GUIDE TO TRADE FINANCE

ITFA

International Trade and Forfaiting Association

TRADE FINANCE GLOBAL

This is a jointly produced guide between Trade Finance Global (TFG) and International Trade & Forfaiting Association (ITFA).

Thanks To
TFG and ITFA would like to extend a special thank you to all contributors.

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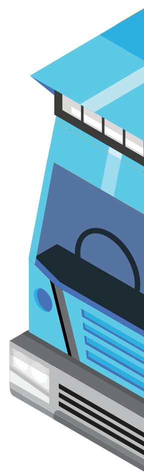
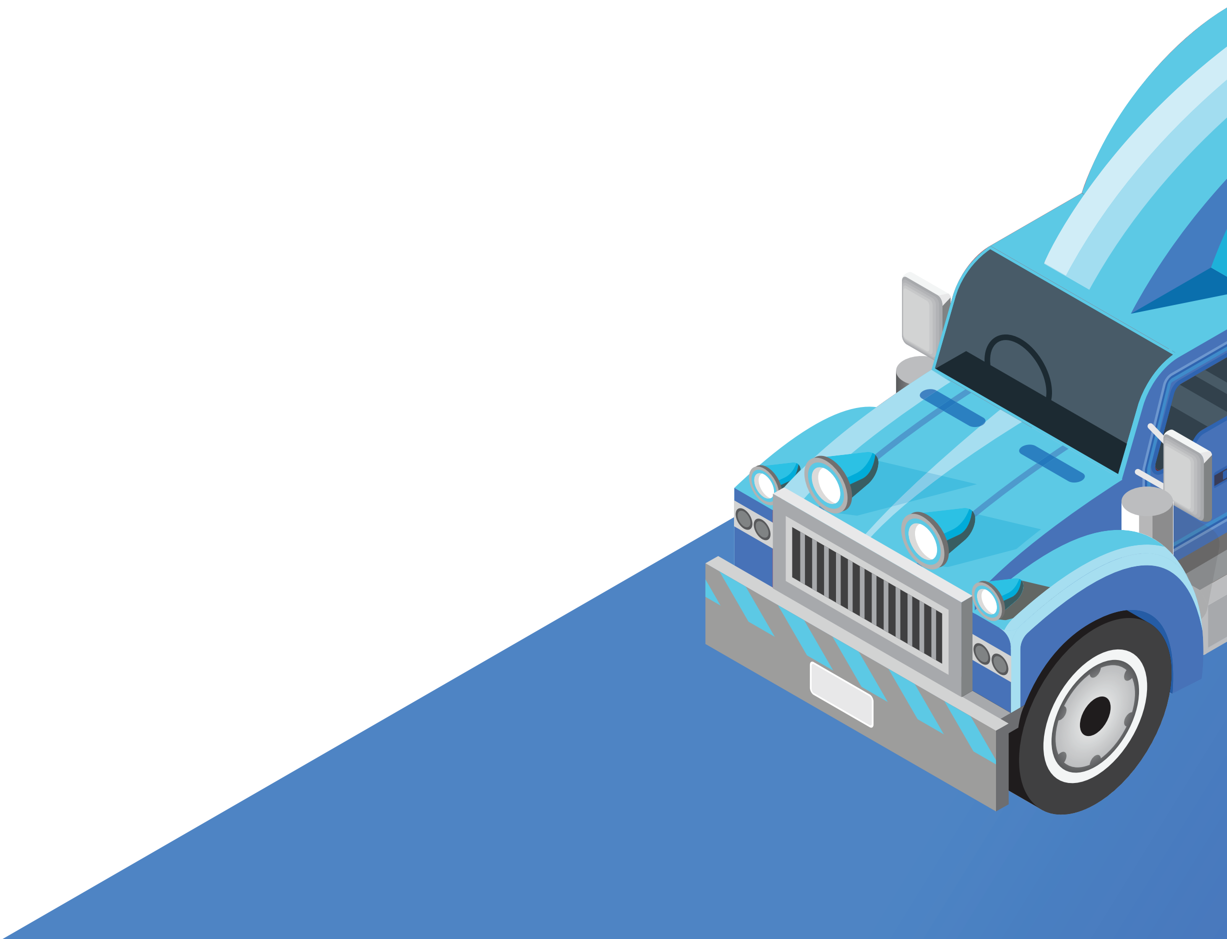
INTRODUCTION
THE TRADE DILEMMA

A common dilemma faced when engaging in the sale and purchase of goods and services, especially where international trade is concerned, is the seller wanting to get paid before shipping the goods and the buyer wanting to receive the goods before paying the seller. In simple terms, this can be called the trade dilemma, where certainty around the inherent risks associated with trade, and the need to bridge working capital cash flow gaps through access to external sources of funding, become key in the facilitation of trade transactions. In order to provide a solution for buyers and sellers, the financial sector intervenes by providing them with trade finance products and services, increasing certainty for both parties involved in a trade as well as funding where necessary.





The Trade Dilemma

Trade finance is a set of techniques aimed at mitigating and transferring trade risks to the financial sector, and/or using bank funding to enable domestic and cross border/ international trade flows. Trade finance focuses on supporting the physical flow of goods across borders while primarily using the goods, receivables and cash generated from the trade as the principal security.

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Trade Finance deals typically involve at least three parties: the exporter (seller), the importer (buyer) and the financier, and differ from other types of credit products as transactions should have the following features:

- An underlying supply of a product or service
- A purchase and sales contract
- Shipping and delivery details
- Other required documentation (certificates of origin, etc)
- Insurance cover
- Terms and instruments of payment, e.g. letter of credit, advance payment, deferred payment, etc.

Trade Finance exists to finance the trade cycle at various points of the transaction, also allowing participants to manage the capital required for trade, while mitigating or reducing the risks involved in an international trade deal.

International and local financial institutions support international trade through a wide range of products that help manage their international payments and associated risks, as well as catering for the need for working capital.

Examples of Providers of Trade Finance

- Banks
- Funds
- Alternative Financiers such as forfaiting houses
- Insurance Underwriters
- Trading Companies

Users of Trade Finance

- Importers
- Exporters
- Trading Companies

RISKS OF TRADE FINANCE

International Trade has particular characteristics that give rise to different types of risks. Trade financiers thus spend most of their time understanding and mitigating these risks. The following is a selection of some of the key risks in international trade finance:

Country Risk

A collection of risks associated with doing business with counterparties based in a foreign country, including exchange rate risk, political risk and ultimately, sovereign risk. Factors to bear in mind when considering country risks involve the current political climate in the country, the state of the local economy, the existence of reliable legal structures and the availability of hard currency liquidity, among other factors.

Corporate Risk

These are risks associated with the exporting/importing entities, primarily focusing on their credit rating and any history of defaults, either through non-payment or through non-delivery/deficient delivery.

Commercial Risk

This refers to potential losses arising from weaknesses stemming from, or defects in, the underlying trade (quality/adequacy of the goods being traded, robustness/adequacy of the contracts, pricing matters, etc).

Fraud Risk

These are risks typically associated with either unknowingly engaging with a fraudulent counterparty, receiving forged documents and insurance scams.

Documentary Risk

Documents play a vital role in international trade. Missing or incorrectly prepared documents pose risk for both buyers and sellers as this can cause delays in shipments and ultimately delays in payments.

Foreign Exchange/Currency Risk

This is the risk posed by fluctuations in the exchange rates, relating to payments and receipts in foreign currency. Unless it is hedged, the exporter or importer has no control over this movement in the rate of exchange and on occasion such changes can wipe out the profit or even more attributed to the transaction.

Transport Risk

About 80% of the world's major transportation of goods is carried out by sea, which gives rise to a number of risk factors associated with transportation of goods. Storms, collisions, theft, leakage, spoilage, cargo theft, scuttling, piracy, fire and robbery are just some of those risks.

TRADE FINANCE PRODUCTS WITHIN THE TRADE CYCLE

Financial institutions support trade with a variety of trade finance products – some focusing chiefly on risk mitigation and others on the actual financing requirements inherent to cash flow gaps in the underlying trade. The products required are typically determined by the stage of the trade cycle participants may find themselves in.

Unfunded and Funded Trade Finance

Trade finance products are typically categorized under two areas: Unfunded Trade Finance and Funded Trade Finance.

Unfunded Trade Finance products are focused on credit enhancement/support, such that the provider involved does not offer liquidity to the trade counterparts, but rather supports the transaction by guaranteeing the performance of the parties in their different roles.

