

# Trade Finance

Can you make your trade finance transactions more secure with or without security?

Presentation by Geoffrey Wynne, Partner and Jacqueline Cook, Of Counsel and Senior Knowledge Development Lawyer, Sullivan & Worcester UK LLP



# This presentation will cover

- Trade finance assets - safe or “inherently risky”
- The risks
- Taking security
- What can go wrong
- Other options instead of security
- Fraud and future “fraud” possibilities with potential solutions
- What you could do
- A look to the future

# What are the risks and what to do

- Identify
- Evaluate
- Eliminate, reduce, mitigate, allocate
- Balance parties' expectations and needs
- But what are the risks?

# 4 areas identified in the recent “Dear CEO letter”

- **Risk Assessment**

- › Financial crime risk factors – more active focus required by firms
- › Risk mitigation – evidence should inform a firm’s rationale in relation to any residual risk
- › Due diligence – should be meaningful and probing, not generic
- › ‘Holistic assessment’ of financial crime risks should be in place

- **Counterparty Analysis**

- › Credit analysis of all trade finance counterparts, including all parties with an interest in the transaction
- › DD on other parties, when this is appropriate and identifying fraudulent activity

- **Transaction Approval**

- › Financial and non-financial risks on end-buyers should be considered. What is the rationale for the transaction? This should never be overlooked

- **Transaction Payments**

- › More effective risk management required in relation to end-buyers, credit insurance arrangements and security

# Common risks in trade finance transactions and how to mitigate them?

- Some common risks
  - › Payment/price risk
  - › Risk stages associated with goods
    - Storage
    - Transport
    - Processing
- Potential mitigants
  - › Third parties?
    - Warehouse operators
    - Collateral managers/logistics service providers
  - › Security?
  - › Insurance?
  - › Finance agreement terms?

# Security in a sample trade finance transaction

- Concentrate on the asset – commodity and the sale proceeds –
- Protection of the asset, the value and the cash
  - › Assignment of receivables
  - › Account charge
  - › Pledge
- *International aspects and English law*
- Chargor/company - jurisdiction
- Location of the asset? More than one jurisdiction when in transit?
- Changing nature of the asset...*commodity to cash!*
- Perfection – English law and local law for company registration

# Categories of security in English law

<b>Real security</b> <ul style="list-style-type: none"><li>- <b>Mortgage</b><ul style="list-style-type: none"><li>assignment</li><li>land</li></ul></li><li>- <b>Charge</b><ul style="list-style-type: none"><li>fixed/floating</li></ul></li><li>- <b>Pledge</b></li><li>- <b>Lien</b></li></ul>	<b>Personal security</b> <ul style="list-style-type: none"><li>- <b>Guarantees</b></li><li>- <b>Indemnities</b></li></ul>
Possessory	Non – possessory
Tangibles	Intangibles

# Back to basics

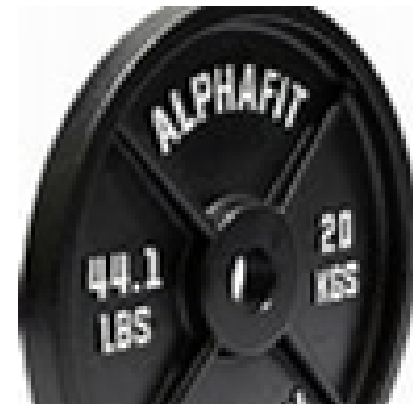
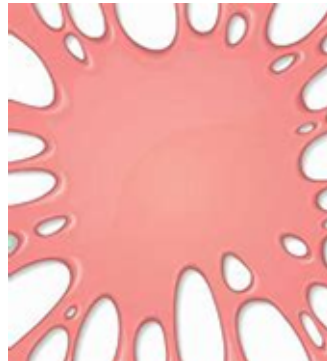
Three stages of security

Jargon for security devices – charge, mortgage, pledge lien

Stage One	Creation	Security Document executed Deposit of asset
Stage Two	Attachment	Immediate or Occurrence of event, trigger or notice
Stage Three	Perfection Valid against third parties	Registration Notice Delivery



# Fixed Charge – key features



# Fixed charge – key features

- Attaches to an asset immediately
- Covers present and future assets
- No freedom for chargor to dispose of asset
- Identification of asset is key, plaques
- Priority over floating charges
- Control by secured creditor – depends on what the asset is, need to protect asset
- Right for secured creditor to have a designated asset appropriated to discharge of indebtedness
- Borrower often can use the asset – see undertakings in security documents

