A Guide to Receivables Finance

(3rd Edition)

Edited by Sullivan partner Geoffrey Wynne,
co-published with ITFA and Deutsche Bank

Now available for download at
sullivanlaw.com/Guide-to-Receivables-Finance

Sullivan
SULLIVAN & WORCESTER

Structuring trade finance transactions using SPVs: how to balance the risks and rewards

Presentation by

Sam Fowler-Holmes, Partner

Sullivan & Worcester UK LLP

21 October 2021

What we will cover

- What is a special purpose vehicle (**SPV**)?
- Why is an SPV used?
- Issues surrounding control of an SPV
- Factors relevant to choosing where to incorporate an SPV
- How can an SPV be used in trade finance transactions?
- Example trade finance structures using SPVs

What is a special purpose vehicle?

- An SPV is a legal entity created for a specific, limited purpose
  - Specific to a transaction
  - Specific form of financing or transaction
- There are a number of different legal forms depending on the relevant jurisdiction
  - Limited liability company
  - Limited liability partnership
  - Trust
  - Not necessarily a bespoke type of entity
- Legal, commercial, tax and accounting issues underpin everything
  - Prioritise and compromise?

Why use an SPV?

There are many reasons why an SPV structure may be used. These include:

- Ring-fencing of assets
- Insolvency remote vehicle
- Better financing terms
- Off balance sheet treatment
- “on-shore” issues
  - Burdensome regulation
  - Tax issues such as withholding tax on interest payments
  - Foreign exchange controls or repatriation of funds
- Challenges to taking security
- Inability of proposed party to perform its intended role (e.g. restriction on “real” borrower borrowing or granting security)

Why use an SPV? (2)

- Some questions to ask:
  - Can I do this transaction without an SPV?
  - What risks am I addressing by using the SPV?
  - What benefits am I obtaining by using the SPV?
  - Are there alternative structures which don’t require an SPV?
  - Do the advantages outweigh the disadvantages?

Ownership and control of SPVs

- There are a number of different ways in which SPVs can be owned and controlled
  - While the two concepts may overlap, ownership does not necessarily mean control and control does not necessarily mean ownership
- Financer owned – full control for the financer and particularly control over cash flows – increasingly common in receivables structures
- But potential difficulties with lending to subsidiaries?
- Obligor owned – may be preferred position for the obligor but much less control for the financer unless this is provided for contractually
- Financer is one step removed from day-to-day running of the SPV and likely to be reliant on prompt reporting by the obligor to be aware of any issues
- Potential restrictions on granting security by the obligor could apply to the obligor group and therefore the SPV

Ownership and control of SPVs (2)

- Shared ownership of obligor and financer – not a commonly chosen position and requires much more focus on the decision making of the SPV
- Dispute resolution mechanism required in the event that obligor and financer cannot agree on appropriate steps to be taken – shareholder agreement sets out the relationship between the financer and the obligor
- Third party owned – number of corporate services providers that can establish and own the SPV – administration of the day-to-day running of the SPV will be set out in the contractual documentation
- No owner – this involves the shares of the SPV typically being held by a trustee for charitable purposes – this is often referred to as an orphan trust or orphan SPV

Management of SPVs

- Involvement of third parties increases costs and likely to require additional obligations of the financer and obligor – for example, indemnities to third parties
  - Directors
  - Administration expenses
- Management and administration of the SPV carried out in accordance with the instructions of the financer or the obligor depending on what has been contractually agreed – but local law requirements to be considered?
- Whichever option is chosen, consideration needs to be given to:
  - the ability of the relevant interested party to direct the activities of the SPV where it is not the owner
  - Shadow directors?
  - Ability of directors of SPV to comply with local law obligations for directors
  - What happens if things go wrong or substantive decisions need to be made?
  - Replacement of servicer

