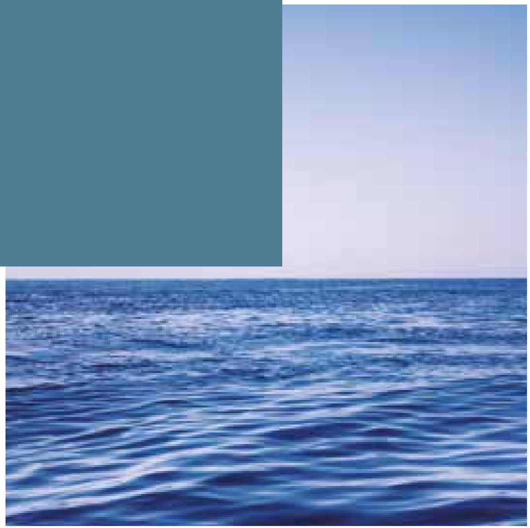
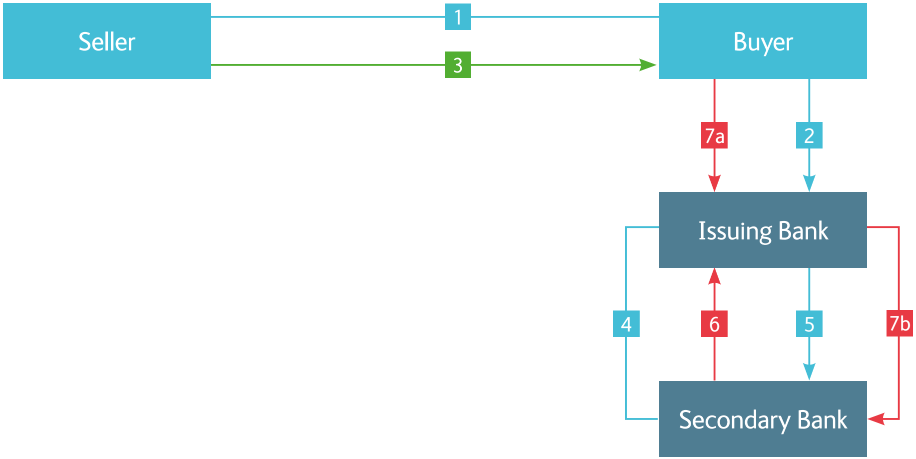
Simmons & Simmons

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

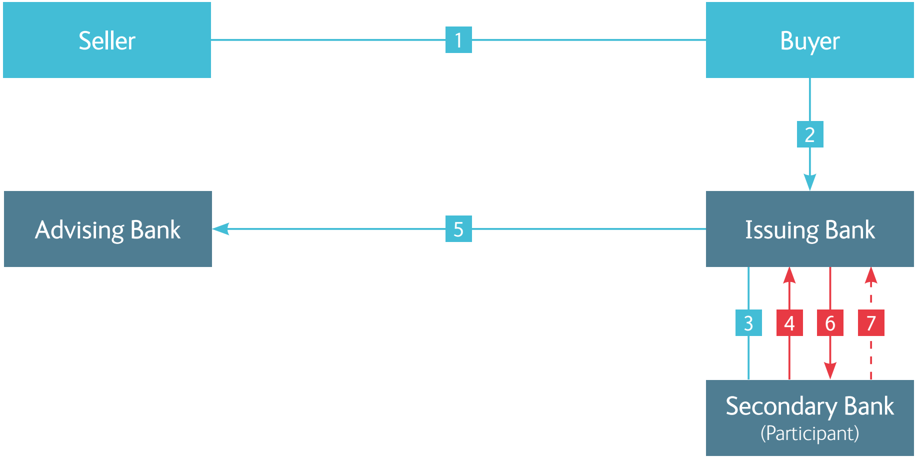
What is it?

