

Export Transactions

Finance and Risk



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International Commercial Transactions

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Export Finance

- Key Attributes
 - Bridges the gap between purchase orders and payment
 - Unless payment is made prior to delivery, the Exporter bears the full weight of financing working capital and trade finance
 - If payment is made at the time the order is placed, the Importer bears the weight of financing
 - Should the Exporter or the Importer finance the transaction?
 - Decision Points
 - » Ability to secure financing
 - » Trading relationship
 - » Type of product
 - Raw materials and consumer goods are typically financed on a cash basis or with short-term credits of up to 180 days
 - Pre-Export Finance
 - Long-lived capital goods and development projects are typically financed on medium (~5 years) or long-term bases
 - Post-Export Finance



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Export Finance – Pre-Export

- Pre-Export Finance: provision of funds to cover the period between signing of purchase orders and payment (short-term, working capital)
 - Pre-export finance typically covers:
 - Cost of inland transport to port
 - Purchase of raw materials for processing
 - Cost of processing
 - Storage costs
 - Illustrative procedure (commodities)
 - Exporter provides title to or pledges products to bank
 - Products that have yet to be produced
 - Products that have been produced (warehouse receipt)
 - Bank provides credit facility
 - Payment
 - Trader takes delivery
 - Bank receives payment directly from buyer
 - » Escrow account
 - » Evidence account



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Methods of Pre-Export Finance

- Advance Payment
 - Importer pays in advance; exporter provides bank guarantee
- Finance working capital:
 - Factoring
 - Bank/financial intermediary purchases accounts receivable
 - Exporter receives accounts receivable purchase price minus a discount
 - Bank/financial intermediary collects on accounts receivable
 - Forfaiting
 - Exporter sells medium-term receivables for cash on a non-recourse basis
 - Importer's obligations usually represented by letter of credit, bill of exchange or promissory note, backed by a bank guarantee
 - Purchase Order finance
 - Financial intermediary advances funds against purchase orders executed by credit worthy buyers
 - Exporter initially receives some percentage of full purchase order amount; discounted remainder advanced after POs become A/R



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Methods of Pre-Export Finance

- Open Account
 - Exporter ships goods without any guarantee of payment, thereby financing importer
 - Risk of transaction dependent on relationship/importer integrity
- Documentary letter of credit (see UCC Art. 5 and UCP 500)
 - Used for over 150 years, accounts for approximately 60% of commodity trade
 - Letter from bank, addressed to exporter, in which bank promises to pay or accept drafts if exporter conforms 100% to conditions within the letter
 - Three parties:
 - Issuer: the issuing bank
 - Account party (importer)
 - Beneficiary (exporter)
 - Three agreements
 - Trade contract between importer and exporter
 - Documentary credit between bank and exporter
 - Reimbursement agreement between bank and importer



Methods of Pre-Export Finance

- Documentary Letter of credit
 - Types of Letters of credit
 - Revocable/Irrevocable
 - A revocable letter of credit can be cancelled or amended by the issuing bank; the bank does not need the exporter/beneficiary's consent
 - Confirmed/Unconfirmed
 - Issuing bank forwards letter of credit to exporter's bank
 - Exporter's bank promises to pay exporter (confirms l/c)
 - In an unconfirmed transaction, the advising bank acts as the issuing bank's agent and bears no obligation to exporter
 - Back-to-back
 - Typically used by brokers, the letter of credit allows the beneficiary to assign its rights in one letter of credit to the issuer of a second letter of credit
 - Both letters of credit must require identical documents
 - Transferable
 - The original beneficiary can transfer the letter of credit to third parties



Methods of Pre-Export Finance

- Documentary Letter of credit
 - Types of Letters of credit
 - Revolving
 - Typically used in construction contracts
 - Allows beneficiary to draw on the letter of credit, up to a certain amount, usually without presentation of documents
 - The account party replenishes the account
 - “Red clause” letter of credit
 - Exporter can use to obtain pre-shipment finance by providing either (i) a statement of purpose or (ii) an undertaking to provide specified documents
 - Issuing bank provides exporter with a percentage of the L/C amount
 - Advising bank guarantees reimbursement
 - “Green clause” letter of credit
 - Similar to “red clause” letters of credit, but pre-shipment finance is contingent upon the production of warehouse receipts



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Methods of Pre-Export Finance

- Documentary Letter of credit
 - Letter of credit Settlement
 - Sight payment (sight draft)
 - Exporter presents documents and receives payment
 - Deferred payment (dated draft)
 - Exporter presents documents and receives payment at some specified future time
 - Acceptance (time draft)
 - Exporter (i) presents documents and (ii) draws a usance draft
 - Bank accepts bill of exchange for payment on a future date
 - Negotiation
 - Exporter may choose a bank and negotiate the payment of a sight or usance draft
 - Bank will either:
 - » Advance payment with recourse to the exporter
 - » Advance payment less a fee (discount)
 - » Pay exporter when issuing bank provides payment



Export Finance – Post-Export

- Post-Export Finance (medium/long-term)
 - Post-Export finance typically covers:
 - Account receivables
 - Equipment
 - Other fixed assets
 - Methods of Post-Export Finance
 - Revolving line of credit
 - Term loan
 - Finance accounts receivable



Methods of Post-Export Finance

- Finance account receivables
 - Typically used in two instances
 - Undercapitalized company with permanent financing need
 - Temporary insufficient cashflow
 - Banks provide loan secured by:
 - Assignment of receivables
 - Assignment of commodity inventory
 - Loan
 - Made on a revolving basis against a pool of receivables
 - Borrower
 - Responsible for collecting from customers
 - Responsible for 100% loan repayment despite inability to collect from customers



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Structured Commodity (Export) Finance