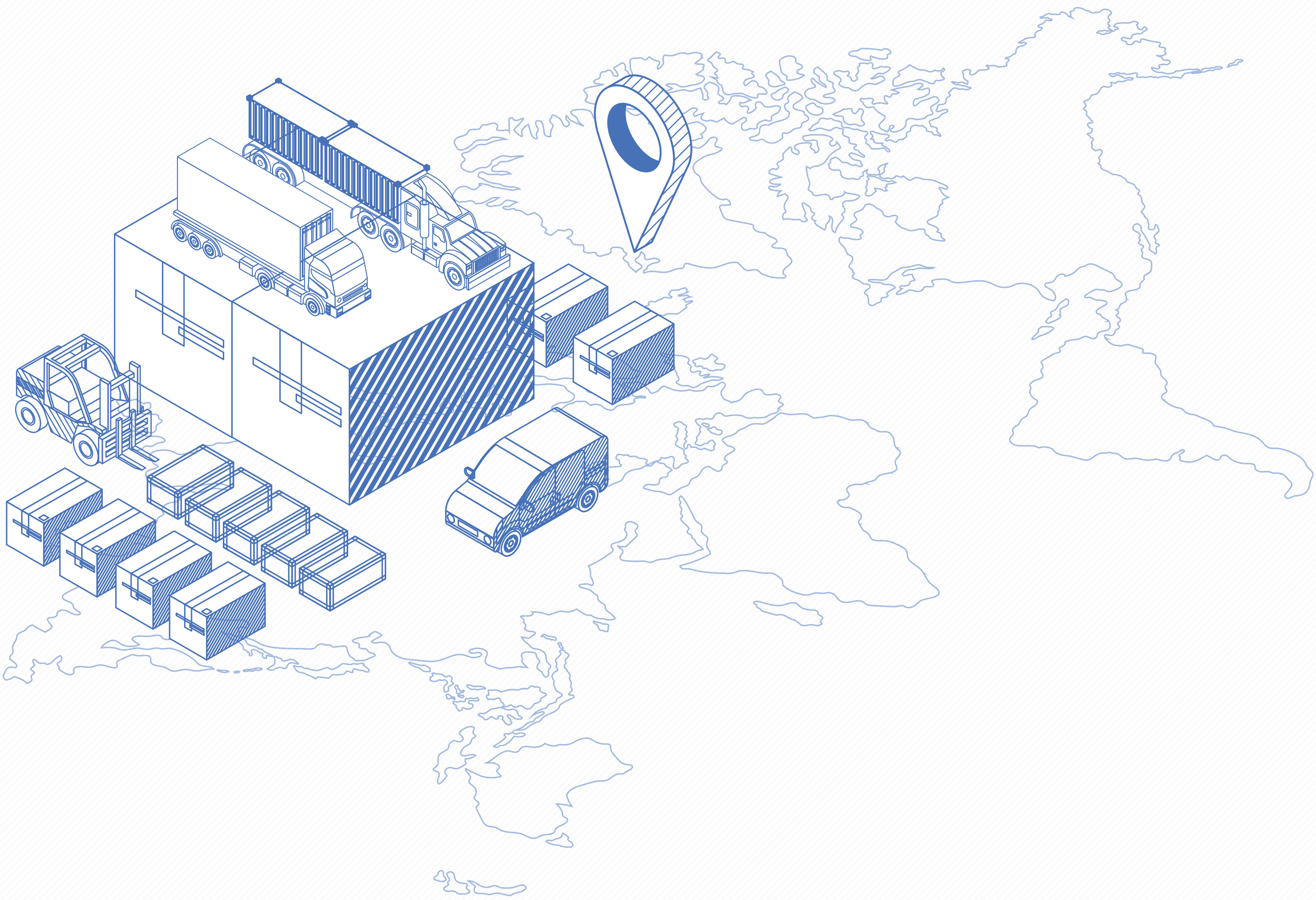
Funded Trade Finance Products are focused on the provision of funding/liquidity by a financial institution to the parties participating in the trade transaction.

In a trade transaction both Buyers and Sellers have it in their best interests to have as much control as possible over the transfer of title of the underlying goods and, naturally, over the proceeds of payment relating to those goods.

As such, trade finance products focused on risk mitigation help settle the conflicting needs of the parties (normally an exporter and an importer, as far as international trade is concerned). Where an exporter needs to mitigate the payment risk from the importer, it would be in its best interests to accelerate the payment from the importer. On the importer's side, its aim is to mitigate the supply/performance risk of the exporter and thus receive the goods before it has to affect payment. In these cases, trade finance products effectively function as a mechanism whereby providers absorb the risks inherent to the trade (mostly payment and supply related risks), whilst also potentially providing the exporter with accelerated receivables and the importer with extended credit.

NON-STRUCTURED UNFUNDED TRADE FINANCE

Non-structured unfunded trade finance products are simple trade finance tools focused on providing credit enhancement to participants involved in trade transactions. Considering the various risks associated with domestic and cross border trade, these tools/products provide additional comfort for the transacting parties.



Letters of Credit (LCs)

One of the products commonly used to achieve this goal is a Letter of Credit. A letter of credit is a contractual payment undertaking issued by a financial institution on behalf of a buyer of goods for the benefit of a seller, covering the amount specified in the credit, payment of which is conditional on the seller fulfilling the credit's documentary requirements within a specific timeframe.

The primary aim of this instrument is to provide increased assurance to both the buyer and seller of the fulfilment of each party's obligations in a commercial trade – namely the seller's obligation to deliver the goods as agreed with the buyer, and the buyer's obligation to pay for those goods within the specified timeframe.

Some variations to the main letter of credit include revolving, escalating, de-escalating, transferrable, back-to-back, as well as red and green clause letters of credit.

An issuer will use its customer's funds to make the payment.

Standby Letters of Credit, Demand Guarantees and Bonds

These instruments can be classified as an independent payment undertaking, i.e. an undertaking issued by one party in support of another party's obligations under an underlying agreement, where the issuing party's obligations are independent of those of the supported party.

These instruments are typically required within a contractual framework with the objective of providing greater certainty and security as to a party's fulfilment of its contractual obligations. In effect, a financial institution intervenes assuming the position of the party they are supporting, thereby replacing that party's ability to perform with their own, providing increased comfort to the contractual party benefiting from the undertaking.

The most common requirements for the issuance of these instruments arise from the need to support bids on projects or contracts, to guarantee the performance of contractual obligations and to ensure the protection of advance payments made under an agreement. In Trade Finance terminology, the instruments issued by financial institutions to cover the aforementioned purposes are, respectively, bid, performance and advance payment bonds. When structured either as demand guarantees or stand-by letters of credit, no shipping documents are needed and only a demand is presented.

Credit Insurance

Credit insurance is a risk mitigation tool which can be used as a protection against commercial and political risks. It is used by both private and public companies and can be provided by private insurers and state-owned Export Credit Agencies (ECAs). Credit insurance presents a series of **unique characteristics** that make it a safe product while acting as a catalyst for the real economy:

- Credit Insurance **contributes to the reduction of systemic risk due to its risk sharing between banking and insurance markets** (which present low levels of correlation). This limits possible contagion risks in case of economic downturn.
- **Recovery rates** are high
- **Non-payment insurance policies are bespoke contracts** that create and require a trust-based long-term relationship between banks and insurers, and therefore allow assessing credit risk with high levels of precision.
- **Claims performance is of the highest quality**. Non-payment insurance is well tested and proved to be a well-functioning insurance cover corresponding to the expectations of all parties. According to published statistics in the period from 2007 to 2018 capturing data from the single risk insurance market, 486 claims on banks' policies were made for a total amount of USD 3.19 billion. Out of that number 471 claims were paid in full, within the required timeframe and without difficulties, amounting to USD 3.07 billion. Only 15 claims had to undergo a compromise, mostly due to failure by the bank to comply with insurance policy requirements (and yet 44% of the "compromised" amounts claimed were still paid in settlement agreements).
- The **insurance claim process is in the bank's control**. The policy as a bespoke contract is tailored to the specific exposure that the bank is running. A long-term relationship combined with standardized claims procedure clauses allows predictable communication during the whole process.
- Due to the credit insurance characteristics (personal and highly prescribed contracts), **there is no basis risk** i.e. no discrepancy between the cover and underlying risk.
- Additionally, **the conditions are fully in the bank's control** which means that, apart from an operational failure on the bank's side where the settlement would be compromised, there is no reason why a bank could not expect settlement in full.

Importance of credit insurance

Credit insurance has a significant role in providing support to the real economy, which goes beyond the actual amount insured, as in many cases the decision on whether a bank grants financing to a company depends on whether there is credit insurance cover available for that particular transaction. This is confirmed by a survey done by ITFA among its members, which shows that (under conservative assumptions) EUR 87bn of insurance cover supports at least EUR 155bn of banking facilities to the real economy, which would not have been supported without credit insurance.

