



News and Views






Issued by: KS-TF AG / April 2024

Contracts in Trade Finance – The Relevance of a Good Fit

Contracts may seem like tedious documents, often long and filled with standard language that can be difficult for anyone to understand. However, they play a crucial role in trade finance, ensuring that agreements between parties are clear and legally binding. One of the primary reasons insurers may refuse to pay a claim under a trade finance insurance policy is that the contract and the insurance policy covering that contract does not accurately reflect the legal structure or the true agreement between the parties involved. For instance, in a recent case, Bond&Credit Company (BCC) refused a claim alleging that the nature of the underlying trades was not envisaged by the policy it had underwritten (see *Stuck in the middle | Global Trade Review (GTR)* (gtreview.com)). Similarly, in the Greensill saga, Zurich Insurance asserted that the receivables purchase agreement between Greensill and Liberty Commodities was “a sham”, citing claims by Sanjeev Gupta that financing was actually arranged verbally as a three-year facility, different from the written agreement, and that it included potential future receivables that never materialized (see *Zurich claims Greensill-Liberty financing was long-term lending, not receivables | Global Trade Review (GTR)* (gtreview.com)).

Indeed, in the receivables and payables financing programs, finding expert lawyers who truly understand the underlying business and processes, can be challenging. As a result, many agreements end up being based on standard templates approved by international organizations, which may not accurately reflect the intricacies of the transaction. Alternatively, excessively lengthy agreements with numerous definitions are drafted, to cover all possible scenarios, but may still fail to accurately reflect the specific processes involved. This issue becomes even more relevant when insurance is used to mitigate the risk. Major insurers often rely on template policies that only partially align with the reality of more innovative structures. While everything may seem fine initially, conflicts or claims can reveal discrepancies, leading to challenges and rejections of claims.





Important points to consider from a legal perspective are:

-  Parties to the transaction: who are the parties to the transaction and is the relationship among them properly reflected?
-  Sale of receivables or advance payment: is the nature of the transaction clearly reflected in the legal documentation?
-  Insurance policy alignment: does the insurance policy accurately align with the underlying transaction details outlined in the contractual documentation? Would the insurer be able to challenge the underlying transaction based on it not being the one described in the policy? Does the insurer thoroughly understand the intricacies of the transaction to properly underwrite the risk?
-  Service agreements alignment: does the service agreement with the programme servicer accurately reflects the processes that are foreseen in the main agreement with the customer?
-  Effective purchase and repurchase events (for receivables programmes): when is the receivable effectively purchased and as of when is the risk passed to the purchaser? Is there recourse to the seller and to what extent? Does it endanger the “true sale”?

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-  Support of the vendor: is the support of the vendor contractually tied up? Is the vendor expected to stop shipment if required? Would the vendor support collections?
-  Formalities: are any formalities required for validity or enforceability in the country of the vendor or of the buyers? Recently, is there an all-electronic way to comply with such formalities?
-  Securities: are there specific securities customary or relevant in the countries of the buyers? Does it make sense to incorporate those into the legal structure, in consideration of the credit amount granted to the buyers and the formalities and cost to put in place such securities?
-  Regulatory: does the offering raise the need of license or authorization in the country of the customer, even at the stage of solicitation?

Ultimately, it is essential to understand the underlying transaction and processes thoroughly to ensure that the contractual documentation and the insurance policy accurately reflect that reality. At KS-TF we have experts that understand not only the legal requirements, but also the processes and the financial background of the transactions, and who are able to craft agreements tailored to the programmes, taking into account the interests of all parties involved.

Of course, it is then required to set up the controls to ensure that the expected reality conforms with what happens in real life, but this is the subject of how to mitigate fraud risk, and this is another topic, to be discussed at a different time.

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After having built reputable and sustainable operations which became market leading, KS-TF AG, Switzerland based, was created as a consulting company and consists today of professionals with expertise in the trade processing and financing space, covering the disciplines of legal, credit, operations, strategy, structuring and software development. The latter in cooperation with suppliers of software dedicated to our services.