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Capital Markets/Alternative Investors; Investing in the Trade Receivable Asset Class

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Who Are We?

- ***Global Receivables and Supply Chain Finance Team***

- Over 50 professionals across our platform focused on receivables and supply chain finance
- Coverage across our platform including the US, the UK, France, Germany, Hong Kong, Singapore, Brazil and Mexico
- We are a go-to law firm for a number of the world's leading participants in the supply chain finance market.



Welcome To Our Webinar Series!

- ***Supply Chain and Working Capital Finance Webinars***

- Nine webinars from July to November (repeated twice daily)
- Previous webinar: July 29 – 10 Most Common Insolvency Questions in Receivables and Payables Finance – A Focus on Europe and Asia
- Next webinars: August 19 – 5 Most Common Questions About Financing Receivables and Payables Through a Platform
 - Full program available in Appendix
- We will have our normal live programs in New York, London, Singapore and Hong Kong in 2021 – circumstances permitting, early in the year.

The background of the slide features a close-up, slightly blurred image of several Euro banknotes. The notes are in shades of blue, green, and yellow. The faces of the historical figures on the notes are visible, and some serial numbers like 'AH 514740' and 'JT 276683' can be seen. A vertical orange bar is positioned on the left side of the slide, partially overlapping the text.

Related Events

- ***Global Supply Chain and Distribution***

- A series of webinars running from June until end of the year focusing on global supply chain issues and solutions to mitigate them
- Previous Webinar:
 - June 24: 10 Key Issues to Managing an Effective Supply Chain
- Next Webinars:
 - August 19: Contract Risk: Building Resilient Relationships with Suppliers and Distributors
 - September 23: Geographic Risk: Reshoring and Diversifying Your Supply Chain
 - October 7: Supplier Compliance and Reputational Risk

The image features a dense, overlapping collage of various international banknotes. Visible currencies include the United States Dollar (featuring portraits of George Washington and Alexander Hamilton), the Chinese Yuan (pink and red notes), and the Euro (green and brown notes). The entire scene is overlaid with a semi-transparent blue filter. Centered on this background is the text "Why is trade finance attractive to investors as an asset class?" in a clean, white, sans-serif font.

Why is trade finance attractive to investors as an asset class?



What is Trade Finance?

- An underlying trade transaction with finance to either Seller or Buyer (whether as direct intermediation within, or separate to, the trade transaction). Typical characteristics:
 - It is short-term and self-liquidating
 - It is often (not always) secured or credit-enhanced
- Three broad buckets:
 - Loans (e.g. import / export loans), receivables and payables, and traditional trade finance instruments
 - All with different risks, characteristics and product parameters



Trade Finance as an Asset Class

- **A booming market**
 - 2018 Merchandise trade US\$19.48 trillion
 - 2018 Commercial services trade US\$5.8 trillion
- **An enormous funding gap for the SME (middle market) space**
 - Rejected trade finance application: \$1.4 trillion – \$1.6 trillion
 - Limited funding offered by institutional investors

Source: 1. World Trade Organization – Global trade growth loses momentum as trade tensions persist 2 April 2020
2. Trade finance funds grow as investors seek 'recession-proof' asset class, S&P Global 4 November 2019

A background image showing several Euro banknotes, including a 100 Euro note and a 50 Euro note, with the faces of the deceased presidents of the European Central Bank. The notes are slightly out of focus and overlap each other.

