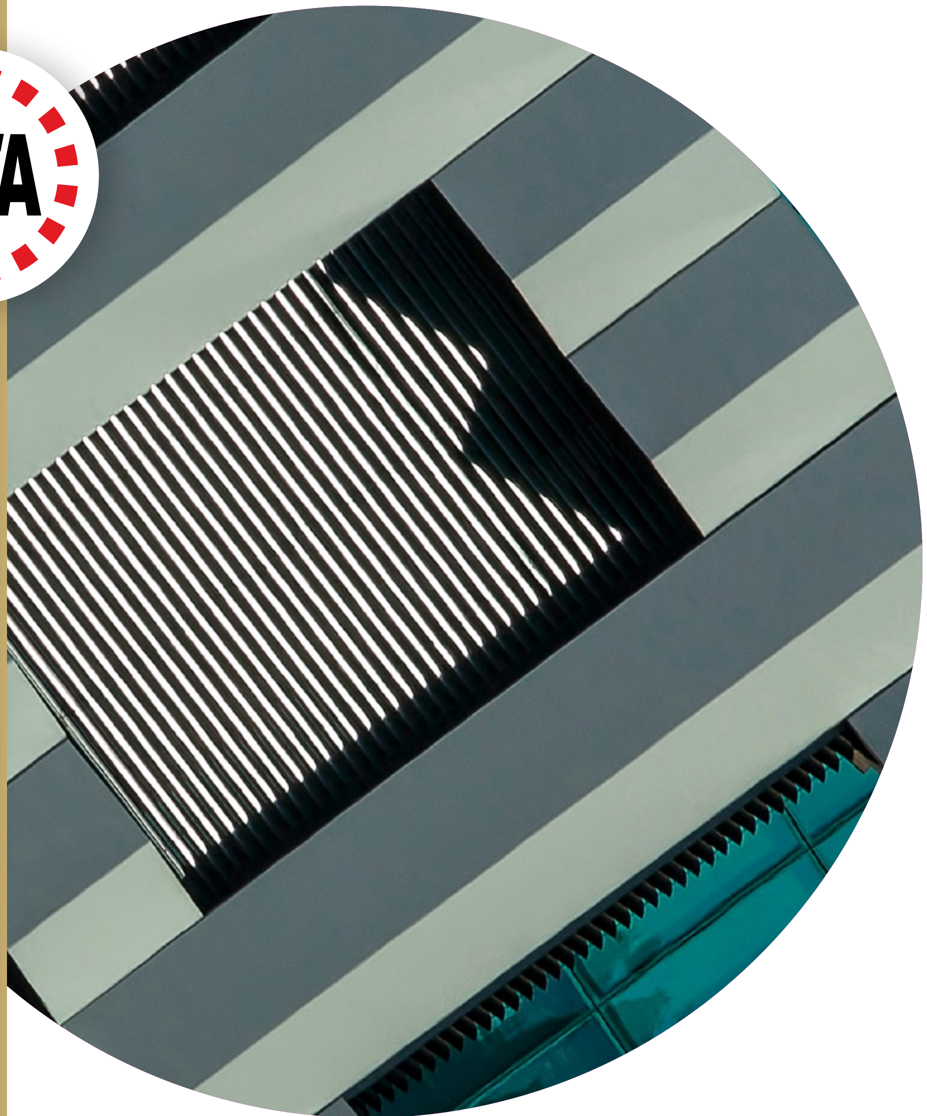

The Rules of the Game

for non-banks investing in trade finance assets

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Introduction

The purpose of this memorandum is to give a high-level overview to non-bank investors into the terminology used in trade finance, where assets are financed generally through banks, other financial institutions, fintech platforms and other non-bank originators.

It also seeks to explain how non-bank investors may become involved in these trade finance assets, and provides some points to be aware of in considering how to invest in a trade finance transaction. These include documentary and structural issues to bear in mind in any involvement.

We fully expect to make future revisions to this paper based on the evolution of the market. This ITFIE workstream may also deem it useful to set up working groups to lead to the drafting of new and dedicated template documentation to facilitate the involvement of non-bank investors.

This is issued for guidance only and does not constitute legal advice.

There are a number of publications aimed at assisting in this area and some of these are referred to in this document.

Some of the terms defined below and in the main text have more extended meanings in other publications and agreements. These terms, as defined here, are to assist in understanding this memorandum and the trade finance assets market.

