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Trends in Trade Receivables Finance

Mayer Brown

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Introduction

With partners having over 30 years' experience in financing trade receivables and trade payables, Mayer Brown has a unique insider's view of the global trade finance industry. Emerging from a tumultuous 12 months in the midst of a global viral pandemic, we look back in wonder at the resilience and innovation this industry demonstrated through exceedingly challenging times. That resilience and innovation continue unabated, and we see certain defining trends emerging for the near term. Given the longevity of trade finance, its critical importance to businesses around the world and a quickly changing and developing global economic, political, regulatory, accounting and overall business environment, it is no surprise to see ongoing innovation in structural technology and disintermediation, the entry of new players in the market, coalescence of thought on accounting implications and broadened use of the product by companies in varying states of the business and credit cycle.

While we could write volumes and fail to capture the nuances of all the types of trade finance tools in the market today and the evolution of such tools over the last 30 years, for the purposes of this article, we will limit the discussion to four particular trends that we have witnessed in the trade finance space in 2020 that seem likely to continue in 2021 and beyond:

1. The convergence of "securitisation" structures and more traditional trade finance technology.
2. The entry of private equity and credit funds and insurance companies as investors.
3. Broader acceptance of US GAAP off-balance sheet structures that do not result in negative consequences under ASC 230.
4. Increasing comfort by lenders and investors in structures that will not only survive but thrive pending and during insolvency proceedings.

We will address each of these trends in turn below.

The Convergence of "Securitisation" Structures and More Traditional Trade Finance Technology

The fact that trade finance has endured for many decades is a testament to the value of business-to-business trade receivables in supporting high credit quality and liquid investments. Traditionally, trade finance can include: (a) investments, typically in the form of factoring or other purchases of individual receivables (or other financial assets created from or otherwise supporting those receivables), whether to provide financing to buyers or suppliers (or other intermediaries) in the supply chain (which we will generically refer to as "obligor-specific transactions"); (b) asset-based lending ("**ABL**"), typically constituting loans, provided to a supplier of goods or services and secured by a revolving portfolio of short-term receivables and inventory; and (c) securitisation of trade receivables (which we will refer to as "structured finance"), which may be financed by banks or more widely in capital markets, but always utilising a bankruptcy remote structure. It should be noted that obligor-specific transactions may provide financing to multiple obligors under the same agreement but with underwriting of each included obligor.

Although obligor-specific transactions can be done in many forms and on a one-off or revolving basis, disclosed or undisclosed, and committed or uncommitted, the common thread in these transactions is that the investor need only assess the credit (and short-term credit at that, given that these assets typically mature in 90 days or less) of one corporate entity – the buyer of the goods or services at issue. Of course, structural elements could add additional risks, such as potential credit risk with respect to a supplier/seller if the transaction is not respected as a legal true sale or if all dilution risk has not been eliminated, potential credit risk with respect to an intermediary that takes title to the receivables for financing purposes or potential credit risk with respect to an insurer if a credit insurance policy has been obtained to insure payment of the purchased receivables. Given the short-term nature of the transaction and the limitation of potential credit risks, pricing for these transactions will typically consist of par minus some discount that reflects the expected time to payment as well as the investor's credit assessment of the obligor.

ABL transactions are typically secured loans and, as such, typically financed by banks and typically on a committed basis as part of a company's overall working capital management or even as part of an acquisition financing. These transactions require more sophisticated underwriting as they must assess the credit quality of a portfolio of receivables as well as that of the supplier/borrower and its ability to continue to generate a consistent portfolio of receivables to support the financing. These facilities are typically longer term (normally over a year) and will therefore often include triggers relating to the supplier/borrower's credit and the pool performance that will stop the committed financing early. While pricing of these facilities will typically be based on pricing the supplier/borrower's secured credit assessment, the amount of funding available at any point in time will depend on the performance of the portfolio of receivables and will take into account the expected life of the portfolio in a run-off scenario, as well as historical defaults and dilutions and obligor, and perhaps other, concentration limits. The combination of all these factors will result in a borrowing base to support the financing but the financing will be full recourse to the supplier/borrower, even if it turns out that, in retrospect, the borrowing base calculation overstated the value of the portfolio of receivables supporting the financing.