Factors relating to incorporating SPVs

- There are a number of jurisdictions that are commonly used for SPVs, including British Virgin Islands, Cayman Islands, Jersey, Luxembourg and Ireland
- A range of factors will underpin any decision to incorporate an SPV in a particular jurisdiction including:
  - Speed of incorporation
  - Costs
    - Cost of incorporation
    - Cost of administration of the SPV
  - Tax neutrality or advantages
  - Sophistication of legal system (and relationship with English law)
    - Knowledge and familiarity with English law concepts
    - Recognition and enforcement of English law and English law judgments/arbitral awards

Factors relating to incorporating SPVs (2)

- Relevant factors (cont.):
  - Regulatory environment
  - Options for legal nature of the SPV
  - (Lack of) Corporate administration burdens – e.g. requirements for annual general meetings, reporting requirements and filings, nature of directors
  - Winding up / dissolution of the SPV
  - Infrastructure, telecommunications and transport
  - Investor familiarity and confidence

Potential issues with using SPVs

- AML, KYC, beneficial ownership and transparency
- Risk assessment of assets involved in the transaction
- Misuse of SPV structures or poor documentation – Enron and Lehman Brothers
- “Piercing the corporate veil” - consolidation

SPVs in trade finance structures

- SPVs can be used in a range of transactional matters, particularly in the oil and gas industry, real estate, project finance, asset finance and securitisations
- SPVs can and have played an increasing role in trade finance transactions
- This does not necessarily involve creating new structures but adapting existing and well-known structures to benefit from the use of the SPV

Securitisation background

- Historically covered asset backed loans
  - E.g. residential mortgages, car loans, credit card receivables etc
- Main benefits
  - Alternative to traditional bank lending/unsecured corporate bonds
  - Lower cost of funds (linked to pool of assets not general credit rating of originator)
  - Off balance sheet so possibly better leverage and returns
- Typical fundamentals
  - Involves sale of assets to SPV at a discount by originator(s)
  - Traditionally funded in the capital markets and rated
  - Credit insurance (common) – but consider how this is factored into the overall structure

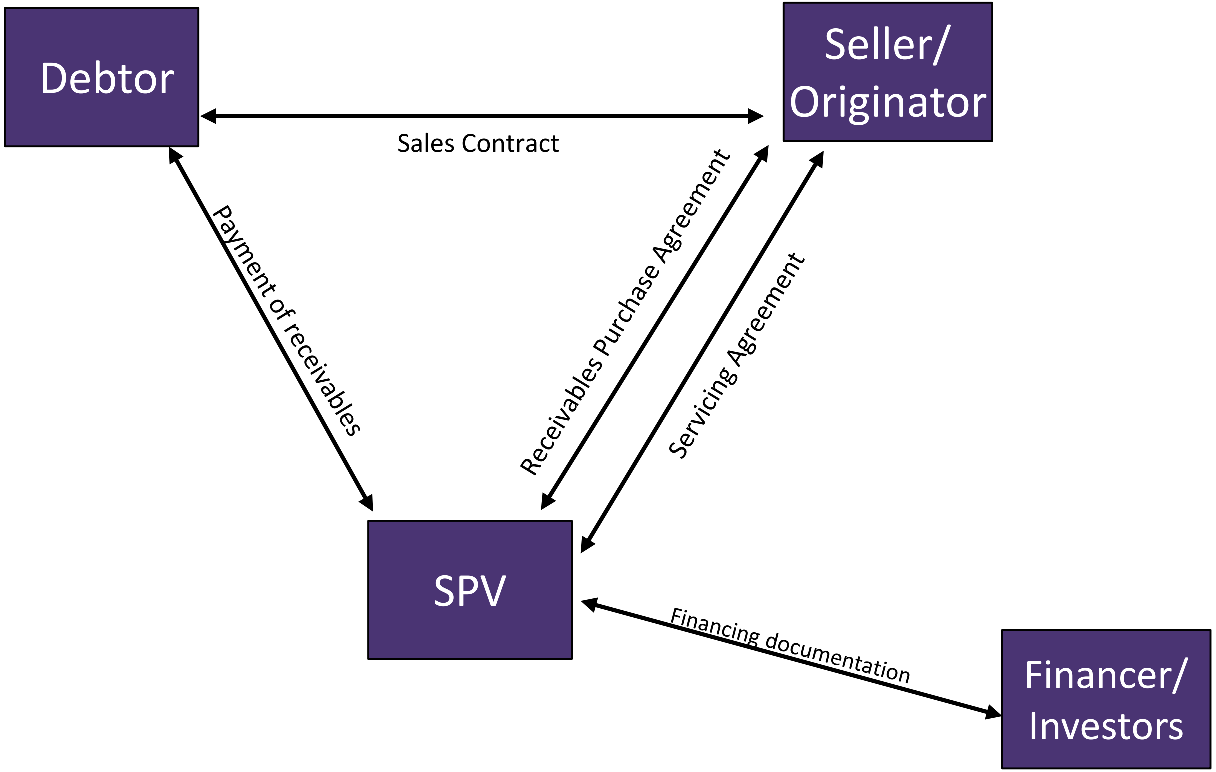
What about trade receivables?