Glossary of Terms

Accounting True Sale	a sale or transfer of an asset that achieves balance sheet derecognition for the Seller of the asset.
Credit Support	rights, protections or collateral in relation to a Trade Finance Asset that are in addition to Recourse Rights, and which may include Trade Credit Insurance.
Funded Participation	a Participation in which the Participant provides funding to the Seller at the outset of their Participation in relation to the underlying Trade Finance Asset.
Guarantor	the counterparty that guarantees payment of financed amounts in the case an Obligor fails to do so.
Investor	the party that gains access to the financial risks and rewards of a Trade Finance Asset through an Investment. For the purposes of this document, it is assumed that this refers to institutional Investors and other professional Investors and not retail Investors.
Investment	an Investor's interest in a Trade Finance Asset, which may be acquired from the Seller by means of a Transfer and Assignment, a Participation, or another distribution structure such as the issuance of notes or other debt obligations by an SPV.
Legal True Sale	the sale, contribution, or transfer for all purposes of the ownership of the Recourse Rights from the Seller to the Investor, entitling the latter to have direct recourse to the Recourse Parties.
Obligor (Debtor)	the counterparty that has a financial obligation towards another party in relation to a Trade Finance Asset, and is the ultimate Recourse Party.
Participant	an Investor that assumes the non-payment risk and financial benefit of a Trade Finance Asset through a Participation but that is not a funder of record.
Participation	the participation by an Investor in Trade Finance Assets through an arrangement with the Seller, such that the Investor becomes the Participant in respect of such Trade Finance Assets.
Payables	payments due from a buyer of goods or receiver of services.
Receivables	payments due to a seller of goods or provider of services.
Recourse Parties	parties from which the Investor may recover its Investment. Guarantors are Recourse Parties in the event of default by the relevant Obligor.

Recourse Rights	rights the Investor enforces to recover its Investment in the event of default by the Obligor.
Seller	the counterparty that transfers the Trade Finance Asset and associated Recourse Rights to an Investor. The Seller may be an originating bank, another financial institution, or a non-bank originator such as a fintech operating through an SPV.
SPV	a bankruptcy remote special purpose vehicle created with the sole purpose of acquiring and distributing one or more Trade Finance Assets to Investors by way of the issuance of notes or other debt obligations on a without recourse basis.
Trade Finance Assets	Receivables / Payables and payment obligations in relation to promissory notes, bills of exchange, loans, letters of credit and guarantees.
Trade Credit Insurance	insurance covering the credit risk of the Obligor (See Schedule 2).
Transfer and Assignment	the transfer of a Trade Finance Asset, whereby the Seller ceases to be the funder of record and the Investor is recognised as the new funder of record.
Unfunded Participation	a Participation in which the Participant provides its commitment to make payment to the Seller under its Participation in the event of default by the Obligor under the underlying Trade Finance Asset.

How to structure Investments for Investors

There are several key methods through which an Investor can gain access to Trade Finance Asset(s). Note that in general, regardless of structure, most Investments in Trade Finance Assets are conducted on an uncommitted basis unless specifically agreed otherwise and as noted below.

1. Transfer and Assignment of the Trade Finance Asset, whereby the Obligor is notified that the funder of record has changed from the Seller to the Investor. The Obligor usually pays the Investor directly on the due date for payment of the Trade Finance Asset.

2. Undisclosed Transfer and Assignment of the Trade Finance Asset, where the beneficial interest in the asset is transferred from the Seller to the Investor without the Obligor being notified. The Obligor continues to pay the Seller as original funder of record, and the Seller acts as collection agent on behalf of the Investor. Triggers are put in place (mainly non-payment by the Obligor or insolvency of the Obligor or Seller) that allow the Investor to notify the Obligor of the Transfer and Assignment, and to require the Obligor to pay the Investor directly.

3. Participations using a Master Participation Agreement (MPA) or similar type of document, where the Seller remains the fronting institution and funder of record and the Participant assumes the risk of non-payment of the Obligor and the financial benefit of the Trade Finance Assets.

4. Introduction to Pooled Structures – such as Specialised Investment Funds, Securitisations or Structured Notes. These are particularly suited to providing single or multiple Investors with access to a diversified portfolio of Trade Finance Assets and aim to reduce the operational burden yet further on the Investor.

   It is the responsibility of the Seller and/or the Agent to manage to allocation of Trade Finance Assets accordingly. The Agent will additionally perform the Portfolio Management duties and enforce the Eligibility and Concentration Risk Criteria of the underlying investments.

