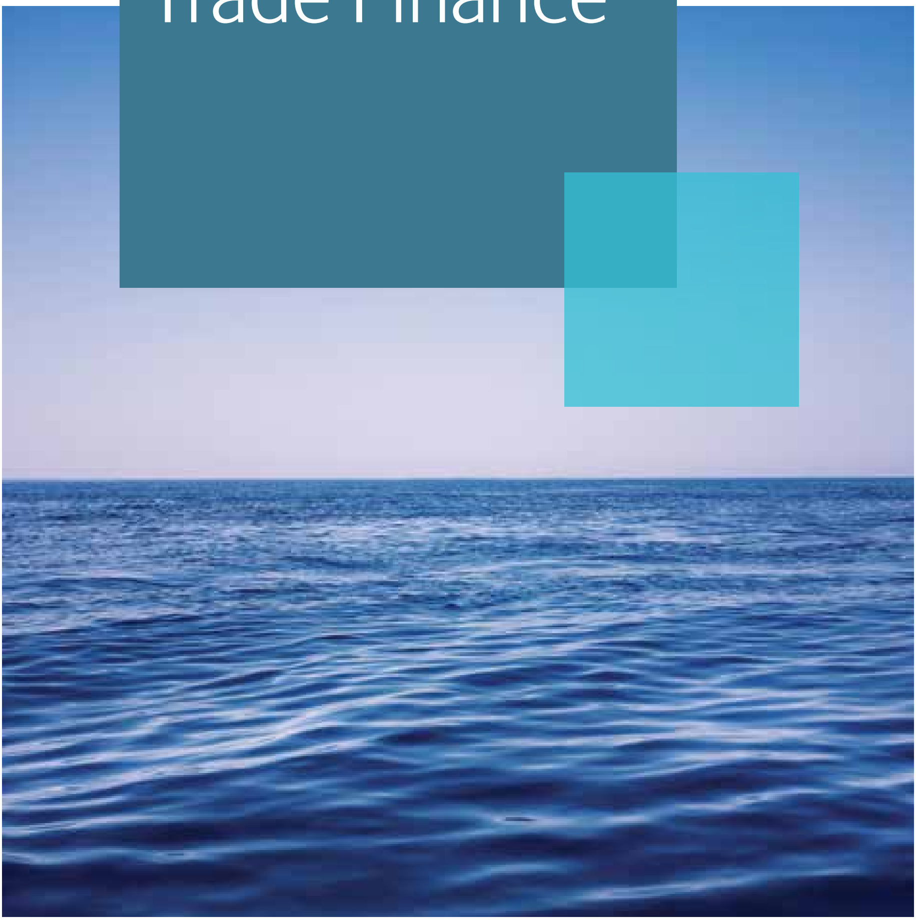
Simmons & Simmons

Structures and Solutions in Trade Finance



Structures & Solutions in Trade Finance is a guide to the different structures in Trade Finance.

Trade Finance is a term used to describe an array of different financing techniques. Often these lending structures, the mechanics involved and core features can be confusing.

Simmons & Simmons has created Structures & Solutions in Trade Finance to give a basic pictorial guide to some of the different structures associated in Trade Finance. Our guide sets out the flow of goods, the flow of documents and the flow of money and receivables to enable the user to easily see the financing supply chain and trade cycle of different Trade & Finance products.

Accompanying Structures & Solutions in Trade Finance is the Simmons & Simmons A to Z of Trade Finance which is a glossary of terms commonly used in international trade and Trade Finance.

Simmons & Simmons recognises the world of Trade Finance develops and moves incredibly quickly. Therefore, we have designed Structures & Solutions in Trade Finance to be easily updated and we will publish new structures, regular commentaries and notes that can all be kept together in this file.

Structures & Solutions in Trade Finance is the essential companion ensuring all those involved in the trade of goods and services, import and export, the supply chain and, of course Trade Finance, all speak a common language.

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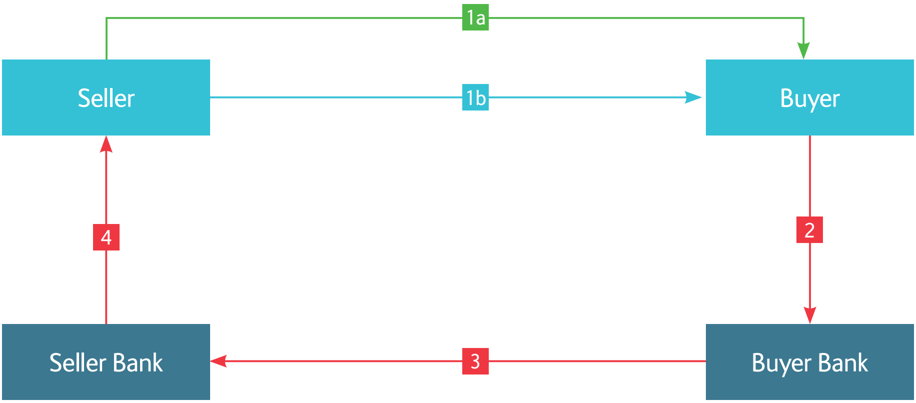
Open Account



Mechanics

- 1a Goods shipped from Seller to Buyer pursuant to a Contract of Sale.
- 1b Invoice sent upon delivery to Buyer.
- 2 Invoice payment made to the Buyer's bank, normally in local currency.
- 3 Bank transfer monies to and notifies Seller's bank through the SWIFT system.
- 4 Payment made to Seller, or credited to Seller's account in local or foreign currency according to invoice and/or Seller's instructions.

Open Account

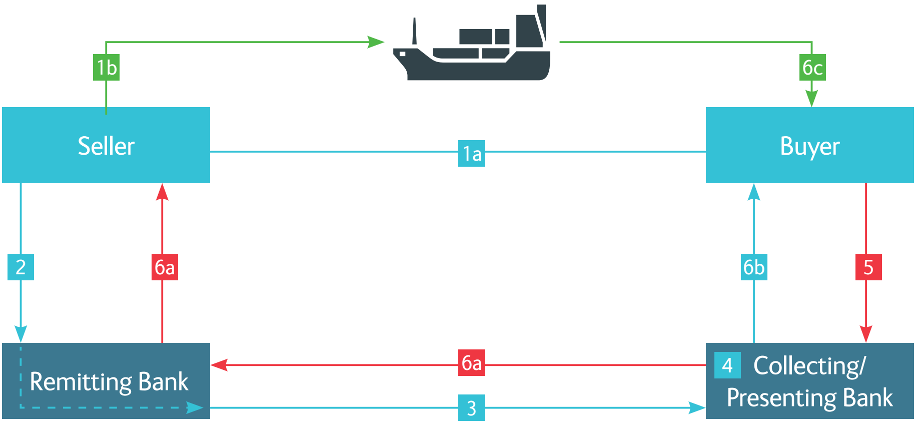
What is it?

1. Trade transactions between a Seller and a Buyer where transactions are not supported by any banking or documentary trade instrument issued on behalf of the Buyer or Seller.
2. The goods are shipped from the Seller to the Buyer before the payment is due and payment is made through the banking system.

Core features

1. Beneficial for an importer and involves fewer parties but contains high-risks for exporters. Open Account carries lower costs because the number of parties are fewer and procedures are less complex.
2. Goods and invoice are delivered directly from Seller to the Buyer who will pay the invoice on the maturity date. The goods are shipped from the Seller to the Buyer before the payment is due.
3. Exporters need to have a good understanding of, confidence in, the risks associated with the importer and the importing country. Open Account tends to be used in mature trading relationships and developed markets. Alternatively if the Seller has concern on Buyer on country risk then alternative default mitigating products such as trade credit insurance can be obtained.
4. Open Account can be more responsive to sudden unexpected changes in contractual arrangements. It can be relatively simple as it concentrates on the contractual terms agreed between the parties. For example, dealing with discrepancies in the Shipping Documents is straight forwarded between Buyer and Seller only.
5. There are relatively fewer structural financing opportunities in Open Account. However, it is likely the bank will be able to offer Open Account as part of its general banking services associated with a Trade Finance Facility (see Trade Finance Facility).

Documentary Collections



Mechanics

- 1a Seller enters into Contract of Sale with the Buyer.
- 1b Seller initiates shipment of goods and loads/ships goods via Shipper or Carrier to the Buyer.
- 2 Seller submits Collection Order, Bill of Exchange and Shipping Documents to Remitting Bank.
- 3 Remitting Bank forwards documents to Collecting Bank also known as Presenting Bank.
- 4 Collecting Bank must act in accordance with Remitting Bank's instruction. Collecting Bank can arrange for Buyer to inspect the documents. If Buyer considers documents are in order, the Collecting Bank releases them against payment or acceptance.
- 5 In a Clean Collection, Buyer pays Seller via banks or accepts Draft (in which a Term Bill of Exchange will remain with the Collecting Bank until Maturity).
- 6a Money sent to Remitting Bank and credit Seller's account.
- 6b Documents released to the Buyer
- 6c Buyer now has Shipping Documents to enable collection of goods from the Carrier.

Documentary Collections

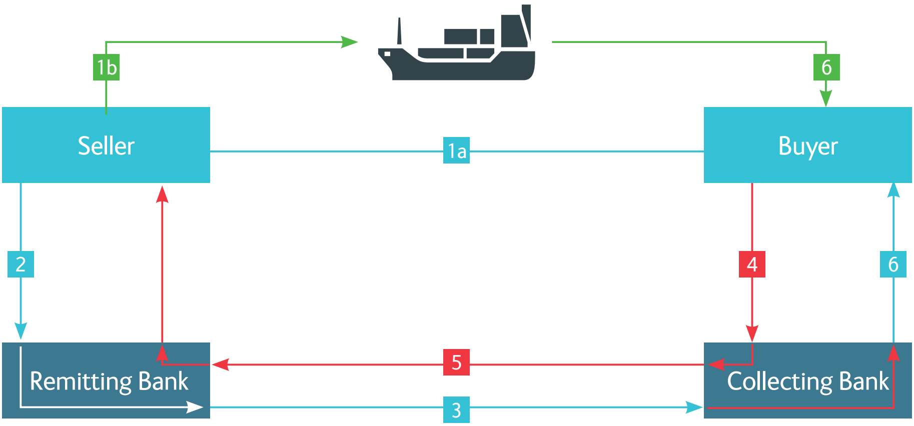
What is it?

Documentary Collections is an inter bank document handling system. A collection service provided by a bank under which the Shipping Documents relating to a cargo are sent to a Buyer but only released once the Seller has the comfort that goods will be paid for by the Buyer. It is a means whereby the Seller in one country can obtain payment from the Buyer in another and the Buyer can obtain the Shipping Documents and, therefore title to the goods, through the banking system in his own country.

Core features

1. Documents are released to the Buyer on payment (Documents Against Payment: D/P) or released to the Buyer on acceptance of a Bill of Exchange (Documents Against Acceptance: D/A).
2. Standard international ICC rules URC 522 govern the roles and responsibilities of the various banks involved.
3. Banks will arrange collections of the financial documents – such as a Bill of Exchange or Promissory Note – and the Shipping Documents such as Bills of Lading and the Commercial Invoices.
4. Outward Collections is where a bank obtains payment from the Buyer on behalf of Seller.
5. Inward Collections is where the bank assists a correspondent bank to obtain payment of a Draft or Promissory Notes or cheque from the Buyer on behalf of Seller.
6. Bank's instruction from the Seller to its Remitting Bank is called a Collection Order.

Documents against Payments (D/P)



Mechanics

1a Under a Contract of Sale, the Seller agrees to ship goods and send documents via Documentary Collections method.

1b Seller initiates shipping goods to Buyer and hands over goods to Shipper or Carrier.

2 Seller sends documents to Remitting Bank together with payment instructions.

3 Seller's bank checks the Seller's instructions and that they conform with the documents. Then send to the Buyer's bank, known as the Collecting Bank.

4 Buyer is advised about Collection by the Collecting Bank. Before payment, Buyer has the right to inspect documents and that they all conform to what is required as specified in the Contract of Sale. If Buyer is satisfied then the Buyer instructs his bank to pay the Seller.

5 Payment is transferred to Remittance Bank according to payment instructions and credited to Seller's account.

6 Documents are then simultaneously released to the Buyer and the Buyer can collect the goods from the Shipper or Carrier.

Documents against Payments (D/P)

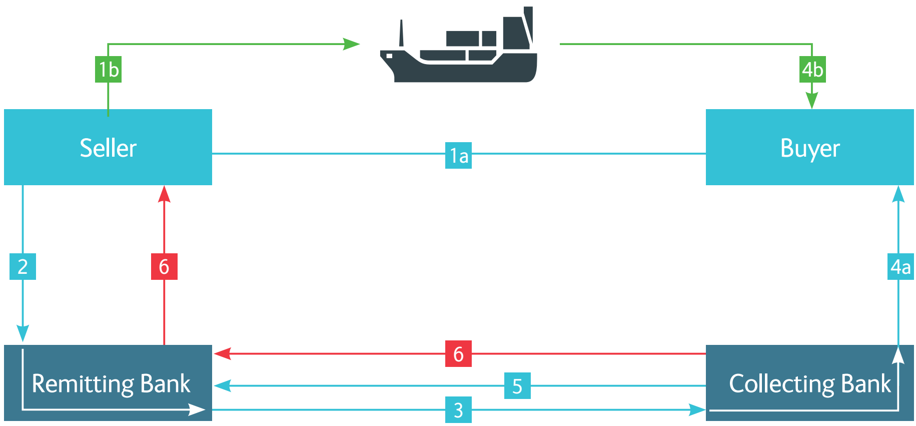
What is it?

The Seller entrusts the goods and title documents to the Seller's bank, also giving it payment instructions as agreed between the Seller and the Buyer in the Contract of Sale. Once the Buyer has made a payment to the Seller's bank, the Buyer can then receive the Shipping Documents and thus access to the goods while paying following the payment instructions.

Core features

1. A key advantage over Open Account is that if the Collection documents include a full set of Bills of Lading then the goods remain in control of the Seller (or at least within the Collection system) until actual payment.
2. Shipping Documents often used include:
   - Draft/Bill of Exchange issued at sight or as a term bill (Usance bill)
   - Commercial invoice
   - Specifications and packing or weight lists
   - Transport documents, such as Bills of Lading, Waybill or Multimodal Transport Documents
   - Certificate of origin
   - Inspection certificates – verifying quality or quality of the goods
   - Insurance documents
3. What if the Commercial Documents are not a Bill of Lading (e.g. a Waybill)? If this is the case, then the Seller, in the Collection Order, can specify to consign the goods to the Collecting Banks order who will only release them when the Buyer makes the payment.

Documents against Acceptance (D/A)



Mechanics

1a Under a Contract of Sale, the Seller agrees to ship goods and send documents via Documentary Collections method.

1b Seller initiates shipping goods to the Buyer and hands over goods to Shipper or Carrier.

2 Seller sends documents via Documentary Collections to Seller's bank together with payment instructions and a Bill of Exchange. A Bill of Exchange is payable (i) on sight or (ii) at the maturity date stated (this is known as a Term Bill or Time Bill).

3 Seller's bank checks the Seller's instructions and that they conform with the documents. Then those documents are sent to Buyer's bank otherwise known as the Collecting Bank.

4a The Buyer is advised about collection by his bank. After satisfactory inspection, the Buyer will Accept the enclosed Bill of Exchange (an Accepted Draft) and receives the documents attached to the Bill of Exchange. Most commonly referred to as the Shipping Documents. This will include the title documents relating to the goods.

4b The Buyer can then present the Shipping Documents to the Carrier and collect the goods.

5 The Bill of Exchange (the Accepted Draft) is given to Seller's bank and the Accepted Draft is kept at Seller's bank until the maturity date.

6 On the maturity, the Accepted Draft is presented for payment to Collecting Bank as a 'Clean Collection' (that is without other shipping documents) and the Buyer's bank makes payment to Seller's bank as per Seller's payment instructions.

Documents against Acceptance (D/A)

What is it?

The documents transferring title of goods are delivered to the Buyer via the banking and Collection system. Only upon the Buyer's Acceptance of the Seller's Bill of Exchange guaranteeing payment at a later date will the documents relating to the goods be released to the Buyer.

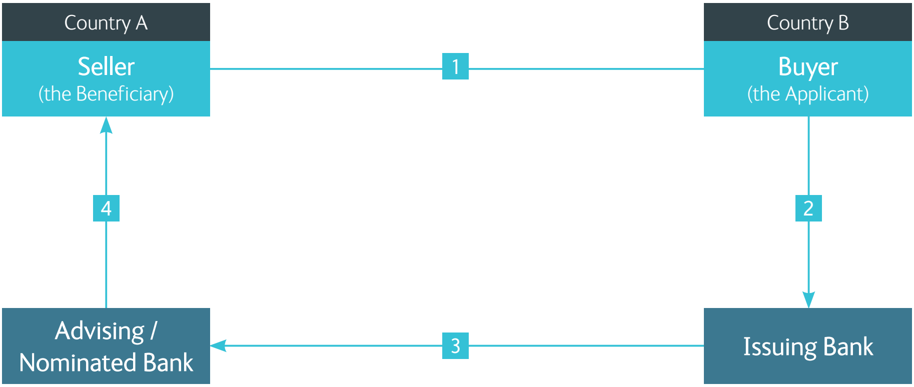
Core features

1. Seller is granting commercial credit terms to the Buyer. The period of credit is the term of the Bill of Exchange.
2. When the Buyer accepts the Draft he can be released with the Shipping Documents and claim the goods. Therefore, D/A collections offer less protection because the Buyer takes title to the goods before he has to pay. However, the Buyer is acknowledging his debt by Acceptance of the Draft. If the Seller is concerned with the credit of the Buyer he may insist on the Draft being 'avalised' by the Issuing Bank, thereby adding an additional payment guarantee.
3. The Bill of Exchange will be held with the Collecting Bank until maturity at which time it will be presented for payment, or alternatively the Seller might be prepared to seek earlier financing based on the Buyer's Acceptance.

Financial Structures

1. The Seller can obtain early payment from the Remitting Bank via an advance or prepayment against the Collection. Advances are usually full recourse to the Seller.
2. Or the Seller can obtain non-recourse financing where the Bills of Exchange are avalised or Bills are accepted by a high credit of the Buyer.
3. An aval is a guarantee added to the Acceptance of the Bill by the Collecting Bank by giving an unconditional undertaking to pay on maturity of the Bill. This then allows the Seller's bank of advance against the Bill without recourse to the Seller.

Opening a Letter of Credit



Mechanics

1. Contract of Sale stipulating payment methods for goods by way of Letter of Credit.
2. Buyer – known as the Applicant – instructs his bank (the Issuing Bank) to issue a Letter of Credit in favour of the Seller as Beneficiary. Issuing Bank will either open or utilise certain pre-arranged (and/or collateralised) credit lines and facilities that the Buyer can draw on for such trade products (see Trade Finance Facility).
3. Issuing Bank arranges with a bank in the Seller's country to advise (usually via SWIFT) the Seller when the Letter of Credit has been opened and to pay against delivery of specified satisfactory Shipping Documents. If the Nominated Bank confirms the credit it will be known as the Confirming Bank that adds its own independent undertaking to pay the L/C – eliminating any country risk associated with the Issuing Bank's country of jurisdiction and credit standing.
4. The Advising Bank informs the Seller when the Letter of Credit has been issued and which documents should be presented to obtain settlement.

