

## Legal Risks in International Trade Finance

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## Introduction

- Types of Transactions (Trade Services, including Letters of Credit, Factoring, Forfaiting, Supply Chain Financing and other Cross-Border Loans and Participations)
- Why is Counsel important?
- What type of Counsel?
- Documentation, Collateral and Default Situations

## Trade Services and Trade Finance

- International trade presents a variety of risks, including the timing of payments between an importer and exporter.
- For each of importer and exporter there are a variety of payment options available each with its own risks and rewards.

## Trade Services and Trade Finance (con't)

- Various Methods of Payment for Trade Transactions:
  - Cash-in-Advance
  - Letters of Credit
  - Documentary Collections
  - Open Account
- Banks involved in each and every transaction

## Cash-in-Advance: Buyer pre-pays for the goods

- Most secure to seller
- Riskiest to buyer
- Can take many forms
  - Wire transfer
  - Credit Card
  - International Check
- Presents various risks to Banks in the chain

## Letters of Credit

- Risk is even between buyer and seller
- This is because a letter of credit is an independent obligation of a bank issued in favor of another party
- Can take various forms
  - Revocable or Irrevocable
  - Confirmed – A second bank is involved and becomes obligated
  - Special – For example, assignable letters of credit
- In event of bank failure – both sides lose

## Documentary Collections:

- More Risk to Seller
- Various types
  - Documents against Payment
  - Documents against Acceptance
- Banks assume responsibility in these types of transactions

## Open Account: Buyer pays later

- Most risk to Seller
- Various forms
  - Export Working Capital Financing
  - Government-Guaranteed or private credit insurance  
Export Working Capital (example, U.S. based Ex-Im bank)
  - Export Factoring
- Banks involved as Lender, often with third party insurers or guarantors
- Foreign law almost always involved



## Trade Services – Letters of Credit

- What type of Letter of Credit?
- Answer gives rise to a variety of legal issues
- Key Issues
  - COUNSEL
    - Coordination with counsel is key
    - Most letters of credit transactions are routine, but legal considerations are always present
  - DOCUMENTATION
    - Properly prepared letter of credit
    - Underlying obligation to pay
    - UCP600 vs. UCC
    - Domestic vs. foreign

## Trade Services – Letters of Credit (con't)

- BANK'S OBLIGATIONS
  - Ensure that obligations are limited
  - Not determining validity or satisfaction of underlying transactions
  - AML concerns
  
- TRANSFER OF INTERESTS
  - Is Letter of Credit transferable?

## Trade Services – Letters of Credit (con't)

- PRESENTATION ISSUES
  - Determining whether payment conditions have been met
  
- OTHER ISSUES
  - Swift Messages

## Trade Services – Letters of Credit (con't)

- Default Situations
  - DOCUMENTATION
    - Gather and analyze all of the documentation that you have received with respect to the transaction.
  - COORDINATION
    - Establish a line of communication with counsel regarding strategy if issues arise.
  - OTHER CONSIDERATIONS
    - Failure of Bank?

## Trade Finance - Factoring

- Description of Process and Players
  - Players
    - Seller of Receivables
    - Buyer of Receivables (i.e., Bank, factoring company)
    - Account Debtors
  - Process
    - Involves Sale of Receivables
    - Not loan with Receivables as collateral
    - Non-recourse (Recourse can affect validity of sale)
  - Notice to Account Debtor
  - Factoring vs. Forfaiting – Similar Legal Issues

## Trade Finance – Factoring (con't)

- Key Issues
  - TRUE SALE
    - It is critical that the documentation provide that the factoring is a “sale” of the receivables and not a loan from Bank to Seller.
    - Notice to Account Debtor
    - Retains Service of Receivables
  - REPURCHASE
    - Obligations
    - Collateral

## Trade Finance – Factoring (con't)

### ○ INFORMATION

- As a factor, you want to ensure that you are entitled to all information and documentation relating to receivables and account debtors.

### ○ DOCUMENTS

- Factoring Agreement
- Receivables
- Foreign Considerations? Restrictions?

## Trade Finance – Factoring (con't)

- Default Situation

- DOCUMENTATION – Gather and analyze all of the documentation that you have received with respect to the transaction.
- COORDINATION
  - Establish a line of communication with Seller regarding strategy.
  - Engage independent outside counsel.
- RESOLUTION – Analyze Seller's Obligations; Repurchase?



## Supply Chain Financing and other Cross-Border Loans

- Description of Players
  - Bank
  - Seller/Buyer (i.e. Borrower)
  - Government Guarantee/Private Insurance
    - Ex-Im Bank
    - Private Coverage

## Supply Chain Financing and other Cross-Border Loans (con't)

- Key Issues
  - LOCAL COUNSEL; LOCAL LAW
    - Engaging competent local counsel is critical to any cross-border loan transaction.
    - Some examples.
  - LOCATION OF BORROWER / GUARANTORS AND COLLATERAL
    - Determine the jurisdictions where the Borrower and Guarantors have operations and the location of collateral.

