade finance.

Payables finance programmes

- Why are these programmes used?
 - Receivable debtor
 - Potentially improved payment terms with seller
 - Supporting sellers and securing supply chain
 - Operational efficiencies
 - Working capital Benefits
 - Receivable seller
 - Access to cheaper source of financing
 - Balance sheet management
 - Working capital and cashflow benefits
 - Risk mitigation
 - Receivable purchaser
 - Financier
 - Typically good quality asset with short term exposure
 - Relationship product
 - Diversify portfolio

Trade debt vs bank debt

- What is a financier looking for in a payables finance programme
 - The 'IPU' (independent payment undertaking)
- Is an IPU trade debt or bank debt? Does it matter?
- Not just a balance sheet question – legal vs accounting treatment
- Auditors and ratings agencies need to appreciate effect
- For example, why should holder of “debt” (invoice) determine what sort of debt it is?
- What problems can arise from this debate?
 - Requirement to do “trade debt” transactions only
 - What about the position in rescheduling, insolvency etc?
- Some solutions
 - Make sure variation to payment period is in the original invoice/payment obligation
 - Look at useful life of asset in receivable financing

FASB proposal

- After the collapse of companies such as Carillion, Aboenga and Greensill, that benefitted from having payable financing programmes, the US Financial Accounting Standards Board - FASB and IFRS received an agenda request from practitioners asking for guidance on disclosures that should apply to payables finance programmes
- Since these requests in 2020, both authorities have been working with preparers, investors, accountants and other users of the financial statements to determine an agreed scope and guidance around this matter
- The first authority to issue their new disclosure standards has been FASB

Disclosure requirements

FASB issued the new disclosure rules update in September this year. In their update, they specifically mentioned the following:

*“a buyer in a payables finance programme to **disclose sufficient information** about the programme, to allow a user of their financial statements to understand the programme’s nature, activity or changes during a specified period, and potential magnitude. To achieve that objective, **the buyer is expected to disclose qualitative and quantitative information** about its payables finance programmes.”*

Focus of a Supplier Finance Programme

The proposal from FASB focuses on the following:

- **Defining “supplier finance programme” to account for whether a corporate must disclose the programme**
- The proposed disclosure requirement for the corporate is to provide the key terms of the programme, including a description of the payment terms and any other forms of security provided, and the balance sheet line item in which outstanding confirmed amount is presented
- Emphasis on the word ‘key’ here, given there are various implementations of payables finance programmes, the use of the word ‘key’ hands over the responsibility of determining what is ‘key’ to the corporate, to apply judgment and assess what key terms and conditions of their programme should be disclosed to satisfy the requirement

What information?

- **To provide numeric information on the obligations made available as part of the programme for suppliers to request advance payments for and any changes within the reporting period**

Reporting starts with:

- Confirmed obligations at the start of year, followed by
- Invoices confirmed during the year, and then
- Confirmed invoices paid in the year, resulting in
- Outstanding balance at the end of the year, to become the carryover figure to start next year

Overall, the proposals put forward by the FASB are generally welcomed, they are not without criticism, the general feedback from a number of industry practitioners includes:

- **The downside to the disclosure requirements being proposed to either be of limited added value to investors and that the suggested definition by FASB is overly-broad.**
 - For example, a corporate considers that disclosing supplier finance programme obligations would create unnecessary work and related costs and would not result in decision-useful information to investors.
- **The definition of supplier finance programs is too vague as for example:**
 - It can be argued that transactions which have buyer confirmation or validation but no waiver of offsets or other defenses; and transactions where the buyer appoints a paying agent to outsource a vendor payments program but does not ask for extended payment terms, should be excluded from the definition of "supplier finance programs". The reason being that investors are interested in the tenor of the payable(s) outstanding, and the extent to which the buyer has extended the payment terms beyond the normal period for such transactions.
 - The suggested definition of "supplier finance programs" may inadvertently capture arrangements not intended to be within the ambit of the proposals and, vice versa, may also result in arrangements intended to be within the ambit of the proposals not being captured.
- **On the flip side, others considers that the FASB consultation does not go far enough and believe additional disclosure is necessary to give investors a meaningful picture of the impact that supplier finance programs have on financial statements.**