Structured finance, like ABL transactions, requires investors to underwrite a revolving portfolio of receivables based on historical performance data but, unlike ABL transactions, is not full recourse to the supplier. Like ABS transactions, structured finance typically includes a dynamic borrowing base that takes into account ongoing pool performance. However, these transactions are designed to isolate the receivables portfolio from any insolvency risk of the supplier by transferring the receivables portfolio to a bankruptcy remote special purpose entity (an "**SPE**"). Consequently, structured finance transactions can result in pricing that is better than that which a supplier may be able to achieve in a full recourse transaction that relies on its credit, even if secured. However, even with such isolation, the transaction will expose investors to some credit risk relating to the supplier, which may include dilution recourse, indemnification for representations and warranties regarding the nature of the portfolio, servicing of the portfolio as well as the continued generation of new receivables to replenish collected receivables in the event that collections are not immediately segregated. Consequently, structured finance transactions in trade receivables will normally include some triggers relating to supplier credit issues that can have the effect of terminating the revolving nature of the portfolio, starting cash trapping or imposing other limitations on the ordinary servicing procedures of the supplier. It is worth noting that in structured finance, although recourse to the supplier for obligor credit performance is typically quite limited in the sale transaction to the SPE, there is no such limit on the recourse of investors to the SPE. That is because the transaction between the SPE and the investors need not be a legal true sale in order to provide investors with the isolation in bankruptcy that they require. The SPE is designed never to become the subject of an insolvency proceeding and the SPE's assets and liabilities cannot be substantively consolidated with the supplier in the event of a supplier insolvency proceeding. The advance rate (or borrowing base) in these transactions will likely be the same or lower than in ABL but with better pricing and, like in ABL transactions, the supplier has no possibility of delivering any "upside" to its investors because the discounting self-adjusts for historical performance both prospectively and retroactively. The investors cannot receive more than their investment and cost of carry for the duration of their investment.

The types of convergence that we are seeing include: (a) obligor-specific transactions that include higher levels of recourse to the supplier that add stress to the legal or accounting sale characterisation of the transaction and may correspond to insurance coverage acquired by the investor; (b) "securitisation-lite" structures designed to solve for the higher levels of recourse by inserting an SPE between the supplier and the investors, but without the more complicated advance rate/borrowing base calculations included in ABL and structured finance transactions; (c) the emergence of "aggregation" entities sponsored by investment managers or payment platforms, which seek to pool trade assets acquired from multiple unrelated suppliers; (d) the inclusion of credit insurance, traditionally endemic to obligor-specific transactions, in structured finance transactions; and (e) investors financing particular obligor "excess concentrations" using obligor-specific transaction technology but from a portfolio otherwise included in a structured finance transaction already, as well as investors financing residual or subordinate interests in structured finance transactions.

The first two types of convergence generally go hand in hand; that is, the desire to increase recourse levels, even for obligor-specific transactions, drives the securitisation-lite structures that have emerged in the market. Suppliers can enjoy a higher purchase price/advance rate if they provide some level of guarantee of payment by their obligors, whether through an increase in discount if the obligor pays late, or an absolute guarantee of a certain percentage of losses. Because higher recourse levels can be detrimental to obtaining a strong legal true sale opinion, which in turn is generally required for off-balance sheet treatment under US GAAP, and can result in non-US GAAP reporters failing to achieve sale treatment under International Financial Reporting Standards ("**IFRS**"), adding an SPE to the structure can often result in the supplier and investors both "having their cake and eating it too". We will discuss current off-balance sheet technology under US GAAP in more detail later.

The third type of convergence is a natural result of the emergence of non-bank investors who want alternative avenues to invest in trade assets outside of the traditional inter-bank participation market.