## Supply Chain Financing and other Cross-Border Loans (con't)

- The locations of the Borrower and Guarantors is important because these are the jurisdictions which you will eventually have to look to in order to satisfy any judgment against the Borrower or Guarantors.
- The location of the collateral will be critical in determining how to legally perfect any lien or mortgage granted to secure the loan.
- FORECLOSURE/JUDGMENT PROCESS
  - Determine the process for obtaining a judgment and foreclosing or executing against collateral in each of the applicable jurisdictions

## Supply Chain Financing and other Cross-Border Loans (con't)

- AUTHORITY OF BORROWER
  - Local law will determine whether the Borrower has the appropriate authority to execute the loan documentation.
- COORDINATION OF CLOSING
  - It is important that closing logistics be coordinated well in advance to avoid any last-minute delays.
  - Notarization?

## Supply Chain Financing and other Cross-Border Loans (con't)

- Default Situation
  - DOCUMENTATION
    - Gather and analyze all of the documentation that you have received with respect to the transaction.
  - CONTACT COUNSEL
    - Establish a line of communication with your in-house or outside counsel and local counsel regarding strategy.
  - RESOLUTION
    - Determine the best resolution based on the current facts.

## Participations

- Description of Process and Players
  - Lead Lender
  - Participant
  - Borrower
- Key Issues
  - TRUE PARTICIPATION
    - It is critical that the documentation provide that the participation is a “sale” of the participated interest and not a loan from Participant to Seller.

## Participations

- REPAYMENT TO PARTICIPANT
  - The Participation Agreement should provide that Participant has a right to its pro-rata portion of any payments received by Seller (including fees and reimbursement of expenses).
- INFORMATION
  - As a participant, you want to ensure that you are entitled to all material information and documentation received by Seller with respect to the loan.
- ACTIONS
  - The Participation Agreement should clearly state what actions cannot be taken by the Seller without the Participant's consent.

## Participations (con't)

- DEFAULT; ASSIGNMENT
  - In the event that there is a disagreement as to how to deal with a default by Borrower, the Participation Agreement should provide a mechanism by which the Participant may request that the participation interest be assigned to it by Seller.
- ADDITIONAL TRANSFERS
  - Participant should require that Seller maintain a percentage of the loan. Participant may want the ability to sub-participate the participation.



## Participations (con't)

- Default Situation
  - DOCUMENTATION
    - Gather and analyze all of the documentation that you have received with respect to the transaction.
  - COORDINATION
    - Establish a line of communication with Seller regarding strategy. Engage independent outside counsel.
  - RESOLUTION
    - Determine whether the Seller's proposed resolution is acceptable to you. If not, and the Participation Agreement provides for an assignment of the participation to you, request that such assignment be effected.

## Trade Services and Trade Finance – Other Considerations

- In 2008, international trade transactions amounted to an estimated \$15.7 trillion in global merchandise exports in 2008.
- According to the 2009 International Narcotics Control Strategy Report, it is estimated that the annual dollar amount laundered through trade ranges into the hundreds of billions.

## Trade Services and Trade Finance – Other Considerations (con't)

- U.S. Immigration and Customs Enforcement (ICE) reports that their trade-based money laundering case initiations have increased since 2004. The international inter-governmental Financial Action Task Force (FATF) names trade-based money laundering as an increasingly important money laundering and terrorist financing vulnerability. FATF lists the physical movement of goods through the trade system as one of three methods criminal organizations and terrorist financiers use to move money for the purpose of disguising its origins and integrating it into the formal global economy.

## Trade Services and Trade Finance – Other Considerations (con't)

- OFAC
  - Blocking of Transactions
- Anti-Money Laundering
  - Responsibilities of Banks

## Red-Flags Banks are Required to Detect

- Third party payments for goods or services made by an intermediary (either an individual or an entity) apparently unrelated to the seller or purchaser of goods. This may be done to obscure the true origin of the funds.
- Amended letters of credit without reasonable justification.
- A customer's inability to produce appropriate documentation (i.e., invoices) to support a requested transaction.
- Significant discrepancies between the descriptions of the goods on the transport document (i.e., bill of lading), the invoice, or other documents (i.e., certificate of origin, packing list, etc.).

## Red-Flags Banks are Required to Detect (con't)

- Negotiable instruments (such as traveler's checks, cashier's checks and money orders) in round denominations under \$3,000 used to fund domestic accounts or, alternatively, smuggled from the United States for placement into accounts at foreign financial institutions.
- International wire transfers received as payment for goods into U.S. bank accounts or processed through U.S. correspondent or intermediary accounts, especially where the ordering party (importer of goods) of the wire does not live in the country from which the wire originated. For example:

## Red-Flags Banks are Required to Detect (con't)

- Funds transferred into U.S. domestic accounts that are subsequently transferred out of the account in the same or nearly the same amounts. Origination and destination locations are frequently high risk jurisdictions.
- Sudden onset and equally sudden cessation of payments – typically wire transfers – within a short duration. This could be an indication that the account is temporarily being used to launder illicit proceeds.
- A foreign import business with U.S. accounts receiving payments from locations outside the areas of their customer base.

## Red-Flags Banks are Required to Detect (con't)

- Beware of:
  - Back to back L/C's
  - Transferable L/C's (because they are brokers)
  - L/C's w/partial shipments and transshipments
  - Frequent and repeated changes through amendments, extending maturity, change of venue, change of payment source and change of beneficiary (all very dangerous and must be dealing with reputable person)



## Conclusions

- Legal, Legal, Legal!
- Do not assume all documentation is created equal
- All transactions are different
- Analyze legal risk – not only credit risk



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