Opening a Letter of Credit

What is it?

1. By passing the obligation to pay the Seller onto the Issuing Bank, the Buyer creates greater assurance and certainty that the payment will be made to the Seller once they ship their goods. The Issuing Bank is giving an irrevocable payment undertaking to the Seller that it will make payment upon presentation of certain documents independent and autonomous of the underlying Contract of Sale.
2. Also known as L/C, Documentary Credit, Documentary Letter of Credit, DLC or credit.

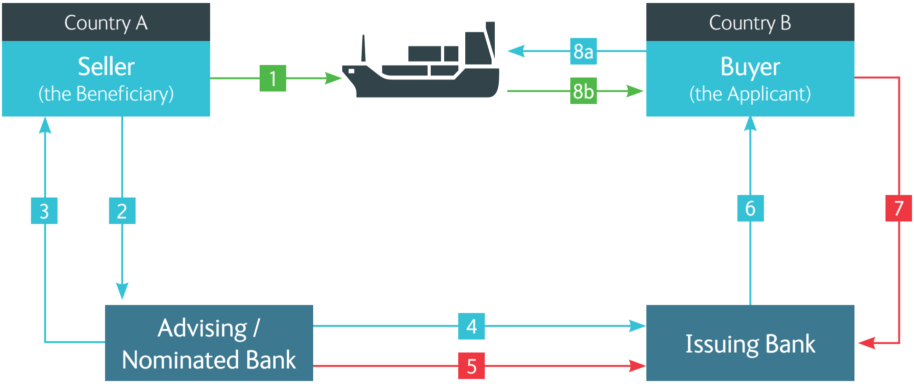
Core features

1. The Letter of Credit is irrevocable and cannot be cancelled or amended without the Seller's agreement. Therefore, the Buyer has committed to the Seller to perform his side of the Contract of Sale, namely payment.
2. The Buyer might be a new customer, a customer with no payment track record or in a jurisdiction the Seller is unfamiliar with. The Letter of Credit is therefore a better payment guarantee and security then relying on the Buyer's own covenant to pay and the ability of the Seller to enforce that promise in the country in which the Buyer is located.
3. Documentary Credits have an internationally recognised set of regulations governing letter of credit activity. This is referred to a UCP 600 and stands for Uniform Customs and Practice for Documentary Credits 600.
4. The Issuing Bank is only concerned with documents and not goods. Payment will be made notwithstanding any damage to goods in transit. Banks need not look behind the transaction under the principle of Autonomy of the Letter of Credit and the principle of Strict Compliance.
5. Banks notify and communicate the forms and contents of Letters of Credit through the SWIFT system.

Financing opportunities using a Letter of Credit

1. Obtaining bank financing for trade finance transactions is essential to give both Buyer and Seller the best working capital position available.
2. Financing can be raised against the security represented by the structure of the transaction, the goods and mechanics of the instruments involved. The Seller may provide commercial credit to the Buyer as part of their negotiated terms and this can often be as long as 180 days for example.
3. Without financing, the Seller may have to wait 180 days to be paid, putting pressure on working capital and reducing operating cash flow. Therefore, the advantages of being paid early by a bank, using finance secured by the structure of letters of credit, can benefit both Buyer, in the Seller offering longer payment terms in the Contract of Sale, and the Seller, in being paid prior to the actual due date.
4. Letters of Credit provides a secure form of payment to the Beneficiary, but also can be structured to offer short term funding. Two structures commonly used are:
   - Discounting Bills of Exchange on the Seller's bank under an Acceptance L/C. In this, the Buyer obtains a period of credit before having to pay for the goods.
   - Negotiating Bills of Exchange. Here, the Seller receives early payment of the amount due to him rather than wait until the end of the period of credit extended to the Buyer under the Contract of Sale.

Operating a Letter of Credit



Mechanics

1 Seller having received confirmation from the Advising Bank that a Letter of Credit has been issued on behalf of the Buyer, then initiates the shipment of goods and places in hands of the Shipper or Carrier.

2 Shipping Documents evidencing shipment and Bills of Lading representing title to the goods are sent to the Advising Bank.

3 The Nominated Bank checks the Shipping Documents against requirements of the Letter of Credit and, if they are in order, advises the Seller that it is authorised (if merely a Nominated Bank) or obliged (if also a Confirming Bank) to pay the Seller in accordance with the terms of the Letter of Credit.

4 Nominated bank sends the documents to the Issuing Bank.

5 After checking and being satisfied that the documents meet the requirements of the Letter of Credit the Issuing Bank reimburses (if paid at sight) or transfers monies to the Nominated Bank.

6 The Issuing Bank delivers the documents to the Buyer.

7 The Issuing Bank is reimbursed by the Buyer or the credit line marked by a utilisation of an existing facility.

8a By virtue of its possession of the documents the Buyer can claim the goods at port from Shipper or Carrier.

8b Buyer now has title and can on sell or process the goods.

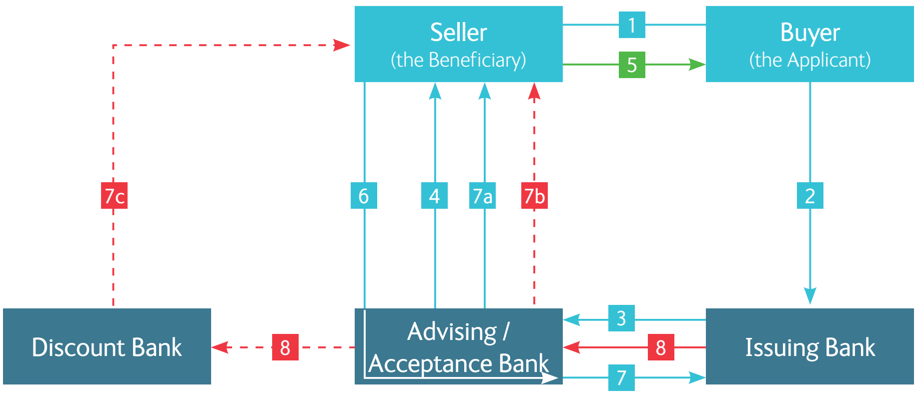
Operating a Letter of Credit

What is it?

A financial document issued by an Issuing Bank at the request of a Buyer (Applicant) to a Seller (Beneficiary), which guarantees payment to the seller if the terms and conditions specified in the Letter of Credit are fulfilled. It usually contains a brief description of the goods, the documents required, shipping date and an expiry date after which payment will no longer be made. There are different types of Letter of Credit, according to the level of security they grant the Beneficiary.

1. Irrevocable Letter of Credit: All Letter of Credit issued under UCP600 are irrevocable. This can neither be modified nor cancelled without the agreement of all the parties concerned. The payment by the Issuing Bank is guaranteed provided that the Beneficiary (Seller/Exporter) satisfies all the terms and conditions of the Letter of Credit.
2. Revocable Letter of Credit: Not often used in the modern era. This may be modified or cancelled by the Issuing Bank at any time and without notice to the Beneficiary. However, payments or drafts negotiated within the terms of the credit before receipt of the revocation or amendment notice from the Issuing Bank remain validly binding for all parties. Negotiability is restricted to the Advising Bank and Confirmation is usually not available.
3. Confirmed Letter of Credit: Letter of Credit in which the responsibility of another bank (the Confirming Bank, which is usually the same as the Advising Bank) has been added to that of the Issuing Bank, upon authorisation or request of the latter. The confirmation represents a definite undertaking by the Confirming Bank, which obligates itself in the same manner as the Issuing Bank. It is used to back up the credit standing of the Issuing Bank and to mitigate risk by replacing a foreign bank risk with a domestic bank risk.
4. Unconfirmed Letter of Credit: Letter of Credit which has been advised through an Advising Bank, acting as an agent of the Issuing Bank, without however assuming any responsibility towards the Beneficiary except for taking reasonable care to check the apparent authenticity of the Documentary Credit which it advises.
5. Revolving Letter of Credit: A type of Letter of Credit issued only once and through which the money made available to the Seller, after being drawn within a stated period of time, will again become available in the future, usually under the same terms and without another Letter of Credit being issued. This type of credit is used in connection with regular and ongoing purchases from a foreign supplier. The revolving element may be linked to time and/or value.
6. Documentary Letter of Credit: Letter of Credit where the Issuing Bank stipulates that certain documents should accompany the Draft. These documents assure the Applicant that the merchandise has been shipped, is in good condition and that title to the goods has been transferred to the importer.
7. Negotiable Letter of Credit: Letter of Credit issued in such form that it allows any bank to Negotiate the documents.
8. Acceptance Letter of Credit: Letter of Credit which provides that it will be honoured by Acceptance by the bank with which the Letter of Credit is available at a time defined in the Letter of Credit (rather than by presentation of complying documents). The seller can therefore obtain earlier payment if discounted.

Discounting Acceptances



Mechanics

1. Seller and Buyer enter into Contract of Sale.
2. Buyer, as Applicant, requests a Letter of Credit from its Issuing Bank.
3. Issuing Bank raises a Letter of Credit and sends to Advising Bank.
4. Advising Bank notifies Seller that the Letter of Credit has been opened.
5. Goods then shipped to the Buyer.
6. Documents forwarded from Seller to Advising Bank and on to Issuing Bank.
7. Banks accept documents as fully compliant with terms of the Letter of Credit. As part of the documents the Seller may have drawn a Term Bill of Exchange which by Acceptance represents the bank's independent undertaking to pay the Accepted Draft on maturity. Seller can either:

7a – hold the accepted bill until maturity if working capital is healthy;

7b – if finance is required, ask Acceptance Bank to discount the bill; or

7c – Seller could ask another bank – i.e. the Discount Bank – to discount the bill drawn on and accepted by the Acceptance Bank. If discounted, the Discounting Bank will pay proceeds to the Seller net of charges and interest for the period of credit until maturity.

8. At maturity of the bill, Acceptance Bank will receive the reimbursement from the Issuing Bank of the original amount either for its own account if it discounted the bill or for the Discount Bank.

Discounting Acceptances

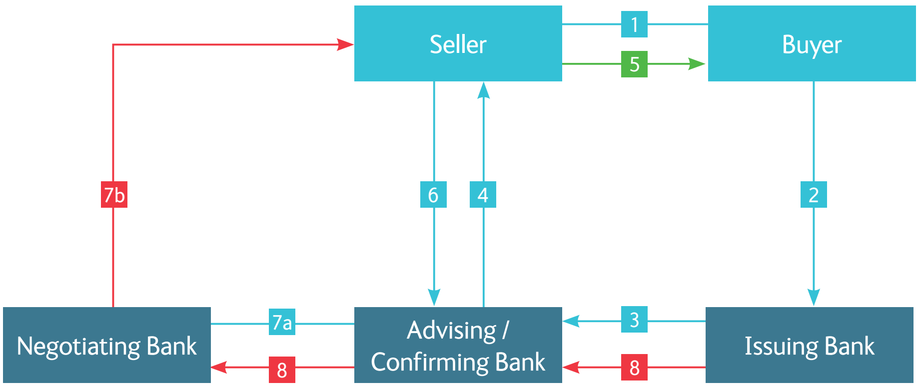
What is it?

Also known as Acceptance Documentary Credit. A Letter of Credit available by Acceptance provides a period of credit for the Buyer. It also allows the Seller to obtain post-shipment financing, which is without recourse, by discounting a Bill of Exchange drawn on a bank.

Core features

1. The Discounting Bank is providing a short term loan known as an Acceptance Facility.
2. Acceptance credits are used to provide the Buyer with extended commercial credit by the Seller. This might encourage and give the Seller a competitive advantage over other similar suppliers when the Buyer is deciding with whom to purchase from.

Negotiating Export L/C



Mechanics

1 Seller and Buyer enter into Contract of Sale and requires the Letter of Credit in its favour that is available by negotiation. The Seller can request a specific Negotiating Bank or freely negotiable

2 Buyer requests the required Letter of Credit.

3 Issuing Bank raises a Letter of Credit and sends to Advising Bank.

4 Advising bank notifies Seller.

5 Goods shipped to Buyer.

6 Documents presented from Seller to Advising Bank for checking in accordance with the Letter of Credit and then Banks accept documents as fully compliant with terms of the Letter of Credit.

7a On the reliance that the Bill of Exchange has been Accepted, the Negotiating Bank purchases the Bill of Exchange or L/C by “Negotiation”.

7b The nominated Negotiating Bank then makes a non-recourse advance of discounted funds to Seller.

8 At maturity of the Bill of Exchange, Advising Bank will receive reimbursement from the Issuing Bank, in turn being used to repay the advance by the Negotiating Bank.

Negotiating Export L/C

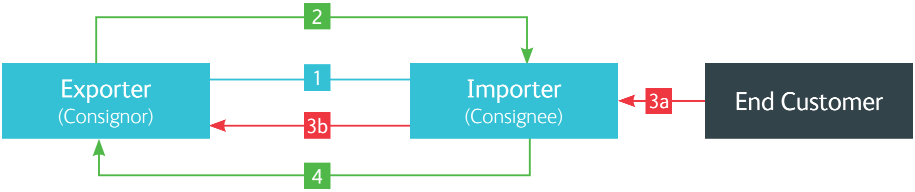
What is it?

A Letter of Credit available by Negotiation provides for immediate payment to the Seller by way of the Negotiating Bank purchases the Letter of Credit and advance funds to the Seller on presentation of the documents stipulated under the Letter of Credit.

Core features

1. The Letter of Credit available by Negotiation will either specifically nominate a Negotiating Bank or indicate that the Letter of Credit is freely negotiable by any bank.
2. The Issuing Bank authorises the Negotiating Bank to negotiate the documents presented to it under the Letter of Credit and that it will reimburse the Negotiating Bank on satisfaction of the terms of the Letter of Credit.
3. The Seller will be paid immediately without needing to wait until the end of the trade credit period.

Consignment



Mechanics

1 Consignment agreement in which the Importer – termed as Consignee – receives, manages and sells goods for the Exporter who retains title until the goods are on sold to an End Customer.

2 Goods shipped by the Exporter and delivered to the Consignee. Consignee hold the goods for Consignor on trust.

3a Payment is sent to Exporter only after goods have been sold by the Importer to an End Customer.

3b Only sold items by the Importer to the End Customer are paid onto Exporter.

4 Goods not sold after an agreed period may be returned to the Exporter.

Consignment

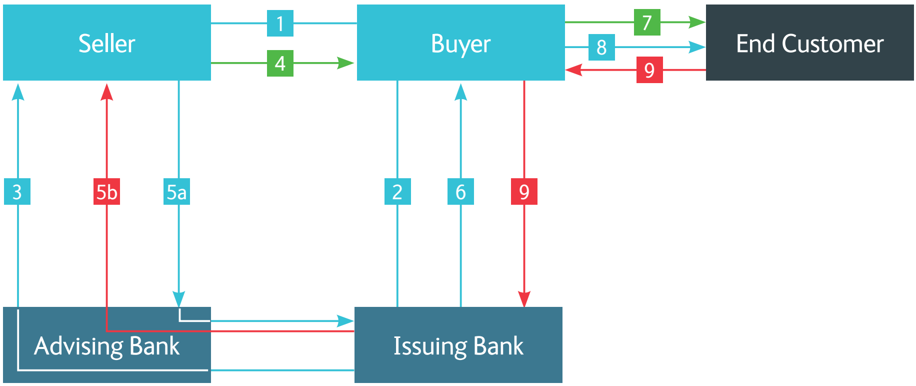
What is it?

An arrangement where the Exporter delivers the goods to the Importer, who then resells the goods and, only when the goods have been sold, pays the purchase price to the Seller. If goods go unsold then they are returned to the Exporter.

Core features

1. The inevitable risk with a Consignment structure is that the Exporter is handing over product (and inventory management) to a party it doesn't control with no guarantee of payment.
2. The advantages are that it can help Exporters compete in a local market it is unfamiliar in with the goods being in the location of the End Customer.
3. Also, the structure reduces the cost to the Exporter of storing and inventory therefore the Exporter can pass on this reduction to the End Customer in an attempt to be more competitive in that local market.
4. The obvious key risk is that the Exporter must have full confidence in and trust its Consignee – given that the Consignee will be a foreign distributor or third-party logistics provider.

Trust Receipt Financing



Mechanics

1 Seller and Buyer enter into a Contract of Sale.

2 Buyer enters into a credit facility with its Bank or may utilise existing credit lines and enters into a pledge in favour of the Bank over the goods and title documents representing the goods (e.g. Bills of Lading).

3 Buyer utilises the credit facility and requests Bank to issue Letter of Credit in favour of Seller as beneficiary for the cost of the goods. Bank issues the requested Letter of Credit and Advising Bank notifies Seller (see also Opening a Letter of Credit).

4 Goods shipped to Buyer on Seller confidence it will receive payment from Issuing Bank on presentation of Shipping Documents at such time as in accordance with the terms of the Letter of Credit.

5a Seller presents Shipping Documents to Advising bank, these are in turn sent onto Issuing Bank. Whilst goods are in transit, Seller has released title to goods and in hands of the Bank pursuant to the pledge representing collateral for making the original Letter of Credit available.

5b Issuing Bank pays in accordance with Letter of Credit either at sight or Term.

6 Upon the request of the Buyer and in advance of when the Buyer might usually receive the title documents in a typical L/C structure, the Bank releases the title documents to the Buyer conditionally on receipt from the Buyer of a trust receipt for the limited purpose of on-selling those goods to the End Customer.

7 Buyer on-sells to End Customer and can pass good title to the End Customer having been released with the title goods from the Bank.

8 Invoice issued to End Customer.

9 Money paid pursuant to invoice and monies held on trust for Bank in order to repay the original utilisation under the L/C financing arrangement between the Buyer and the Bank.

Trust Receipt Financing

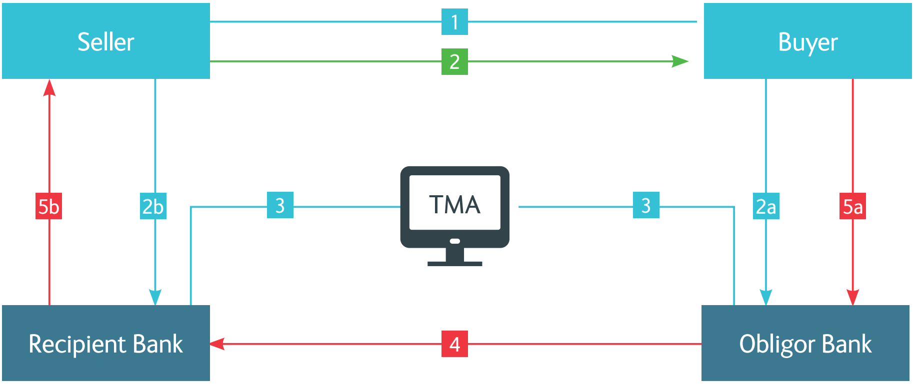
What is it?