There is also an increasing trend in the marketplace for buyers of goods to want to engage in arrangements where they can arrange for their inventory to be financed on an off-balance sheet basis. This usually involves the imposition of a third-party entity agreeing to purchase the inventory either from the buyer or directly from the buyer's suppliers and holding the inventory on its own books. Often, the third-party entity will finance its ownership of the inventory through one or more banks. These arrangements involve complex accounting and regulatory questions and are often highly bespoke in nature.

We have observed an increase in the inclusion of credit insurance policies in trade finance transactions for several years. Of course, a credit insurance policy can be used as an enhancement to the credit risk of obligors in any of the trade finance structures in the market. However, it has more recently found its way into structured finance transactions. For many banks that are not subject to US regulatory capital rules, credit insurance can dramatically reduce the required capital to support these transactions (although, unless cash collateralised, there is little utility in such insurance in the US, outside the securitisation framework). Although clearly beneficial to investors in these transactions, regardless of the capital benefit, the motivation for such inclusion often comes from the supplier. With an insurance policy covering the portfolio, the supplier can obtain a higher advance rate against its portfolio but also may be able to obtain off-balance sheet treatment for a transaction that is otherwise investment grade risk to its primary investors. That is because the risk assumed by the insurer may be considered to satisfy the IFRS requirements to have a significant risk transfer. Investors in transactions with such insurance policies should consider whether counsel should be charged with reviewing the policies in detail, as structured finance transactions can result in complexity in determining what entity holds the receivable and has an insurable interest under local insurance law. Often, there may need to be multiple insureds in order to ensure that the interests of the investors and the SPE (as to its residual interest) are covered. Also, the policy will normally need to be adapted to fit the transaction to ensure that although the supplier may no longer own the receivables, it is still the entity servicing them and responsible for insurance reporting.

As we will discuss below, the level of interest from non-bank investors in the trade finance space has increased rapidly over the past several years. Given that many of the non-bank entrants in this market are private equity, credit funds and other alternative lenders that are not constrained by banking regulations and that typically seek higher yields, it is not surprising that these investors are finding ways to acquire residual or subordinate tranches in existing and new structured finance transactions. Of course, in new transactions, the structure can be designed to accommodate subordinate investors through subordinated notes or other similar mechanics. In existing transactions this can be trickier but these new investors and banks are finding ways to make it work, including by transferring subordinated participation interests, acquiring financial guarantees or credit default swaps, or by issuing credit linked notes that support a subordinated tranche of the bank's investment. We also see investors applying obligor-specific technology to existing structured finance transactions, by acquiring receivables owing by particular obligors that are in excess of the amount of funding available against such obligors in the structured finance transactions. These "excess concentrations" can be financed by the supplier with other investors but typically require the consent of the existing bank investors.

One particular aspect to keep in mind when structuring a trade finance transaction is whether any of the parties to it are or could be subject to the EU Securitisation Regulation (as defined below) or the parallel regime that now applies in the United Kingdom. Regulation (EU) 2017/2402 (the "**EU Securitisation Regulation**") applies to any new "securitisation" (as defined therein) entered into from 1 January 2019 and to any existing securitisation entered into before that date where new securities are issued or a new securitisation position is created on or after that date. Following the end of the Brexit transition period on 31 December 2020, the EU Securitisation Regulation now forms part of UK domestic law, as part of "retained EU law", and pursuant to the "onshoring" process has been amended by the Securitisation (Amendment) (EU Exit) Regulations 2019 (the "**Securitisation Amendment Regulations**" (as so amended, the "**UK Securitisation Regulation**"), creating a similar, but not identical, regime in the UK. The EU Securitisation Regulation and the UK Securitisation Regulation both contain requirements relating to investor due diligence, risk retention, disclosure, credit granting and various other matters and a ban on resecuritisation.

The definition of securitisation in the EU Securitisation Regulation and the UK Securitisation Regulation is widely drafted and refers to a transaction or scheme involving the tranching of the credit risk of an exposure or pool of exposures, where payments are dependent upon the performance of such exposure or pool of exposures and where the subordination of tranches determines the distribution of losses during the ongoing life of the transaction or scheme. Consequently, while many trade receivables transactions do involve an issuance of securities, the definition can also apply to other types of transactions, such as loans or sales of receivables, if they involve tranching of the credit risk of the receivables and meet the other requirements described above. In addition, the definition does not require there to be an SPE. In the event that the transaction does fall within that definition, the relevant parties will need to consider how they are going to comply with the applicable requirements.