- Characteristics
  - Short-term “business” assets
  - Not income-generating assets
  - Not usually secured
  - More complex jurisdictional issues (cross border)
- Typical structure
  - Receivables can be pooled and sold to the SPV at a discount
  - Purchase can be:
    - by way of a specified pool of receivables
    - on a revolving basis
    - Different methods of documenting sale

What about trade receivables? (2)

- Options for funding
  - Note/bond issuance etc. (capital markets)
  - Bank/alternative funder debt
- Watch out for specific considerations
  - Funding mismatch
  - Servicing issues

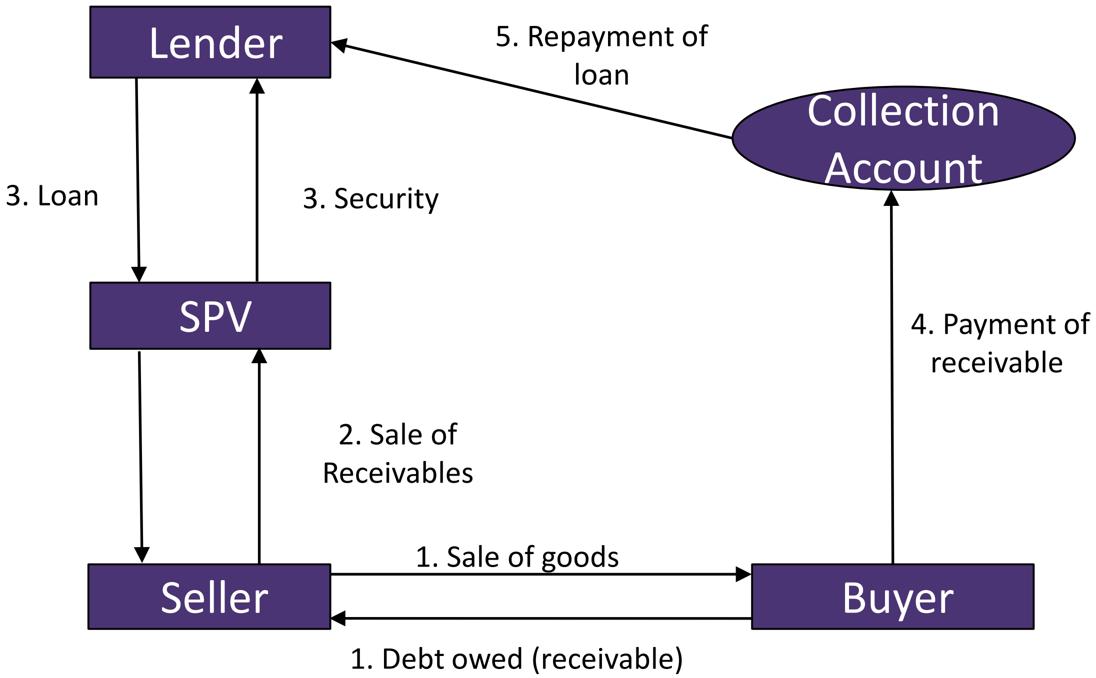
How does it work (at its simplest)?