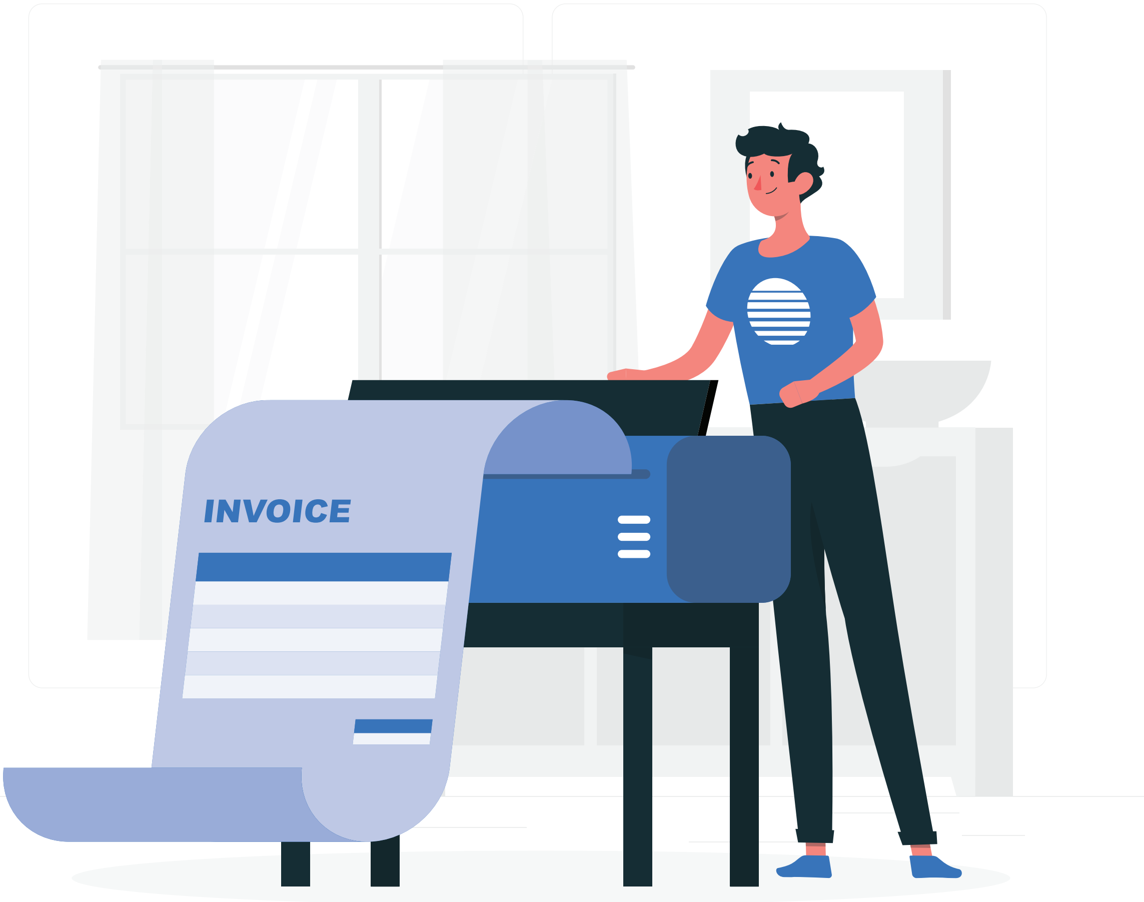
This role for credit insurance has been confirmed by the European Investment Bank (EIB) which considers that credit guarantee schemes are significant tools for unlocking lending in Europe because they enhance risk taking capacity of banks through risk sharing. This adds to the situation that in Europe in many instances capital markets cannot accommodate such large-scale transactions in an efficient manner.

NON-STRUCTURED FUNDED TRADE FINANCE

Non-structured funded products are simple trade finance tools focused on providing funding/ liquidity to either the buyer or seller in the transaction (or both). In some cases, the seller will need funding in order to produce or ship the goods being exported. Concurrently, the buyer may also need funding in order to pay for the goods being purchased. The products below address this issue, allowing financial institutions to fund these transactions. Some products are focused on supporting sellers by accelerating cash flows from receivables generated by sales (factoring, invoice discounting, the seller side of supply chain finance, forfaiting), whilst others are focused on supporting buyers elongating their cash flow cycles by providing them with liquidity to settle their purchases while they wait to generate funds from their own onward sales (LC refinancing, the buyer side of supply chain finance).

Factoring and Invoice Discounting Finance

These tools achieve the same end-result, i.e. the acceleration of a seller's receivables under a commercial transaction, from their original due date in the future to the present. Both techniques utilize different methodologies, with a focus on the factor/discounter taking security from the repayment of the buyer's debt on its original due date either through ownership of the receivable or, less commonly, through a charge or pledge.



Factoring

Factoring solutions offer the seller of a receivable a wider service than just the advance of funds to shorten its cash conversion cycle as the entity buying the receivable will also usually take on the responsibility of collecting the debt.

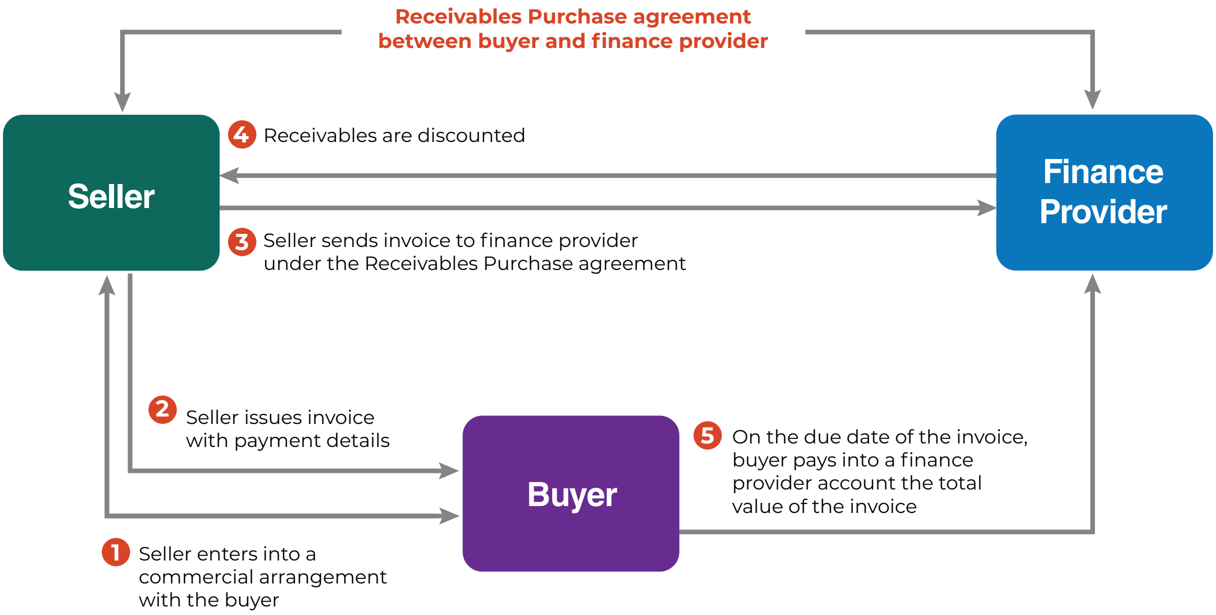
Factoring can take several forms. For example, a factor may agree, subject to limits, to buy the whole of a seller's receivables. This is known as whole turn-over factoring. Conversely, a factor may select which invoices he wishes to buy. It can be with or without recourse to the seller and may or may not be notified to the buyer or obligor.

The vast majority of factoring is domestic and individual invoices are often of a low value. Cross-border factoring is possible using the two-factor system. One factor is in the buyer's country (known as the 'Import Factor') and the other in the seller's country (known as the 'Export Factor'). The two Factors establish a contractual or correspondent relationship to service the buyer and the seller respectively under which the Import Factor in effect, guarantees the receipt of funds from the importer and remits payment to the Export Factor. Typically, the two factors use an established framework such as the General Rules for International Factoring (GRIF), provided by FCI.

Invoice discounting

Invoice discounting solutions tend to focus on shortening a seller's cash conversion cycle, as opposed to encompassing debt management and collection aspects. The degree of disclosure to the debtor under this type of facility varies, ranging from full disclosure to no-disclosure, depending on the level of comfort taken by the purchaser of the receivables over the nature and standing of the seller. In most cases, the greater the control the financing entity/purchaser of the receivables manages to attain over the process, the better the discounting conditions offered.

An invoice discounting facility without disclosure to the debtor will grant the seller of the receivables full confidentiality, and therefore avoid reputational hazards. Most invoice discounting is without recourse to the seller so as to ensure de-recognition of the receivables from the seller's balance sheet (so-called "true sale") but recourse is normally retained for commercial dispute e.g. where the buyer refuses to pay because the goods or service are defective.