Institutional investors (as defined in the EU Securitisation Regulation or the UK Securitisation Regulation, as applicable) that are established in the EU or the UK, and in some cases their consolidated affiliates, are required to comply with certain due diligence obligations with respect to verifying compliance with risk retention, credit-granting and, where applicable, transparency requirements, and carry out a due diligence assessment to assess the risks of the securitisation position and the underlying exposures, and the structural features of the transaction. They must also put in place procedures for ongoing monitoring, perform stress tests, carry out internal reporting and be able to demonstrate their understanding of the relevant aspects to their regulators.

Originators, sponsors and original lenders of a securitisation (as such terms are defined in the EU Securitisation Regulation or the UK Securitisation Regulation, as applicable) are required to comply with risk retention requirements, meaning that a material net economic interest in the securitisation of not less than 5% must be retained for the life of the transaction, using one of five specified methods. In the case of trade receivables transactions, the most common method is the retention of a first loss tranche, either by way of deferred purchase price ("**DPP**") (as discussed further below) or by way of a subordinated loan or note. While the EU Securitisation Regulation and the UK Securitisation Regulation do not specifically set out the jurisdictional scope of these requirements, it is generally understood by market participants that the risk retention obligations (and the credit-granting and transparency requirements) apply directly only to entities that are established in the EU, or the UK, as applicable. However, entities that are not directly subject to the risk retention requirements may also decide to agree contractually to risk retention obligations in order that investors can meet their due diligence requirements as described above.

The originator, sponsor or the securitisation special purpose entity ("**SSPE**") of a securitisation is also required to comply with certain disclosure obligations, including requirements to provide periodic reports on the underlying exposures and periodic investor reports, all relevant transaction documents and information relating to significant events such as material breaches, changes in structural features and changes in risk characteristics of the securitisation or the underlying exposures. The reports on the underlying exposures and the investor reports are required to be provided in the form of specified templates. These reporting obligations are significant and need to be considered carefully when entering into a securitisation transaction. Asset-level data is required to be included in the reporting templates unless the transaction is funded via an asset-backed commercial paper, or ABCP, conduit. Reporting for non-ABCP transactions needs to be provided on a quarterly basis, although in practice it is often done on a monthly basis, to align with the monthly servicer reports. Sponsors of ABCP conduits need to provide the relevant reports to their ABCP investors on a monthly basis.

The extent to which an EU institutional investor needs to verify that there has been compliance with the reporting obligations remains unclear where a transaction does not have an originator, sponsor or SSPE that is established in the EU. One interpretation is that because the reporting obligations do not apply directly to non-EU entities, EU investors should not be required to obtain such reporting. However, another interpretation is that an EU investor would still be required to obtain such reporting in these circumstances. Investors are having to make their own determination as to how to interpret these requirements and some are taking what is sometimes referred to as a "substantive compliance" approach. While some recommendations on this point were published in a report by the High Level Forum on Capital Markets Union last year, it is still not clear how these requirements should be interpreted.

The rules are now different for UK investors as a result of the amendments made to the EU Securitisation Regulation, as it applies in the UK, by the Securitisation Amendment Regulations. UK investors must verify that an originator, sponsor or SSPE that is not established in the UK has made available information that is substantially the same, and with substantially the same "frequency and modalities", as would be required if such entity were directly subject to the UK disclosure requirements. There remains uncertainty with respect to how the words "substantially the same" should be interpreted and exactly what this means in practice.

The EU Securitisation Regulation and the UK Securitisation Regulation also allow for securitisations to be designated as "simple, transparent and standardised", or "**STS**", provided that they meet certain specified criteria, and this allows investors to benefit from lower regulatory capital requirements as well as conferring other favourable regulatory capital treatment. Many existing trade receivables securitisations (both funded by banks on their balance sheets and funded by ABCP conduits) have now been converted to STS and this can be an important consideration when putting together a new securitisation transaction, given the recent increases in regulatory capital requirements for securitisations and originators' pricing requirements.