   These structures can use intermediate vehicles (generally Investment Funds or SPVs (see further below) or both) to purchase the Trade Finance Assets, and the vehicle then issues instruments such as Shares or Notes which are backed by the performance of the underlying Trade Finance Assets. A Security Trustee may often be appointed to enforce the rights of the Participant.

5. Investments via an SPV as Seller. SPVs acquire Trade Finance Assets either directly from Obligors or via other originators who transfer such assets to the SPV. The SPVs typically fund themselves either by: (a) the issuance of notes to, or borrowing of loans from, Investors, with the SPV's obligations under the notes/loans secured on a without recourse basis by the Trade Finance Assets; or (b) by distributing the Trade Finance Assets to Investors using one the methods outlined in paragraphs 1-3 above. Investors may either acquire Trade Finance Assets from the SPV in a pooled portfolio format via traditional Securitisation (see Schedule 1 Part 1) or the assets may be acquired on an individual, whole asset, basis whereby the Investor's Investment in that asset is segregated from the other assets of the SPV (see Schedule 1 Part 2).

6. The addition of unfunded risk mitigation in the form of Trade Credit Insurance as explained in Schedule 2.

Each has its associated advantages and disadvantages, and with this in mind an Investor should be aware that compromises are an integral component of the structures.

1) The Transfer and Assignment is a clean way for an Investor to gain access to a Trade Finance Asset, as the assignment is perfected (usually through a notice of assignment to the Obligor) and the Investor becomes the new funder of record. Payment at maturity is made directly by the Obligor to the Investor, and the Seller of the Trade Finance Asset is no longer party to the transaction. The disadvantage is that this can be operationally cumbersome and is also typically not scalable for high volume / low value assets (e.g. invoices under Payables or Receivables finance programmes). The Obligor may also not wish to transact with a party other than the original provider of the financing or risk structure.

2) A more practical alternative to the above would be a Transfer and Assignment on an undisclosed basis where the beneficial interest in the Trade Finance Asset is transferred from the Seller to the Investor (typically on a true sale basis), but the transfer/assignment is not perfected (i.e. no notice of assignment and redirection of funds notice is sent to the Obligor). The Seller becomes, in effect, a collection agent on behalf of the investor, and the Obligor continues to pay as per normal course of business to the Seller. The Seller is then obliged to pay such funds over to the Investor and generally holds any rights and receipts for the benefit of the Investor and not as part of its assets. The Investor therefore takes settlement / servicer risk on the Seller of the asset but with these protections. In a scenario of a non-payment by (or insolvency of) the Obligor or non-performance / insolvency of the Seller (usually called a notification or elevation trigger), the Investor has the right to serve notice of the Transfer / Assignment directly on the Obligor and as a result the Investor becomes the full legal owner of the Trade Finance Asset by perfecting the Transfer / Assignment of the Trade Finance Asset. Where the entirety (100%) of the Trade Finance Asset has been transferred to the Investor (i.e. a pooled structure is not being used), once the assignment has been perfected the Investor has full control on recoveries and remedial strategy.

3) Master Participation Agreements provide an easy way for an Investor to access Trade Finance Assets without becoming too operationally involved. The Seller remains the funder of record and also administers all the operational aspects of the transaction, including the collection of funds from the Obligor at maturity.

    a. There are two industry templates that should be considered by Sellers and Investors:

        i. The BAFT MPAs (“Master Participation Agreement”; 2018 form under English law, and similar 2019 form under New York law)

        ii. The ITFA MARA (“Master Accounts Receivable Assignment Agreement”; 2024 form under English law)

    b. The BAFT MPAs, using a specific Offer mechanism, are particularly suitable for one-off transactions and both funded and unfunded underlying Trade Finance Assets (such as letters of credit, trade loans, guarantees), and would typically require some additional drafting work for more complex / revolving structures. There are also provisions which can be incorporated where the Trade Finance asset is a Receivable.

    c. The ITFA MARA has been specifically drafted with Funded Participations for both Payables and Receivables finance programmes. This operates as an undisclosed assignment with

rights to elevation as outlined in Transfer / Assignment above. It is mentioned here as a useful master document similar to the BAFT MPAs.

d. Both documents are designed to be two-way bilateral documents, where either party can be either the Seller or the Participant.

e. In all cases involving Participations under a participation agreement or MARA, Investors also need to consider the performance and/or settlement risk of the Seller, since the flow of funds passes to the Participant through the Seller's accounts.