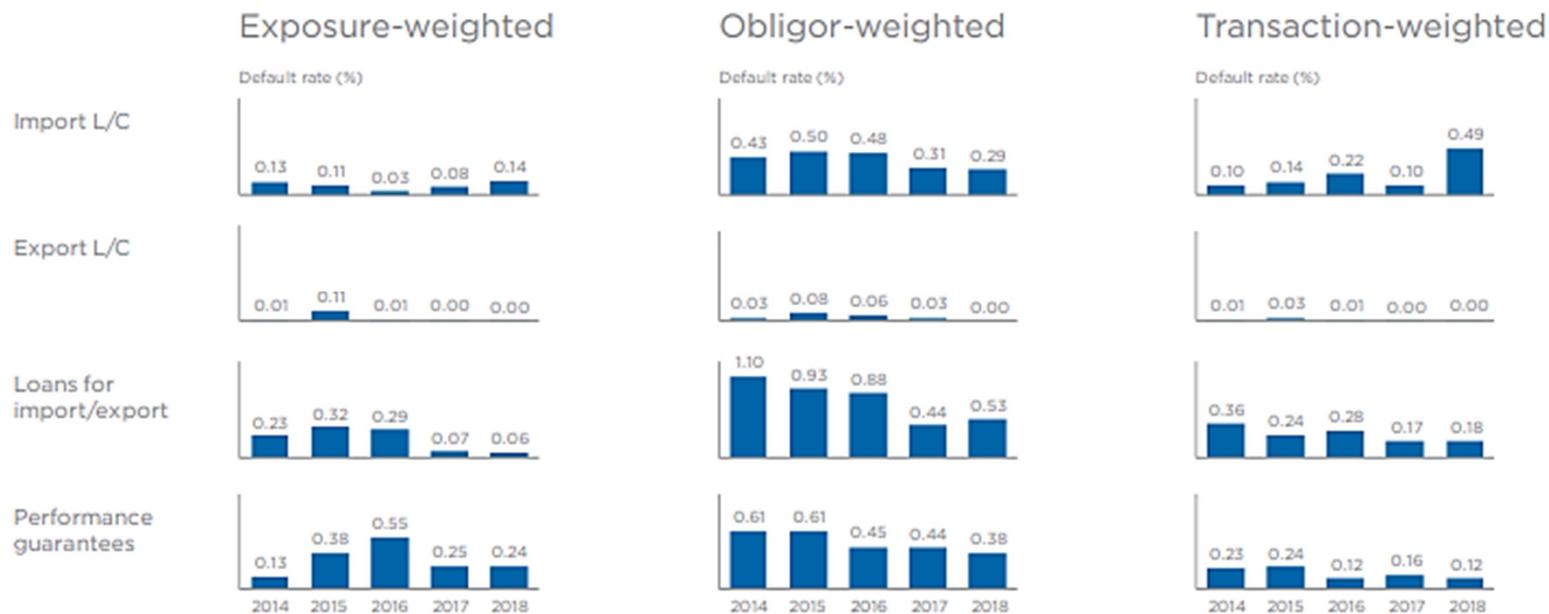
Attractiveness of Trade Finance

- **High flexibility** - in terms of tenor, value, industry and geography
- **Low market risk** - low correlations to market volatility
- **Low credit risk**
 - primarily contract risk
 - low default rate
 - short-term maturity
- **Higher spread in the SME (middle market) space**

Source: . Trade finance funds grow as investors seek 'recession-proof' asset class, S&P Global