- Selling points
 - Provides the ability to isolate the funding of commodities from other financial and economic risks (contract performance, foreign exchange and political risks)
 - Low default rate, even in times of stress
- Typical Products
 - Export receivables-backed financing
 - Inventory financing (warehouse receipt financing)
 - Prepayments
 - Asset-backed securities
- Agricultural Finance
 - Trade-related paper and discount (refinancing) windows increase liquidity
 - U.S. Federal Reserve
 - Foreign trade-related credits accepted
 - Discount windows provide low financing alternatives



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Structured Commodity (Export) Finance

- Pre-Export Warehouse Receipt Finance
 - Basic underlying conditions
 - Entering into transaction
 - Reliable warehouse
 - Sound legal basis for warehouse receipts
 - Ability to obtain export license
 - Ability to protect value of goods
 - » Insurance
 - » Hedging
 - Default and ability to Liquidate
 - Ability to obtain possession
 - » Clear bankruptcy laws; speedy transfer of commodities
 - Ability to export
 - » Foreigners able to hold export licenses
 - Low risk of government intervention
 - » Affordable sovereign risk insurance



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Structured Commodity (Export) Finance

- Pre-Export Warehouse Receipt Finance
 - Traditional form
 - Bank takes control of goods in either a warehouse or tank facility; if borrower defaults, bank seizes goods
 - Repurchase agreements
 - Bank purchases goods and executes a re-sale contract; the resale price reflects the cost of funds from original purchase to re-sale
 - Warehouse receipts and law
 - Legal Bases
 - Bailment
 - Pledge
 - Obtaining a Security Interest
 - Receive legal title to the collateral (mortgaging)
 - Registration of security interest with central depository (pledge)
 - Take possession of the collateral (pledge)



Export Finance – Forms of Risk

- Four main Forms of Export Finance Risk
 - Commercial risk
 - The risk that either party will not fulfill its obligations
 - Transportation risk
 - The risk that goods become damaged or destroyed during transport
 - Exchange risk
 - The risk that currency fluctuations will affect the value of the transaction
 - Political risk
 - The risk that government policy changes, wars, embargoes, etc., will prevent the conclusion or affect the value of the transaction



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Export Finance – Risk Mitigation

- Direct Credit
 - Export Credit Agencies support exports through the provision of direct credits to either the importer or the exporter
 - Importer: a buyer credit is provided to the importer to purchase goods
 - Exporter: makes a deferred payment sale; insurance is used to protect the seller or bank
- Guarantees
 - Bid bond (tender guarantee): protects against exporter's unrealistic bid or failure to execute the contract after winning the bid
 - Performance bond: guarantees exporter's performance after a contract is signed
 - Advance payment guarantee (letter of indemnity): in the case where an importer advances funds, guarantees a refund if exporter does not perform
 - Standby letter of credit: issuing bank promises to pay exporter on behalf of importer



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Export Finance – Risk Mitigation

- Insurance
 - Transportation insurance
 - Covers goods during transport; degree of coverage varies
 - Credit Insurance
 - Protects against buyer insolvency or protracted defaults and/or political risks
 - Seller non-compliance (credit insurance)
 - Covers advance payment risk
 - Foreign exchange risk insurance
 - Provides a hedge against foreign exchange risk



Export Finance – Risk Mitigation

- Export Finance - Instruments used to Hedge Price Risk
 - Stabilization programs and funds
 - Timing of purchase/sale
 - Fixed price long-term contracts
 - Forward contracts
 - Primarily trade-related
 - Can help in obtaining export financing
 - Futures or options
 - Futures contracts can be used to obtain export financing
 - Use of OTC markets
 - Primarily trade-related
 - Swaps
 - Often used to secure loan repayment
 - Commodity-linked loans bonds
 - Primarily used to obtain financing



Export Finance and U.S. Agencies

- U.S. Government Export Finance Assistance
 - U.S. Small Exporters
 - SBA Export Express loan program
 - SBA International Trade Loan program
 - Working Capital Loans
 - SBA Export Working Capital Program
 - Ex-Im Bank Working Capital Guarantee Program
 - Foreign Buyer Credit
 - Ex-Im Bank loan guarantee
 - Ex-Im Bank Export Credit Insurance program
 - Ex-Im Bank Medium and Long-term fixed-rate loans



Export Finance and U.S. Agencies

- U.S. Government Export Finance Assistance
 - Export Finance Matchmaker
 - For more information on the EFM, visit the *Export Finance Matchmaker* webpage at <http://www.trade.gov/efm> or contact the Office of Finance at (202) 482-3277.
 - Credit Checks
 - Department of Commerce International Company Profile (ICP)
- Other
 - Private Export Funding Company (PEFCO)
 - For more information, visit the PEFCO website at <http://www.pefco.com> or call (212) 916-0300
 - New York State Export Working Capital Program



Internet-based Export Finance Solutions

- Bolero
 - www.bolero.net
 - Founded by SWIFT, and the Through Transport Club (TT Club). Apax Partners and Baring Private Equity Partners invested capital in 2000
 - Customers: primarily corporate importers and exporters
 - Integrates trade activity of the importers/exporters with freight forwarders and logistics services providers and banks and other providers of export finance



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Internet-based Export Finance Solutions

- Certegy
 - www.certegy.com
 - NYSE listed (CEY)
 - Certegy Inc. provides credit, debit and merchant card processing, e-banking, check risk management and check cashing services to over 6,000 financial institutions, 117,000 retailers and 100 million consumers worldwide
- TradeCard
 - www.tradecard.com
 - Connects trading partners and routes and stores their trade documentation electronically, from purchase orders (P.O.s) to commercial invoices
 - Provides automated supply chain finance, credit protection and export finance





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