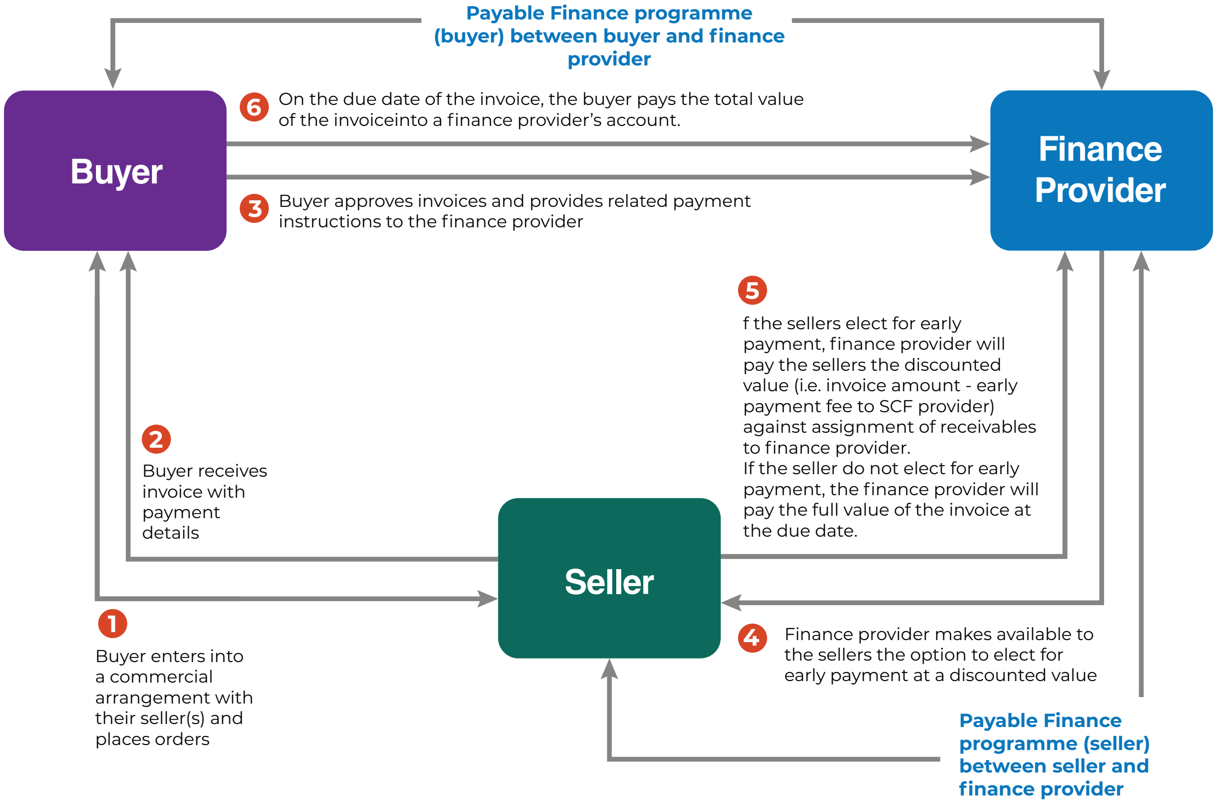
Supply Chain Finance (SCF) – Payables Finance

Supply Chain Finance has recently been defined as a much broader category of trade financing, encompassing all the financing opportunities across a supply chain. Notwithstanding, the product is still very much seen from a narrower perspective, where its key feature is that it is buyer/debtor driven. In such a case, a buyer approaches its financial provider for the establishment of a receivables discounting line for its suppliers to use and discount the invoices they issued to that buyer. This technique is sometimes called reverse factoring or payables finance (the latter is our preferred term).

This is a very efficient way to underpin the stability of a Buyer's supply chain and market reach vis-a-vis its suppliers, allowing it to benefit from better credit terms and streamlined invoice payment procedures (supply chain finance tends to be made available through online platforms). It is also very beneficial to suppliers, as it allows them to shorten their receivables cycle and therefore reinvest their operational cash-flow at a faster pace. The advantages also tend to include financing in better terms for both parties, as suppliers don't need to take out financing under their own credit lines and may benefit from their clients' access to credit at lower rates, and buyers may get credit from their suppliers at a lower cost than that of taking out a loan.

Process:

1. A Supply Chain Finance facility is entered by the buyer, financier and supplier
2. Goods are shipped and sales invoice is raised on the buyer by the supplier
3. Supplier submits invoice to financier's supply chain finance platform
4. Buyer approves the invoice on the financier's supply chain finance platform
5. The financier pays the supplier, excluding interest and fees.
6. The financier debits the account of the buyer on the maturity of the invoice



Forfaiting

Forfaiting is a form of receivables purchase, consisting of the without recourse purchase of future payment obligations represented by financial instruments or payment obligations (normally in negotiable or transferable form), at a discount or at face value in return for a financing charge.

Typical payment instruments in Forfaiting include negotiable instruments such as:

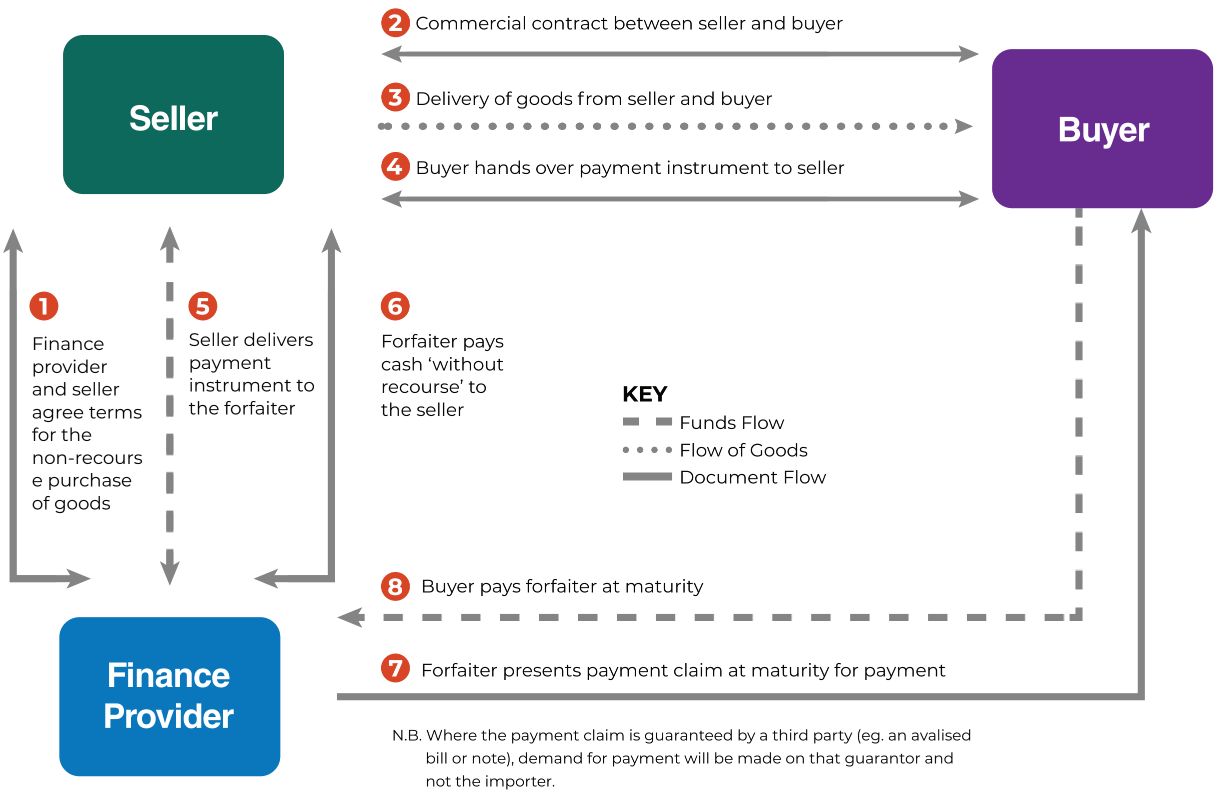
- **Bills of exchange**: An unconditional and irrevocable order in writing addressed by the drawer (exporter) to the drawee (importer) requiring the drawee to pay on demand or at a fixed determinable future time a sum certain in money to, or to the order of, a specified institution/person (payee) or the bearer on demand or on a specified determinable future date.

- **Promissory notes**: An unconditional and irrevocable negotiable instrument issued by a buyer/borrower, such as an importer for example, promising to pay the seller/financing party a definite sum of money at a future fixed date. The right to receive payment under a promissory note may be transferred by endorsement unless endorsement or transfer is expressly prohibited. The same applies to bills of exchange.

- **Digitalisation of negotiable instruments:** ITFA has launched an initiative to transform negotiable instruments, which currently must be on paper in many jurisdictions, into digital assets e.g. on a blockchain. The technology for this already exists but digital transformation faces a number of legal and regulatory hurdles. The Digital Negotiable Instrument Initiative (DNI) proposes an interim contractual solution whilst continuing advocacy efforts for a permanent legal change. Details can be found on the ITFA website.

The main benefits of forfaiting include:

- Working capital optimization for buyer and supplier, where 100% of the contract value may be financed on a without recourse basis
- Eliminating or minimizing the risk of payment default, arising from political, credit and transfer events
- Potential finance raised against a strong credit rating (either of buyer or financial institution providing security for the payment obligation) with lower implied cost of funding for the Supplier
- Assists suppliers in selling to countries where they have little or no knowledge of the country's legal framework and where open-account sales would not otherwise be possible
- Potentially improved payment and commercial terms for the supplier and buyer
- Finance and liquidity availability for suppliers with limited credit availability from traditional banking sources
- Supply chain stability
- Relieving Suppliers of administration and collection costs



N.B. Where the payment claim is guaranteed by a third party (eg. an avalised bill or note), demand for payment will be made on that guarantor and not the importer.

LC Refinancing

The utility to importers of post-shipment financing is centered around the importer's cash conversion cycle. Letter of Credit (LC) refinancing also includes several other instruments and techniques, such as goods in transit financing, warehouse financing and receivables financing from the importer's perspective, whereby receivables are those generated by an end-buyer.