Attractiveness of Trade Finance – Low Credit Risk

Summary of Default Rate Trends, Trade Finance, 2014 -2018



Attractiveness of Trade Finance – Low Credit Risk

Total exposures and default rate by exposure, by product, 2008–2018

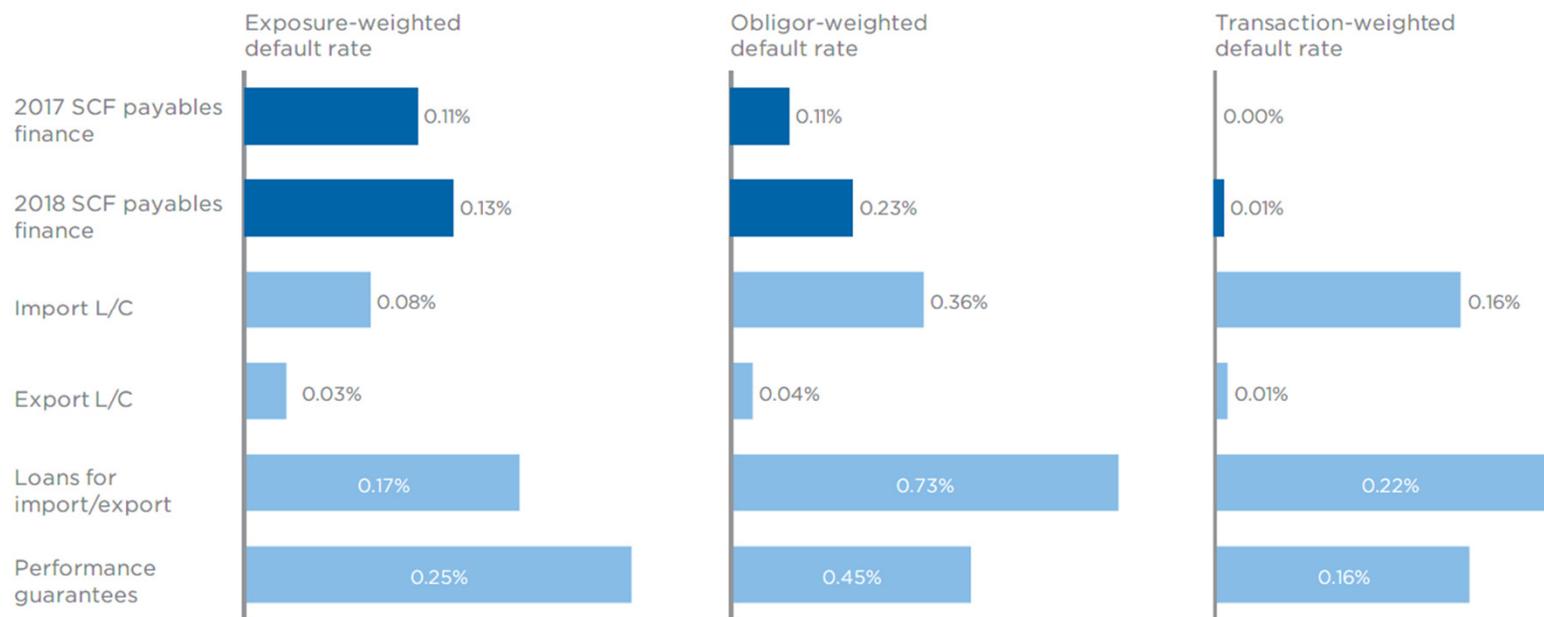
| | Total exposure (USD M) | Defaulting exposure (USD M) | Exposure-weighted default rate (%) |
|-------------------------|-----------------------------------|--|---|
| Import L/C | 3,202,070 | 2,544 | 0.08% |
| Export L/C | 1,901,356 | 496 | 0.03% |
| Loans for import/export | 6,645,580 | 11,546 | 0.17% |
| Performance guarantees | 2,559,444 | 6,275 | 0.25% |

Average maturity by trade finance products, 2008–2018 (days)

| | Average maturity | 10th percentile | 90th percentile |
|-------------------------|-------------------------|------------------------|------------------------|
| Import L/C | 111.0 | 74.8 | 183.4 |
| Export L/C | 129.0 | 74.8 | 297.4 |
| Loans for import/export | 132.7 | 78.4 | 257.0 |
| Performance guarantees | 624.6 | 395.4 | 1055.5 |