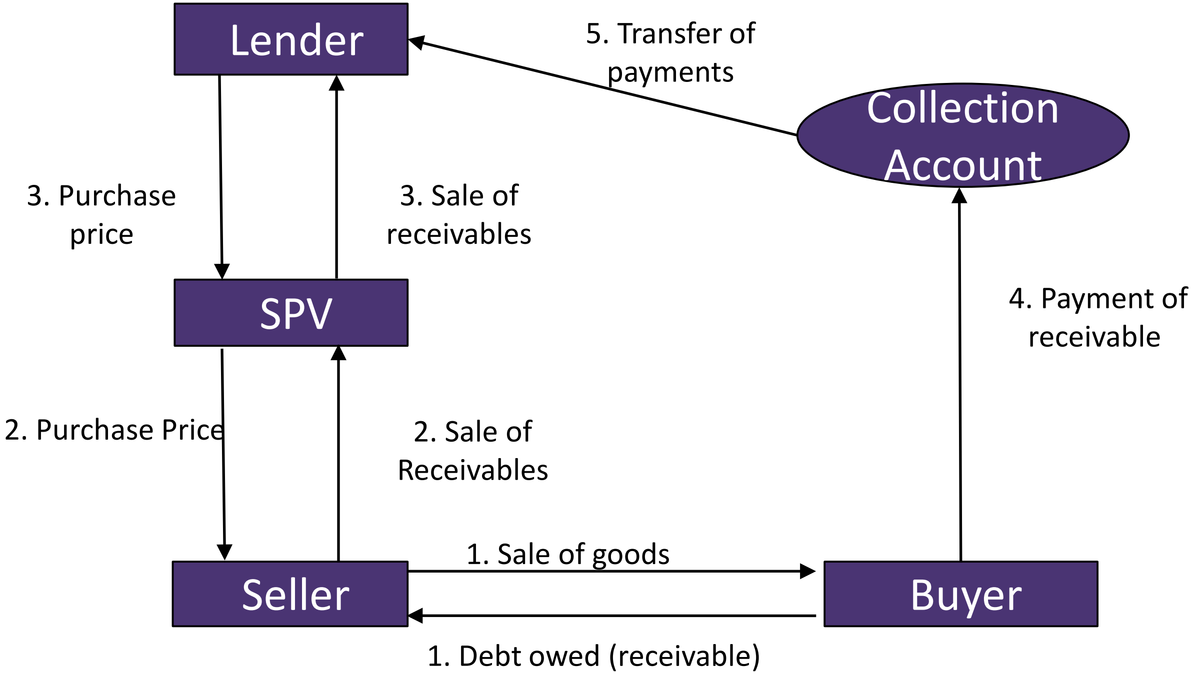
Additional complexities

- Alternative levels of funding
  - Subordinated debt
- Prepayments
- Third party roles
  - investment manager
  - paying agent
  - collateral agent
- More complex structures can be created
  - Use of offshore SPV and an onshore SPV or an aggregator of receivables
- Requires additional due diligence and increased focus on cash flows and funding of reserve accounts to meet instalment payments to investors