Refinancing letters of credit involves the financial institution issuing the letter of credit intervening to pay the seller on the buyer's behalf, using money it has taken from a loan account opened in the buyer's name. In principle, this gives the buyer a longer timeframe to sell the goods purchased under the letter of credit, while allowing them to keep up with its commitment to pay the seller within a shorter timeframe.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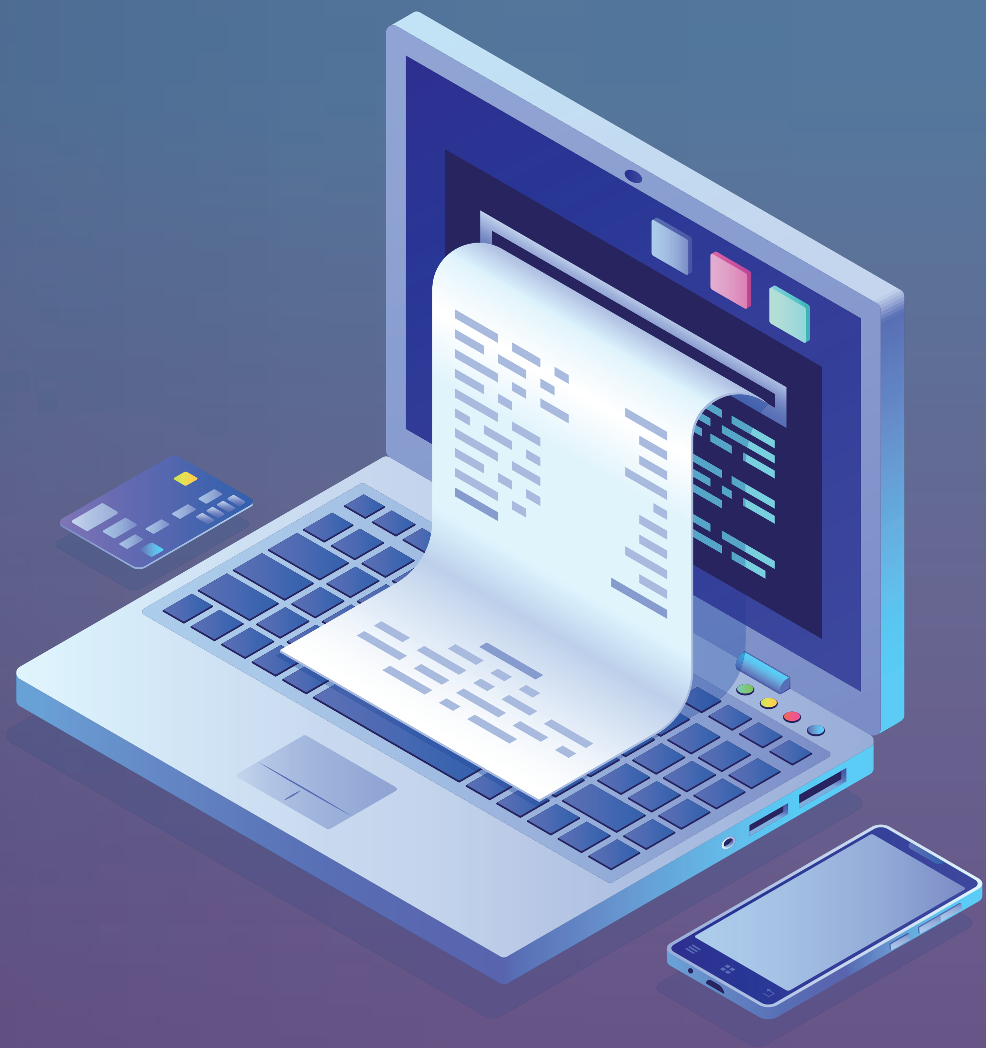
STRUCTURED FUNDED TRADE FINANCE

Structured Funded trade finance products are complex trade finance tools focused on the provision of funding and/or credit to participants in the trade transaction. These tools include pre-export finance, pre-payment finance, tolling, inventory finance, borrowing based facilities and asset-based lending amongst others.



Pre-Export Finance

Pre-export finance takes place when the borrower (seller) requires funding in order to produce and supply goods prior to delivery and shipment. Financial institutions advance the funds based on proven orders from buyers and an assessment of the performance risks related to the production and supply of the financed goods.

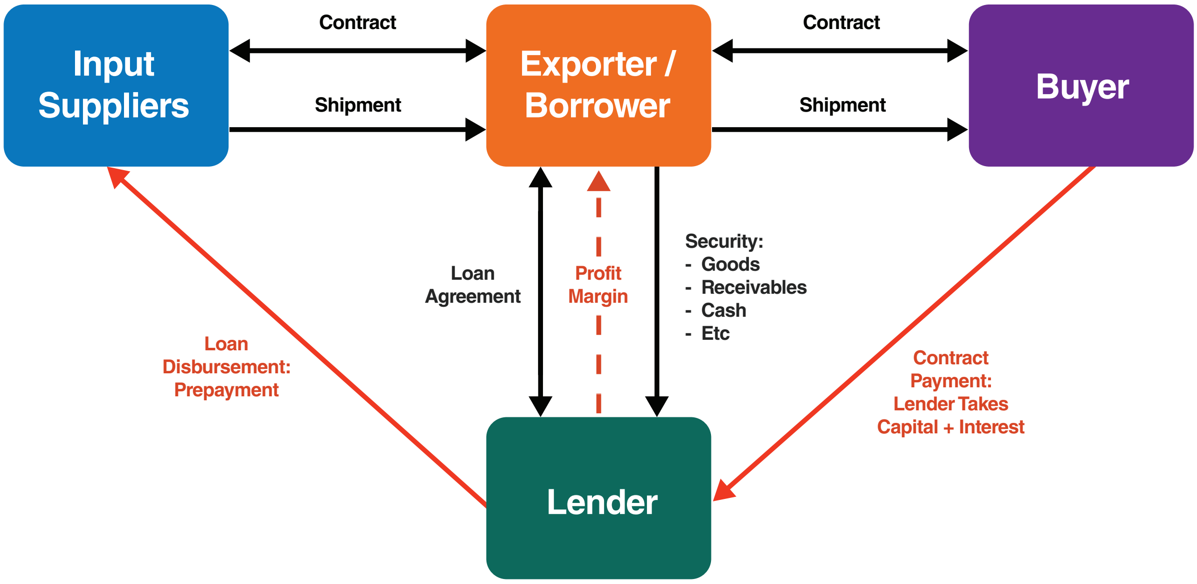
Commodity businesses are some of the largest users of pre-export financing, usually using the funds to finance large production operations. The borrower needs to ensure it has sufficient liquidity to maximize production, which is one of the key reasons exporters use pre-export financing.

Funds are provided directly from the lender to the borrower, with legal provisions that focus on the borrower being able to produce commodities and sell the product. Lenders will consider factors including production and delivery risk as the repayment of the loan is contingent on the production and sale of goods. Payment is made directly to the lender from the buyer, with the lender sending funds on to the seller once charges, interest and the original borrowed amount has been deducted. Payment risk is also an issue the lender will consider, in the event that the seller distributes the goods and the buyer fails to pay. Pre-export finance transactions are based on a strong buyer or additional payment security to support the firm orders and commercial contracts.

The lender will generally take security by obtaining:

- An assignment from the producer of its rights under an 'offtake contract'
- A charge over collection or segregated bank accounts that proceeds from the sale are paid into; and
- Security over the goods or commodities

Third-party collateral management firms are often employed in Pre-export financing structures. This is to ensure that goods financed are properly stored, monitored and held to the order of the lender.

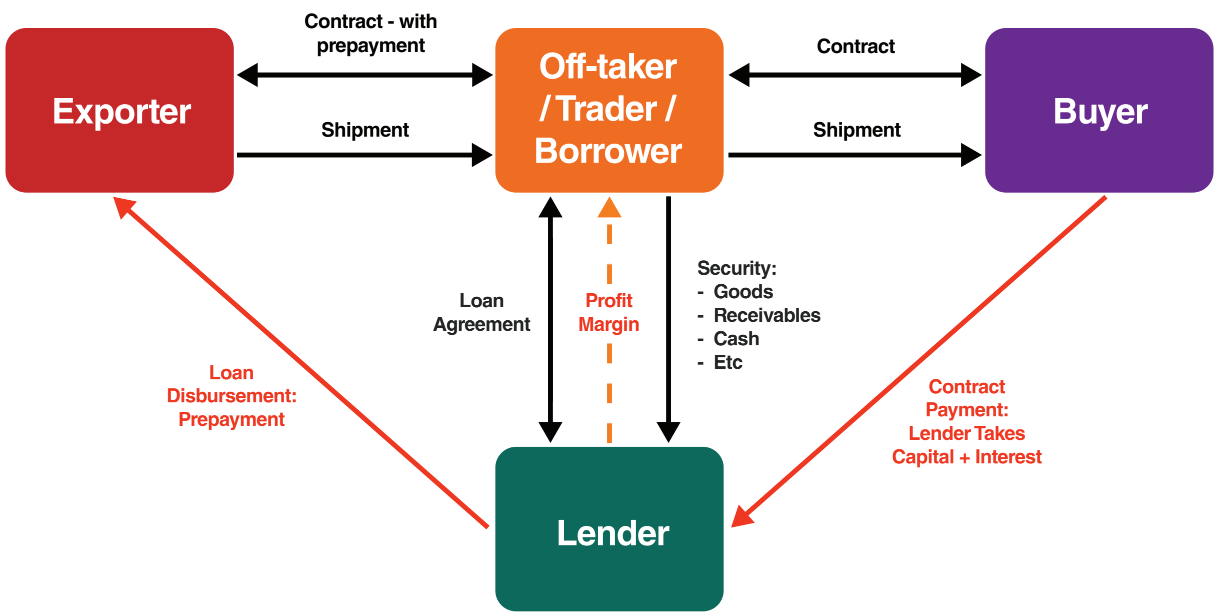


Pre-Payment Finance

The underlying rationale of a prepayment finance facility is similar to that of a pre-export finance facility, i.e. to allow an exporter to obtain sufficient funds in order to procure and store raw materials, undertake production and deliver finished goods to the buyer under an export contract.