Attractiveness of Trade Finance – Low Credit Risk

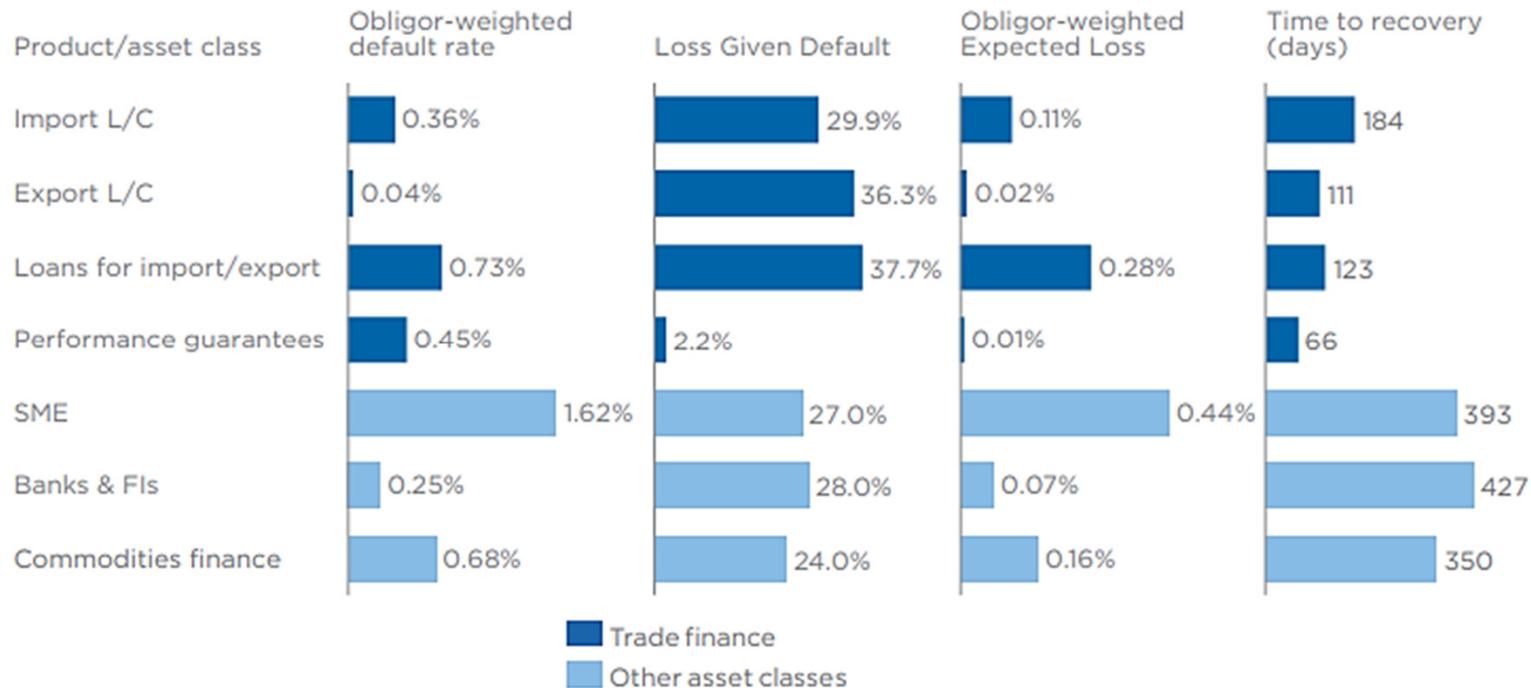
Summary of Default Rate for SCF (2017 and 2018) vs trade finance products (2008 -2018)



Source: ICC Trade Register 2019

Attractiveness of Trade Finance – Low Credit Risk

Comparison of trade finance to other asset classes, 2008–2018



Source: ICC Trade Register 2019

The image features a dense, overlapping collage of various international banknotes. Visible currencies include the United States Dollar (featuring portraits of George Washington, Thomas Jefferson, and Alexander Hamilton), the Euro (featuring a portrait of a woman), and the Chinese Yuan (featuring a portrait of a man). The banknotes are arranged in a way that creates a sense of depth and movement. A semi-transparent blue overlay covers the entire image, and the title text is centered in a clean, white, sans-serif font.

Current Trends in Distribution of Trade Finance Exposures



Trends and Developments for Distribution *Asia Overview*

- **Origination**

- Expanding origination of trade finance exposures
 - Bank focus
 - Multilaterals funding the real economy
 - New supply chains
- Client segments (Regionals v Global Banks)
- Limited non-bank origination but increasingly alternative financiers
- Funds focusing on trade finance are common (but not often primary origination)



Trends and Developments for Distribution *Asia Overview (Cont.)*

- **Distribution**

- Traditional hold-to-maturity mentality
- Jurisdiction, legal requirements and applicable accounting standards complexities
- Secondary Loan Trading, Participations and Receivables Sale Agreements
 - Larger lending facilities in syndicated format
 - Participations often use BAFT templates (and transitioning to new equitable assignment)
 - Receivables Purchase highly negotiated and FI-specific
- Credit insurance common with increasing acceptance of Basel principles
- Limited use of securitisation except on global transactions



