

# Uses of Special Purpose Vehicles (SPVs) in structuring financing transactions

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# What we will cover

- What is a special purpose vehicle (**SPV**)?
- Why is an SPV used?
- Issues surrounding control of an SPV
- Factors relevant to choosing where to incorporate an SPV
- How can an SPV be used in trade finance transactions?
- Example trade finance structures using SPVs

# What is a special purpose vehicle

- An SPV is a legal entity created for a specific, limited purpose
  - Transaction specific
  - Specific form of financing or transaction
- There are a number of different legal forms depending on the relevant jurisdiction
  - Limited liability company
  - Limited liability partnership
  - Others
- Legal, commercial, tax and accounting issues underpin everything

# Why use an SPV?

There are many reasons why an SPV structure may be used. These include:

- Ring-fencing of assets
- Insolvency remote vehicle
- Better financing terms
- Off balance sheet treatment
- “on-shore” issues
  - Burdensome regulation
  - Tax issues such as withholding tax on interest payments
  - Foreign exchange controls or repatriation of funds
- Challenges to taking security
- Inability of proposed party to perform its intended role (e.g. restriction on “real” borrower borrowing or granting security)
- Allowing financing to multiple ‘borrowers’ via the SPV

# Ownership and control of SPVs

- There are a number of different ways in which SPVs can be owned and controlled
- Financer owned – full control for the financer and particularly control over cash flows
- But potential difficulties with lending to subsidiaries?
- Obligor owned – likely to be preferred position for the obligor but much less control for the financer unless this is provided for contractually
- Financer is one step removed from day-to-day running of the SPV and likely to be reliant on prompt reporting by the obligor to be aware of any issues
- Potential restrictions on granting security by the obligor could apply to the obligor group and therefore the SPV

# Ownership and control of SPVs (2)

- Shared ownership of obligor and financier – not a commonly chosen position and requires much more focus on the decision making of the SPV
- Dispute resolution mechanism required in the event that obligor and financier cannot agree on appropriate steps to be taken – shareholder agreement sets out the relationship between the financier and the obligor
- Third party owned – number of corporate services providers that can establish and own the SPV – administration of the day-to-day running of the SPV will be set out in the contractual documentation
- No owner – this involves the ownership of the SPV typically being held by a charitable trust – this is often referred to as an orphan trust

# Management of SPVs

- Involvement of third parties increases costs and likely to require additional obligations of the financier and obligor – for example, indemnities to third party owner
- Management and administration of the SPV carried out in accordance with the instructions of the financier or the obligor depending on what has been contractually agreed
- Whichever option is chosen, consideration needs to be given to:
  - the ability of the relevant interested party to direct the activities of the SPV where it is not the owner
  - Shadow directors?
  - Ability of directors of SPV to comply with local law director's duties
  - What happens if things go wrong or substantive decisions need to be made

# Factors relating to incorporating SPVs

- There are a number of jurisdictions that are commonly used for SPVs, including British Virgin Islands, Cayman Islands, Jersey, Luxembourg and Ireland
- A range of factors will underpin any decision to incorporate an SPV in a particular jurisdiction including:
  - Speed of incorporation
  - Costs
    - Cost of incorporation
    - Cost of administration of the SPV
  - Tax neutrality or advantages
  - Sophistication of legal system (and relationship with English law)
    - Knowledge and familiarity with English law concepts
    - Recognition and enforcement of English law and English law judgments/arbitral awards



# Factors relating to incorporating SPVs (2)

- Relevant factors (cont.):
  - Regulatory environment
  - Options for legal nature of the SPV
  - (Lack of) Corporate administration burdens – e.g. requirements for annual general meetings, reporting requirements and filings, nature of directors
  - Winding up / dissolution of the SPV
  - Infrastructure, telecommunications and transport

# Potential issues with using SPVs

- AML, KYC, beneficial ownership and transparency
- Misuse of SPV structures – Enron
- “Piercing the corporate veil”

# SPVs in trade finance structures

- SPVs can be used in a range of transactional matters, particularly in the oil and gas industry, real estate, project finance, asset finance and securitisations
- SPVs can and have played an increasing role in trade finance transactions
- This does not necessarily involve creating new structures but adapting existing and well-known structures to benefit from the use of the SPV