The main difference lies in the fact that rather than the seller, the buyer is the actual borrower under the facility and uses the financing to prepay the seller. Repayment of the facility originates from money received under the onward sale of the imported goods by the buyer to another ultimate end-buyer.

This type of financing is widely used in the international trade markets, primarily by traders with a requirement to source goods to deliver to their end-buyers, seeking to empower their suppliers by financing their operations and thereby gaining access to the goods they require in more advantageous conditions. The key support elements that financial institutions look for when considering prepayment finance are the nature of the goods involved and the creditworthiness of the end-buyers. An assessment of the exporter's track record and ability to deliver is also pertinent, considering the financing institution may retain performance risk on the exporter.

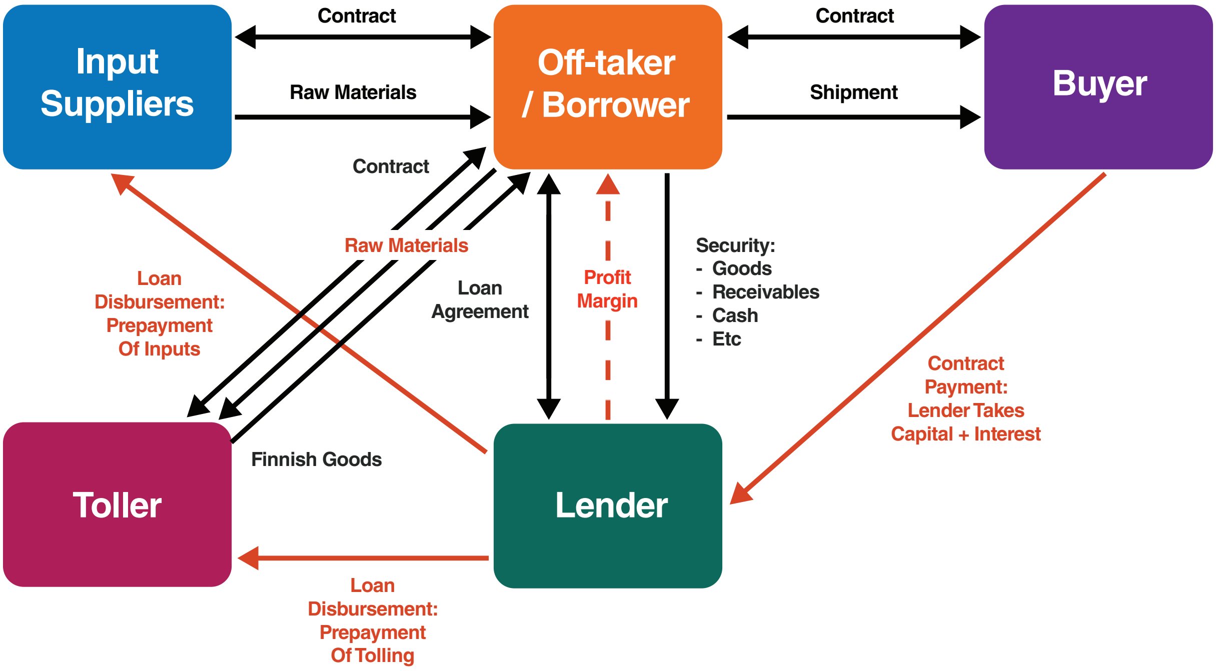


Tolling

A tolling facility adds to the concepts underlying pre-export and pre-payment facilities. In a tolling facility, the borrower is usually a trader or company that requires financing for the acquisition of raw materials, payment for the transformation of these raw materials into finished goods and delivery to an end buyer under an order or a contract.

The first leg of the financing can be seen as a pre-export or pre-payment finance, whereby the lender will finance the export of the raw materials in order to enable the trader to facilitate the fulfilment of their obligations. The raw materials are then delivered into a production facility/toller and more funds are disbursed by the lender for the settlement of the production/tolling fees. Finally, the finished goods are delivered to the end-buyer who makes the payment that settles the financing.

With the goods continuously evolving and being transported through various jurisdictions, a structuring challenge becomes apparent and will need to be addressed carefully. This is such that the notion of collateral is kept intact throughout the life of the facility, benefitting both the lending institution and the borrowing trader/company.

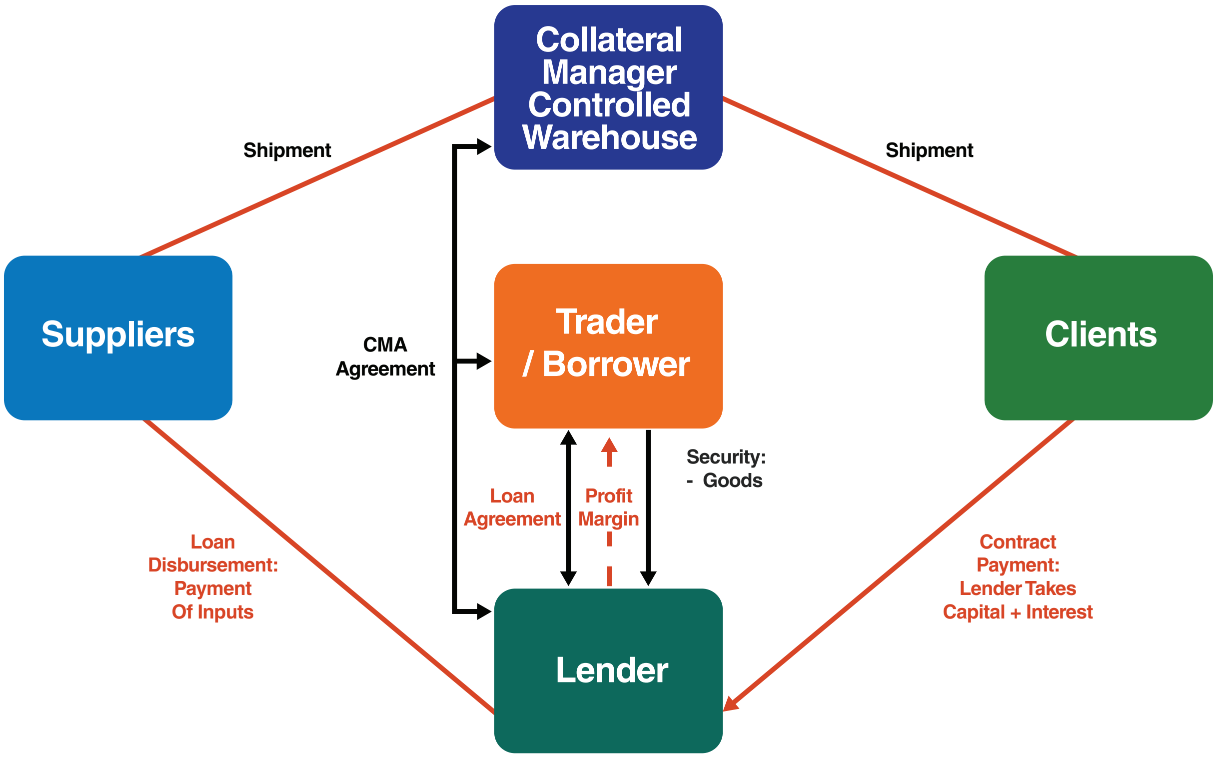


Inventory Finance

Inventory finance, also known as warehouse financing, aims at monetizing stocks held by the borrower, releasing cash-flow which can be reinvested in the operational cycle.

When establishing the degree of security associated with a potential inventory finance facility, financial institutions will assess the available legal instruments, allowing them to retain adequate security through the establishment of tight control mechanisms over the goods being financed (or even direct or indirect possession in some jurisdictions) and entitling them to sell the goods being financed in the open market should the borrower default, under the shortest timeframe possible, with the least amount of red tape. This assessment allows a lender to establish an acceptable ratio of financing vs goods given as collateral, against which the borrower will be able to draw on the facility on a revolving basis.

The repayment of an inventory finance facility is made with the money received from the sale of the stored goods, and as such, the structure may be extended to include the use of trade receivables as collateral in addition to stocks.