Trends and Developments for Distribution

EU Overview

- Balance sheet management and capital requirements are still of primary focus for European FIs
- FIs are continuing to originate Trade Finance Assets and distribute risk to other FIs via BAFT MRPA, direct assignments or disclosed participation/trust arrangements
- FIs are commonly using Credit Insurance to manage their capital requirements as an alternative to distributing to other FIs
- FIs also looking to minimise capital requirements through more structured / tranching funding arrangements
- FIs are increasingly looking to distribute Trade Finance Assets into the Capital Markets
- Fintechs "originating" Trade Finance Assets are creating finance and/or distribution structures and FIs are increasingly looking at Fintech "originated" Trade Finance Assets



Trends and Developments for Distribution

US Overview

- US trends and developments are similar to the EU
- Distribution among financial institutions increased materially in 2020 as several large banks looked to reduce name specific hold positions on large programmes and liquidity risk
- The US is much more of an open account receivables and payables market with traditional trade instruments in long-term decline
- Given the prominence of these types of programmes, and the long history of trade receivables securitisation in the US, many market participants have a much more structured finance background rather than a pure trade background
- BAFT documentation is less prominent as many supply chain finance groups will distribute exposure using more proprietary open account focused documentation which is more "familiar" to them

A collage of various international banknotes, including US dollars, Chinese yuan, and Euro, with a blue overlay and the text "So, how are Investors investing?". The image features several banknotes of different denominations and colors, including a \$100 bill with Benjamin Franklin, a \$20 bill with Andrew Jackson, a 20 Euro note, and a 100 Chinese Yuan note. The notes are arranged in a layered, overlapping fashion. A semi-transparent blue overlay covers the entire image, and the text "So, how are Investors investing?" is centered in white, sans-serif font.

So, how are Investors investing?



Typical Methods

- Direct Origination
 - Non-core business and impracticable for most non-bank investors and regulatory restrictions
- Business Exposures
 - Equity or Whole Business Lending
 - Business Risk not targeted investment – exposure on originator, not on underlying trade finance
- Acquiring Exposure through
 - Participations and Assignment / Purchase Structures
 - Historically FI market with heavily negotiated bilateral arrangements, which may not be not easily tradeable (although short-term nature of trade finance exposures assists)
 - Platforms
 - Funds and Capital Markets Structures

The background of the slide features a close-up, slightly blurred image of several Euro banknotes. The focus is on the intricate patterns and colors of the currency, with the portrait of a man (likely a historical figure) visible on one of the notes. The overall tone is professional and financial.

Capital Markets and Trade Finance

- Alternative to traditional distribution/participation channels
- Why would a capital markets solution be attractive?
 - large, untapped investor base
 - investors looking for relatively safe-haven assets but with more attractive yields than sovereign bonds or unsecured bank exposure
 - once programme is set up, could switch investors in and out
 - could, in theory, avoid the regulatory and reporting requirements of securitisation
 - could, in theory, help with counterparty risk on current pooling/aggregating structures



Structuring considerations for
capital markets investments in
trade finance

The background of the slide features a close-up, slightly blurred image of several Euro banknotes. The focus is on the portrait of a man, likely a historical figure, with intricate patterns and colors like blue, green, and pink. The text 'Some Typical Considerations' is overlaid in white on the left side of this image.

Some Typical Considerations

- Understanding the investment

- What are the underlying assets?
- What are the risks?
- Who am I taking risk on?

We will cover this aspect shortly

- Obtaining a focused investment

- Special Purpose Entity (bankruptcy remoteness, accounting consolidation)
- Isolating Assets (accounting derecognition, legal true sale and perfection)
- Servicing Assets (licensing and cash flows)



Some Typical Considerations (Cont.)

- Enhancing the investment

- Hedging, credit and liquidity enhancements

We will cover trade credit insurance later in the webinar series

- Rating agency requirements

- Capital markets and regulatory considerations

- Securities laws

- Control, voting, asset selection and servicing

- Securitisation regulation and risk retention

We will cover trade receivables securitisation later in the webinar series

The background of the slide features a close-up, slightly blurred image of several Euro banknotes. The notes are in shades of blue, green, and yellow. The faces of the historical figures on the notes are visible, and some serial numbers like '14740' and 'JT 276683' can be seen. A vertical orange bar is positioned on the left side of the image.