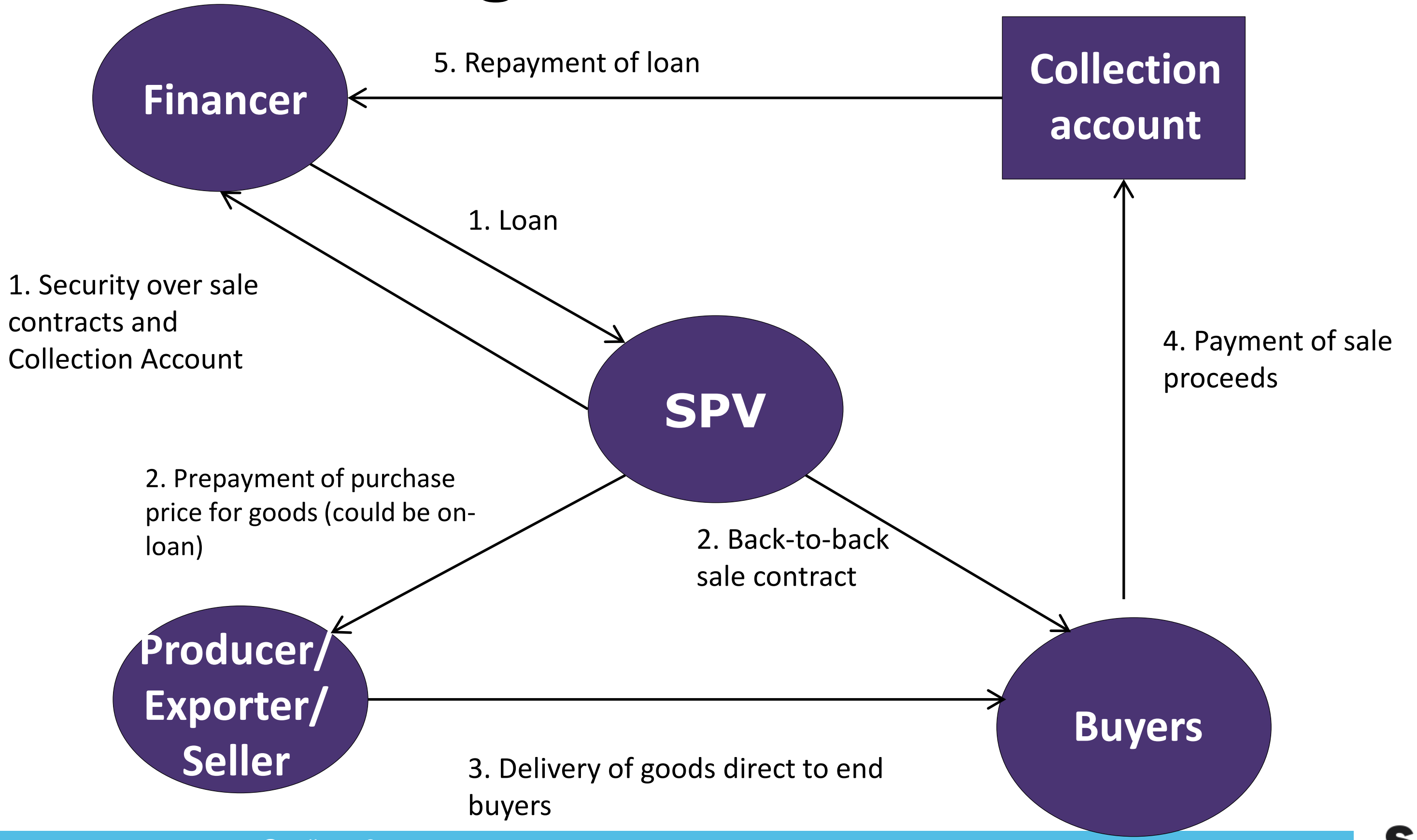
Receivables purchase using SPV



Receivables purchase using SPV (2)