An import credit facility structure and related security in the form of a pledge over the goods purchased with the proceeds of the facility between Buyer / Pledgor and its Bank whereby the Bank issues L/C to purchase goods from Seller but where the Bank allows the goods to be released from the pledge in order for the Buyer to on sell the goods to an End Customer. The release is conditional that the Pledgor, i.e. the Buyer, acknowledges that it holds the goods and proceeds of sale from the End Customer on trust for the Bank. Therefore, in the event of an insolvency of the Buyer those goods and proceeds remain outside the general bankruptcy estate of the Buyer and can be claimed by the Bank to settle the original facility or credit line.

Core features

1. Advantages for the Buyer is that they will not be required to effect payment of goods purchased immediately when documents are presented under a Sight L/C for example and this is a form of import finance where the mechanism allows the Bank to maintain security over the goods and proceeds.
2. Warehousing of goods may be involved if Buyer has not scheduled delivery of goods to the End Customer immediately upon arrival of goods (see also Warehouse and Inventory financing)
3. Risks for the Bank is that notwithstanding the pledge over goods and undertaking to keep goods separate in warehouse, for certain types of goods and commodities (e.g. oil) it may be the case that the commodity is co-mingled in storage or while shipping. Therefore, on an insolvency of the Buyer, notwithstanding the commodity is held on trust for the Bank, tracing will be difficult. However, some commodities like oil is fungible and the law has developed methods to account for goods of an exact equivalent provided it is still held on trust for the Bank.
4. The test, of whether a Buyer holds those commodities or goods and monies as trustee, is whether the Buyer is, on the facts, entitled to use the property or its proceeds permanently as his own. If the Buyer does have control then a Bank ceases to be a super-priority creditor. Therefore, it is often recommended that monies from the receivables of the End Customer are deposited into a trust account or at least an account with the Bank.

BPO (Bank Payment Obligation)



Mechanics

1 Buyer and Seller enter into a Contract of Sale and agree to use a BPO arrangement to effect payment rather than a L/C.

- Data in respect of the underlying trade transaction otherwise known as a Baseline is established via banks from data in purchase order ("PO").

2 Seller ships goods pursuant to PO from the Buyer and also sends Shipping documents.

2a Buyer provides PO data to Obligor Bank.

2b Seller provides shipping data to Recipient Bank (such as commercial, transport or insurance data equivalent to Information found in Shipping Documents).

3 Trade Matching Application (TMA) which is utilised between Obligor Bank and Recipient Bank is used to match data according to Baseline.

4 BPO becomes operative upon data match through the TMA and Obligor Bank must pay Recipient Bank on maturity in the form of an irrevocable and independent payment undertaking or Bank Payment Obligation (BPO).

5a Buyer makes repayment to Obligor Bank on maturity.

5b Seller receives money from Recipient Bank.

BPO (Bank Payment Obligation)

What is it?

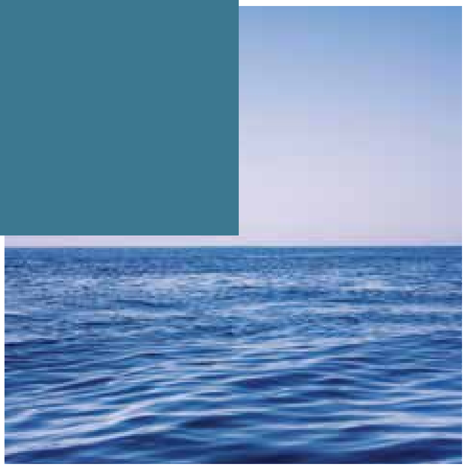
1. Separate and independent of the underlying trade or Contract of Sale, the BPO is an independent irrevocable payment undertaking from an Obligor Bank to pay the beneficiary via the Recipient Bank on the conditional matching of purchase order and shipping data.
2. The BPO is an instrument that provides risk mitigation, and the basis for financing a transaction between buyers and sellers who chose not to use documentary instruments but wish to rely on the exchange and validation of electronic data rather than physical documents to effect payment.
3. It is an enabling framework to avoid the use of physical document presentation in Documentary Credits.
4. A Letter of Credit requires physical presentation of documents through Collections. Under a BPO those physical documents are sent direct to Buyer as per an Open Account transaction. However, the independent obligation to pay upon certain conditions is still maintained.

Core features

1. No documents are needed under the BPO payment framework, as such there is a reduction in expenses related to document examination and also a focus on efficiency given only data flow framework.
2. The banks deal in data and not documents meaning a reduction of discrepancies.
3. Obligor and Recipient Banks must be participant members with the SWIFT Trade Services Utility (TSU) and the TSU Rulebook.
4. BPOs are issued in favour of the Recipient Bank and not the Seller.
5. Under a BPO framework, the Seller is paid by the Recipient Bank, and the Recipient Bank is paid by the Obligor Bank. The Obligor bank is not directly indebted to the Seller.
6. The ICC Uniform Rules for Bank Payment Obligation (URBPO 750) govern the BPO framework and are similar usage of UCP 600 for Letters of Credit.
7. Unless otherwise specified, the governing law and jurisdiction will be that of the Obligor Bank.

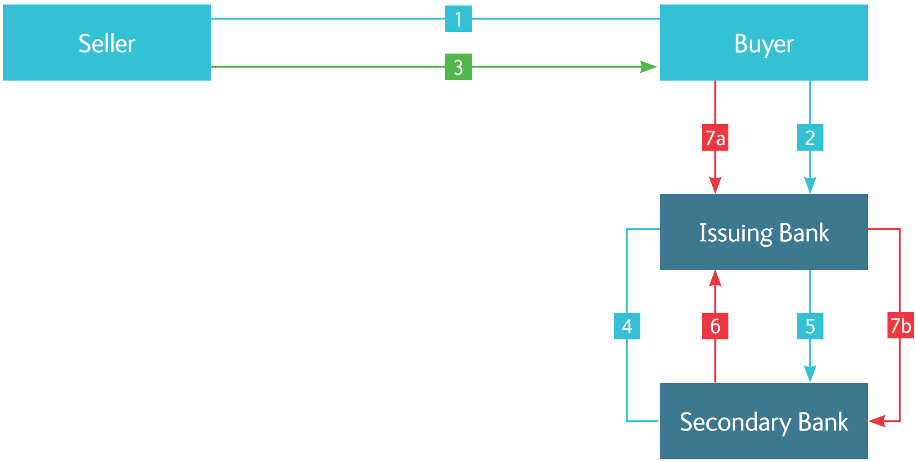
Simmons & Simmons

Secondary Market Trade Finance



Secondary Market Trade Finance

Bank-to-Bank Trade Finance Loans



Mechanics

1 Seller and Buyer enter into a Contract of Sale. Condition includes payment method to Seller via a Letter of Credit or other trade product.

2 Buyer requests a Letter of Credit to be issued to the Seller in the normal way (see Opening a Letter of Credit).

3 Seller ships goods and invoices the Buyer.

4 Behind the scenes, Issuing Bank and Secondary Bank enter into trade loan agreement (BAFT, a master agreement or stand alone swift MT799).

5 Issuing Bank sends to the Secondary Bank details of the underlying trade between Buyer and Seller and a drawdown request for the amount the Issuing Bank wants to utilise.

6 Secondary Bank advances principal amount to Issuing Bank.

7a Following underlying trade completion and payout of the Letter of Credit to the Seller, Buyer reimburses the Issuing Bank or marked as a utilisation of an existing bi-lateral trade facility between Buyer and Issuing Bank.

7b Issuing Bank repays principal and interest at maturity to Secondary Bank.

Bank-to-Bank Trade Finance Loans

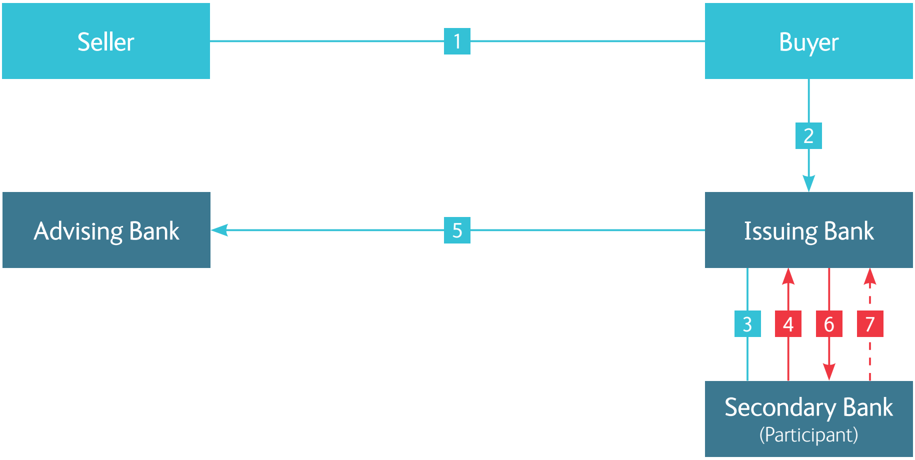
What is it?

1. Financial institutions can make available bi-lateral loans to an Issuing Bank for the purpose of on lending trade finance products and issuing letters of credit on behalf of the Buyer. The loan documentation is based on and similar to typical loan structures.
2. The Issuing Bank does not need to notify Buyer or Seller of arrangement with Secondary Bank, thus can retain commercial relationship and an opportunity to offer larger trade credit lines to that Buyer.

Core features

1. A typical loan, but the purpose is for on lending of trade products.
2. The loan agreement contains full sets of representation warranties, and events of default relating to the underlying transaction.
3. The loan agreement will also contain certain representations from the Issuing Bank in relation to Sanctions and local regulatory requirements of the underlying trade.
4. BAFT has drafted a standard form loan agreement. However, in some Asian jurisdictions this is considered too detailed and so a shorter agreement or single MT799 message is used.

BAFT Sub-participation (Funded or Risk Participation)



Mechanics

1. Buyer and Seller enter into a Contract of Sale with condition that L/C is used as the method of payment.
2. Buyer, as Applicant, makes request to Issuing Bank to issue L/C.
3. Issuing Bank offers Secondary Bank an opportunity to participate in the risk of the underlying L/C either on a funded or unfunded basis. If the Secondary Bank accepts, the Secondary Bank and the Issuing Bank will enter into a Master Participation Agreement ("MPA") pursuant to which the Secondary Bank makes a participation commitment to the Issuing Bank (i.e. the Grantor) on a risk or funded basis.
4. (In the case of funded participation) Secondary Bank provides their upfront participation of the funding in respect of the L/C issuance to the Issuing Bank.
5. L/C is issued in normal way and in accordance with its terms. Either Buyer or Seller needs not be made aware of the arrangement between Grantor and Participant.
6. (In the case of funded participation) Payment made by Issuing Bank to the Secondary Bank in an amount equal to the original principal participation plus interest.
7. (In the case of risk participation) While there is no initial outlay of principal, the Secondary Bank is on risk and committed to share in any of the Issuing Bank's loss if the Buyer refuses to reimburse the Issuing Bank after Issuing Bank has paid out under the L/C to the Seller. If the Buyer fails to repay the Issuing Bank, the Secondary Bank (as risk participant) will be called upon to make a payment to the Issuing Bank in accordance with the MPA.

BAFT Sub-participation (Funded or Risk Participation)

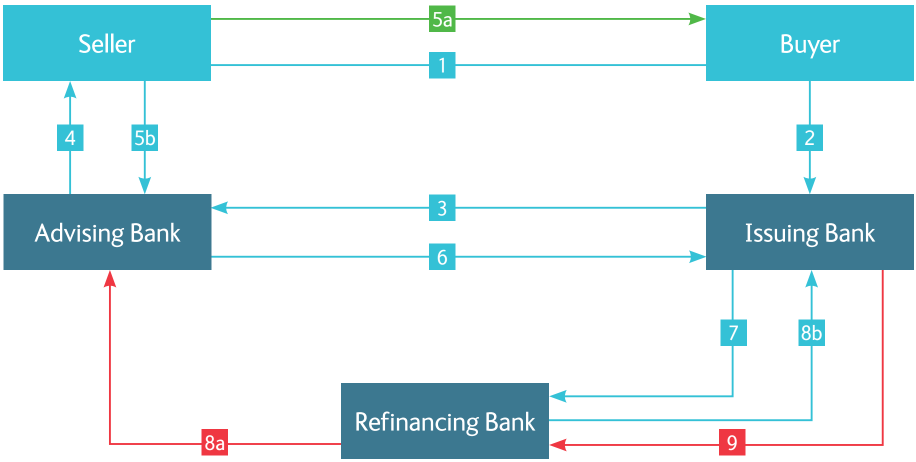
What is it?

A BAFT sub-participation is another method of an Issuing Bank selling down its risk of an underlying trade transaction to another financial institution.

Core features

1. The BAFT (Bankers' Association for Finance and Trade) form of MPA is a template master agreement for sub-participations in trade transactions, which takes in either of two forms: Funded Participation or Risk Participation (see LMA Sub-participation for difference between Funded and Risk Participation).
2. The standard form MPA has two versions – English law governed version or New York law governed. The key difference is as follows:
   - English law – The relationship between the grantor and participant is that of an independent debtor and creditor relationship, i.e. if the grantor becomes insolvent, the participant would be treated as one of the creditors of the grantor and has no preferential treatment in respect of moneys repaid by buyer to the grantor.
   - New York law – Distinguishes between "financing" (as in English law) and "true sale" for accounting purposes. If the participation transfers a direct interest in the underlying obligor and the transaction to the participant, a "true sale" is achieved and the participant is entitled to its share of payments from the buyer in the event of insolvency of the grantor even though there is no direct contract between the Buyer and the participant.

LC Refinancing



Mechanics

1 Seller and Buyer enter into a Contract of Sale with condition that a L/C is utilised for settlement of payment.

2 Buyer, as Applicant, makes request to Issuing Bank to issue L/C.

3 Issuing Bank issues L/C (assuming Buyer has some arrangement or existing credit line with the Issuing Bank).

4 Seller's Advising Bank notifies Seller that L/C has been issued.

5a Seller takes comfort from L/C receipt and initiates shipment of goods.

5b Seller presents Shipping Documents to the Advising Bank at same time as shipping.

6 Advising Bank presents documents to Issuing Bank.

7 In the secondary market, a formal refinancing request is sent by Issuing Bank to Refinancing Bank (often in form of MT799), with details of the drawdown, amount, tenor, interest rate, maturity date and repayment undertaking.

8a Refinancing Bank makes payment to beneficiary of L/C, the Seller, via Advising Bank on behalf on L/C Issuing Bank.

8b Refinancing Bank sends MT799 to Issuing Bank confirming payment effected (with repayment detail).

9 Issuing Bank repays principal and interest at maturity to Refinancing Bank.

LC Refinancing

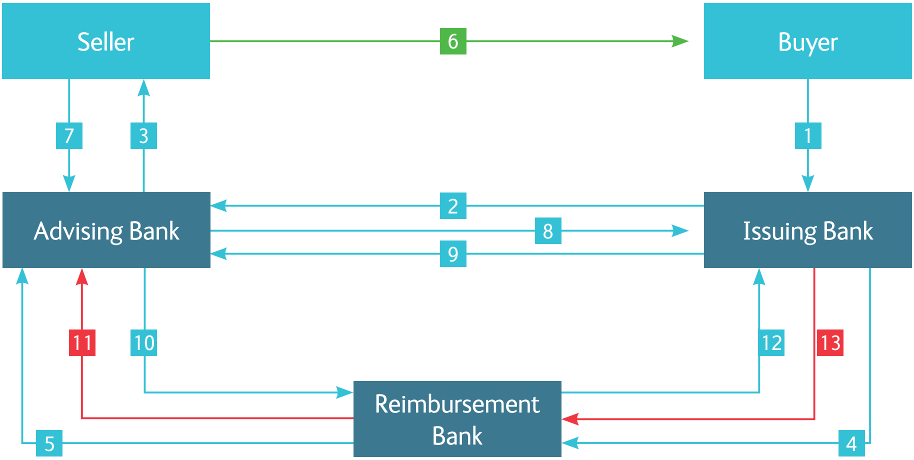
What is it?

L/C Refinancing is a way for an Issuing Bank to manage its risk and credit lines with its trade customers, by taking short term refinancing from other financial institutional participants. The Refinancing Bank will participate by financial underlying Letter of Credit issuance. It is a means of creating secondary market liquidity in the L/C market.

Core features

1. The L/C Refinancing Bank is not concerned with the Shipping Documents of the underlying L/C transaction and only acts as the financing bank.
2. Documentation can be under a master agreement between the Issuing Bank and L/C Refinancing Bank or by a simple stand alone SWIFT message.
3. It is a method of financing the Issuing Bank without the need for Documentary Credit teams in the Refinancing Bank to check underlying L/C documentation while at the same time participating in the L/C and potentially establishing relationships with the Seller.

LC Reimbursement



Mechanics

1. Instruction to issue L/C as per normal L/C transaction (see Opening a Letter of Credit).
2. Issuing Bank issues L/C.
3. Advising Bank advises Seller a L/C has been opened.
4. Issuing Bank authorises/appoints Reimbursement Bank as reimbursing under the L/C (via swift MT740) and documents the pre-agreed terms of financing. If the financing is covered by a framework agreement then this would be referenced.
5. Reimbursement Bank may add its own Irrecoverable Reimbursement Undertaking (IRU) if required to give Seller and Advising Ban greater credit comfort.
6. Goods shipped to the Buyer.
7. Documents presented to Advising Bank.
8. Documents sent to Issuing Bank for acceptance.
9. Issuing Bank accepts documents and authorises Advising Bank to claim on Reimbursement Bank for payment at sight or term as specified within L/C terms.
10. Advising Bank claims on Reimbursement Bank.
11. Reimbursement Bank makes payment to the Advising Bank.
12. Reimbursement Bank advises Issuing Bank of payment, maturity date and interest charges.
13. Issuing Bank pays Reimbursement Bank by MT202 at maturity.

LC Reimbursement

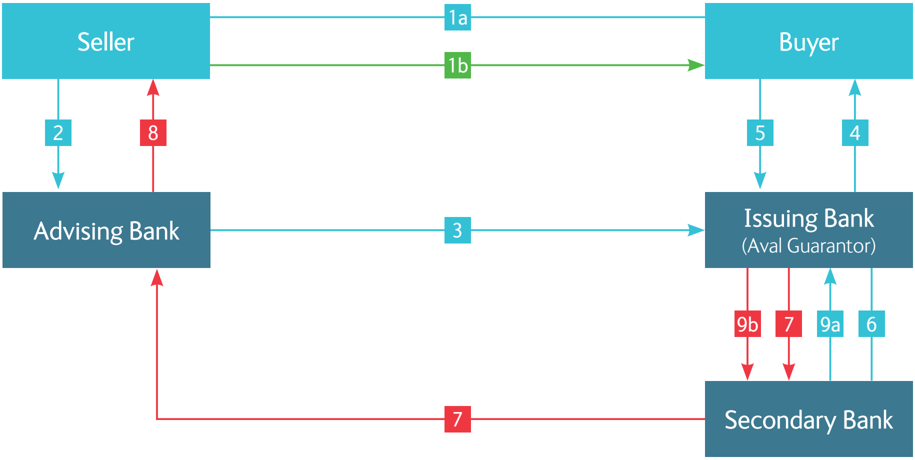
What is it?