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)

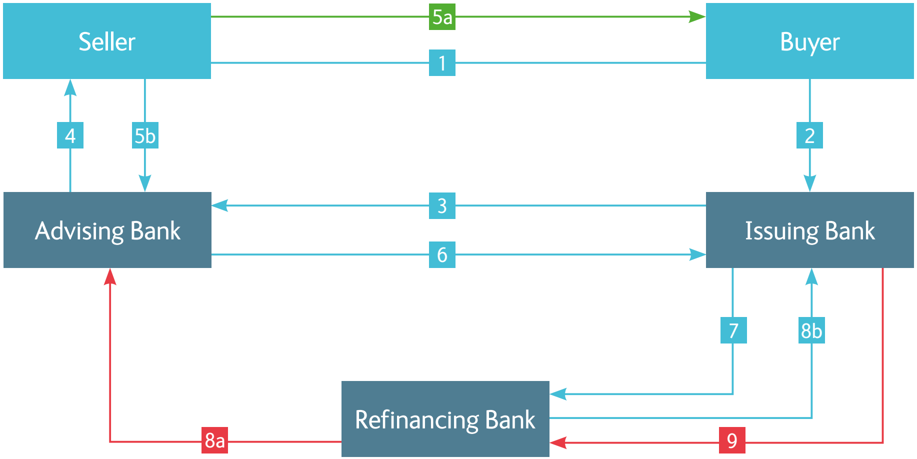
What is it?

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

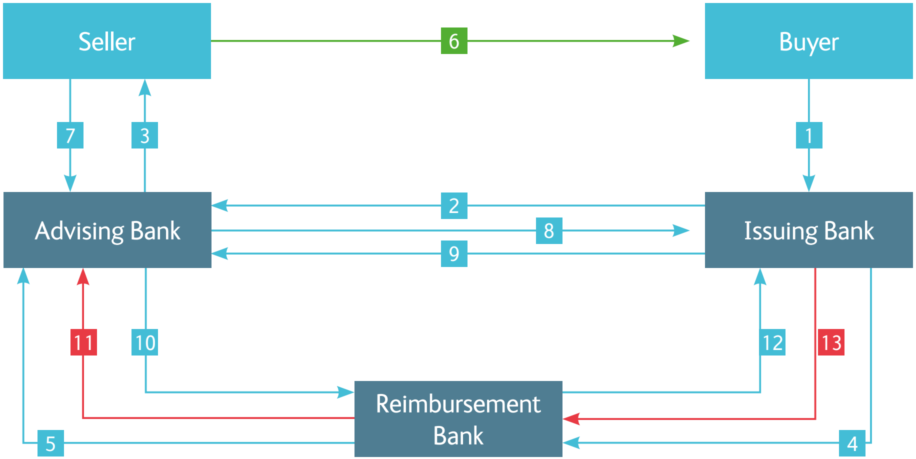
What is it?

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

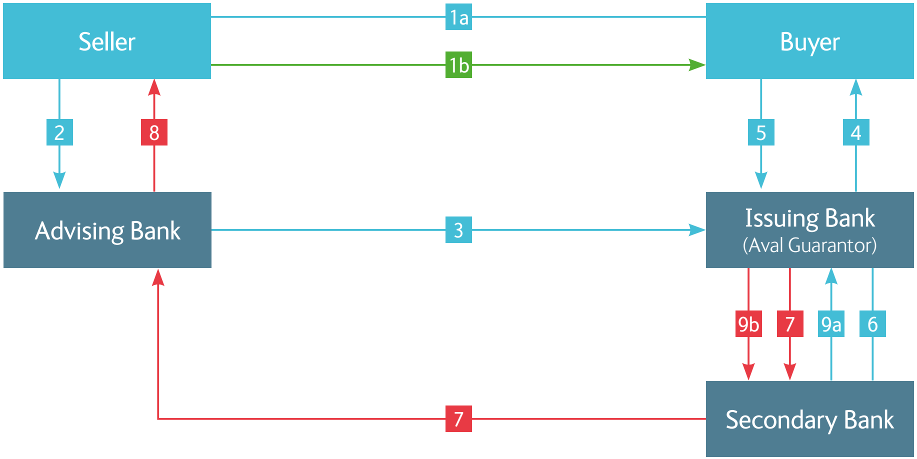
What is it?

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.