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Briefing note

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Trade receivables financings – documentary considerations

This briefing explores some of the common documentary issues and solutions encountered by businesses and banks when undertaking trade receivables financings and securitisations.

No one-size-fits-all

Structured trade receivables financings and securitisations are bespoke – they take many different and varied forms, dove-tailing with the business of the particular company the structure is being put in place to finance. Just as no two businesses are identical, it follows that no two trade receivables financings or securitisations will be the same either – a structure that works for one company will not necessarily work for another. This principle is even more relevant in the context of cross-border businesses, where the international dimension brings to the fore myriad jurisdictions and laws which need to be taken into account when putting a trade receivables financing or securitisation structure together.

Add to this the range of market participants now involved in such transactions (from banks to insurance companies to fund investors to data reporting providers), the interests they may have and how that might drive the structure then, save for actually putting a transaction in place, there is little that can be done in advance to know precisely what structure a company will need to employ.

Planning for a trade receivables financing or securitisation

Nevertheless, when a company is considering undertaking a trade receivables financing or securitisation, or even if it simply wants that option open as a possible funding source in the future, there is a number of documentary points that the company can consider in advance which will help ease the execution process further down the line if and when the company chooses to put such a transaction in place.

These documentary considerations fall into three broad categories – sales contracts, restrictive covenants and security.

Sale contracts

Many companies have grown through acquisition and what that means is that the terms and conditions applicable to customer relationships may differ quite significantly even within the same company depending on whether that customer is a legacy customer of one acquired business or another.

The essence of a trade receivables financing or securitisation is to transfer the credit risk of a pool of receivables away from the company which generated them and over to a bank or other funding provider. The terms and conditions attached to the receivable are fundamentally important as they determine several key points relating to this transfer, including:

(a) whether or not the receivable is actually transferable;

(b) whether or not any transfer of the receivable can be enforced against the customer by the transferee;

(c) what law a transfer of the receivable should be governed by;

(d) whether a customer might be entitled to exercise any set-off rights against the transferee; and

(e) whether the transferee can give good discharge for the debt to the customer.

Achieving a degree of homogeneity in its use of terms and conditions across its business is something a company can do to reduce the lead-in time to a possible trade receivables financing or securitisation. Having a single set of terms and conditions, governed by a single law will cut down the time any funding providers need to take to investigate which terms and conditions apply to which customers. It might also result in a simplified structure – for instance if there is a single law governing all the receivables there can in most

instances be a single law governed transfer agreement (supported by a single true sale opinion) which may cut down on paperwork and also implementation costs.

If achieving that degree of homogeneity is not possible, for instance, if the company's customer base is made of large corporates which trade only on their own terms and conditions then there are two things a corporate can do in contemplation of a trade receivables financing or securitisation:

- try to achieve homogeneity of some common terms across all its customer relationships (e.g., items such as governing law, assignability, no set-off, ability to disclose customer details to a transferee for collection purposes); and
- have a thorough understanding of what terms apply to which customers, so if it is necessary to deal with receivables within a financing or securitisation differently depending on which terms and conditions apply to them there is a single point of reference each transaction participant can go to in order to check what terms and conditions apply to a particular receivable.

Restrictive covenants

Many companies, and particularly those which have recently been the subject of an acquisition (whether by private equity or otherwise), will have existing financing in place, whether that be a senior secured term loan, revolving bank facility, high-yield bond or any combination of these or others. In almost all instances those financings will include a number of restrictive covenants which, unless crafted carefully, will prohibit the company putting in place a trade receivables financing or securitisation with a structure which works for it. The restrictive covenants which need to be thought of most carefully are:

- **disposals** – transfers of receivables will more than likely constitute a disposal of assets so disposals in the context of a trade receivables financing or securitisation will need to be permitted. In particular, any monetary cap on disposals needs to be carefully considered as receivables have relatively short maturity dates and will be constantly created and transferred during the life of a trade receivables financing or securitisation – for instance a €200 million receivables pool with a weighted average life of 30 days will turn over twelve times during the course of a year resulting in what may be regarded as aggregate disposals of receivables worth roughly €2.4 billion;
- **debt** – depending on precisely how the definition of "financial indebtedness" (or an equivalent term) is defined in the financing documents, a trade receivables financing or securitisation might constitute the company incurring debt so would need to be permitted. Similarly, credit enhancement in a trade receivables financing or securitisation might be provided by way of a subordinated loan to the securitisation SPV and such loans should therefore also be permitted;
- **guarantees** – a parental performance guarantee is a typical feature in a trade receivables financing or securitisation and should be permitted;
- **security** – in many trade receivables financings and securitisations the originator grants security or other interests (for instance, in the UK, a declaration of trust) over its collection accounts. The granting of such interests, in connection with a trade receivables financing or securitisation, should be permitted; and
- **contracting with entities outside of the company's group** – securitisation SPVs may or may not be within the company's group depending on which jurisdictions are ultimately included in the trade receivables financing or securitisation. Dealings with companies set-up for the sole purpose of a trade receivables financing or securitisation should be permitted.

One drafting technique which has developed over the last few years is to define, in the financing documents, a "permitted securitisation" or "permitted receivables financing" which is then excluded from the restrictive covenants above. However, in many instances, these definitions are overly prescriptive and when the company actually comes to undertake a trade receivables financing or securitisation it is not able to structure the transaction within the confines of that definition. To the extent these definitions are used they should strive to be as generic as possible and limit commercial, rather than legal or structural aspects, of a possible trade receivables financing or securitisation – for instance they:

- could limit the inclusion of debtors from only particular countries or originated by certain entities within the group or have an overall aggregate "purchase

limit" of receivables which could be included; but

- should avoid limiting the types of entities which can be used as SPVs, whether those SPVs are in or outside of the company's group, the legal methods by which receivables can be transferred, indemnity and buy-back obligations and a requirement for debtor notification.

Security

In addition to restrictive covenants it is also possible, and, if an existing financing is in place, likely, that a company will also have granted security over its receivables. Just because a trade receivables financing or securitisation is permitted by the financing documents does not necessarily mean that the security in favour of those existing finance providers will automatically be released upon implementing a trade receivables financing or securitisation. The security may well, albeit unintentionally, continue to subsist until is it actively released by the existing security agent. Any company which is considering a trade receivables financing or securitisation as an option in the future should bear a few points in mind when negotiating security documents on other financings:

- any security over receivables should, to the extent legally possible, be automatically released when those receivables are transferred as part of a trade receivables financing or securitisation; and
- where security cannot be automatically released, the security agent should be given an obligation, upon receiving notice from the company that a permitted trade receivables financing or securitisation has been put in place, to immediately release any security over the trade receivables which are, or are to be, the subject of that financing or securitisation.

Context

A company which is able to prepare and organise its customer and financier documentation so as to be financing or securitisation-friendly will find the process of implementing a trade receivables financing or securitisation far more straightforward than would otherwise be the case. Given the number of variables which can drive the structure of a trade receivables financing or securitisation, having a sound base on which to build a structure is important to everyone involved in the process and is something which, with appropriate thought, planning and guidance, can certainly be achieved.

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