1. Reimbursement financing is a way a financial institution can participate in the L/C secondary market. It allows a secondary bank to provide direct payment to the Seller's Advising Bank of the Letter of Credit. It also provides the Issuing Bank with short term financing and allows the Issuing Bank to manage credit lines and risk with the Buyer.
2. The Reimbursement Bank only acts in the secondary market and has no responsibility for verifying or checking Shipping Documents related to the underlying Letter of Credit.

Core features

1. LC Reimbursement is governed by ICC Uniform Rules for Reimbursement under Documentary Credit (URR 725 2008).
2. There is a highly liquid market in LC Reimbursement which allows banks to manage their financial institutional credit limits efficiently.
3. The key payment risk mitigant for the L/C Advising Bank is that the Reimbursement Bank provides the undertaking to pay rather than the Issuing Bank.
4. This is known as an Irrevocable Reimbursement Undertaking (IRU). Once issued the IRU is irrevocable and independent of the underlying credit of the Issuing Bank. This is a potential means for an Advising Bank to manage its country risk and correspondent banking relationship credit lines.

Bill of Exchange and Aval Guarantee



Mechanics

- **1a** Seller enters into a Contract of Sale with the Buyer. As a condition, the Seller requests that a Bill of Exchange or Promissory Note is avalised on the prospect of obtaining non-recourse short term financing in that the Advising Bank would be prepared, more readily, to make early payment to the Seller, if the instrument has been guaranteed (i.e. avalised) by the Issuing Bank.
- **1b** Seller ships goods to the Buyer.
- **2** Seller presents Shipping and Commercial Documents to Advising Bank at same time as shipping. Seller draws a Term Bill and requesting finance in form of discounting and payment to Seller in advance of the maturity of the Bill of Exchange (or Promissory Note).
- **3** Advising Bank forwards documents to the Issuing Bank in the normal way as Collection or presentation for Documentary Credits.
- **4** Issuing Bank advises Buyer of the Bill of Exchange and allows Buyer to examine documents for Acceptance.
- **5** Buyer accepts the Bill of Exchange.
- **6** Issuing Bank signs agreement with Secondary Bank to discount the Bill of Exchange and then the Issuing Bank adds its “pour aval” guarantee and forwards documents and Bill of Exchange for discounting.
- **7** Secondary Bank pays discounted proceeds to the Seller via their Advising Bank.
- **8** Exporter obtains early payment on the Term Bill that has not yet reached maturity and due for repayment i.e. short-term non-recourse financing.
- **9a** Secondary Bank presents Bill of Exchange for payment at maturity.
- **9b** Aval Guarantor repays Bill of Exchange to Secondary Bank at maturity.

Bill of Exchange and Aval Guarantee

What is it?

1. Another method for a financial institution to participate in an underlying Bill of Exchange payment mechanics. Avalisation is the process whereby a bank guarantees a Bill of Exchange. This is achieved by the bank endorsing the accepted Bill of Exchange on a "pour aval" basis.
2. At the Exporter's initiation, their Bank can specify that Commercial Documents are not released until the Buyer has (i) accepted the Bill and (ii) the Issuing Bank has avalised the Bill. This means the Exporter can then seek non-recourse finance on the strength of an independent bank guaranteed payment obligation.

Core features

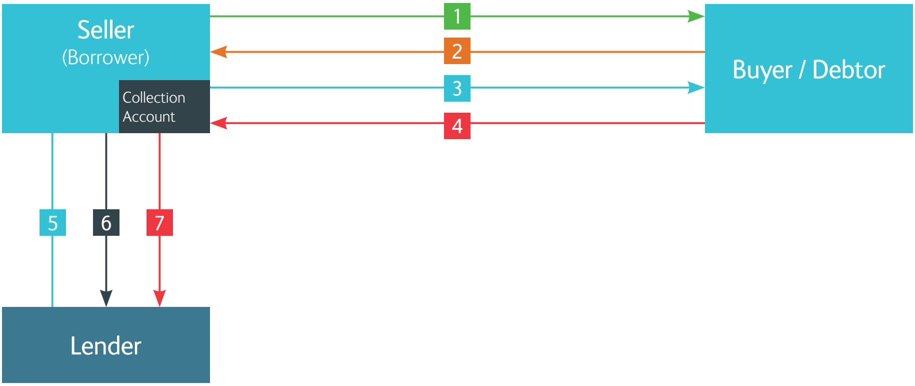
1. Adding the Aval to the Bill of Exchange is the key requirement for a bank to be able to advance against the Bill of Exchange on a without recourse basis to the Seller.
2. An avalised Bill of Exchange means that a financing bank, whether the Seller's own bank or a financial institution Secondary Bank can rely on an overseas bank guarantee of payment at a fixed date. Accordingly the financing bank is only taking risk on the corresponding Aval guarantor bank.
3. Generally governed by the 1930 Geneva Convention Providing a Uniform Law for Bills of Exchange and Promissory Notes for many civil jurisdictions or the Bill of Exchange Act (1882) for common law jurisdictions.
4. In addition to the typical Bill of Exchange drawn on the Buyer accepted and the aval added, Promissory Notes can be issued in favour of the Seller and avalised by the Issuing Bank. The Promissory Notes can then be discounted and early payment made to the beneficiary, in the same way as a Bill of Exchange and then the financing bank presents the Promissory Notes or Bill to the avalising guarantor at maturity for payment.

Simmons & Simmons

Receivables Finance

Receivables Finance

Loan Secured against Receivables



Mechanics

1. Seller supplies goods and services under a Contract of Sale to its customers.
2. Buyer owes a debt to Seller for goods or services received or performed.
3. Seller issues an invoice to the Buyer which evidences debt and payment terms due to the Seller.
4. On invoice payment date, debtor settles debt by payment to Seller's bank account.
5. Independently of the Seller, Buyer relationship in the Contract of Sale, the Bank enters into a Receivables Loan Agreement with Borrower and makes available a loan facility. Security provided is the Borrower's book debts or accounts receivable.
6. Security granted by the Borrower over debts and charges over the bank accounts into which the debts and accounts receivables are paid into – the Collection Account.
7. Scheduled Repayments made in accordance with the terms of the Loan Agreement not necessary directly linked to the Borrower's debtor book profile or monies held in the Collection Account

Loan Secured against Receivables

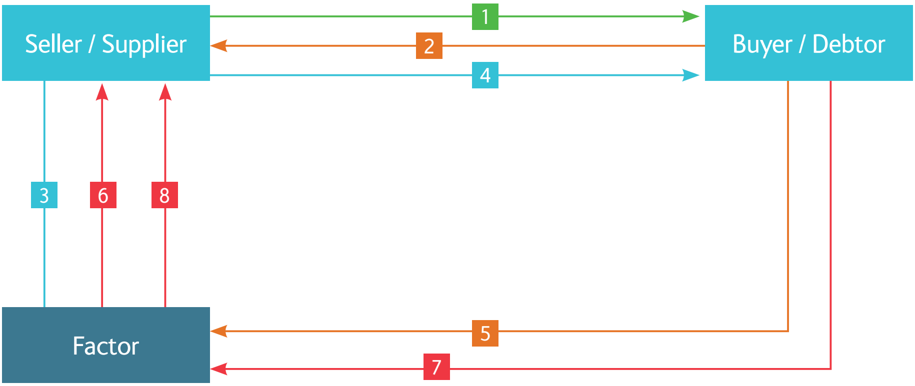
What is it?

1. A form of finance which involves a Lender providing advances to a Seller against the security of its book debts / accounts receivables.
2. Also known as Receivables Lending or Trade Receivables Loans.
3. It is no different to a standard LMA or APLMA loan except that care must be taken in taking effective security over the book debts. The typical difficulty is the exercise of sufficient control by the Lender over the book debt and the collection account to have a valid fixed charge. Furthermore, local jurisdictional considerations of the Contract of Sale must be examined and also the ability of the Seller to assign, by way of security, the receivable to the Lender.

Core features

1. The loan is a debtor creditor relationship as between the Bank and Borrower and not a purchase of the receivable.
2. Key risks are those of normal balance sheet lending of the Supplier's creditworthiness and the trade finance risk in the ability to perform.
3. Receivables are the key collateral to the financing and secured as an assignment, by way of security, pursuant to a security deed. In most jurisdictions the security deed will be registrable at a central register against the Seller in order to protect priority of the Security Interest.
4. Enforcement of security is affected by Lender's ability to show control over receivables.
5. Different from Receivables Discounting in that it does not involve an assignment of the receivables, as a True Sale.
6. This may be similar to working capital finance if the loan is given in expectation of receivables arising at a future date.
7. Some Lenders may opt not to take specific receivables security but use the existence of Receivables as informal credit comfort, or require the Borrower to satisfy financial covenants or tests.
8. Furthermore, failure to register within a certain period of time may have the consequence of a loss of priority against subsequent creditors or the security deed becoming re-enforceable on an insolvency.

Factoring



Mechanics

1 Seller supplies goods and services under a Contract of Sale.

2 Buyer owes debt, i.e. a Receivable, to Seller and evidenced by an invoice invoiced.

3 Factoring agreement is entered into between the Factor and the Seller whereby debts are assigned by way of purchase to the Factor.

4 Seller serves notice of assignment on each of the Buyer – that arrangement with Factor has been entered into.

5 The Buyer, i.e. the Debtor, now owes debt to Factor.

6 Factor makes an advance or prepayment of the invoice on account of purchase price and formula agreed in the Factoring Agreement.

7 Debtor pays debt in accordance with the Invoice on the due date to Factor.

8 Factor pays remainder of invoice amount (minus discount and other charges) to the Seller.

Factoring

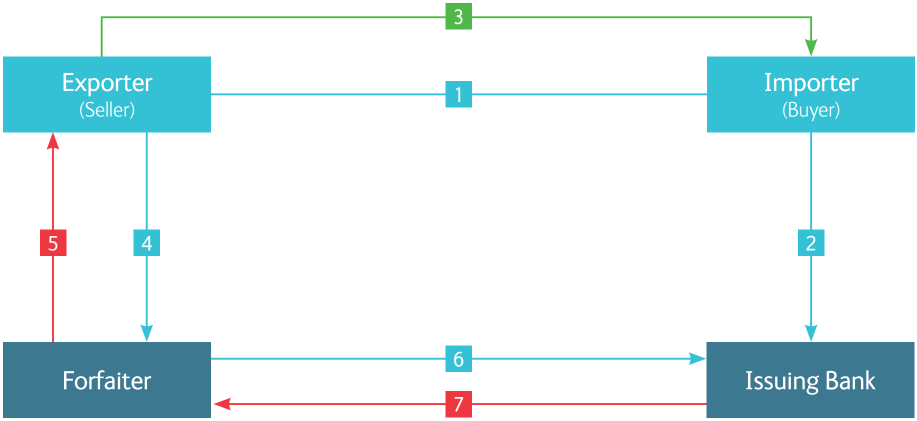
What is it?

A form of short-term financing which involves a company selling its book debts at a discount to the Factor. Usually a source of funding for SMEs as the Factor will also take responsibility for the ledger and collecting the debts.

Core features

1. The sale is almost always disclosed to the underlying debtor(s) given the need for a legal assignment of the debts to the Factor.
2. Can be either recourse or non-recourse (accounting treatment): where non-recourse, the financier may take the benefit of any credit insurance policy.
3. The Factor usually assumes responsibility for collecting the debts and administering the company's ledger. Popular for small businesses who do not have the resources or systems to collect their own debts.
4. Differs from Receivables Discounting, in Receivables Discounting the business is responsible for collecting its debts and administering its company's ledger.
5. Ownership of receivables will lie with the Factor, and the buyer settles invoices with the Factor directly instead of the Seller.
6. In addition to financing benefits the Factor will offer a risk mitigant protection against buyer insolvency.
7. Can be done on a facultative basis, where only certain receivables are sold to the Factor.
8. Most commonly arranged on a whole turnover basis, where all receivables are sold to the Factor.

Forfaiting



Mechanics

1. Buyer and Seller enter into a Contract of Sale requiring payment to be settled by Importer via L/C or Bank Guarantee.
2. Importer procures L/C or Bank Guarantee in favour of Exporter as beneficiary.
3. Exporter initiates shipping of goods.
4. Exporter delivers Shipping Documents (together with L/C) to Forfaiter.
5. Forfaiter purchases the future payment obligation of the Issuing Bank from the Exporter and pays an advance payment to Exporter on a non-recourse basis. Reliance of the Forfaiter is on the irrevocable payment undertaking the Issuing Bank.
6. Forfaiter arranges or presents Shipping Documents to the Issuing Bank in the normal way as if the Supplier.
7. Issuing Bank pays Forfaiter on maturity of the L/C or Bank Guarantee.

Forfaiting

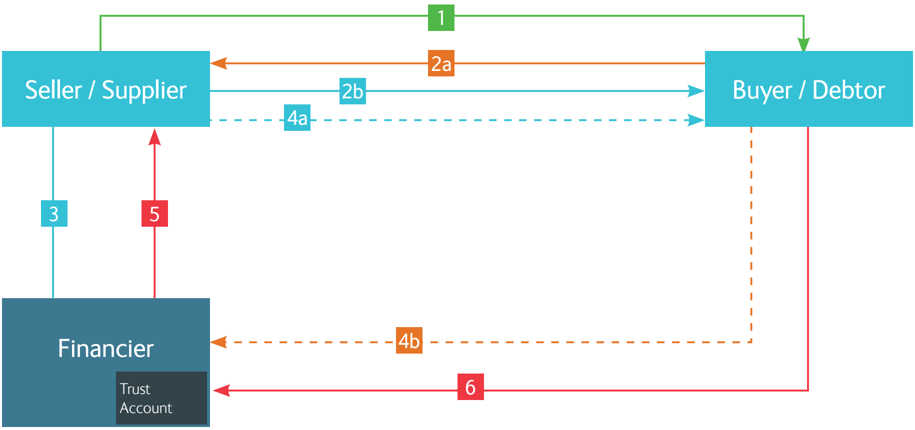
What is it?

1. A form of financing which involves an Exporter selling its receivables that has the advantage of independent credit in the form of an L/C (or other independent payment obligation/undertaking), without recourse and in advance of the due date at a discounted price, to the Forfaiter.
2. Also known as without recourse financing or discounting, or discounting of promissory notes/bills of exchange.

Core features

1. Requires an underlying documentary payment obligation from the commercial transaction (e.g. bills of exchange, letter of credit, promissory notes) independent from the Contract of Sale.
2. The underlying payment obligation may sometimes require a guarantee or aval.
3. Assignable contractual undertakings may be forfaited if suitable words are used.
4. Forfaiting is usually taken without recourse to the Exporter given the strength of the independent payment obligation of the Issuing Bank.
5. Secondary markets exists for forfaiting.

Receivables Discounting



Mechanics

1 Supplier sells goods or services to Buyer under a Contract of Sale.

2a Buyer owes a debt to the Supplier.

2b Supplier evidences debt or account receivable by issuing an invoice setting out amount and payment due date.

3 Seller and Financier enter into a Receivables Purchase Agreement (RPA). Debts are assigned by way of a purchase as a True Sale from the Seller to the Financier.

4a Arrangement can be on a disclosed or undisclosed basis to the Buyer i.e. no notice of assignment is sent to the Buyer if undisclosed.

4b If disclosed, Debtor now should make payment to Financier as new owner of the debt. However, often the purchase of debt is on an undisclosed basis given the Seller's desire to maintain the commercial relationship with their Buyer uninterrupted.

5 Financier makes a prepayment on account of a purchase price (which is usually calculated as the face value of the invoice less the Discount Fee (i.e. the financing costs for the period)).

6 Buyer pays debt on maturity of invoice into a Trust Account usually held with the Financier.

Receivables Discounting

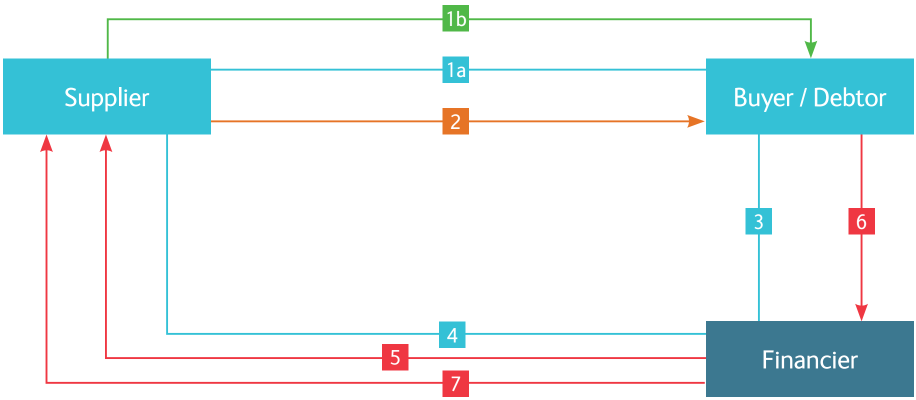
What is it?

1. A form of short-term finance which involves a company selling its book debts at a discount. The company retains responsibility for collecting the debts, administering the sales ledger and accounting to the financier in respect of the proceeds of the debts. In contrast to Factoring, invoice discounting is better suited to large companies with sophisticated sales ledger and debt collection processes.
2. These facilities can be offered on a bilateral or a syndicated basis and can be Whole Turnover but most often are Facultative.
3. Also known as Receivables Purchase, Invoice Discounting, Early Payment (of Receivables) Financing.

Core features

1. Debt proceeds are typically collected into the company's account which should be segregated from its other funds and held on trust for the financier.
2. Invoice discounting facilities can be Disclosed or Confidential (i.e. non-disclosed), but are typically confidential until a termination event occurs. For this reason, these facilities operate by way of an equitable rather than a legal assignment, and a financier will set reserves for any Contra-Accounts or often limited exposures for particular debtors.
3. Invoice discounting facilities can be offered on a recourse or non-recourse basis, depending on who assumes the debtor credit risk. However, this is not only a question of True Sale and Recharacterisation but also an accounting consideration.
4. Invoice discounting can be provided on a Whole Turnover or Facultative basis. The former means that all present and future debts are purchased (regardless of whether they are actually financed (i.e. – prepayment is made)). The latter means that only certain debts are purchased, and each of these is typically financed.
5. The facilities may be secured or unsecured. Security would typically extend to all assets including non-vesting debts. Where the company has other credit facilities, the financier would typically enter into priority arrangements whereby it would have priority over non-vesting debts.
6. If properly structured, the collection of debts can be and should be made into a trust account and therefore outside of the insolvency process and the Seller's estate.
7. Usually offered to larger corporate clients selling to multiple buyers.
8. Buyer coverage depends on how many buyers the Financier is willing to take credit risk on.
9. The Supplier retains control of the company ledger, as such must usually adhere to the Financier's reporting or account management requirements.
10. The Supplier may already have or the Financier may insist the Seller to insure the payment obligation (e.g. trade credit insurance).

Supply Chain / Payables Finance



Mechanics

1a Contract of Sale between Buyer and Supplier. Buyer is usually able to impose extended payment terms on when invoice becomes due for payment.

1b Supplier provides certain services and/or goods to Buyer.

2 Buyer owes Seller account receivables arising under the Contract of Sale and any invoices issued by the Seller. Due to negotiation strength of the Buyer, payment terms tend to be extremely long and thus adverse to the cash flow position of the Supplier.