4) Investments in Trade Finance Assets via SPVs are an increasingly popular mechanism for Investors (whether banks or non-banks) to get access to Trade Finance Assets. The SPV route can be used to either acquire a portfolio of trade assets using pooled structures such as Securitisations, or the Investors can pick and choose specific Obligors / assets in which to make an Investment. The SPVs are structured to be bankruptcy remote and are typically set up in jurisdictions like Luxembourg, Ireland, Delaware etc. These SPVs provide financing of Payables / Receivables (and other assets) to the buyers / sellers of goods and services, in order to acquire such Trade Finance Assets. SPVs usually fund the acquisition of Trade Finance Assets by: (a) the issuance of notes to, or borrowing of loans from, Investors, with the SPV's obligations under the notes / loans secured by the Trade Finance Assets; or (b) by distributing the Trade Finance Assets to Investors using one the methods outlined in paragraphs 1-3 above. An outline of both pooled securitisation and single asset-based SPV structures is given below and further detailed in Schedule 1 (parts 1 and 2):

   a. Traditional Securitisations involve a "pool" of Trade Finance Assets that are acquired by the SPV and distributed to Investors on a portfolio basis. This allows the Investors to take risk on a portfolio of diversified assets with some form of tranching / risk retention by the SPV and the originator. Under the pooled structures Investors will typically establish Eligibility and Concentration Risk Criteria at the outset, and it is the responsibility of the Seller SPV and/or its agent to manage the allocation of Trade Finance Assets accordingly. A Security Trustee will typically be appointed in order to enforce the rights of the Investors. It is usual for multiple Investors to share interests in the Trade Finance Assets in a pooled securitisation structure.

   b. Typically, the SPVs (by law or contract depending on the jurisdiction where the SPV is set up) can create multiple cell compartments / partitions within the same SPV. This effectively segregates the asset / liabilities sitting in the various compartments / partitions (i.e. the assets of one compartment / partition cannot be accessed by the creditors of another compartment / partition). This segregation is used by the SPV to book all Trade Finance Assets owed by a single, specified, Obligor in a single, specified compartment / partition. Such individual compartment / partition can then offer Investments in Trade Finance Assets that relate solely to that Obligor. This enables Investors to make Investments in Trade Finance Assets related toa single Obligor or transaction, rather than on a pooled or portfolio basis.

5) Credit Insurance may also assist Participants (see Schedule 2).

Structural points for a Participant in relation to Participation Agreements

1. Participants may need to further consider whether a two-way document is appropriate when the flows will typically be one-way (e.g. from a bank to an Investor).

2. Specifically, some risks may need to be considered in a different way for Investors: in particular, documentation risk and fraud risk. In a traditional bank-to-bank relationship, the Participant is typically responsible for performing its due diligence on the full transaction – as it will have its own back office processes for the origination and processing of such transactions – and would therefore be expected to take the risk on all aspects of the underlying structure.

3. An Investor may need to clarify in its agreements which risks (for example credit risk) it agrees to take and which risks it leaves with the Seller (for example documentation risk).

Portfolios of Trade Finance Assets

1. In essence an Investor is offered an Investment in a pool of Trade Finance Assets, which will usually change as time goes on but will still have to meet the agreed eligibility criteria. The underlying transactions are often short term and so amounts are paid back and re-used. Unless requested otherwise, the Investor is usually required to make its Investment on a committed basis and leave the funds with the Seller for a period of 1-5 years. It receives income but no repayment outside of the terms agreed in the documentation governing the terms of the Investment. It is important to clarify that the Investor can only recover its funds from the payments received from the underlying Trade Finance Assets, unless otherwise specifically agreed.

2. Usually, the Investor is buying senior notes from the Seller that are secured on the portfolio of Trade Finance Assets and the attachment point (i.e. advance rate) is typically determined by a rating agency methodology (even if the note is not publicly rated). The Seller will retain the junior note to have skin in the game.

3. Usually there is no recourse against the Seller but only to the underlying Trade Finance Assets.

Specialised Investment Funds, Securitisations and Issuance of Structured Notes – General Issues for Investors

1. Revolving structure with assets dynamically being added into the SPV account.

2. Eligibility criteria among others describing type of Trade Finance Assets, quality of Obligor; no intragroup assets, country; maximum tenor of the Trade Finance Assets, sector, trade credit insurance etc.