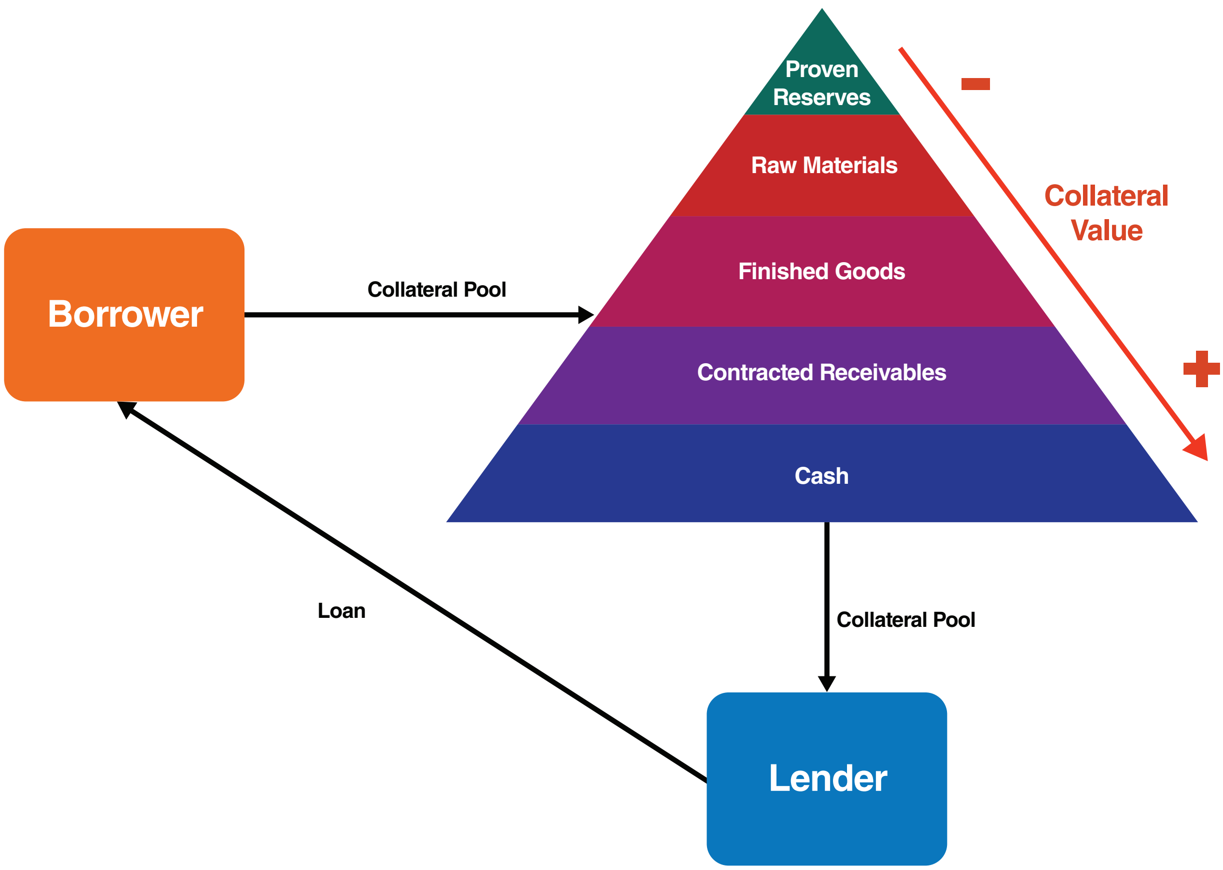


Borrowing Base Facilities

Contrary to inventory finance, borrowing base facilities do not only rely on goods stored, but rather on an evolving pool of stocks, receivable and cash, including reserves of unextracted commodities (and respective production licenses and equipment).

A borrowing base is usually established using proved commodity reserves (if applicable), warehoused stocks of raw materials and ready-for-sale goods, goods in transit, goods sold (receivables) and cash. The amount made available to the borrower is a ratio of the total value of the collateral pool, with a different financing percentage applicable to each type of collateral, reflecting inherent risks.

As may be easily perceived, borrowing base facilities provide an encompassing technique that extends the monetization concept throughout the collateral pool, therefore enhancing the release of cash from the operational cycle.



Export & Agency Finance

Export Credit Agency (ECA) financing is used to assist importers in challenging jurisdictions, materializing through a number of incentives being availed to importers by export credit agencies linked to developed exporting countries.

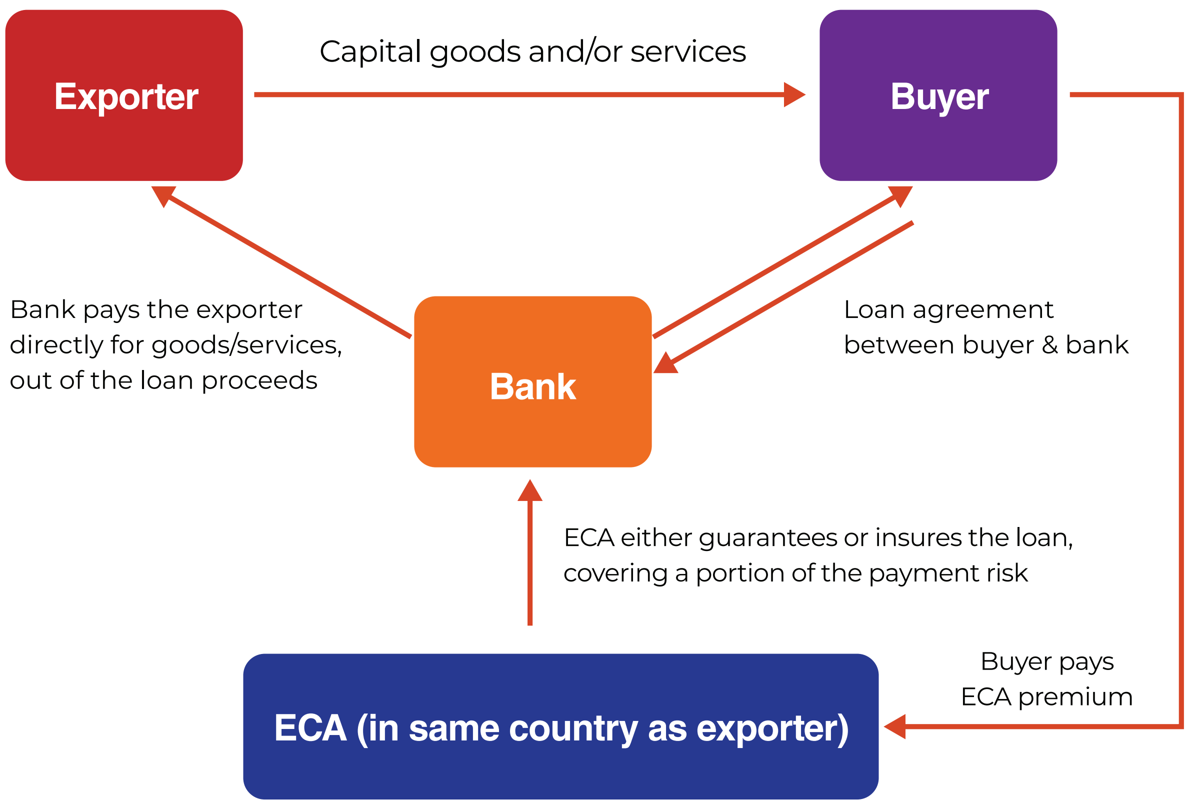
The types of transactions usually supported by ECAs are capital intensive, including the importation of heavy machinery to be included in large scale projects in the importing country, offering long term financing maturities with attractive conditions.

ECA support is usually provided via:

- Government guarantees offered to financial institutions supporting exports
- Financing facilities directly offered to importers
- Insurance mechanisms offered to both exporters and financing entities under the underlying trade transaction with a view of enabling credit to the importer

What are the eligibility criteria for export finance?

- Most ECAs have national content criteria and will only support exports that they deem beneficial to their economy and, if applicable, in accordance with the OECD Agreement. In practice, the exact criteria vary from country to country ;
- ECAs finance a portion of home country content plus a varying amount of foreign content of the purchase order amount;
- The project must be deemed to be creating enough national value;
- The importer must be able to find alternative means of payment for at least 15% of the contract value, called the down-payment. Buyers can use equity or finance the down-payment, the latter on a subordinated basis to the ECA ;
- Local parts of the contract may only be supported up to a 30% of eligible procurement.



OTHER TECHNIQUES IN TRADE FINANCE

Trade Risk Distribution

Trade Risk Distribution provides the opportunity to distribute and manage the risk of trade finance transactions with a number of investors (participants).

Main objectives:

- Risk mitigation and creation of additional lending capacity
  While the reasons for distributing risk have evolved, risk mitigation and capacity creation are usually the main objectives for establishing a programme and a dedicated distribution team.

  Distribution operates by way of securing credit protection against the underlying risk (unfunded distribution) or by a true sale of the risk (funded distribution).

  While credit policies differ from bank to bank, most will recognize the effect of the protection or sale and allow the creation of additional lending capacity.

- Increased return on capital and increase the return on assets for a particular transaction

  An increased return on capital is best achieved by funded distribution but can sometimes be achieved by unfunded distribution.

  Distributing unfunded to a "better" rated entity generally allows for a lower capital cost to be allocated to the transaction.

  An increased financial return on assets is only achieved through funded distribution which qualifies for true sale treatment. (See the ITFA paper on IFRS 9).

  Unfunded distribution sometimes helps in increasing the return on risk weighted assets by lowering capital costs but will always be detrimental to the cash or bottom-line return on asset ratio.

Master Risk Participation Agreement

The BAFT Master Risk Participation Agreement is an industry standard document that is widely accepted by the players in the trade risk distribution market to facilitate the buying and selling of trade finance assets globally.