The spectre of future Regulation for banks and financial institutions

- Changes to Basel III
- UK and EU to diverge?
- Can we improve the regulatory landscape?
- Trade Finance and Supply Chain Finance improvements?
 - Action required now

Path to a new Capital Requirements Regime (1)

- **Retained EU Law (Revocation and Reform) Bill 2022-23** going through UK Parliament listed EU Capital Requirements Regulation (CRR) onshored to be revoked and replaced with new UK sourced legislation.
- **Two UK Consultations published 30 November 2022 “Implementation of the Basel 3.1 Standards”**
- **HM Treasury Consultation:** Responses by 23.45 on 31 January 2023. Largely focusses on the technical and legal changes necessary to facilitate Basel 3.1 by the PRA as anticipated by the Financial Services Act 2021. Key areas: equivalence, resolution and overseas exchanges. It lists specific articles of the EU CRR onshored to the UK after the Brexit transition period to be repealed and replaced.
- **Strong and simple regime** proposed for small non-systemic UK firms.

Path to a new Capital Requirements Regime (2)

- **Prudential Regulation Authority/Bank of England CP 16/22:** Responses by 31 March 2023. Proposals to implement the final package of banking prudential reforms by BCBS - Basel Committee, in response to global financial crisis. Full online document: chapters on Credit risk/market risk/own funds/credit risk mitigation etc. **Basel 3.1**
- Proposes significant changes to way firms calculate Risk-Weighted Assets to calculate risk-based capital ratios. New methods to reduce variation in calculations; to improve the measurement of risk in both standardised approach and internal ratings-based approach; more robust boundary between trading book and non-trading book.
- UK following international Basel 3.1 rather than EU variations on Basel 3.1. Transitional arrangements proposed. Date of implementation **1 January 2025**.
- **Edinburgh Reforms just announced** for financial services on capital regime and ring-fencing by UK Chancellor, Jeremy Hunt – details to follow. Add your voice to the consultation.

EBA – proposals for treatment of credit insurance in the prudential framework (1)

- December 2017 – Basel Committee on Banking Supervision (**BCBS**) finalised so-called Basel 3 framework
- Aim of providing a comprehensive set of prudential standards
- May 2018 – European Commission issued Call for Advice requesting the EBA to advise the commission on the implementation of Basel 3 reforms in the EU and assess the impact
- Concurrently EBA published proposals to reform the Internals Ratings-Based (**IRB**) Approach for institutions applying IRB approach with own estimate of LGD
- EBA concerned about excessive variability in the calculation of risk weights
- EBA proposed to reduce use of internal models

EBA – proposals for treatment of credit insurance in the prudential framework (2)

- Effect of EBA proposal would have been to:
 - Rule out use of own estimates of LGD and conversion factors
 - Classify exposures to insurance companies as exposures to corporates
 - Impose higher LGD floors - fixed 45% input floor where a Bank has a lending exposure to an insurer
- Respondents to EBA proposal (including ITFA) suggested that unique features of insurance justify a lower LGD floor where the Bank is a policyholder as opposed to having loan exposure to insurer
- In the event of insurer insolvency, insurance claims treated more favourably than claims of other creditors

EBA – proposals for treatment of credit insurance in the prudential framework (3)