While the EU Securitisation Regulation and the UK Securitisation Regulation are similar, there are some important differences. The EU and UK rules may also diverge over time (for example, as a result of the new regulatory technical standards on risk retention, which still need to be finalised in both the EU and the UK) and there may be further revisions following further reviews of the rules. Consequently, if there is any actual or potential EU or UK nexus for a trade receivables securitisation transaction, it will be important to consider to what extent there will need to be compliance with one or both regimes.

The Entry of Private Equity and Credit Funds and Insurance Companies as Investors

Given that trade finance enables banks to utilise so many of their core banking products for any particular customer, the long dominance by banks as investors in this space should come as no surprise. Trade finance, regardless of form or type, can include bank products that are yield and episodic fee generators, such as lending, letter of credit insurance and other types of bank guarantees and receivables purchasing, as well as tried and true flow fee generation through cash management systems that underlie trade finance. However, financial disintermediation has been at play in the capital markets and has impacted so many asset classes over the last decade, from the various unsecured consumer lending "peer to peer" or "marketplace" programmes, which supplement the more traditional bank credit card platforms, to the more recent proliferation of credit funds competing with banks in the traditional corporate lending arena.

Alternative lenders often have higher benchmarks for yield and, correspondingly, lower thresholds for risk than their highly regulated bank counterparts. This makes them perfect candidates for subordinated and residual tranches of structured finance transactions. Indeed, most of the investors that we are observing in these new forms of structured finance are such alternative lenders. For transactions that seek off-balance sheet treatment, they may be essential as off-balance sheet treatment can require a transfer of significant risk (such as under IFRS). Because most banks will normally structure their investments to at least an investment grade level of support in order to avoid regulatory scrutiny or punitive capital requirements, transactions supported by non-investment grade pools or obligors will often need an alternative lender to finance the non-investment grade portion. We have worked on many significant trade finance transactions over the last couple of years that involved non-bank equity or subordinated investors for this reason. With interest rates at all-time lows, even throughout the pandemic, alternative investors appear quite willing to fill that non-investment grade void.

In addition to their role in structured finance transactions, the evolution of technology in disintermediation has generally enabled alternative lenders to quickly invest in liquid assets at yields higher than cash equivalents. The proliferation of trade finance platforms that enable trading in the business-to-business short-term receivables of highly regarded corporate credits, at rapid speeds and over the last few years, has been fuelled by these investors, although banks have also been investing in these assets and many have had their own platforms with similar trading technology for many years. The early non-bank intermediaries in this space had advantages in technology that enabled them to match suppliers or obligors with investors. With that technology fairly well trodden at this point, other investors are primed to establish their own aggregation vehicles for their own investment without the additional cost of a fee-earning intermediary.

We expect this trend to continue for years to come.

Broader Acceptance of US GAAP Off-balance Sheet Structures That Do Not Result in Negative Consequences Under ASC 230

As has been noted at several points in this article, derecognition of assets following transfer (often referred to as "sale treatment" or "off-balance sheet treatment") is sometimes an important factor for a supplier when it seeks trade receivables financing. Although derecognition is typically not an issue in obligor-specific transactions (at least so long as they do not run afoul of standard recourse and other limitations), derecognition is rarely a given in structured receivables transactions and is generally not available in ABL transactions. Here we will be discussing trends in structured finance transactions that have achieved off-balance sheet treatment under US GAAP.

For decades, structured trade receivables financings funded by banks (directly or indirectly through their sponsored asset-backed commercial paper conduits) have implemented structures that achieve off-balance sheet treatment for the seller/supplier. While the relevant US GAAP rules have changed, from FAS 125 to FAS 140 to FAS 166 with respect to accounting for transfers of financial assets (currently codified as ASC 860), and from FIN 46 to FIN 46(R) to FAS 167 with respect to consolidation of variable interest entities (currently codified as ASC 810), the core principles enabling derecognition for these transactions have remained the same. The guiding principle throughout the various iterations of the accounting guidelines has been that the receivables must be transferred, through one or more levels (or tiers) to an entity that is not consolidated with the seller under GAAP.