3 Buyer Agreement between Buyer and Financier pursuant to which Buyer (i) confirms value of Accounts Payable and (ii) undertakes to pay full value to the Financier on maturity.

4 Supplier is on boarded to the Financier's payables platform and Supplier Agreement / Receivables Purchase Agreement between Supplier and Financier pursuant to which Supplier agrees to sell all those Receivables due from the Buyer to the Financier at a discount but Supplier gets paid earlier than maturity date of original invoice.

5 Financier offers to Supplier to discount Buyer Receivables by payment of a set prepayment sum (e.g. 90% of Buyer Receivables' face value less a discount charge).

6 Buyer pays to Financier full value of Buyer Receivables on maturity or invoice due date.

7 Financier pays to Supplier the balance of the purchase price (e.g. 10%) less any other deductions relating to fees and charges then applicable.

Supply Chain / Payables Finance

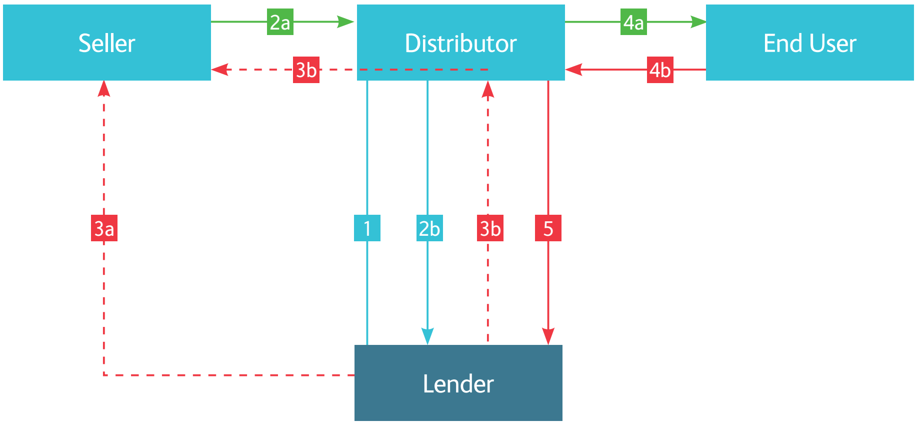
What is it?

1. A form of finance for the supply chain of blue-chip or investment grade buyers whereby a financier purchases the receivables of its blue-chip client at a discount and collects the debt from that client at maturity.
2. Also known as Supplier Finance, Approved Payables Finance, Confirming, Confirmed Payables, Reverse Factoring, Supplier Payments, and Buyer-Led Supply Chain Finance.
3. When applied as an individual 'technique' rather than a holistic category, this is known as Supply Chain Finance.

Core features

1. This technique is "Buyer-Centric" as the Buyer will arrange the financing program in favour of its suppliers. The Financier's primary relationship will be with the Buyer.
2. Buyer acts as an anchor party and will usually have established approved payables financing programs with the financier for its suppliers.
3. The Buyer has to identify accounts payable(s) where the Buyer is unconditionally, irrevocably obliged to pay, and the Supplier has the option to sell the receivables(s) for the transaction to work.
4. The credit worthiness of the Buyer is a key risk factor to the financier as the program is usually without recourse to the Supplier, for any non-payment by the Buyer.
5. Usually arranged by large corporate buyers and their financiers, but also can be implemented by non-investment grade and medium-sized buyers.
6. The Financier's recourse against the Supplier relating to commercial disputes, and representations and warranties are usually retained in the Supplier Agreement, but the Supplier might often be in a difficult jurisdiction to pursue in event of breach.
7. Buyer pays the total invoice amounts either at invoice maturity or an agreed date with the Financier.

Distributor Finance



Mechanics

1 Distributor enters into a financing agreement with Lender. This may include security over the Distributor's receivables and inventory.

2a Seller sends goods to Distributor and issues invoices to the Distributor.

2b Distributor forwards Lender the invoice as an indicator and evidence of how much it wants to draw down under the financing agreement subject to a set formula.

3a Lender pays the invoiced amount direct to the Seller; or

3b Lender pays the invoiced amount to the Distributor for onward settlement of the Seller invoice.

4a Goods sold on to the End User by Distributor.

4b Distributor receives payment from End User for delivery of goods.

5 Distributor repays the loan and interest to Lender under terms of the financing agreement.

Distributor Finance

What is it?

1. Form of financing providing loan funding to a Distributor to cover the costs of holding goods before realising funds from the sale of goods to an End User.
2. Also known as channel or floor plan finance.

Core features

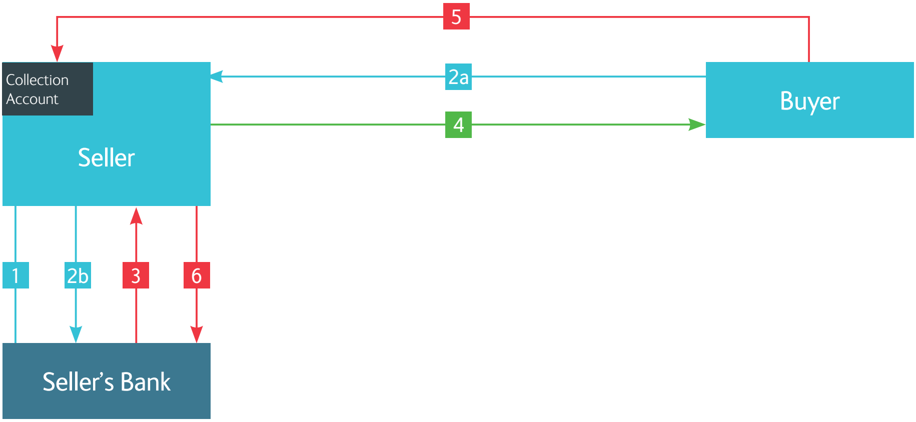
1. Offered to distributors as a direct loan.
2. Especially useful when there is a gap between credit terms and resale date.
3. No recourse to the Seller.
4. To manage risk on the Distributor's credit, Financiers may insist on additional comfort such as a stop-supply letter, buy back guarantee or risk sharing arrangement with the Seller.
5. Optimises working capital, and increases credit availability for distributors.
6. Potentially aids the Seller in generating sales growth or to provide extended credit terms for its distribution network.

Simmons & Simmons

Structured Trade & Commodities Finance

Structured Trade & Commodities Finance

Pre-shipment Finance



Mechanics

1 Seller enters financing arrangement with the Bank. This may involve security over the underlying works/receivables/finished goods related to the financing.

2a The Buyer sends a Purchase Order (PO) to the Seller.

2b The Seller forwards the PO to the Bank in evidence to drawdown working capital funds in order to manufacture or prepare the goods for shipment.

3 Funds are provided to the Seller.

4 Finished goods are sent to the Buyer by the Seller in accordance with the PO.

5 The Buyer pays the Seller on receipt of goods or in accordance with the Seller's invoice and into a controlled account or Collection Account that is subject to a charge in favour of the Seller's Bank.

6 Seller repays the Bank in accordance with the terms of the financing arrangement but usually tracking the payment patterns of the Buyer's POs or cash cycle.

Pre-shipment Finance

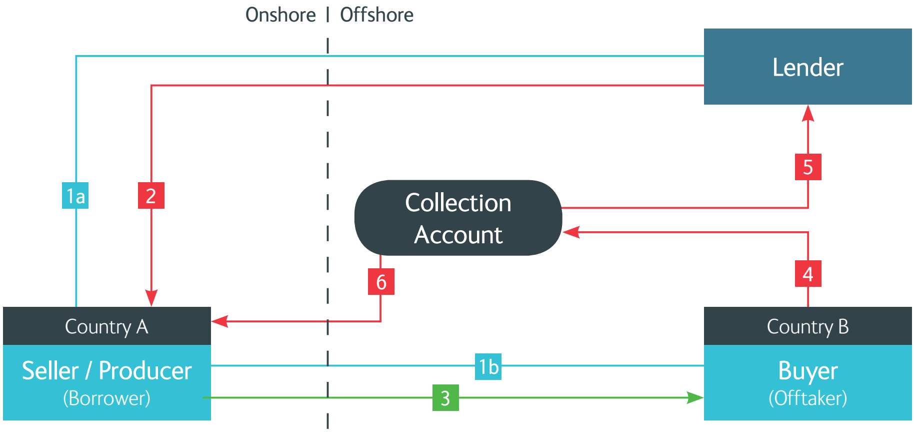
What is it?

1. A loan provided to a Supplier for sourcing, manufacturing or conversion of goods to finished goods, which are then shipped to a Buyer.
2. Also known as Purchase Order Financing, Packing Finance or Contract Monetization.

Core features

1. Financing can be provided against POs, demand forecasts, or underlying commercial contracts.
2. Can cover a series of POs or be conducted on a transactional basis.
3. The financier may provide post-shipment finance in conjunction to this PO financing arrangement, often called a Multi-Trade Facility.
4. Sources of repayment from the Buyer may include the proceeds of Letter of Credit or Bank Payment Obligations.
5. The Seller's Bank will usually lend a certain percentage of the PO, and disburse it in stages only as the PO is being fulfilled.
6. The facility's maturity date is usually agreed between the Seller and the Seller's Bank, and is linked to the date of the Buyer's payment in order to provide self-liquidating risk mitigation.
7. The Seller's Bank is subject to non-payment of the Buyer and non-performance of the Seller, this can be mitigated by:
   - having inspection rights over the Seller during the period of manufacture or conversion; or
   - assessing the commercial history and supply chain performance between Seller and Buyer.

Pre-export Financing



Mechanics

1a Lender and Seller enter into a Pre-Export Finance agreement (PXF Agreement) whereby a facility is made available for the purposes of the purchase of raw material, production and the export of goods and structured together with a specific purchase agreements in place with the Offtaker.

1b Buyer, or Offtaker, enter into longer term commodity purchase Contract of Sale with the Producer, usually matched to the tenor and repayment profile set out in the PXF Agreement.

2 An advance is made by the Lender to Seller of, for example, upto 90% of the Offtake Contract, as an utilisation of the PFX Agreement.

3 Seller then exports and ships goods to Offtaker.

4 Buyer pays for goods into a specified Collection Account, that is segregated from the general cash accounts of the Seller, and secured in favour of the Lender.

5 The Lender is then repaid scheduled repayments and interest from monies in the Collection Account or a specified debt service repayment account in accordance with the PXF Agreement.

6 Any excess cash after Lender has been repaid can then be swept or released back to the Producer in accordance with a prescribed account waterfall procedure set out in the PXF Agreement.

Pre-export Financing

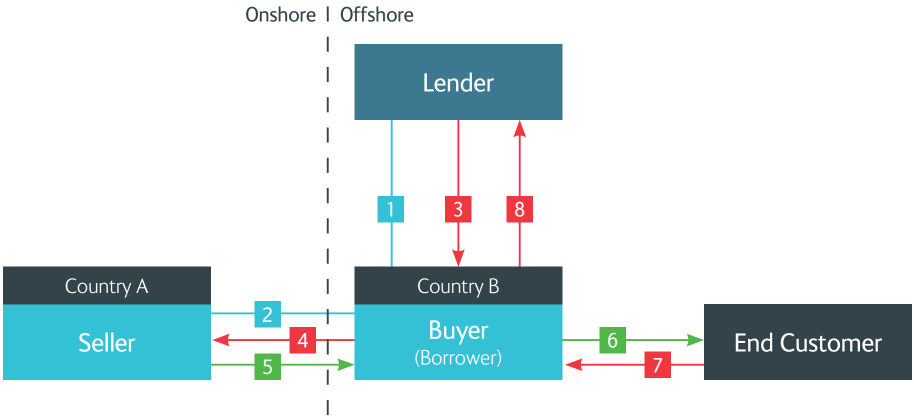
What is it?

Advance funding to an exporter or producer to enable the production or supply of goods to be exported. The Lender makes a direct loan to the Seller in order for them to purchase materials and refine products that are not yet ready for export. In turn the producer is able to give the Offtaker potential buyer credit terms. The Lender gets paid from Buyer on delivery of goods from the producer under an Offtake Contract.

Core features

1. The Exporter will often be situated in less developed and politically higher risk countries.
2. The Lender will often be located offshore in a financially mature country but will have experience in doing business in the less developed location.
3. The Lender will often have a long standing relationship with the Buyer (Offtaker) and will understand his business model as ultimately the Lender receives payment from the Offtaker in the form of the Seller's receivable.
4. Most important Security granted to the Lender are assignments of the Offtake Contract and control over the Collection Account. Therefore, the structure is often seen as having a limited security structure. Because of the jurisdiction of the Producer it is unlikely any collateral granted by the Seller will be a form of acceptable collateral for a typical direct loan.
5. LMA has now produced a LMA PFX agreement for international Pre-export transactions.

Prepayment Financing



Mechanics

1 Lender and Borrower enter into a finance prepayment arrangement subject to satisfactory conditions precedent and legal documentation.

2 Buyer and Seller enters into Contract of Sale, a specific term of which includes that the Buyer will make a prepayment of consideration in advance of receipt or shipment of goods

3 Lender advances funds to the Buyer.

4 Buyer advances prepayment to the Seller.

5 Seller can use monies to produce, mine or process goods in order to perform under Contract of Sale. Seller then ships goods to Buyer.

6 Buyer sells goods onto End Customer.

7 End Customer pays Buyer for goods.

8 Buyer repays the Lender in accordance with terms of the prepayment facility which is often linked to the delivery schedule of the goods set out in the Contract of Sale.

Prepayment Financing

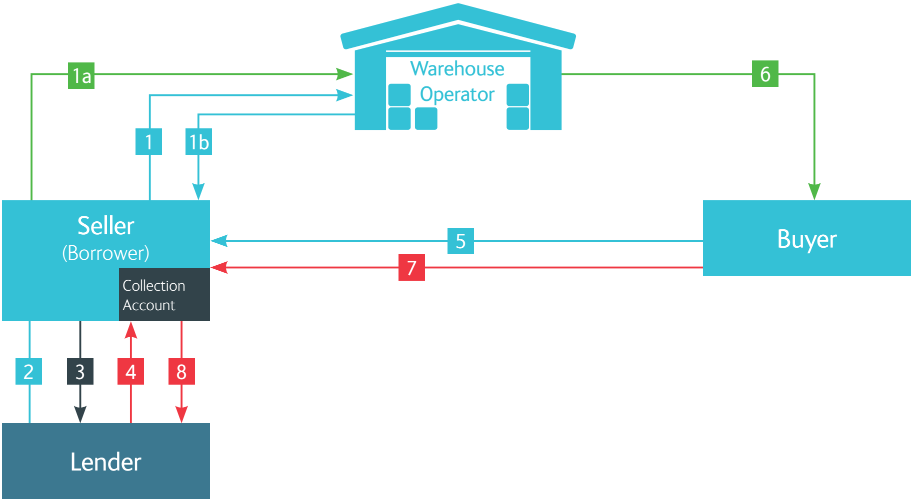
What is it?

Credit facility under which the Lender provides an advance to Buyer for prepayment to Seller under the Contract of Sale. The advance can address the Seller's funding issues and by offering the Seller advance payment before delivery of goods enables Buyer to secure a favourable long term contract price. Seller delivers goods to Buyer which in turn sells to End Customer. Repayment is realised from the sale to End Customer. This structure is also known as Indirect Pre-Export Financing.

Core features

1. Seller and Buyer in these structures are often located in different jurisdictions.
2. The loan is often made on a limited recourse basis against the Buyer. Therefore the payment risk of the Offtaker is passed onto the performance risk of the Seller. To mitigate performance risk taken by the Lender, they will often insist on performance guarantees of the Seller or some kind of ECA standby L/C or guarantees.
3. There is no direct relationship between the Lender and Seller and the transaction can be structured as self-liquidating. The Lenders, in providing this type of facility, often maintain long-standing relationships with the Buyer – although as a trader often thinly capitalised – and so understanding the supply chain cycle is of critical importance.
4. Given Lender and Borrower are both offshore, the structure tends to provide some resilience against country default.
5. Will include a limited Security package, but control by the Lender over the Export or Offshore contract and Collection Account is very important.

Warehouse and Inventory Financing



Mechanics

- **1** Borrower and warehouse provider enter into an agreement.
- **1a** Goods are sent to the warehouse.
- **1b** Warehouse issues a warehouse receipt for storage of goods.
- **2** Lender and Borrower enter into financing agreement.
- **3** Borrower provides security to Lender in form of a Charge over receivables; a Security Interest over the Warehouse Receipts; and Pledge of goods.
- **4** Lender releases financing to Borrower.
- **5** Buyer sends PO to Seller under existing or new Contract of Sale.
- **6** Seller sends goods to the Buyer from the warehouse.
- **7** Buyer pays the Seller for the goods. The payment is placed into the Seller's bank account (usually subject to a Charge) held with the Lender.
- **8** Seller repays Lender in accordance with the financing agreement but usually linked to monies due and received from the Buyer ensuring Self Liquidating characteristic of the financing arrangement.

Warehouse and Inventory Financing

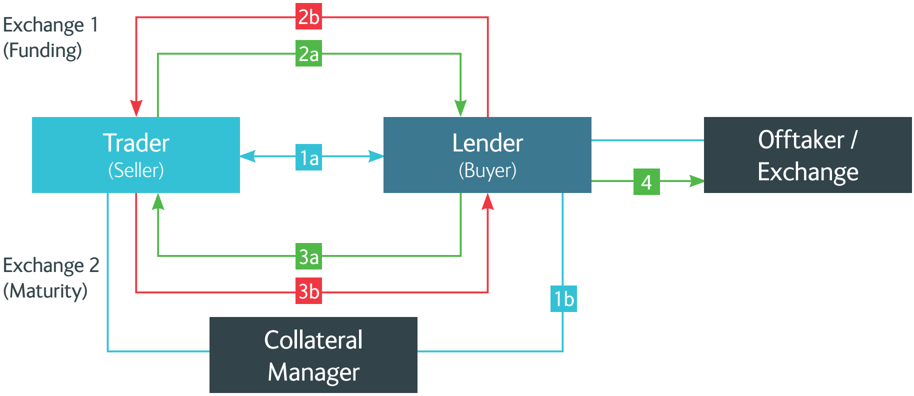
What is it?

1. Financing given to a Borrower in exchange for security over inventory or goods.
2. Also known as Warehouse Finance, Inventory Sale and Repurchase.

Core Features

1. Usually a short-term uncommitted facility with annual review.
2. Usually constrained by the time frame that inventory awaits sale.
3. It is possible for the Borrower to store the goods on-site, and not use a warehouse operator. In such a case, the Borrower will give the Lender a pledge of the goods, or an assignment of rights relevant to the inventory location, in place of warehouse receipts.
4. Ancillary agreements with warehouse operator and third party collateral management or inspection agents may be used often known as a Collateral Management Agreement.
5. Goods that are in transit may also be included within this arrangement. Security over goods in transit may be given in form of bills of lading consigned to the Lender.
6. A major risk to the Lender is the resale value of the inventory/goods. The loan is usually only a percentage of the inventory's value. The Lender must be confident of its ability to re-possess and dispose of the inventory in the event of Borrower default. Typically confined to qualifying marketable commodities which value is easy to ascertain. Where the finished goods or work-in-progress has potential lack of marketability, Lenders may require a buyer to be identified as a condition to drawdown.
7. Title to the goods will usually be held by the Lender for the duration of the loan. Title is released when the loan is repaid, or the inventory is purchased.
8. To perfect any security given, the goods must be identifiable, and the Lender must be able to exert control over the goods.
9. It is a risk that a Borrower may double-pledge their goods. Lenders should check that they can control good title over the goods.
10. Destruction of goods will lead to a Borrower being unable to repay. Lenders should ensure that appropriate insurance is taken to cover loss and damage to the goods.