The English Law MRPA was originally launched by BAFT, an international financial services association, in 2008, to streamline the sub-participation documentary process by developing a two-way agreement (i.e. balanced), making it trade-finance specific, and most importantly simplifying the exchange of documentation, reducing legal costs, increasing efficiency and promoting trade.

The Supplementary Form governed by New York was introduced in 2010.

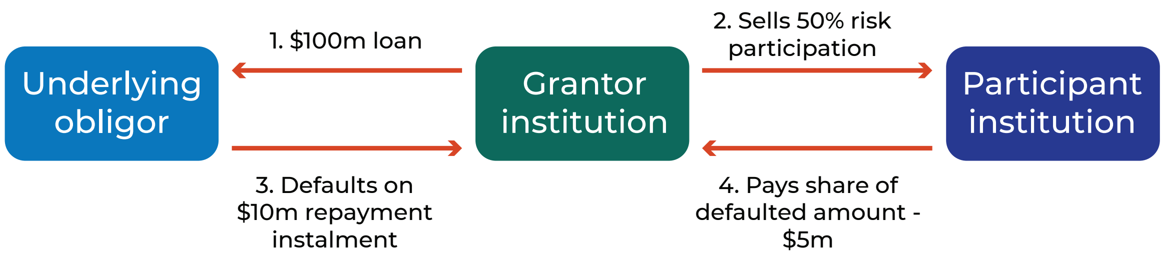
During 2018-2019 BAFT and ITFA put together a working group of experts to review the existing forms and identify necessary changes based on current market practice. The international law firm, Sullivan & Worcester, drafted the modernised English and New York law MPA forms and associated usage guidelines.

Both English and New York MRPAs facilitate both unfunded and funded risk distributions.

The MRPAs are accompanied by legal opinions as required to obtain bank capital relief under the Basle rules. ITFA members may legally rely on these.

Unfunded risk distribution

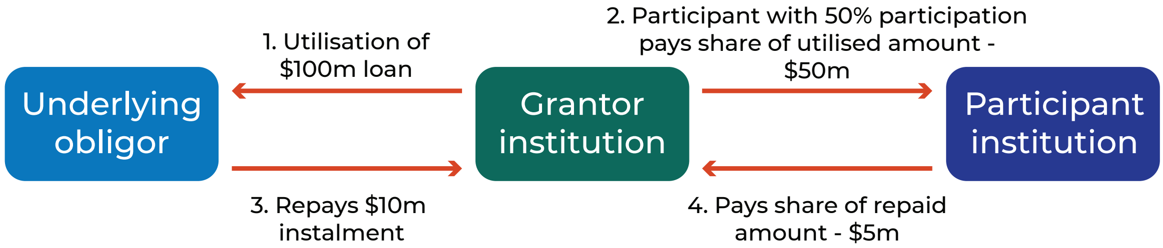
In an unfunded scenario the participant 'participates' in the risk by agreeing to pay upon default – akin to a guarantee.



Funded risk distribution

The dynamics of funded distribution are relatively straightforward – funds are provided from the outset.

It provides liquidity and the Grantor (seller) has no risk on the participant, since they have funded their participation up-front.



Islamic Finance

Islamic Finance is the means by which individuals and companies in the Muslim world can conduct financial activity that complies with the principles of Sharia, or Islamic law. Islamic Finance also refers to the types of investments that are permissible under this form of law. Sharia is a religious law forming part of the Islamic tradition based on the teachings of the Qur'an and the traditions of the Prophet.

Sharia's key prohibitions are

- Lending money in return for payments of interest (Riba)
- Uncertainty / the sale of what is not present (Gharar)
- Gambling (Maisir)
- Unethical Investments
- Unjust Enrichment

Conventional financing is not Sharia compliant and so Islamic Finance seeks to replicate the economics and risk profile of a conventional financial instrument by using assets and services. A benchmark is set by using a conventional financial instrument, but Islamic Finance will differ largely in a structural way. One of the most notable differences in a Sharia compliant financing structure is that interest and price speculation are not permitted.

The main structures of Islamic Finance are

- Murabaha (Cost-plus financing)
- Ljara (Leasing)
- Mudaraba (Investment Capital)
- Musharaka (Partnership)
- Istisna'a (Construction)
- Wakala (Agency)
- Sukuk (Islamic Bonds)

Every transaction under Sharia will need to be approved from a Sharia perspective. Approval is provided by qualified scholars who typically have good knowledge of conventional financing. Most financial institutions who provide Islamic Finance have their own board of Sharia scholars.

Syndication

Syndication is financing provided by a group of lenders for a single borrower. Usually, syndication occurs when a borrower requires capital too large for an individual lender to provide or when the credit facility is not within the scope of the lender's risk exposure.

The lead bank which is the bank that oversees the arrangement and administration of the syndication recruits the syndicate members and negotiates financing terms. The lead bank conducts necessary due diligence, thereafter an information memorandum is prepared. The information memorandum includes financial statements, company profile and directorship details of the borrower.

Syndications have become a major source of corporate funding. Firms seek loans and funding for various business reasons that include capital for mergers and acquisitions and capital expenditure projects. The prime motive of a syndicated loan is to distribute the risk of a borrower's payment default across multiple lenders. Usually, there is only one loan agreement for the entire syndicate.

Process

- The Arranger Bank analyses the funding requirements of a client;
- The Arranger Bank receives documents from the client i.e. company profile along with financial data and credit score;
- The Arranger Bank approaches different banks for participation in the syndication; those who agree to advance the largest "tickets" will normally form an arranger syndicate and will undertake various roles in the syndication e.g. book-runner, documentation bank, facility agent etc.;
- A term sheet will be drafted. This document will include details such as terms and conditions, repayment schedule and collateral;
- The loan documentation is circulated amongst the syndicate members for review;
- The loan documentation is eventually executed by all parties and, where the loan is secured, the process of perfection immediately commences at the Stamp Duties Office; Land Registry; Ship Registry; and Corporate Affairs Commission depending on the type of asset used as security;
- Upon execution of the documentation, the borrower has to satisfy the conditions precedent stipulated in the loan agreement before any disbursement can be made on the loan;
- Often in syndications, bankers appoint a security trustee - the security trustees act on the direction of syndicate lenders for security enforcement;
- In any syndication an individual entity cannot take enforcement action, it requires majority votes from other lenders.

TFDI Initiative

The TFD Initiative helps trade originators automate trade asset/risk distribution and find new avenues for growth by partnering with institutional investors.

The TFDI technology combines old and cutting-edge technology to allow banks and other originators to transfer and transform trade assets via a repackaging vehicle which can turn trade assets into instruments more closely resembling bonds which are easier for many investors to handle.

Visit the ITFA website for more details.

TRADE FINANCE GLOBAL

About Trade Finance Global (TFG)

Trade Finance Global (TFG) is the leading trade finance platform. We assist companies to access trade and receivables finance through our relationships with banks, funds and alternative finance houses.

Our award winning educational portal, Trade Finance Talks, serves an audience of 140k+ monthly readers (6m+ monthly impressions) across 187 countries, covering news and insights across print & digital magazines, guides, research papers, podcasts, webinars and videos.
Visit www.tradefinanceglobal.com for more.

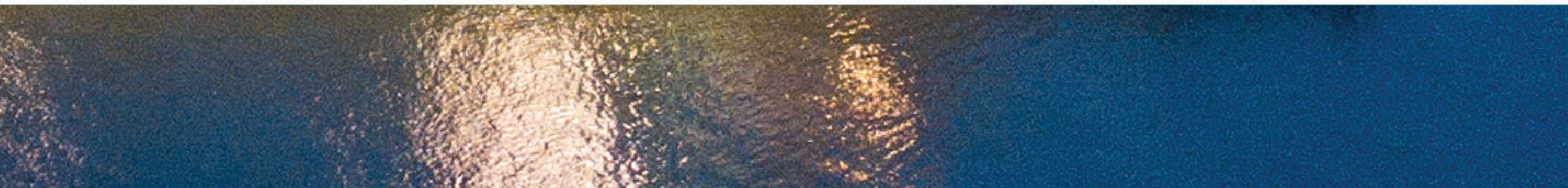
International Trade and Forfaiting Association

About International Trade & Forfaiting Association (ITFA)

The International Trade and Forfaiting Association (ITFA) is the worldwide trade association for companies, financial institutions and intermediaries engaged in trade and the origination, structuring, risk mitigation and distribution of trade debt. ITFA also represents the wider trade finance syndication and secondary market for trade assets. ITFA prides itself in being the voice of the secondary market for trade finance, whilst also focusing on matters that are relevant to the whole trade finance spectrum. Expanding from its original focus on the purchase and discounting of simple but robust payment instruments, such as negotiable instruments and letters of credit, the forfaiting industry has embraced new instruments and created new structures to become a prominent part of supply chain finance. ITFA acts as a valuable forum for its members to interact and transact business together profitably and safely.

ITFA presently has more than 300 members, located in over 50 different countries. These are classified under a variety of business sectors, with the most predominant being the banking industry. Others include forfaiting, insurance underwriters, law firms, fintechs as well as other institutions having a business interest in the areas of Trade Finance and Forfaiting.

To find out more about ITFA, please visit www.itfa.org or send an email on info@itfa.org.



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