# Floating charge – key features




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- **3 badges** of a floating charge under English law
  1. Granted over a class of '**present and future**' assets
  2. **Class of assets which changes from time to time** in ordinary course of business
  3. Chargor **continues to use assets in ordinary way** until future event occurs or steps are taken by those with interest in the charge (Re Yorkshire Woolcombers Association Ltd 1903 2 Ch 284)
- Hovers over assets – there is an immediate equitable interest in assets
- No transfer of ownership; No transfer of possession; No delivery
- Bodies corporate can create them – co; LLP, not individuals
- Crystallisation – floating charge becomes a fixed charge on assets in the pool at that moment and charge then attaches to those assets
- By certain events or by agreement or notice as set out in security document

# Mortgage – Assignment in security

- Transfer by way of security with a right to reassignment (equity of redemption)
- Transfer of ownership
- Legal assignment **section 136 Law of Property Act 1925** – must meet requirements
- Equitable assignment – not completed all formalities or asset is in equity
- **Notice – for perfection – notice to contract counterparty/debtor**
- **Assets – contractual rights, chose in action, insurance, rights in accounts, receivables.**
- Legal assignment –
  - party can deal directly with debtor/ contract counterparty
  - priority over equitable assignment

# Mortgage- key features

- Transfer of ownership      mortgagor  secured creditor
- Implied or express condition of retransfer – equity of redemption
- Delivery of asset is not required
- Existing and future indebtedness
- Power of sale
- Legal or equitable mortgage - asset must exist for legal mortgage
- Identification of asset essential
  
- Assets – plant, machinery, equipment, IP rights

# Pledge – key features

- Delivery of asset is required
- Actual or constructive delivery – assets/ equipment/machinery/ commodity/warehousing/document of title/keys
- Ownership remains with pledgor
- Power of sale on default
- Assets – tangible moveable assets



- For intangibles, the requirement for delivery is in the process of reform – draft Electronic Trade Documents Bill and Law Commission consultation

# Lien – key features

- Right to retain asset till payment received - usually for works or repairs on asset
- Delivery of asset
- No right to use asset
- No transfer of ownership
- No implied power of sale



- Lien in contracts
- Lien by operation of law, solicitor's lien, banker's lien.



# WATCH OUT FOR!!!!!!



- › Additional costs and time – notarising, legalisation, apostille – needed in some jurisdictions
- › Financial collateral rules relaxing registration requirements in EU and UK
- › Hardening periods prior to insolvency proceedings when security can be unwound
- › Rules of priority – which jurisdiction for priority rules pre- and post-insolvency
- › Preferential creditors or cash for unsecured creditors in insolvency
- **Registration requirements – either in UK company charges or locally where company is incorporated**
- Asset registration – land, ships, IP, aircraft
- Enforcement methods – self help, court order to enforce, recognition of judgments in another state or enforcement by insolvency practitioner!

# What can go wrong?

- All trade transactions in reality, pay back through performance, and then payment by the buyer
- What do you need?
  - › Seller/producer performance
  - › Buyer pays
- So, trade finance is easy?
- It should be so long as
  - › Receivable is created properly and paid
  - › Receivable is not already sold or charged to another
- The solution is to structure and check these aspects
  - › Not always done if you cannot get security
  - › Not always needed? That is not the case

# What else can you do?

- Documentation (even security) may not make a bad transaction good!
- Analyse the commercial transaction
- Look at all the involved parties
  - › Not just the obligor(s)
  - › Other parties may help or hinder
- Who needs the money?
- Who gets the money!
- Will all this put money back to the financier?
- What else might stop this happening?

# What should you look out for on the Seller side?

- On seller/producer side
  - › Non-performance
  - › Defective performance
  - › Misleading performance - cheating
- Seller cannot perform due to lack of finance, lack of technical expertise, failure of other parties
- Seller's product does not meet buyer's requirements
- Seller tells two financiers the same story

# What should you look out for on the Buyer side?

- Buyer does not want to pay
- Buyer cannot pay
- Buyer agrees to pay two people
- Easier solutions here?

# Does trade debt get preference in insolvency?

- Answer is likely no but maybe if you structure it well
- How does this affect structuring?
- Comparison between trade debt and bank debt misleading?
- Better to structure to “achieve” trade debt
  - What is trade debt anyway?
- That may mean just evidence of a trading transaction
- Check for real goods and their flow
- Look at the purpose of the financing
- Structured can be good; should be good!