Repurchase (Repo)



Mechanics

1a Seller, usually a trader, enters into a master purchase and sale agreement (MPSA) with a Buyer, usually a Lender or financial institution.

1b The Buyer, Seller and a Collateral Manager can sign upto a Collateral Management Agreement. The Collateral Manager, usually a warehouse operator or surveillance company, is employed to control the asset in its storage facility, monitor levels of the commodity and report directly to the Buyer.

2a A Repo is a two part exchange between the parties. In the first exchange, Seller delivers the assets to the Buyer, together with the commitment to buy back the assets at a specified date in the future.

2b Simultaneously, the Buyer will advance cash to the Seller at an amount equal to the market value of the assets.

3a The second exchange occurs at maturity, when the Buyer returns the asset to the Seller.

3b Simultaneously, the Seller repays the original cash amount to the Buyer plus an agreed sum of interest – known as the Repo Rate.

4 In the event of a default by the Seller (to repurchase the goods), the Buyer, as owner of the goods can sell them to a pre-arranged conditional offtaker (in less liquid goods) under a conditional offtake agreement or sell the goods on a commodity exchange to recover the original position.

Repurchase (Repo)

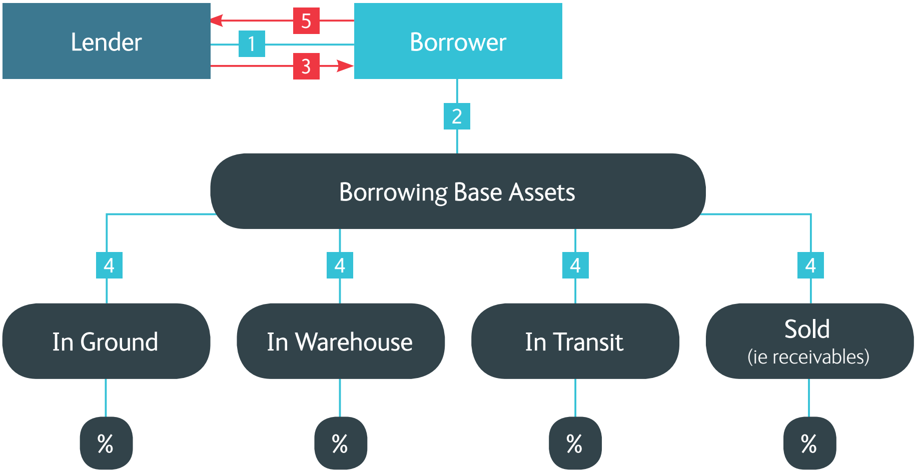
What is it?

A Repurchase or Repo is a form of inventory finance pursuant to which a creditor purchases, on a True Sale basis and as owner, goods from a debtor and sells the goods back to the debtor following the expiry of a specified period. The Repo is effectively a cash transaction with a forward contract. The difference between the full price and spot price is effectively the interest and the settlement date of the forward contract is effectively the maturity date.

Core features

1. The Repo transaction can be perceived as a collateralised loan. However, the legal relationship is as a sale and repurchase and not a debtor creditor relationship as per a loan. Given that the Repo is entered into on the basis of full True Sale and title transfer the Buyer must complete all the correct due diligence to ensure the Seller has good title and can legally transfer title to the Buyer.
2. To mitigate exposure from changes in market price movement, the commodity is usually marked-to-market. Therefore, this allows the Buyer to call for additional cash or top-up of additional asset should the price fall.
3. Given that the Buyer is obligated to return the assets at maturity there must also be a right of set-off in the event of an insolvency of the Seller prior to the maturity date. Furthermore, the Lender will want the resale to be on a "as is, wherever basis" to avoid additional disputes on the goods on return.
4. There is the risk of re-characterisation by the courts that the sale and purchase of goods is characterised as loan secured on the goods. If that is the case, then the Lender will be deemed not to own the goods and the goods will form part of the Seller's estate on an insolvency. It is more than likely that there would be no valid security in that case and the Lender merely has an unsecured claim against the debtor.
5. In order to avoid any re-characterisation these must be carefully drafted documents.
6. The key to a Repo is that the Lender has ownership in absolute terms and not just a security interest over the goods. The benefit of this is that, on an insolvency of the Seller for example, the Lender can sell the goods without any competing claims over the goods.
7. As an owner of the goods, the Lender must act as an owner and have the requisite skills to deal in that particular goods or commodity. Issues that might need to be considered by the Lender include risks associated with insurance responsibility, relationship with the storage provider or damage or loss of goods.

Borrowing Base Lending



Mechanics

1 Borrowing Base facility agreement signed between Lender and Borrower whereby utilisations can be made provided the Borrower demonstrates an adequate cover of collateral relative to the amounts borrowed – this is known as the Borrowing Base.

2 Security interests, or otherwise known as collateral, is granted under Security Agreement(s) by the Borrower and other security provider(s) in favour of the Lender over the assets in the Borrowing Base. Borrower and the other security provider perfects the securities created under the Security Agreements(s) in accordance with local law requirement.

3 Lender provides funding to Borrower based on a percentage of the available collateral pooled within the Borrowing Base.

4 The Lender can adjust the credit limit in line with the Borrowing Base from time to time.

5 Repayments made by Borrower to Lender as scheduled under terms of Loan Agreement or in the event of any price fall or collateral value deterioration.

Borrowing Base Lending

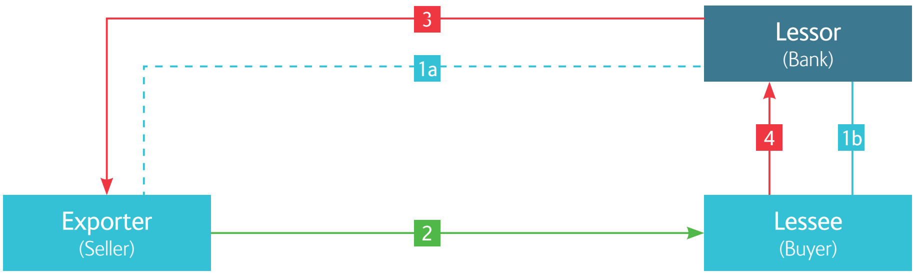
What is it?

Credit facilities secured by way of collateral furnished by the Borrower or third parties for a flexible source of funding. The amount of available facility is adjusted according to the underlying value of the collateral, i.e. the Borrower may increase the credit limit in line with its financing requirements from time to time by varying the amount of the collateral furnished.

Core features

1. Borrowing Base Report will be issued periodically during the term of the facility to determine the value of the Borrowing Base and thus the credit limit.
2. The key difference between a Borrowing Base Lending and a traditional working capital asset based facility is that Lender of a Borrowing Base Lending has discretion (subject to agreed parameters) to revise commodity pricing assumptions in valuing the collateral and setting the credit limit.
3. The collateral pool to be taken will vary depending on the asset base and the jurisdiction in which they are situated. These often can be (a) security over bank accounts, (b) assignment of key contracts, (c) stock or inventory and (d) security over physical reserves in the ground.
4. In taking security over the Borrowing Base, the Lender should take note the legal and regulatory requirement (e.g. licensing) in the jurisdiction where the Borrowing Base assets are located, and the effective creation and enforcement of securities in these jurisdictions.
5. Depending on the quality of the collateral, the Lender will discount, by a percentage of the asset being furnished or reported in the Borrowing Base Report. For example, cash in a charged account may be allocated a percentage of 100% due to the ease with which that collateral can be realised. Security over receivables may be allocated slightly less if in an easily reasonable jurisdiction against a debt in that jurisdiction (or whether or not insurance is attached to a particular receivable). However, security over production inventory, or even more so raw asset in ground (i.e. reserves) will be allocated at a far lower percentage given the difficulty to liquidate the security asset.

Lease Financing



Mechanics

- 1a Exporter and Lessor usually a bank or financial institution enter into sales agreement for the purchase of equipment or machinery.
- 1b Lessor enters into a leasing agreement with the Lessee.
- 2 Delivery of equipment is usually made directly to the Lessee.
- 3 Bank pays Exporter amounts in the invoice.
- 4 Lessee makes repayment and interest payments to the Lessor.

Lease Financing

What is it?

A medium term financing structure used primarily for assets such as machinery, equipment and vehicles. The lease is a contract where the Lessor provides an asset for usage to the Lessee for a specified period of time in return for specified payments. The Lessee has the legal right to use the asset for the period without owning or title to the asset which remains with the Lessor.

Core features

Leases fall into two categories:

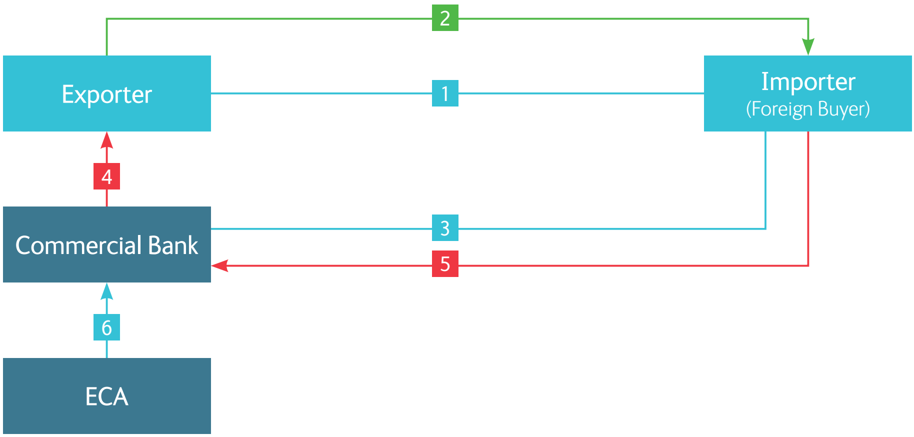
1. Operating lease – often termed as a rental and where the Lessee uses the asset but risk of ownership and all corresponding related rights (e.g. insurance and maintenance) is borne by the Lessor and remains on the Lessor's book. The duration of the lease is usually much shorter than the expected life of the asset.
2. Finance lease – where practical risks of ownership are borne by the Lessee. From the lease payments the Lessor is expecting to recover the capital cost of the equipment together with interest for the period of the lease. From a tax perspective the equipment remains on the books of the Lessee.
3. Detailed knowledge of the legal and tax implications is crucial in leasing. For example, should, and who is responsible for any sales tax. Legal ownership may depend on a particular's jurisdiction interpretation of whether an operating or financing lease considering factors such as length of lease, in relation to the life of the asset or transfer of ownership. Legal ownership is important in relation to allocation of commercial and political risk. For example, who is responsible for any damage or third party claims.
4. Often Export Credit Agencies (ECAs) offer insurance policies to facilitate this form of trade finance (see ECA Finance).

Simmons & Simmons

Export Credit Agency Finance

Export Credit Agency Finance

Supply Credit: ECA Loan and Facility Guarantees



Mechanics

1. Exporter and Importer enter into a Contract of Sale or supply of goods or services to the Foreign Buyer. Rather than Exporter offering credit payment terms, a commercial bank offers accompanying financing to the Importer.
2. Exporter Ships goods to Importer on credit terms.
3. Bank enters into Loan Agreement direct with Foreign Buyer.
4. Bank pays the Exporter as a utilisation of the Loan Agreement.
5. Importer repays loan on maturity in accordance with Loan Agreement terms.
6. ECA provides a guarantee to the Bank that the Foreign Buyer will repay amounts due under Loan Agreement thereby eliminating the Bank taking country risk exposure on the Importer.

Supply Credit: ECA Loan and Facility Guarantees

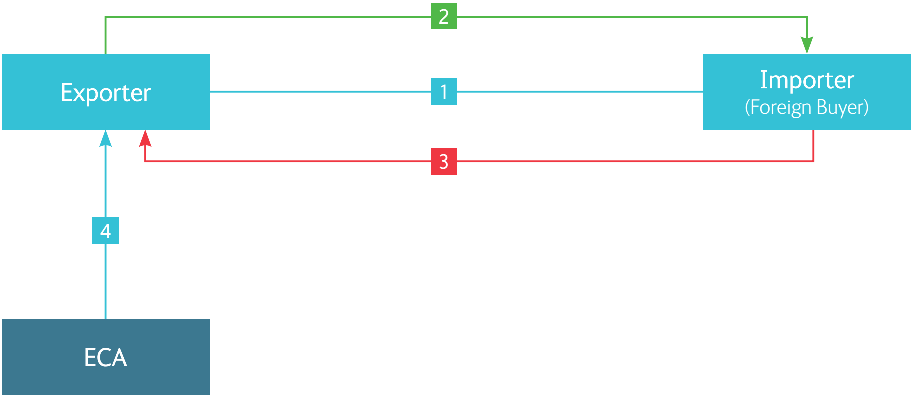
What is it?

An ECA provides a guarantee to a commercial bank in the jurisdiction of the Exporter to enable the bank to make a loan to an overseas buyer to finance the purchase of goods and services from an Exporter.

Core features

1. Enables Exporter to provide Buyer with commercial credit while not on the Exporter's own balance sheet.
2. Commercial credit risk on the Buyer and country risk is transferred to the ECA.
3. Aim of the ECA backing is to encourage a country's export industry and thus boost a country's balance of payment.

Supply Credit: Insurance Cover



Mechanics

1. Exporter and Foreign Buyer enter into a Contract of Sale and terms include period of commercial credit for the Foreign Buyer to settle invoices.
2. Goods shipped for export.
3. Payment made by Importer on agreed maturity and invoice due date.
4. ECA provides Exporter with Insurance Policy to cover payment default of the Importer.

Supply Credit: Insurance Cover

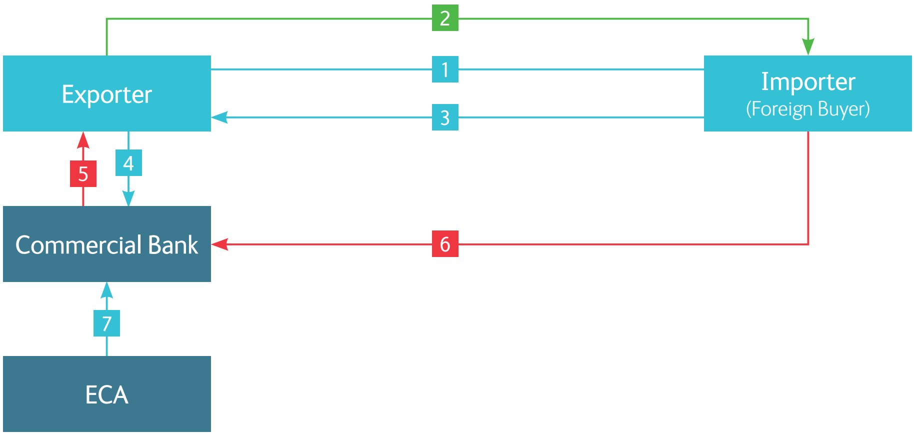
What is it?

Insurance cover on deferment of payment by the Exporter to its foreign counterpart for the supply of goods and services. Policy provided by Export Credit Agency (ECA) to promote a nations exports.

Core features

1. Enables Exporters to offer favorable and competitive credit terms to Foreign Buyer.
2. Mitigates credit risk of Foreign Buyer defaulting on payment.
3. ECA offers lower costs to Exporter compared to commercial financing costs.
4. Exporter can transfer the benefit of the policy to a bank or other financial intermediary to discount the underlying credit without recourse.

Supply Credit: Bills and Notes Facility Guarantee



Mechanics

1. Exporter and Importer enter into a Contract of Sale for supply of goods and services to a Foreign Buyer. Payment terms are via acceptance of Bills of Exchange or Promissory Notes of the Importer.
2. Exporter ships Goods.
3. Importer pays for Goods with accepted Term Bills or Promissory Notes. i.e. undertaking to pay on future date otherwise known as the Maturity Date.
4. The Bank purchases the bills or notes from the Exporter at a discount.
5. Bank pays the Exporter in advance assisting with working capital financing of the Exporter.
6. Importer makes payment under the bills or notes on maturity direct to bank upon presentation.
7. ECA provides a guarantee to the commercial bank that the Buyer will pay the amounts due under the bills or notes on the Maturity Date.

Supply Credit: Bills and Notes Facility Guarantee

What is it?

An Export Credit Agency (ECA) will provide a guarantee to a bank to cover payments due under Bills of Exchange or Promissory Notes from a Foreign Buyer, purchased by a bank from an Exporter.

Core features

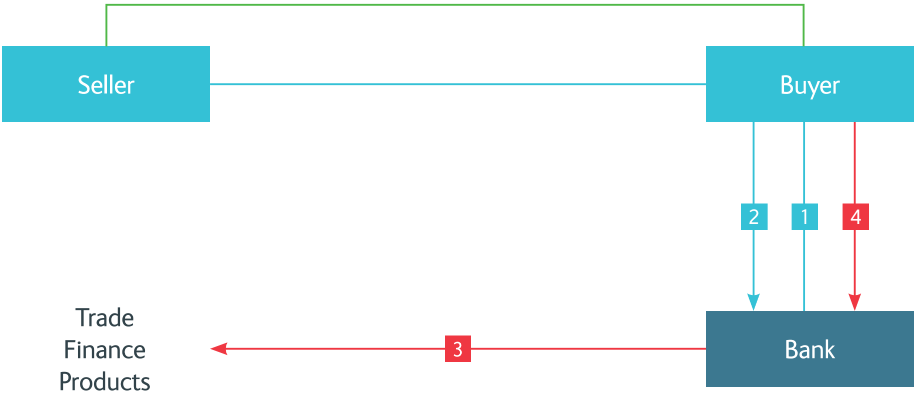
1. Exporter increases competitive advantage by offering commercial credit to Foreign Buyers.
2. Exporter is paid by the commercial bank as soon as goods are shipped helping cash flow and mitigating payment and country risk of the Foreign Buyer.
3. Commercial bank receives an ECA guarantee of the Foreign Buyer's credit risk.

Simmons & Simmons

Loans & Security

Loans & Security

Trade Finance Facility



Mechanics

1 Trade Facility Letter signed between Bank and Borrower, a Buyer for example, that will pay for imports via Letters of Credit or other trade finance instruments.

2 Borrower utilises by requesting Bank to provide specific trade finance product(s). For example, as applicant under a Letter of Credit, it applies for its Bank to issue a Letter of Credit or SBLC or Bank Guarantees.

3 Bank provides trade finance products as a utilisation of the credit line agreed in the Trade Facility Letter.

4 Repayment made by Borrower to Bank under terms of the Facility Letter.

Trade Finance Facility

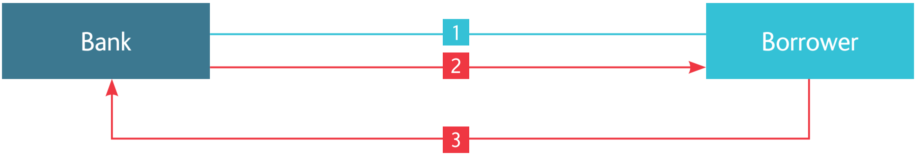
What is it?