As discussed above, in structured finance transactions an SPE is typically utilised in order to achieve legal isolation of the assets and, at least in trade finance, to enable investors to achieve an investment-grade level of support for their investment. If a transaction results in the seller retaining significant risk and rewards (e.g., by retaining subordinated or residual tranches of exposure in the structure), the SPE will likely be consolidated with the seller/supplier under US GAAP FAS 167/ASC 810. Indeed, in most (but not all) US trade receivables structured finance transactions, the SPE is a wholly owned subsidiary of the seller/supplier and is consolidated with the seller/supplier under US GAAP. So long as the SPE is consolidated with the seller/supplier for financial accounting purposes, the seller/supplier's transfer of receivables to the SPE (even if the transfer constitutes a "true sale") will not, in and of itself, result in the desired off-balance sheet treatment.

However, once receivables have been "legally isolated" in a bankruptcy-remote SPE (i.e., via a legal "true sale" to an SPE that would not be substantively consolidated with the seller/supplier in the event of the seller/supplier's bankruptcy), FAS 166/ASC 860 permit derecognition (or "sale treatment") when the receivables are further on-sold by the SPE to an entity, such as a third-party bank or a conduit that is not consolidated with the seller/supplier for financial accounting purposes so long as specified criteria are met – even if that sale by the SPE is not supported by a "true sale" legal opinion and the buyer benefits from credit and yield enhancement provided by the SPE. Rather, if the receivables have been legally isolated in an SPE, the derecognition analysis under FAS 166/ASC 860 focuses on whether effective control of the receivables has been transferred to the non-consolidated buyer and whether such buyer has the right to further transfer the receivables. Although care must be taken to meet the specific requirements under FAS 166/ASC 860 for transferring control to the buyer and maintaining free transferability, those criteria can usually be satisfied in a structured trade receivables financing, while maintaining business terms (e.g., with respect to economics, servicing, credit enhancement and yield protection) commonly found in corresponding on-balance sheet transactions.

When FAS 166 and 167 were first implemented, we worked to create structures that would adhere to these core principles in US accounting while permitting banks and sellers to achieve the credit protections and derecognition they both sought. The structure that gained the most traction with sellers and accountants alike was referred to as the "DPP structure". The structure required a legal true sale to an SPE, followed by a sale that would not be required to be a legal true sale from such SPE to the bank or other investor. The investor would owe the SPE a purchase price equal to the fair value of the transferred receivables. The purchase price would be paid in cash upfront in an amount that would factor in a dynamic discount (or reserves) approximating investment grade loss protection as well as the cost of carry for a stressed liquidation period, and, sometimes, other reserves for dilutions, taxes and other items. The difference between the total purchase price and the upfront cash payment is referred to as a DPP obligation of the investor. Payment of the DPP is limited recourse to funds from the transferred assets that are available to pay such DPP.

This DPP structure had been used and widely accepted by accounting firms for well over a decade. In 2017, the accounting community sought clarity regarding the income statement cash-flow treatment that resulted in this structure – whether the cash-flows should be characterised as cash-flow from operating activity ("**CFOA**") or as cash-flow from investment activity ("**CFIA**"). Clearly, cash-flows from trade receivables are CFOA. Likewise, cash received at the time of sale of trade receivables is treated as CFOA. What was unclear, however, was how to treat cash paid by the investors in a DPP deal in respect of the DPP asset owed to the seller. August 2016 amendments to ASC 230 (which for public business entities were effective for fiscal years beginning after 15 December 2017) provided the desired clarity. The cash-flows from the DPP asset (as a beneficial interest in a securitisation) would be treated as CFIA. In addition to being an undesirable income item for operating companies whose primary business is to produce and sell goods and services, rather than engage in trading or investing, the bifurcation of the cash-flow treatment into CFOA and CFIA for the same pool of assets would be a challenging, if not impossible, exercise for most sellers. Consequently, many of the prior DPP structure transactions wound down in their normal course without renewal or were restructured to eliminate the DPP asset but also to no longer be off-balance sheet for the seller.