# What about Fraud Risk?

- Has fraud risk always been there?
- Yes - but not that many - always large when they happen
- What can these be?
- Some experiences, old and new
- Duplicate business
  - › Brought in a number of lenders
- Only a few real deals to satisfy the curious
  - › Built up over a number of years
  - › Brought in many banks
- Then completed the fraud
- So what did we learn?
  - › Nothing?
- Recent examples used warehouses in Far East – warning signs?

# The collapse of Hin Leong

- Oil trader Hin Leong used various methods to defraud Banks and other creditors into providing finance
- At the centre of it all appears to be
  - › A reliance on forging key documentation
  - › Non-existent inventory or selling the same inventory to multiple parties
  - › Inflating receivables balances by moving one customer's funds to a previous customer's account
  - › Overstating inventory balances to secure finance
  - › Forging sales invoices to secure factoring services from banks



# Agritrade and Qingdao

- Following the collapse of Agritrade in 2020, its former CFO was arrested on charges that he had used invalid Bills of Lading to deceive Shanghai Pudong Development Bank out of almost \$20m of financing
- Agritrade used Bills of Lading that were purported to be “legally and validly pledged in the Bank’s favour”
- However, industry players have openly accused Agritrade of using fraudulent methods to secure financing
- “Qingdao raised \$1.78bn in funds using either fake warehouse receipts or fake certificates for aluminium ingots, alumina and refined copper and raised \$520.8mn in loans, letters of credit and bank acceptance bills from 13 banks by repeatedly using the same cargoes as pledged collateral”

# Greenwashing – a risk in ESG transactions

- Misleading or unsubstantiated claims about environmental performance made by businesses or investment funds about their products or activities
- Caused by a lack of consistency in instrument labelling and a lack of commonly accepted definitions
- Even more prevalent given the increasing importance of ESG to investors and consumers
  - › Many prominent companies have been called out for misleading statements, including Shell, Ryanair and Volkswagen and several major financial institutions
- Recent push for enhanced disclosure in this area to help prevent greenwashing:
  - › FCA Discussion Paper: ‘Sustainable Disclosure Requirements (SDR) and investment labels’
  - › UK Green Taxonomy
  - › CMA’s ‘Green Claims Code’
  - › International Organisation of Securities Commissions (IOSCO) report on sustainability related practices, policies, procedures and disclosures in asset management
  - › Greening Finance: Roadmap to Sustainable Investing
  - › New rules to come into force making it mandatory for UK’s largest businesses to disclose climate-related risks and opportunities (from April 2022)

# Potential solutions to combat fraud

- Companies Swift and MonetaGo are working together to bring a technology platform which can allow institutions to check for duplications of documents
  - › “If the same document is submitted to the network by multiple lenders, the system will reject or flag all duplicates after the first unique instance is marked as financed on the system.”
- The World Blockchain Trade Consortium is attempting to create a decentralised registry for invoices which will span across multiple jurisdictions. This would allow financiers to cross-reference an invoice on the registry before financing it
- Will these take too long to be a general solution?

# Open banking solutions

- Use of financial technology for financiers to integrate third party solutions with in house efforts
  - › Transmit and receive financial data with third parties
  - › Enhance transparency from and about customers and their dealings
- Will this improve the ability to onboard and check?
- What needs to be resolved in trade finance?
  - › Turnaround time
  - › Managing documentation
  - › Level of information needed for KYC, AML etc.
- What can Fintechs provide?
  - › Will laws permit this - data protection; duty of confidentiality
  - › Will Regulators support this - protect financiers

# What should you be doing in practice?

- Are you not already doing this?
- Will you have to change some practices and tighten up documents?
- Will some flexibility have to go?
- Is this yet another problem for trade finance to overcome?
- Will it stop or slow down trade transactions when the opposite is required?
- Think about what should be done now – the UK Regulators have!
- Structuring in the future
- What should you do?
- What should you watch out for?

# What could 2022 have in store?

- Less or more of the same?
- Less or more counterparties?
- Plenty of opportunities in trade to finance
- Regulatory pressure on ESG in trade finance
  - › Limitation or opportunities?
- Put pressure on Regulators to support “good” trade
- Will digitalisation offer more options?
  - › Should do
  - › Embrace the Fintech options
  - › Use URDTT
- Understand what digital trade means
- Expand horizons
- Is the time right?
- See you doing all this in 2022

# Any Questions?

# Suggestions for future topics and webinar dates

Please feel free to send any suggestions for future topics to London Events ([londonevents@sullivanlaw.com](mailto:londonevents@sullivanlaw.com))

## **Future webinar dates:**

- Thursday 27 January
- Thursday 24 February
- Thursday 24 March
- Thursday 28 April
- Thursday 26 May
- Thursday 23 June



# Geoffrey Wynne

## Partner

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

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

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

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

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# Jacqueline Cook

## Of Counsel and Senior Knowledge Development Lawyer

**Jacqueline Cook** is a senior finance lawyer and has been in practice for over 25 years. She has experience in syndicated lending, general banking, structured and asset finance, Brexit issues, legal training, advising on legal opinions, precedent drafting, current awareness, legal analysis and knowledge management and is now expanding into trade and export finance and has recently been focusing on Brexit, LIBOR, training and opinions.