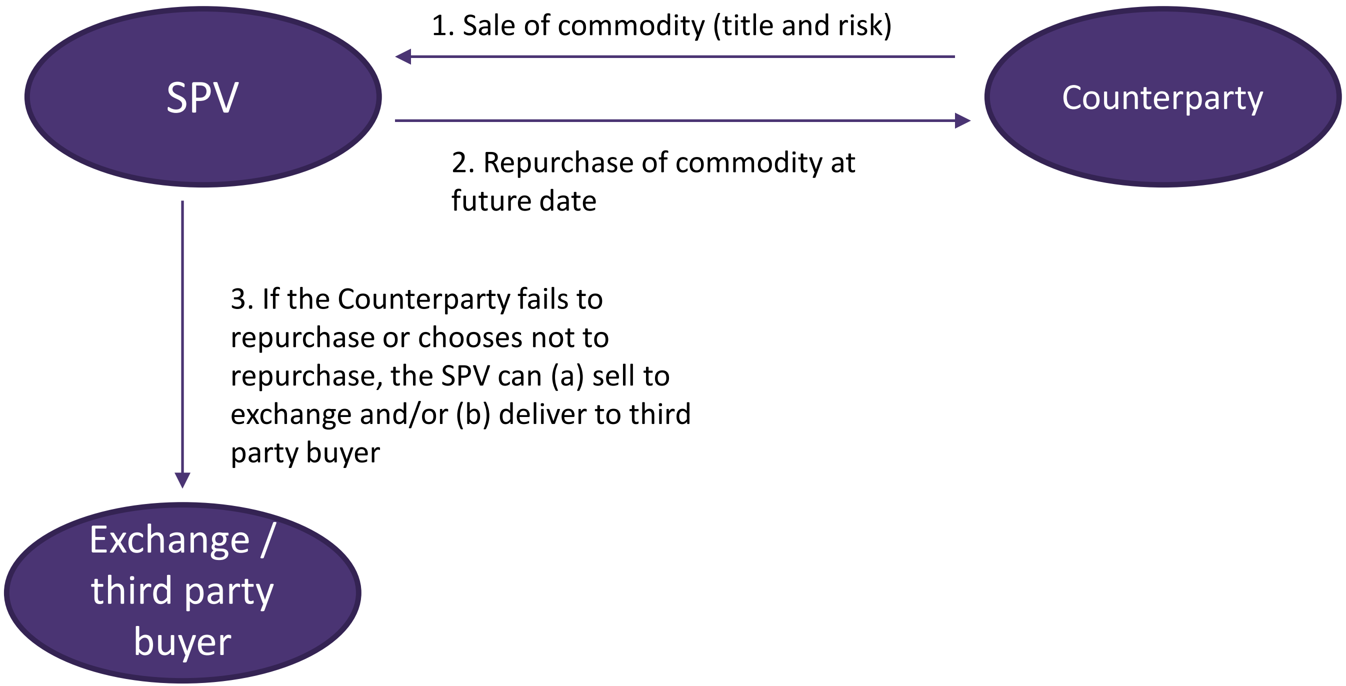
SPVs in Financings



Pre-export financing

- Although the structure is very similar to a normal PXF structure without an SPV, there are additional issues to be dealt with
- Additional sale contract required as goods sold first to SPV and then to end-buyers – the relevant sale terms should be back-to-back
- Performance risk still with the producer/exporter (the “real” borrower)
- If SPV has been established solely for this transaction, the financer may decide not to take security over the SPV’s assets