Some Typical Considerations (Cont.)

- Challenges

- As with ABS – revolving structures with daily liquidity needs are challenging
- Market participants have little history with securities laws, risk retention, etc.
- Currency complications
- To date, there has typically been another way
- Availability of CP



Trade Finance and the Different Risks

Where does the credit risk sit within trade finance products?

- **Trade Loans**

- Import loan
 - Loan to Buyer
 - Credit risk against Buyer
- Export loan – e.g. pre-shipment seller loan
 - Loan to Seller potentially secured against goods and typically with LC restricted to lender
 - Credit risk against Seller and, once compliant documents delivered under the LC, the issuer of LC



Trade Finance and the Different Risks (Cont.)

- **Receivables and Negotiable Instruments**

- Non / limited recourse receivables purchase
 - Credit risk against Buyers with performance and legal risk against Seller
- Recourse receivables purchase (aka invoice discounting and factoring)
 - Credit risk against Seller and Buyers with potential mitigation from guarantors and boot collateral
- Payables finance
 - Credit risk against Buyer with dilution, dispute and performance risk of Sellers removed by Buyer waiver/confirmation
- Forfaiting / negotiation
 - Credit risk against Buyer with performance risk greatly mitigated



Trade Finance and the Different Risks (Cont.)

- **Traditional Trade Instruments**

- Letters of credit – FI risk
 - Confirmed by XYZ Bank (Credit risk on LC Issuing Bank)
 - Negotiated by XYZ Bank (Credit risk on LC Issuing Bank / LC Confirming Bank)
- Letters of credit – corporate risk
 - Issued by XYZ Bank (Credit risk on customer – Buyer or Seller)
- Other
 - Acceptance of Drafts (credit risk on either customer or LC Issuing Bank)

The background of the slide features a close-up, slightly blurred image of several Euro banknotes. The notes are in shades of blue, green, and yellow, with the faces of historical figures visible. The text 'Trade Finance and non-Credit Risks' is overlaid in white on the left side of this image.

Trade Finance and non-Credit Risks

- Trade Transaction
 - Commercial disputes
 - Dilutions
 - Fraud
 - Force majeure (including pandemic)
 - Licensing
- Other Legal Considerations
 - Governing law and conflicts of laws
 - Sanctions



The future Addressing
investors' questions and
facilitating trade finance
investments

A background image showing several Euro banknotes, including a 100 Euro note and a 20 Euro note, with a blue and orange vertical bar on the left side.

Questions Asked by Investors

- What is trade finance? What does it do and how?
- What are the type of products and different types of risk?
- How is risk managed and mitigated?
- How is trade finance documented?
- What are the type of default events in trade finance and can this be compared with capital market instruments?



Responses to Investors' Questions

Questions asked by Investors:

- What is trade finance? What does it do and how?
- What are the types of products and different types of risk?
- How is risk managed and mitigated?
- How is trade finance documented?

How the industry responds:

- Global Supply Chain Finance Forum publishes standard definitions
- trade bodies work to harmonise "gold standards" across the globe



Responses to Investors' Questions (Cont.)

Questions asked by Investors:

- What are the types of default events in trade finance and can this be compared with capital market instruments?

How the industry responds:

- ICC continues to simplify and standardise the data collection process and maintain regular Trade Register publication
- Given the nature of trade finance, investors may rely on any credit rating of the underlying obligors
- Trade bodies enhance investors' education and promote their awareness in trade finance

Potential Sources of Investment

- Assets under management (AuM) will continue to grow rapidly from US\$84.9 trillion in 2016 to US\$111.2 trillion by 2020 and then to US\$145.4 trillion in 2025.