Jacqueline has been a member of the Consulting Editorial Board of LexisPSL Banking & Finance since 2016 and in 2020 was on the judging panel for the Lexis Nexis Awards for the Knowledge/PSL award. She has a great interest in law reform, including LIBOR reform and Brexit, and has been involved in projects on the CLLS Secured Transactions Code and the Secured Transactions Law Reform Project. She has also helped out on the Cape Town Convention Academic Project and developments on the Pretoria (MAC) protocol, publishing articles in Leasing Life and for UNIDROIT. She has been an active member of the City Finance PSL network for many years in her role in professional support.

Jacqueline has had a number of articles published in JIBFL and in her latest, 'Book Review' in June 2020 she gives a flavour of a new text on contract law "Contents of Commercial Contracts: Terms Affecting Freedoms" which was published by Hart and edited by Paul S Davies and Magda Raczynska both of UCL. Jacqueline has written the last chapter pulling together themes from earlier chapters by leading commercial lawyers and adding her own experience in finance and commercial contracts.

Jacqueline's passion is for Mary's Meals, the Scottish charity which combines the fight against hunger and poverty by providing daily meals in schools and nurseries for some of the world's poorest children bringing children back to education. She is a community ambassador and volunteer speaker giving presentations virtually and in person. She has just completed lots of little walks totaling 159km in the month leading up to Christmas 2020 walking every day and has raised over £3,200. In 2019, she was the guest speaker at the Global Trade Review Awards Dinner for Mary's Meals. [www.marysmeals.org.uk](http://www.marysmeals.org.uk)

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# Awards & Recognition

## **Chambers UK, 2022**

*Chambers UK, 2022* ranked Sullivan in Commodities: Trade Finance (UK-wide)  
Geoffrey Wynne and Simon Cook are Ranked Lawyers in Tier 1 and Tier 2 respectively  
Sam Fowler-Holmes is recognised as an “Up and Coming” lawyer

## **The Legal 500 UK, 2022**

Sullivan is ranked in Tier 1 for Trade Finance by *The Legal 500 UK, 2022* for the eighth year running  
Partner Geoffrey Wynne is included as a Leading Individual for Trade Finance in the “Hall of Fame”  
Simon Cook and Mark Norris are recognised as Leading Individuals  
Sam Fowler-Holmes is recognised as a Next Generation Partner and Hannah Fearn as a Rising Star

## **IFLR1000 Banking and Finance Guide, 2022**

Sullivan recognised for Banking Lending - Lender Side, United Kingdom, in *IFLR1000's Banking and Finance Guide, 2022*  
Partner Geoffrey Wynne is ranked as a Leading Lawyer in the United Kingdom

## **Global Trade Review “Law Firm of the Year” in the category “Leaders in Trade for Innovation”, 2021**

*Global Trade Review* (GTR) named Sullivan the “Best Trade Finance Law Firm” in the category “Leaders in Trade for Innovation” at the 2021 GTR Leaders in Trade Awards

## **2021 Lexology “Client Choice” award for Banking, United Kingdom**

Geoffrey Wynne named a recipient of the Lexology “Client Choice” Award 2021 for Banking, United Kingdom

## **Global Trade Review “Best Trade Finance Law Firm” 2020 and 2019**

*Global Trade Review* (GTR) named Sullivan “Best Trade Finance Law Firm” at their GTR Leaders in Trade Awards in 2020 and 2019

## **Trade Finance Global “Best Trade Finance Law Firm” 2019**

Sullivan named “Best Trade Finance Law Firm” 2019 by *Trade Finance Global* at its International Trade Finance Awards, 2019

## **Trade Finance Magazine “Best Law Firm of the Year” 2019**

*Trade Finance Magazine* named Sullivan “Best Law Firm of the Year” at its Awards for Excellence, 2019





**What's  
Your  
Next?**

**Move forward with Sullivan**

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