A consolidated working capital facility, and usually on demand, provided by Bank to Borrower with an aggregate credit limit allocated among a variety of trade finance products.

Core features

1. Typical trade finance products available under a Trade Finance Facility include the following:
   - Issuance of import L/C
   - Issuance of back-to-back L/C
   - Issuance of standby L/C
   - Import loans under L/C
   - Shipping guarantee
   - Import loans under collection
   - Export loans under collection
   - Export L/C negotiation or financing
2. Advantage to Borrower is it provides Borrower with a variety of trade finance solutions (e.g. payment options) as may be required from time to time depending on their import and export activities or what is required under their Contract of Sale.
3. This type of facility would typically be documented under an individual Bank's general facility letter with the Bank's trade specific terms and conditions annexed and incorporated.
4. The main security granted for this type of financing is pledges over the Shipping Documents in the L/C Collection process. Such security or pledges may often be created under the opening mandate letter or by entering into a trade security document over the trade related proceeds.

Unsecured Facility (Bilateral)



Mechanics

1. Bilateral Loan Agreement signed between the Bank and the Borrower.
2. Bank provides funding to the Borrower or Borrower utilises an overdraft.
3. Either scheduled Repayments made by the Borrower to the Bank as set out under terms of the Loan Agreement or, more typically, the loan or facility provided by the Bank is on an 'on-demand basis'.

Unsecured Facility (Bilateral)

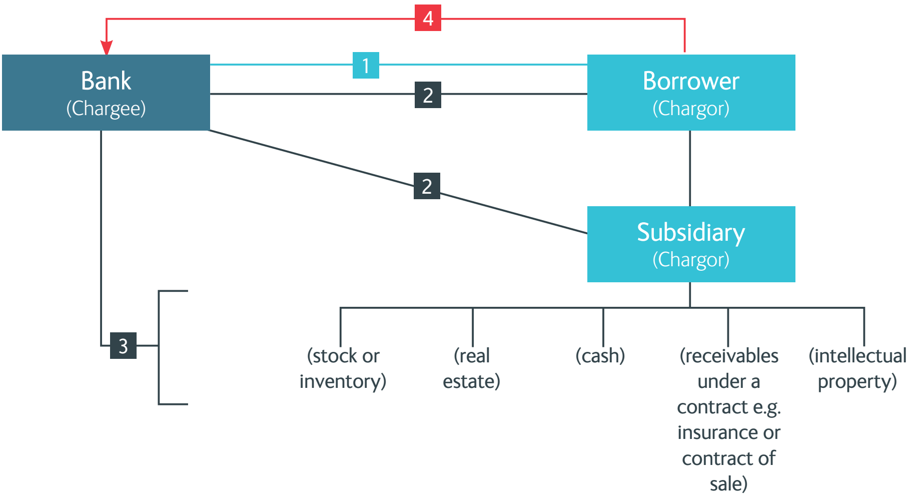
What is it?

A bilateral facility is a facility provided by a single creditor to a borrower, i.e. only two parties (the bank and the borrower) are involved. An unsecured facility means the bank has no direct recourse to any assets if the borrower fails to repay.

Core features

1. This structure is typically used for smaller term loans, revolving credit and overdraft facilities. This is in contrast to syndicated facilities which banks group together to form a syndicate to lend a larger sum of money.
2. Advantage is that the financing is private between the two parties. This allows for simpler documentation although often on the banks standard forms. Ongoing confidentiality is also easier to be kept, in contrast to information being provided and shared among all banks in a syndicated facility.
3. Bilateral facility would require less fees as there would be no arrangement or underwriting fees as would have been required for a syndicated facility.
4. In an unsecured facility, the banks would have to satisfy themselves that the borrower has the ability to repay based on their financial conditions and strength of financial covenant alone with no pledges or asset security.

Secured Facility (Bilateral)



Mechanics

1 Bilateral Loan Agreement signed between the Bank and the Borrower.

2 Security Interests, or otherwise known as collateral is granted under Security Agreement(s) by the Borrower and other security provider(s) (these may be within the group structure or third party security providers) in favour of the Bank over any or all of their assets as the parties may agree. Borrower (or Chargor) and the other security provider(s) perfects the securities created under the Security Agreement(s) in a manner determined by the asset class and in accordance with local law requirement.

3 Bank provides funding to Borrower as per the terms of the Loan Agreement.

4 Scheduled Repayments made by the Borrower to the Bank under terms of the Loan Agreement.

Secured Facility (Bilateral)

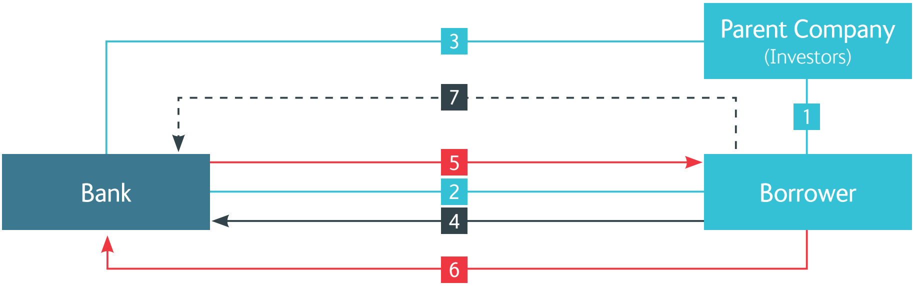
What is it?

A bilateral facility provided by a bank to a borrower with security and guarantees granted by the borrower, any material subsidiaries or other members of the group in favour of the bank. A full fixed and floating security agreement given by a Borrower – or otherwise known as the Chargor – is often referred to as a Debenture.

Core features

1. The extent to which security and guarantees are to be granted will depend on the assessment of the value of the borrower's collateral on offer against the size of the facility.
2. A comprehensive security and guarantee package can include the following: security over land, property, shares in the borrower and other subsidiaries of the group, receivables, cash held in bank accounts, machinery, intellectual property, and guarantees granted by any company or individual. The securities can be over assets where ever the borrower might operate.
3. An advantage is that security, charges or pledges protects the bank in the event of the borrower's insolvency, giving the bank priority over unsecured creditors and allow them to maximize their recoveries in such circumstances.
4. Security is typically required to be registered at the relevant Companies Registry, depending on the laws of the relevant jurisdiction and the type of collaterals charged or pledged. These registrations are also often subject to statutory time limits within which registration has to be submitted or completed. Registration perfects the security by providing notice of its creation to third parties and ensure the security takes priority over future securities on the same assets.

Secured Facility (Subordination)



Mechanics

1. Existing Shareholder Loan or Investor Loan Notes injected into the Borrower by the Parent as an alternative to equity funding (e.g. for tax purposes) creating debt due from Borrower to Parent.
2. Loan Agreement signed between the Bank and the Borrower. Bank will want to ensure that its debt is priorities ahead of inter group funding.
3. Deed of Subordination/Deed of Priority entered into between the Bank, the Parent Company and the Borrower in respect of the Shareholder Loan Investor/Loan Notes.
4. Security granted under Security Agreement over any assets of the Borrower in favour of the Bank.
5. Bank provides funds to Borrower.
6. Scheduled Repayments made by the Borrower to the Bank under terms of the Loan Agreement.
7. Under the terms of the Deed of Subordination/Deed of Priority any claim made by the Parent against the Borrower for repayment of debt will be prohibited. Furthermore, on an insolvency of the Borrower, any proceeds of a liquidation due to the Parent will be directed to the bank in satisfaction of monies due.

Secured Facility (Subordination)

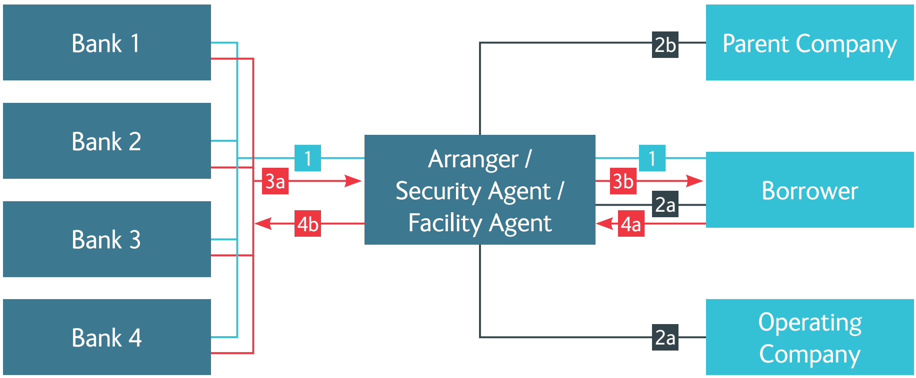
What is it?

When a facility is provided by a Bank to a Borrower, it often requires existing intragroup debt to be subordinated. A Deed of Subordination/Deed of Priority will be entered into between the Bank, the Parent Company and the Borrower in respect of any Shareholder Loans or Investor Loan Notes in order to subordinate any claim the Parent or Investor might have against the Borrower for repayment of the Shareholder Loan or Investor Loan Notes until such time as the Bank is repaid in full.

Core features

Deed of Subordination/Deed of Priority – Given the Parent Company and the Bank are both creditors of the Borrower and, as the case may be, grantee of security over the same assets of the Borrower, the Bank, Parent Company and the Borrower will enter into (1) a Deed of Subordination pursuant to which the Parent Company/investor as junior creditor gives an undertaking not to collect the debts under the Shareholder Loan until the debts under the Loan Agreement has been paid in full, and/or (2) a Deed of Priority that the security interests created securing the debts under the Loan Agreement shall rank in priority to that created securing the Shareholder Loan.

Syndicated Secured Facility



Mechanics

1 Loan Agreement signed between the Banks, the Arranger, the Security Agent, the Facility Agent and the Borrower.

2a Security granted under various Security Agreement(s) by the Borrower and other security provider(s) in favour of a Security Agent over any or all of their assets as the parties may agree and perfects the security created under the Security Agreement(s) in accordance with local law requirement.

2b Parent Company granting a guarantee in favour of the Security Agent.

3a Banks provide their participation of the funding to the Facility Agent.

3b Facility Agent passes on funding of all Banks to the Borrower.

4a Scheduled Repayments and interest payments are made by the Borrower to the Facility Agent under terms of the Loan Agreement.

4b Schedule Repayments, interest and sometimes fees in turn are made by the Facility Agent to the Banks in accordance with their participation or share in the Loan.

Syndicated Secured Facility

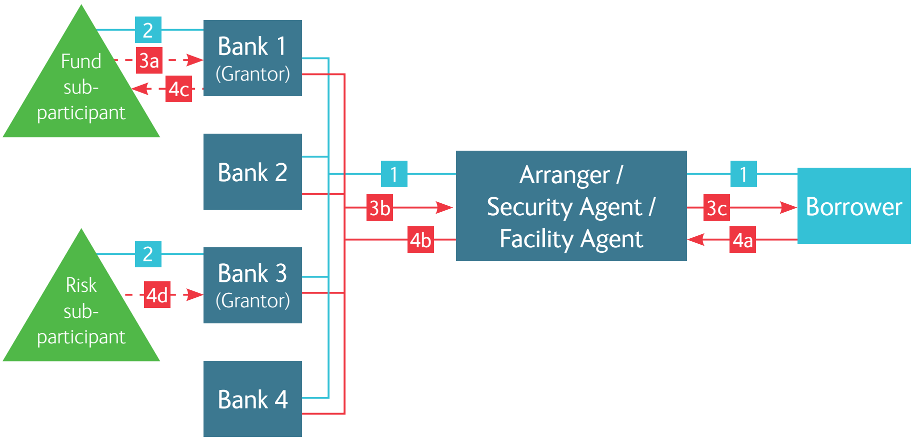
What is it?

A syndicated facility is a facility provided by two or more creditors each lending a proportion of a facility to a borrower. Where syndication is limited to only a few banks then it is often referred to as a "Club Deal".

Core features

1. The Arranger is also sometimes called Bookrunner or Mandated Lead Arranger.
2. Syndicated loans generally gives the borrower access to a larger amount of funding by sharing the risk of the Borrower among a number of Lenders.
3. A syndicate can be more effective way of borrowing in different currencies than a bilateral loan.
4. Fees for the arranger, security agent, facility agent can be more substantial than a bilateral facility.
5. Involves more complex documentation such as APLMA or LMA Documents, e.g. where it deals with inter-bank arrangements.
6. Security Agent holds the security on trust for all the lenders. Security trust provisions often contained in a security trust deed or as part of the intercreditor deed.
7. A Lender's claim against the Borrower is regulated by an intercreditor agreement. This agreement will also restrict any claim the investors might have against the Borrower in terms of shareholder loans or dividends and it will also regulate the entitlement of and different tiers of lenders, for example, mezzanine debt or discounted bonds.

LMA Sub-participation (Funded or Risk Participation)



Mechanics

- **1** Loan Agreement signed between the Banks, the Arranger, the Security Agent, the Facility Agent and the Borrower.
- **2** Sub-participation Agreement signed between the relevant Bank (the Grantor) and its sub-participant (Participant).
- **3a** (In the case of funded participation) Funded sub-participant provides their participation of the funding to the relevant Bank.
- **3b** Banks provide their participation of the funding to the Facility Agent.
- **3c** Facility Agent passes on funding of all Banks to the Borrower by way of utilisation of the Loan Agreement.
- **4a** Scheduled Repayments made by the Borrower to the Facility Agent under terms of the Loan Agreement.
- **4b** Schedule Repayments in turn made by the Facility Agent to the Banks in accordance with their participation in the Loan.
- **4c** (In the case of funded participation) Scheduled Repayments and interest in turn made by the relevant Bank to its funded sub-participant in accordance with the Sub-participation Agreement.
- **4d** (In the case of risk participation) If the Borrower fails to make Scheduled Repayments to the relevant Bank (i.e. in a default situation), the risk sub-participant will be called upon to make a payment to the relevant Bank (the Grantor) in accordance with the Sub-participation Agreement thus sharing in the Borrower default risk.

LMA Sub-participation (Funded or Risk Participation)

What is it?

1. A method of selling risk in a particular underlying credit. Used by lenders to manage their balance sheet.
2. A sub-participation occurs when a lender under a Loan Agreement in a particular credit sub-contracts all or part of its risks to another financier by way of a Sub-participation Agreement between the lender as grantor and such financier as sub-participant.

Core features

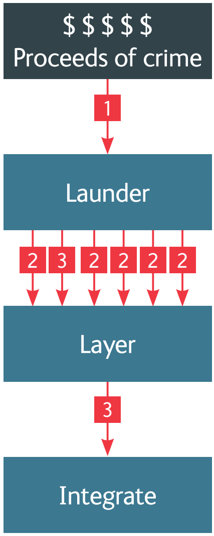
1. Sub-participation typically takes either of the two forms: Funded Participation or Risk Participation.
2. Funded Participation – The sub-participant provides funds to the grantor in order for the grantor to fulfil its obligations under the Loan Agreement to fund the borrower. In return, the grantor pays a fee to the sub-participant and passes it capital and interest when the grantor receives the same from the underlying borrower.
3. Risk Participation – The sub-participant shares only the risk and only reimburses the grantor in the event of default the amounts unpaid by the borrower. A risk participation is therefore similar to a guarantee but in the event of reimbursement to the grantor, the sub-participant shall acquire rights against the borrower by way of subrogation, i.e. it will substitute for the grantor and may pursue against the borrower.
4. LMA provides a suite of documentation, referred to as Secondary Market documentation.

Simmons & Simmons

Trade Based Money Laundering

Trade Based Money Laundering

Invoice Fraud



Mechanics

1 **Launder** – criminals place, deposit and wash illicit money through financial institutions via small quantities deposits so not to trigger financial alerts.

2 **Layer** – that money is then transferred to and from multiple bank accounts, banks and jurisdictions to hide its origins.

3 **Integrate** – The criminals then integrate the illicit sums back into the real economy through transactions such as real estate, asset and stock purchases.

Invoice Fraud

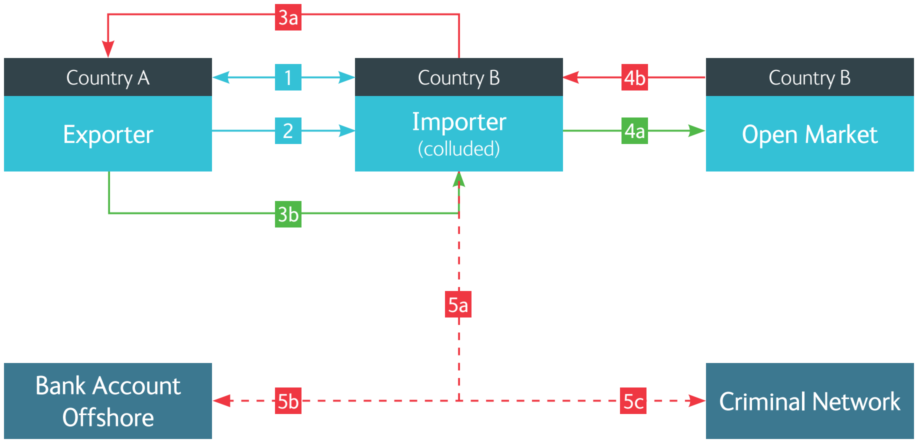
What is it?

1. Trade Based Money Laundering is commonly abbreviated to TBML.
2. TBML uses similar techniques to traditional money laundering, namely launder, layer and integrate which are all designed to make it impossible to detect or investigate the original illicit origin or purpose.
3. Vast majority of TBML involves invoice fraud and associated manipulation of supporting documentation.

Core features

1. Buyer and seller collude and conspire to manipulate the price of goods and services through deliberate false pricing.
2. Primary techniques include:
   - over/under invoicing and shipments
   - multiple invoicing
   - misrepresenting the goods or falsely describing the goods
3. Shipping techniques include:
   - short shipping – shipping fewer goods than invoiced and misrepresenting value of goods
   - over shipping – exporter ships more goods than invoiced and thus misrepresenting the value of goods
   - phantom shipping – fraudulent documents presented and no goods actually shipped
4. Invoice fraud can be used as a method of moving money in or out of a country without the need for physical cash transfers
   - Moving money out:
     - import at an overvalue
     - export at an undervalue
   - Moving money in:
     - import at an undervalue
     - export at an overvalue

Underinvoicing



Mechanics

1 Exporter and Importer are colluding together to deliberately move value offshore from Exporter's country of origin. Exporter has goods to sell to Importer with real worth of $1 million.

2 Exporter issues an Invoice of $500,000 to Importer – misrepresenting the real price and value.

3a Importer pays Exporter in accordance with the Invoice as per any normal trade

3b Exporter ships goods to Importer.

4a Importer on sells goods in the open market at market value

4b Importer receives $1 million by selling the goods at true market value

5a Importer can keep the proceeds.

5b Deposit proceeds into an offshore account to split with the Exporter.

5c Monies used for criminal organization that may have been the power behind original arrangement.