3. Concentration Limits: at Obligor, Seller and industry level.

4. Structural protection triggers in place such as Stop Funding Event and Early Amortisation Event (each as

defined in the agreement); timing of real repayment vs. maturity date of the underlying Trade Finance Asset.

5. Income: margins that are sufficiently attractive whilst correctly measuring the risk.

6. Utilisation of limits: achieving maximum utilisation of the invested monies while not surpassing imposed limits.

7. Insurance policies may be considered as well, with different limits and insurance coverages.

8. Avoid commingling risk across Eligible and Non-eligible Assets from the originator's (Seller's) book.

9. Standardised reporting of day-to-day monitoring of the investment vehicle carried out by an independent management company.

SCHEDULE 1

Part 1

PORTFOLIO SECURITISATIONS VIA SPVs

True sale transaction through bankruptcy remoteness to mitigate credit risk to the Seller.

The eligible Trade Finance Assets would be transferred into the bankruptcy remote SPV managed by an independent management company as opposed to directly transferring the funds to the Seller as explained above and in Part 2 of this Schedule in relation to the formation of an SPV.

Securitisation consists of three steps:

1. SPV set up: a Deed of Incorporation will be introduced to the Financial Authority detailing among others the structural mechanics, portfolio characteristics, counterparties to the transaction.

2. The SPV will purchase the Receivables at a discount price agreed between the Seller and the Investor. The SPV will issue at the same time a note / loan backed by the underlying Receivables (paying principal and interest). This note can be structured as a zero-coupon (issued at a discount) bond or an interest paying note. The interest of the note / loan will pay floating (index + margin).

3. Once interest has been paid to the Investors, the monies will be applied to the waterfall. Once all the items in the Priority of Payments have been paid the remaining excess spread will get back to the Seller.

The payment schedule and characteristics of the note can be customised to meet Investor's demands.

The advantages of a securitisation structure are:

- Segregation of the Eligible Assets from the Seller's book.

- Additional checks carried out by the management company, plus a verification agent (usually a big four accountancy firm) auditing the securitised portfolio.

- Easiness to transfer note / loan stakes to additional note / loan holders into the structure, providing efficient access to capital markets.

- Diversifying risk into a multiple-underlying portfolio through a singular security. Possibility to create liquidity for the Seller where the underlying assets are not easily sellable.

- Potential standard clearing houses involvement and ISIN issuance (only applicable for Note issuances).

Part 2

SINGLE OBLIGOR / TRANSACTIONS VIA SPVs

This is typically achieved with the following steps:

1. An SPV is set up in a jurisdiction like Luxembourg, Delaware or Ireland where there is the ability either by law or contract to segregate various assets / liabilities of the SPVs into individual segregated "cells" of the SPV.

2. The segregated "cells" of the SPV may be referred to as Compartments, Series or Partitions depending on jurisdiction.

3. Each Obligor (e.g. the buyer of goods in a Payables / supply chain finance deal or the supplier / buyer combination in a Receivables finance transaction) is booked by the SPV in its own unique Compartment, Series or Partition. Therefore, that Compartment, Series or Partition will only acquire Trade Finance Assets related to that Obligor.

4. The relevant Compartment, Series or Partition funds its purchase of underlying Trade Finance Assets by either (a) the issuance of notes to, or borrowing of loans from, Investors, with the SPV's obligations under the notes / loans secured by the Trade Finance Assets; or (b) by distributing the Trade Finance Assets to Investors using one the methods described in this memorandum.

5. Typically, individual Trade Finance Assets will not be shared between Investors – i.e. while there may be multiple Investors investing in Trade Finance Assets offered by a single Compartment / Partition / Series of the SPV, each Investor will acquire an interest in the entirety of the specific Trade Finance Assets it elects to fund (e.g. if a Compartment holds multiple Payables due by a single Obligor, each Payable may be financed by a different, single, Investor but generally no Payable will be split between multiple Investors).

6. It should be noted that there are potential complications to be considered where only a percentage of a Payable is transferred to an Investor.

The advantages of an SPV based structure for a single Obligor / transaction are:

1. Ability to pick and choose specific assets to invest in – note that here the Investor carries out its own independent credit and legal due diligence on a case by case basis.

2. Ability to buy the asset in a note format, which may help in ease of operational booking.

3. Ability for both banks and non-banks to Invest in Trade Finance Assets.

There are some challenges in reviewing SPV based structures:

- Complexity leading to lengthier periods of due diligence required than alternative financing solutions.