| Clients | 2004 | 2007 | 2012 | 2016 | 2020e | 2025e | CAGR 2016-2025e |
|------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|-----------------|
| Pension funds | 21.3 | 29.4 | 33.9 | 38.3 | 53.1 | 64.6 | 6.0% |
| Insurance companies | 17.7 | 21.2 | 24.1 | 29.4 | 38.4 | 44.7 | 4.8% |
| Sovereign wealth funds (SWF) | 1.9 | 3.3 | 5.2 | 7.4 | 10.0 | 13.6 | 7.0% |
| HNWI | 37.9 | 50.1 | 52.4 | 72.3 | 93.4 | 119.9 | 5.8% |
| Mass affluent | 42.1 | 55.8 | 59.5 | 67.2 | 84.4 | 102.2 | 4.8% |
| Total client assets | 120.9 | 159.7 | 175.1 | 214.6 | 279.3 | 345.0 | 5.4% |
| Global AuM | 37.3 | 59.4 | 63.9 | 84.9 | 111.2 | 145.4 | 6.2% |
| Penetration rate | 30.9% | 37.2% | 36.5% | 39.6% | 39.8% | 42.1% | 0.7% |

Questions



Presenter Bios



Angelia Chia | Partner, Singapore

Angelia Chia is a partner in Mayer Brown's Singapore office and a member of Mayer Brown's Global Finance Practice Group. She has more than 20 years of experience in trade and trade finance spanning the globe. Angelia's unique advisory capability stems from her in-house experience in Cargill, JPMorgan and, most recently, Standard Chartered Bank where she was global head of legal for trade, ensuring she can provide comprehensive end-to-end advice covering the myriad of issues faced by clients as they manage the interplay of laws, regulations, industry rules, systems and policies in the confines of the organisation's operational requirements. Angelia is an active member of the ICC Legal, ITFA and BAFT Committees and is internationally recognised for her trade advisory experience.



Ben Sandstad | Partner, Hong Kong and Singapore

Benjamin Sandstad is a partner in Mayer Brown's Hong Kong and Singapore offices and a member of Mayer Brown's Global Finance Practice Group. Ben has over twenty years' legal experience, including as global head of legal for credit, lending and governance for a leading global bank, and specialises in on- and off-balance sheet financing, structured finance, trade finance (particularly trade lending and open account finance) and governance of legal risk. Ben draws on his combination of senior in-house and private practice experience to holistically advise clients on the origination of, process and governance for, and distribution of risks in respect of, the full spectrum of credit and lending transactions, particularly where there is an underlying asset, trade transaction, recourse, tax or regulatory requirement.

Presenter Bios



Charles Thain | Partner, London

Charles Thain is a partner in the Banking & Finance practice of the London office. His work is particularly focused on asset based lending (ABL), receivables finance, supply chain/payables finance and trade finance. Charles represents financial institutions, sponsors, corporates and fintechs in both domestic and cross-border transactions. He joined Mayer Brown in 2015.



Massimo Capretta | Partner, Chicago and New York

Massimo Capretta is a partner in Mayer Brown's Chicago and New York offices and a member of the Banking & Finance practice. Massimo's transactional practice focuses on representing both financial institutions and companies across a broad spectrum of domestic and international financing transactions. He has been involved in transactions spanning a number of key industries including automotive, heavy manufacturing, chemicals, metals and energy.

Massimo has particular experience with domestic and cross-border trade receivables securitization, asset-based finance, factoring, supply chain/vendor finance, trade finance and other receivables monetization strategies. He regularly advises clients on the creation and management of bespoke receivables finance transactions. He also has considerable experience advising creditors on workouts and other out of court restructurings of troubled credit facilities.

Massimo has been a speaker and panellist on a number of presentations to industry participants on topics including receivables finance, asset-based lending and cross-border finance.



Appendix - Upcoming webinars

- **Supply Chain and Working Capital Finance Webinars**

- August 19: 5 Most Common Questions About Financing Receivables and Payables Through a Platform
- September 2: 5 Most Common Questions About Financing Foreign Receivables; Issues Beyond Simple Perfection, Priority and Enforcement
- September 16: Supply Chain Finance Using Drafts and Bills of Exchange
- October 7: Working Together for Mutual Benefit: Non-Recourse Receivables Purchase and Trade Receivables Securitization
- October 21: Credit Insurance – How Does It Actually Work in Supply Chain Finance?
- November 4: The UN Convention on the Assignment of Receivables – What Is It, and How Will It Change Trade Finance?

Registrations for the upcoming webinars will be sent approximately a week in advance.

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