We took the challenge in 2018 to create a new structure that would achieve the same derecognition benefits of the DPP structure but avoid the inclusion of any DPP asset and thus the bifurcation of CFOA and CFIA cash-flows. We call that structure the "Secured Guarantee" structure. With this structure, the DPP asset is replaced with a secured guarantee from the SPE. Because the resulting cash-flows from the portfolio are all cash-flow from the receivables collections or from cash purchase price paid for the receivables, all of which are clearly CFOA, the Secured Guarantee structure eliminates any CFIA. The growth in use of this structure over the last few years has been great and there is now widespread acceptance of the structure among accounting firms and companies. We expect this to continue in 2021 and beyond.

Increasing Comfort by Lenders and Investors in Structures That Will Not Only Survive but Thrive Pending and During Insolvency Proceedings

Increased availability of trade receivables securitisation for companies lower on the credit spectrum has been a significant trend over the past few years. It is now common to see trade receivables securitisations provided to unrated portfolio companies of private equity funds, as acquisition financing (including in highly leveraged transactions) and as alternative debt for companies in varying states of financial distress. That trend seems likely driven (at least in part) by investors' increased confidence in the bankruptcy-remote structures employed in these transactions, particularly in light of a number of recent US bankruptcy cases in which the structure proved itself. Examples include bankruptcies of AbitibiBowater, Arch Coal, Centric Brands, Cloud Peak Energy, Covia, Dean Foods, Patriot Coal, Peabody Energy and Tribune, among others. In each of those cases, the securitisation was either paid in full or continued by the investors on a voluntary basis as an alternative to traditional debtor in possession ("**DIP**") financing.

Trade receivables securitisation as an alternative to customary DIP financing has been a particularly interesting trend and, in the past few years, has been used in bankruptcy by companies including Arch Coal, Centric Brands, Cloud Peak Energy, Dean Foods and Peabody Energy. AbitibiBowater and Tribune also utilised similar structures pioneered by Mayer Brown in the prior decade, but we did not see wider adoption until recently. Investors and debtor-sponsors alike have seen value in obtaining liquidity for a debtor's estate using securitisation technology. Investors benefit from keeping the debt and security package at the level of a non-bankrupt SPE outside the sponsor's bankruptcy estate, while debtor-sponsors may find more attractive pricing, covenants and financing availability compared to traditional DIP facilities. In each transaction, we have evolved and enhanced the legal protections available to securitisation investors funding into a sponsor's bankruptcy, methods of addressing intercreditor issues, and structuring to ensure the securitisation works side-by-side with a defensive secured DIP facility. Key protections include obtaining a super-priority claim for amounts owed by the debtors in connection with the securitisation (e.g., for misrepresentations, dilution, indemnities and the like), relief from the automatic stay, approval of continued true sales of receivables by the debtors to the SPE, debtors' assumption of securitisation-related agreements and findings to support the bankruptcy-remoteness of the securitisation facility, among others. It has been our experience that, in appropriate circumstances with proper structural protections in place, trade receivables securitisation can be an attractive financing option for companies restructuring through the bankruptcy process.

On the other hand, providing trade receivables securitisations to less creditworthy sponsors certainly brings added risks that investors and other parties should keep at front of mind. It is critical to ensure a sound bankruptcy-remote structure, address intercreditor and competing-lien issues, tightly control cash management and collection functions and frequently monitor borrowing base coverage – particularly for declining sales, dilutive activity, set-off risks and cash leakage, which may or may not be readily apparent. The legal structure can be tight as a drum, but that may be of little help if an investor inadvertently funds against an overstated borrowing base and finds its investment underwater when the sponsor files for bankruptcy protection.

For investors willing to accept some additional but well-understood risks in exchange for increased returns and opportunities to lend, we anticipate that trade receivables securitisation will continue to grow as an offering for companies in less than ideal financial situations.

We will continue to monitor all the above trends, as well as other innovations and developments in connection with securitisations and other financing transactions with respect to trade receivables.

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