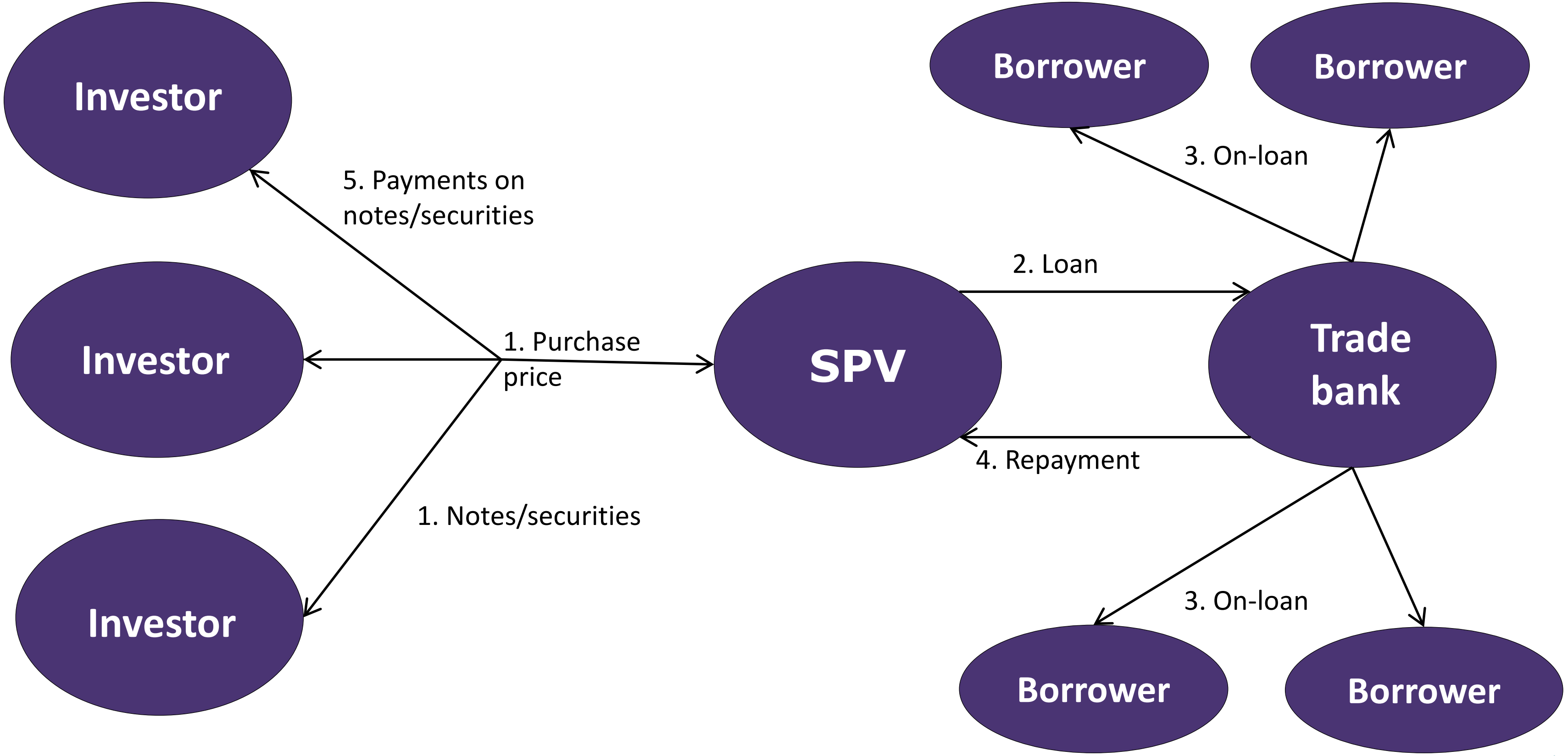
Commodity ownership – the "repo"



Regulatory issues with ownership

- Regulated activities
  - Purchase and sale of goods
  - Owning certain goods, e.g. do you need a licence to hold oil stocks?
  - Reporting obligations, e.g. REACH in the EU
- Environmental laws and liabilities
- Oil reserve obligations
- Restrictions on offshore payments
- Tax
  - Tax on profits, withholding tax, stamp taxes
  - VAT / GST and bonded warehouses
- Importance of local due diligence to structure properly and documents can address any regulatory issues
- True sale issues

Funding structure



Summary and conclusions

- SPVs have had a long history
  - Not always without issue
- Good uses but over-used?
  - Can add complexity when not needed
- Take care to lock in all the issues
  - Extra contracts
  - Trustworthy third parties
- Will future regulations inhibit use?
  - Beneficial ownership registers etc.
- Better rewards for structures using SPVs?
- Carry on using SPVs?

Sullivan
SULLIVAN & WORCESTER

Questions?

Sam Fowler-Holmes

Partner

Sam Fowler Holmes is a Partner in Sullivan's Trade and Commodity finance team, advising a wide spectrum of traditional and alternative financial institutions and corporate clients of all sizes.

Sam's experience includes advising clients on a range of traditional and innovative trade finance products in relation to a broad range of commodities, both in developed and emerging markets across the globe. He regularly acts for clients in relation to structured and unstructured trade financings and has extensive experience in supply chain finance matters, including acting for both electronic platform providers and platform participants.

He speaks regularly at the Sullivan trade and export finance seminars and has presented at events organised by ITFA Emerging Leaders Committee. He has been a member of the ITFA Emerging Leaders Committee since January 2020.

Sullivan & Worcester UK LLP
Tower 42
25 Old Broad Street

T+44(0)2074481006
F+44(0)2079003472
sfowlerholmes@sullivanlaw.com

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

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

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

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

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

sullivanlaw.com

@sullivanlaw

What's Your Next?

Move forward with Sullivan

Sullivan
SULLIVAN & WORCESTER