- Legal expense to review the underlying structure and documentation.

SCHEDULE 2

CREDIT INSURANCE

Unlike most trade finance lenders, the credit insurance market takes a disparate approach when it comes to the underlying instruments in this asset class through distinct products, which summarises into the following:

- Distinct underwriting teams / capability for each;
- Distinct reinsurance treaties for each that drive primary appetite;
- Separate obligor & exposure limits for each product.

The Credit Insurance market is organised around 3 key products as follows:

- **Trade Credit** = Receivables & Payables (single name and pools known as "whole turnover")
  - "Short Term" e.g. max 12 months on single names, but typically multiple flows with shorter payment terms.
  - +/- 10 active insurers.
  - Insurer driven risk transfer contracts with varying degrees of CRR compliance.

- **Structured Credit** = lending instruments e.g. documentary credits and trade loans.
  - Medium / long term e.g. tenors 12 months plus and out to 15 years.
  - Over 60 active insurers with a preference for secured "Trade Related" assets.
  - Lender driven strong homogenised CRR compliant risk transfer contracts.

- **Surety Market** = Unfunded contingent obligations e.g. guarantees & SBLCs.
  - Also medium / long term e.g. tenors 12 months to 15 years.
  - +/- 20 insurers covering a range of guarantees where there is performance risk (not financial guarantees) e.g. advance payment and performance bonds.
  - ITFA or BAFT standard risk transfer documentation.

The Credit Insurance market is not so familiar with ICC as a reference point for Trade Finance (e.g. empirical default data). Rather, insurers look at their portfolio performance as a whole (e.g. mix of commodity finance, corporate loans, project finance, Trade Finance, etc).

Credit insurers are concerned with underwriting against Obligor credit fundamentals e.g. balance sheets – Trade Credit Insurers (e.g. Allianz / Atradius / Coface) run huge Obligor databases to set individual name limits / ratings etc.

- Recent success with insurers to convince them of taking a true portfolio approach on lending instruments and guarantees (recognising the long-standing Trade Credit securitisation programs):
  - Economic loss vs. expected credit loss (5 years of performance data)
  - Attachment Points.
  - Eligibility Criteria:
    - Blind underwriting and/or limited to selected larger single name concentrations.
    - Selected assets within specified rating ranges.
    - % caps applied to countries, sectors ratings (internal & external) and names etc.
    - Static or auto replenishing portfolios within eligibility criteria.

  Broadly speaking the credit insurance risk transfer documentation is fit for purpose and supported by legal opinions – other than in the "Trade Credit" market where the quality can be variable. Any attempts to standardise documentation across the markets have been unsuccessful, however many industry associations hold base "templates" e.g. ITFA & LMA.

  - Potential for existing documentation to be represented as a broader "Trade Finance" product / solution capturing all assets across the three products both in single name and portfolio form.
  - Potential for "pre-agreed" capacity for certain Trade Finance Assets subject to eligibility criteria based on ongoing performance data.

Ongoing regulatory lobbying continues to secure appropriate recognition of exposures covered by insurance – currently a key work stream for ITFA.

About ITFIE

This paper is a publication of the ITFIE Working Group.

The ITFA Trade Finance Investment Ecosystem (ITFIE) Working Group strives to enhance the trade finance investment ecosystem by facilitating more efficient asset and risk transfer between banks and non-bank investors, while promoting broader risk appetite from non-traditional investors.

By harmonising, standardising and digitising processes, ITFIE aims to support the real economy by increasing capital availability for trade and offering institutional investors a diversified asset class.

ITFA has been at the forefront of this initiative since 2021, when it took over the International Chamber of Commerce-led Investors in Trade Finance (IITF) Group.

ITFIE's work streams strives to achieve several objectives, including articulating the requirements of institutional investors and ensuring a clear understanding of the technical aspects of distribution; developing an asset originator guide for streamlined distribution; driving automation and digitisation for trade finance distribution; and promoting market awareness and education for both, asset originators, and investors.

ITFIES is constructed under three work main streams:

Stream A: Voice of the Institutional Investors

Stream B: Rules of the Game

Stream C: Technology and Data

This paper, a first of others to come, will be jointly published as part of ITFIE´s findings and conclusions from its three Work Streams at a later day.

For additional information on ITFIE´s activities please do not hesitate to access:

https://itfa.org/about-us/working-groups/itfie/

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