Underinvoicing

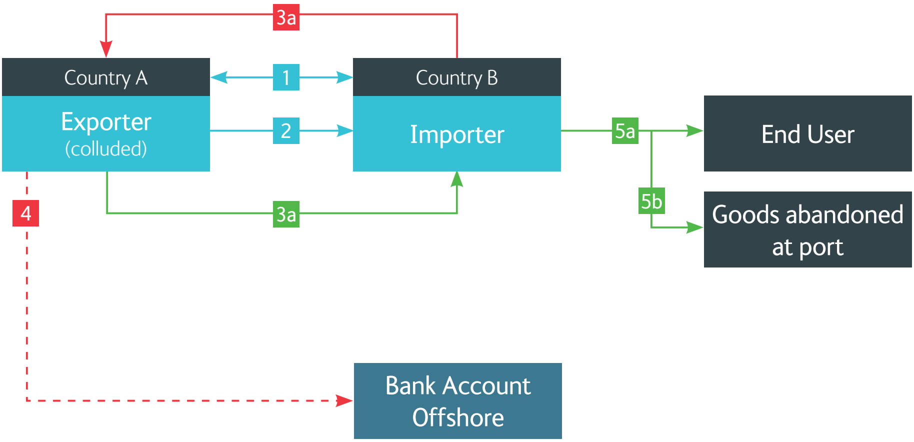
What is it?

1. Underinvoicing is a form of value transfer which involves deliberately underreporting the market value of a commercial transaction on an invoice.
2. Exporter is able to transfer value to the Importer (i.e. moving money into a country) while avoiding scrutiny associated with direct form of money transfer.
3. The importer then on sells the good on the open market at market price for far higher than Importer paid.

Core features

1. This form of Trade Based Money Laundering involves genuinely or fraudulently buying and selling trade goods that transfer value.
2. The value of the trade good is misrepresented (at an undervalue) in order to transfer additional value or settle debts between an importer and exporter.
3. False sets of books and accounting records are often created to match the fraudulent invoices.
4. Common examples of moving money offshore at an undervalue include:
   - Bulldozers being shipped to Colombia at $1.74 each
   - Prefab buildings sold to Trinidad at $1.20/unit

Overinvoicing



Mechanics

- 1 Exporter and Importer are colluding to move misrepresented value out of Importer's country and into Exporter's country. Exporter enters into a Contract of Sale with Importer for goods worth $1 million
- 2 Exporter issues an Invoice of $1.5M to Importer
- 3a Exporter ships the goods directly to Importer
- 3b Importer pays for goods via Letter of Credit or Open Account
- 4 Exporter deposits the extra money of $ 500,000 into Exporter's offshore bank account and potentially to a criminal network
- 5a Importer sells for goods for true value to end customer for $1 million
- 5b Sometimes if goods are of such low value then abandoned at port as goods are secondary to the primary objective of moving money offshore

Overinvoicing

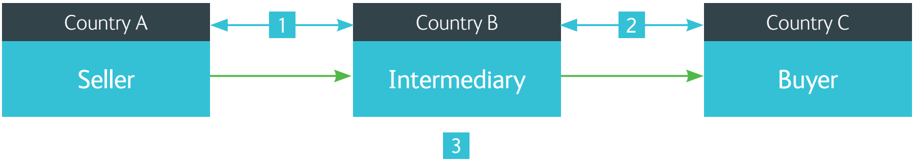
What is it?

1. Overinvoicing is a form of value transfer which involves deliberate overinvoicing goods above their market value.
2. The Exporter is thereby able to receive value from the Importer as the Importer payment is higher than the goods actual value on the open market.
3. Can be used as a method to move money out or offshore if Importer pays over valued invoices thereby avoiding domestic capital and exchange controls.

Core features

1. The value of goods is inflated to transfer value to the Exporter from the Importer.
2. Common examples of overinvoicing include:
   - China imported toilet tissue from the UK at an overinvoiced price of US$4,121 per kilo.
   - Plastic buckets were being exported from the Czech Republic and invoiced at US$972 per unit.
   - In Pakistan, a Madrassa, which was an Islamic school linked to radical jihadist groups such as Al Qaeda and Islamic State had received huge amount of money from offshore and foreign sources. To mask and legitimise the vast inward cashflows that was then being passed on to, and used for, terrorist financing. The Madrassa issued invoices for animal hides and carpets at vastly inflated amounts.
   - Argentina was subject to a fraud whereby a fraudulent Exporter was selling gold plated coins or solid gold coins to the USA and invoicing the goods accordingly. This allowed huge amounts of criminal money to move from USA to Argentina and also for the Exporter to claim false government incentives for the export of solid gold coins.

Tax and Transfer Pricing



Mechanics

1 Seller sells the product to Intermediary at an artificially low price

- Seller's Government receiving little tax revenue

2 Intermediary sells the products to Buyer at a very high price

- Where the sale price per unit between corporations is almost as high as the final retail price per unit offered for sale in the Buyer's country
- Buyer has a very low tax bill and the government receives little tax revenue

3 Given Intermediary buys at a low price and sell them at a very high price

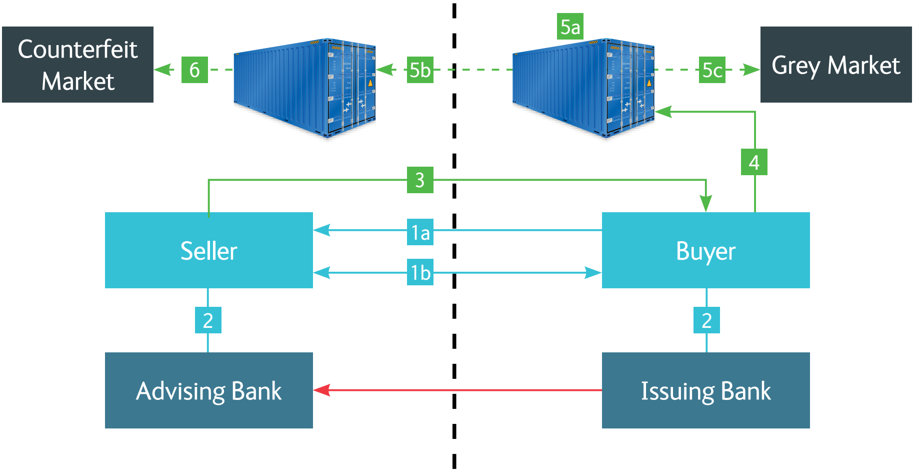
- Intermediary profits are high because Intermediary that is based in a tax haven jurisdiction, it has little (if any) tax liability

Tax and Transfer Pricing

What is this?

Where two related companies that trade with each other artificially distort the price at which the trade is recorded via the use of a tax heaven, to minimise the overall tax bill.

U-Boating Shipments



Mechanics

1a A fraudulent Buyer approaches a Seller (e.g. a large sophisticated multinational company), presenting a large and seemingly legitimate purchase order for goods sold into a legitimate market the Seller has no current presence or customers.

1b The Seller asks the Buyer for a Letter of Credit and enters into a Contract of Sale.

2 The Buyer makes an application to the Issuing Bank to issue a Letter of Credit to Seller. Advising Bank notifies Seller of open Letter of Credit

3 Seller ships goods to Buyer.

4 Upon taking control of the goods, the Buyer transships the goods via an intermediary location.

5a The containers are then mixed, stripped, stuffed and reloaded with counterfeit items.

5b Fraudulent containers are then shipped back to the country of origin, where customs laws provides duty-free treatment for goods returned.

5c Original genuine goods are then sold into new market at higher prices than original intended in that jurisdiction but without Seller knowing of the corrupt scheme.

6 A co-conspirator located in the Seller's jurisdiction takes control of the goods and sells and distributes them at a steep discount to prevailing prices usually on the black market.

U-Boating Shipments

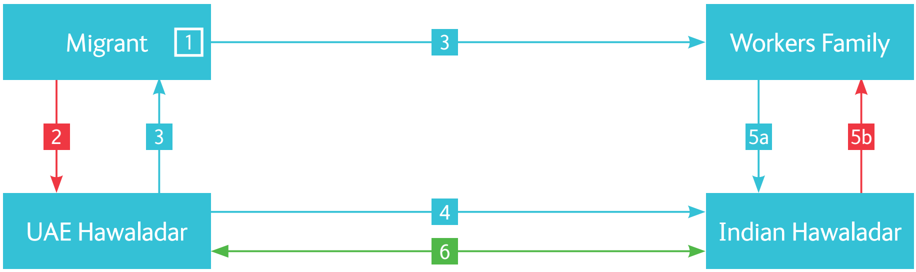
What is it?

U-Boating is a commercial trade diversion scheme which involves the diversion of genuine products from its intended international market back to its country of production, thereby avoiding duty on the returning goods. The goods will often be resold on the black market or other illegitimate distribution channels.

Core Features

1. Diverters seek out well-known commercial brands in order to add a veneer of authenticity.
2. Diverters use shell companies and other fronts to facilitate the transaction.
3. The transaction is usually presented in such a way that the Buyer helps the Seller "break into a new market".
4. Counterfeit goods are usually introduced into the transaction, and it can be very difficult to determine the difference between goods acquired in the grey market and goods acquired through legitimate trade.
5. These schemes require an international network of conspirators.

Hawala Payment Systems



Mechanics

1 A Worker in the UAE gets paid in local currency in the U.A.E.

2 The Worker contacts a UAE Hawaladar and gives it the amount he wants to transfer to his family in India.

3 The Worker receives a code number, which he sends to his family.

4 The UAE Hawaladar contacts his associate in India with the information about the transfer.

5a The Worker's family present the client or code as evidence to demand payment. Code is usually in form of text message code. Traditionally used to be more elaborate coded playing cards or chits.

5b The Indian Hawaladar delivers the equivalent in Indian rupees in cash to the Worker's family. A small percentage is deducted as commission for the transaction.

6 No money is transferred between UAE & India but at the end of multiple transactions coming each way (i.e. in reverse India to UAE) via other customers, Hawaladar settles difference whether in cash, gold or jewellery, rather than transfer net cash cross border.

Hawala Payment Systems

What is it?

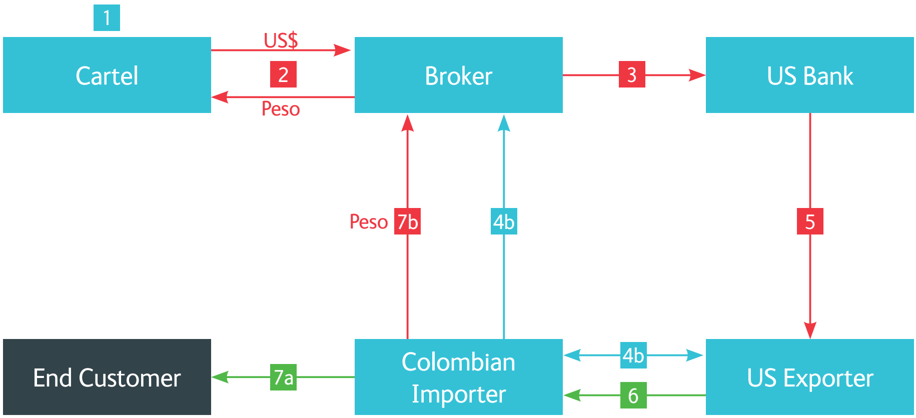
Hawala systems refer to informal money transfer systems occurring in the absence of or in parallel to regulated banking sector channels, used predominantly in the Middle East and South Asia and particularly by migrant communities to transfer money back to their hometowns.

The value of earnings is transferred without actual money movement. Also known as "flying money" or Fei Chien in China.

Core features

1. The systems are based on trust, making them difficult to detect.
2. The exchange rate offered is generally more favourable than the official exchange rate.
3. The transaction can often take place immediately.
4. The transaction is anonymous.
5. The transferor does not need a bank account or to show proof of identity.
6. The Hawaladar – the broker who handles the transfer usually provides free delivery of funds to the recipient.
7. No money passes between the two Hawaladars – they promise to settle the debt at a later date.
8. The Hawaladar may front his Hawala business with a legitimate business, and earn additional money from these side businesses.

Black Market Currency Exchange



Mechanics

1 A Cartel smuggles drugs into the United States and sells them on the street and receives and accumulates large quantities of Dollars.

2 A Colombian peso exchange Broker, with connections in US and Colombia, buys the Dollars at a discount from the Cartel gang in the US, paying for them in clean pesos to the Cartel in Colombia.

3 The Broker directs his representatives in the US to place the Dollars into US financial institutions in a way that does not trigger any reporting requirements.

4a A Colombian Importer enters into a contract with a US Export to import goods. US Exporter will only send goods if Importer pays in advance.

4b Rather than go to licenced money exchange, the Colombian Importer requests the Brokers pay the US Exporter Dollars in the US in exchange for the Importer paying the Broker in pesos in Colombian.

5 The Broker arranges for the Dollars to be transferred to US Exporters for the purchase of the goods from his Dollar account derived from illicit sums.

6 The US Exporter receives the Dollars and then the goods are shipped to Colombia.

7a The goods are sold in Colombia.

7b The pesos are given to the Broker, which it can then use to conduct further business with cartels purchasing their illegitimate Dollars.

Black Market Currency Exchange

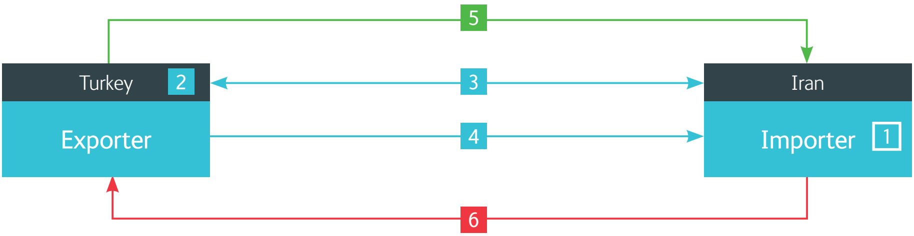
What is it?

The Black Market Currency Exchange is the illegal foreign exchange market in certain countries, forming part of the underground economy outside of legal banking and foreign exchange channels. The Colombian Black Market Peso Exchange is an example, which developed as a result of the Colombian government restricting access to foreign currencies.

Core features

1. A broker uses runners to ‘structure’ drug proceeds – they are directed to make a series of relatively minor deposits in a large number of financial institutions, in a manner that does not trigger financial reporting requirements.
2. Illicit proceeds are typically comingled with legitimate receipts.
3. Dollars can also enter the system through the use of third party checks and money orders.

Sanctions Circumvention



Mechanics

1 Iran is subject to trade sanctions. Therefore commercial entity cannot import goods or send monies out. Iran wants to send money offshore but no offshore bank will accept money transfer from Iran due to sanctions blacklist. On humanitarian grounds, however, certain goods and foods are permitted to be imported into Sanctioned countries.

2 Iranian company sets up a front company in Turkey. Common ownership held in an offshore shelter.

3 Colluded Exporter and Importer enter into contract of sale and purchase of sugar.

4 Exporter sends invoice for sugar at highly inflated price of US$240 per lb. Usual price is between 10 – 30 cents per lb.

5 Turkey Exporter ships sugar to Iranian Importer.

6 Iranian Importer pays inflated invoice and moves misrepresented value offshore and no doubt subjecting any bank, financial institution or logistics provider to potential sanctions breach and enforcement actions.

Sanctions Circumvention

What is it?

A method or scheme whereby an entity linked to or located in a sanctioned country devises a trade based fraud in order to circumvent strict international financial and trade sanctions.

Core Features

1. Office of Foreign Assets Control (OFAC) is the administrative department that implements and monitors sanctions under US law.
2. Sanctions can be targeted against countries, entities or individuals.
3. There are very heavy fines imposed on those institutions involved in OFAC violations.
4. OFAC have extraterritorial reach.
5. Emphasis on positive due diligence to ensure that a transaction does not involve OFAC violations.
6. Breach is "knowing" violation but test includes a standard of "should have known".
7. EU sanctions generally follow US sanctions and attract criminal liability for breaches of commercial risks.
8. Essential for financial institutions to screen trade documents against current sanctions lists and then identify and escalate any red flags.

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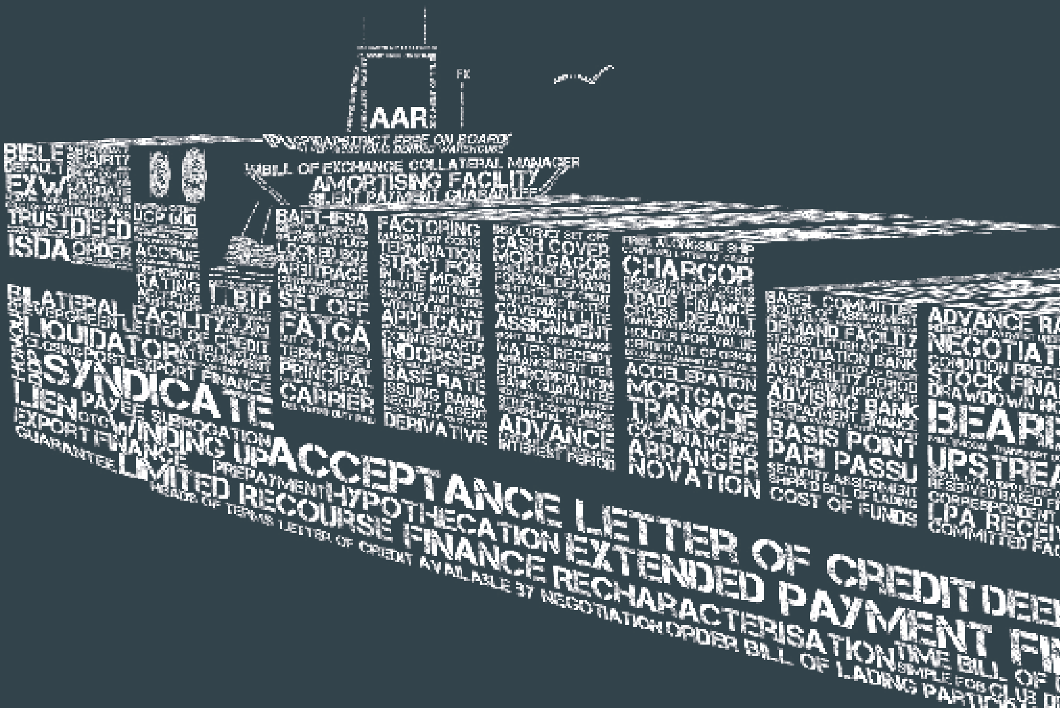
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AMORTISING FACILITY
SILENT PAYMENT GUARANTEE
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LIQUIDATOR
SYNDICATE
LIEN
WINDING UP
EXPORT FINANCE
LIMITED RECOURSE
BAFT-IFSA
ARBITRAGE
SET OFF
FATCA
PRINCIPAL
CARRIER
FACTORING
TERMINATION
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DERIVATIVE
CASH COVER
MORTGAGOR
ASSIGNMENT
ADVANCE
CHARGOR
TRADE FINANCE
CROSS DEFAULT
HOLDER FOR VALUE
ACCELERATION
MORTGAGE
TRANCHE
CO-FINANCING
ARRANGER
NOVATION
BASEL COMMITTEE
DEMAND FACILITY
NEGOTIATION BANK
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HEADS OF TERMS LETTER OF CREDIT AVAILABLE BY NEGOTIATION ORDER BILL OF LADING