- ITFA suggested approx. €600 billion annually of support offered by credit insurance facilitating the efficient financing of trade/ funding to SMEs
- If EBA proposal were to be implemented, likely net effect- no longer economically viable for Banks to insure many credit risks, leading to:
 - Insurers appetite for continuing to offer credit insurance diminishing
 - Less competition in market as smaller players may stop writing in business entirely
 - Many European banks likely to decrease their levels of lending if non-payment risk not mitigated by/shared with insurers
- ITFA, IUA, Lloyd's Market Association and International Insurance Surety Association commissioned KPMG to prepare Insurance Insolvency Study reviewing failures of non-life insurers over the last 30 years in 7 European markets

EBA – proposals for treatment of credit insurance in the prudential framework (4)

- KPMG concluded:
 - Enhanced capital and regulatory requirements introduced by Solvency directives have contributed to marked decrease in the number and size of insurance failures
 - Solvency directives harmonization of policyholder priority in insurance company insolvency meant that Banks, as credit insurance policyholders, would rank ahead of other creditors due to preferred policyholder status
- ITFA marshalled its extensive membership network -including commissioning authoritative study on claims payments statistics and worked with Brussels-based public affairs consultancy to assist with advocacy to EU policymakers and regulators
- Lobbying efforts has resulted in significant change of approach by the regulators including the release of a draft revised enabling clause recognising the unique position of insurance
- Consultation and lobbying ongoing
- Aim is for agreement on EU CRR final text by summer 2023

2023 and Beyond

- More of the same but better?
- Going Greener?
 - ESG
 - Will this hold back financing in emerging markets?
 - More emphasis on S (social) and G (governance)?
- Legal landscape and a dramatic change?
 - Time to tear up paper?
 - In the hands of technology providers?
 - Plenty still to do
- Wake up call to legislators and regulators
 - Let trade finance prosper
 - SMEs and emerging markets need us
- The year for increased involvement of funds and other NBFIs?
- Happy 2023!

Geoffrey Wynne

Partner

Geoffrey Wynne is head of Sullivan & Worcester's London office and also head of its Trade & Export Finance Group. He has extensive experience in banking and finance, specifically trade and structured trade and commodity finance. He also advises on corporate and international finance, asset and project finance, syndicated lending, equipment leasing and workouts and financing restructuring.

Geoff is one of the leading trade finance lawyers and has advised extensively many of the major trade finance banks, multilateral financiers and companies around the world on trade and commodity transactions in virtually every emerging market including CIS, Far East, India, Africa and Latin America. He has worked on many structured trade transactions covering such diverse commodities as oil, nickel, steel, tobacco, cocoa and coffee. He has worked on warehouse financings in many jurisdictions and advised on how to structure involving warehouse operators and collateral managers. He has also advised on ownership structures and repos for commodities and receivables financings.

Geoff sits on the editorial boards of a number of publications and is a regular contributor and speaker at conferences. He is also the editor of and contributor to *The Practitioner's Guide to Trade and Commodity Finance* published by Sweet & Maxwell and *A Guide to Receivables Finance*, a special report from TFR published by Ark.

Geoff has recently been recognized as the only UK lawyer included in the Trade Finance section of the *UK Legal 500's* all new UK 'Hall of Fame.' *Trade & Forfeiting Review* (TFR) honoured Geoff with the TFR Fellowship Award in its 2017 TFR Excellence Awards.

Sullivan & Worcester UK LLP T +44 (0)20 7448 1001
Tower 42 F +44 (0)20 7900 3472
25 Old Broad Street gwynne@sullivanlaw.com
London EC2N 1HQ

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

Geoffrey Wynne and Simon Cook as Ranked individuals in Band 1, making Sullivan the only firm to have two such ranked lawyers in the Commodities: Trade Finance (UK-wide) category. In addition, Mark Norris was recognised as a Ranked Individual in Band 3, and Sam Fowler-Holmes was again included 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?**

Move forward with Sullivan

Boston

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

London

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

New York

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

Washington, DC

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

Tel Aviv

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

sullivanlaw.com

[@sullivanlaw](https://twitter.com/sullivanlaw)



Sullivan
SULLIVAN & WORCESTER