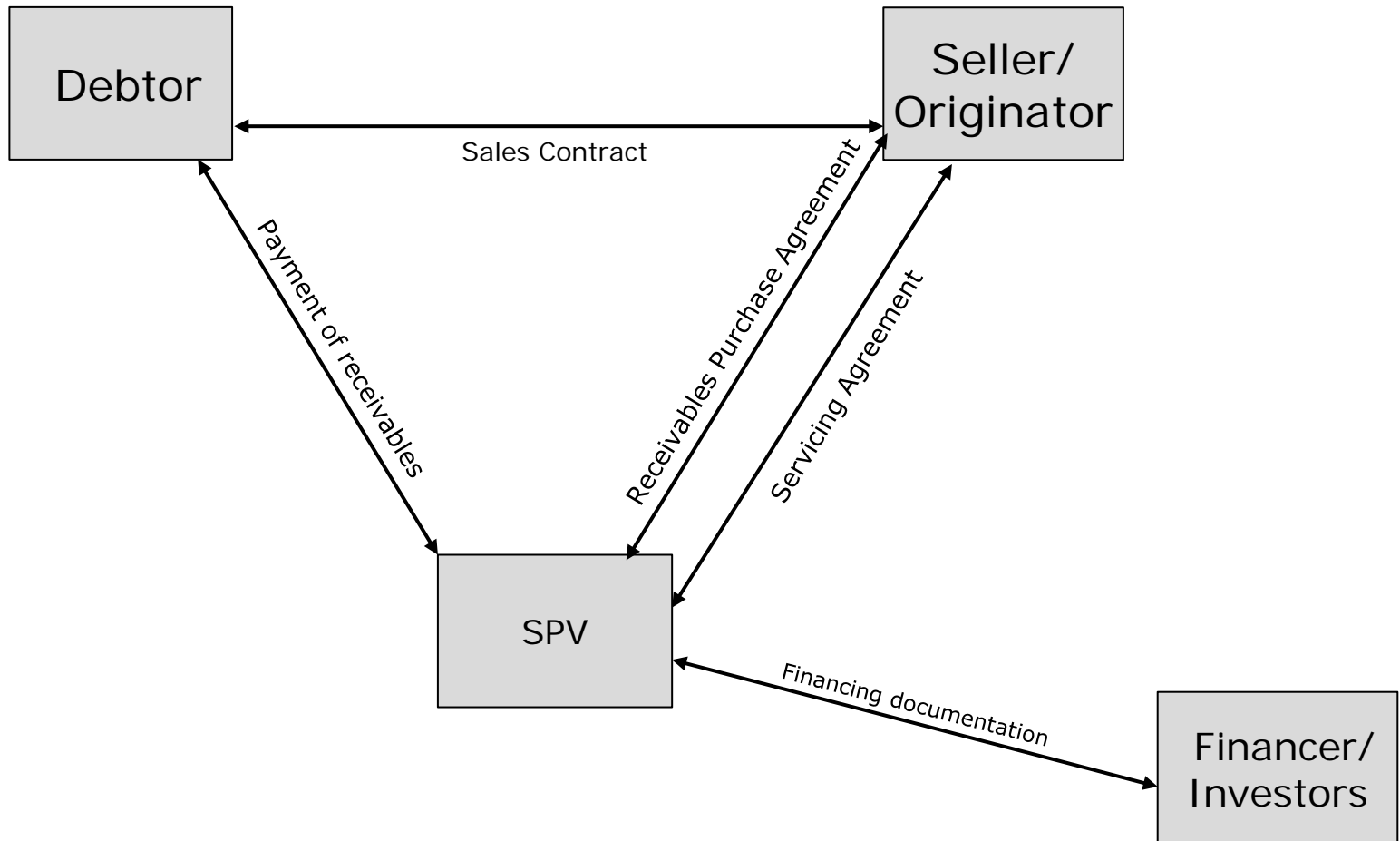
# Securitisation background

- Historically covered asset backed loans
  - eg residential mortgages, car loans, credit card receivables etc
- Trade receivables?
  - More recent
- Main benefits
  - Alternative to traditional bank lending/unsecured corporate bonds
  - Lower cost of funds (linked to pool of assets not general credit rating of originator)
  - Off balance sheet so possibly better leverage and returns
- Typical fundamentals
  - Involves sale of assets to SPV at a discount by originator(s)
  - Traditionally funded in the capital markets and rated
  - Credit insurance (common)

# What about trade receivables?

- Characteristics
  - Short-term “business” assets
  - Not income-generating assets
  - Not usually secured
  - More complex jurisdictional issues (cross border)
- Typical structure
  - Receivables can be pooled and sold to the SPV at a discount
  - Purchase can be
    - by way of a specified pool of receivables
    - on a revolving basis
  - Options for funding
    - Note/bond issuance etc. (capital markets)
    - Bank/alternative funder debt
  - Watch out for specific considerations
    - Funding mismatch
    - Servicing issues

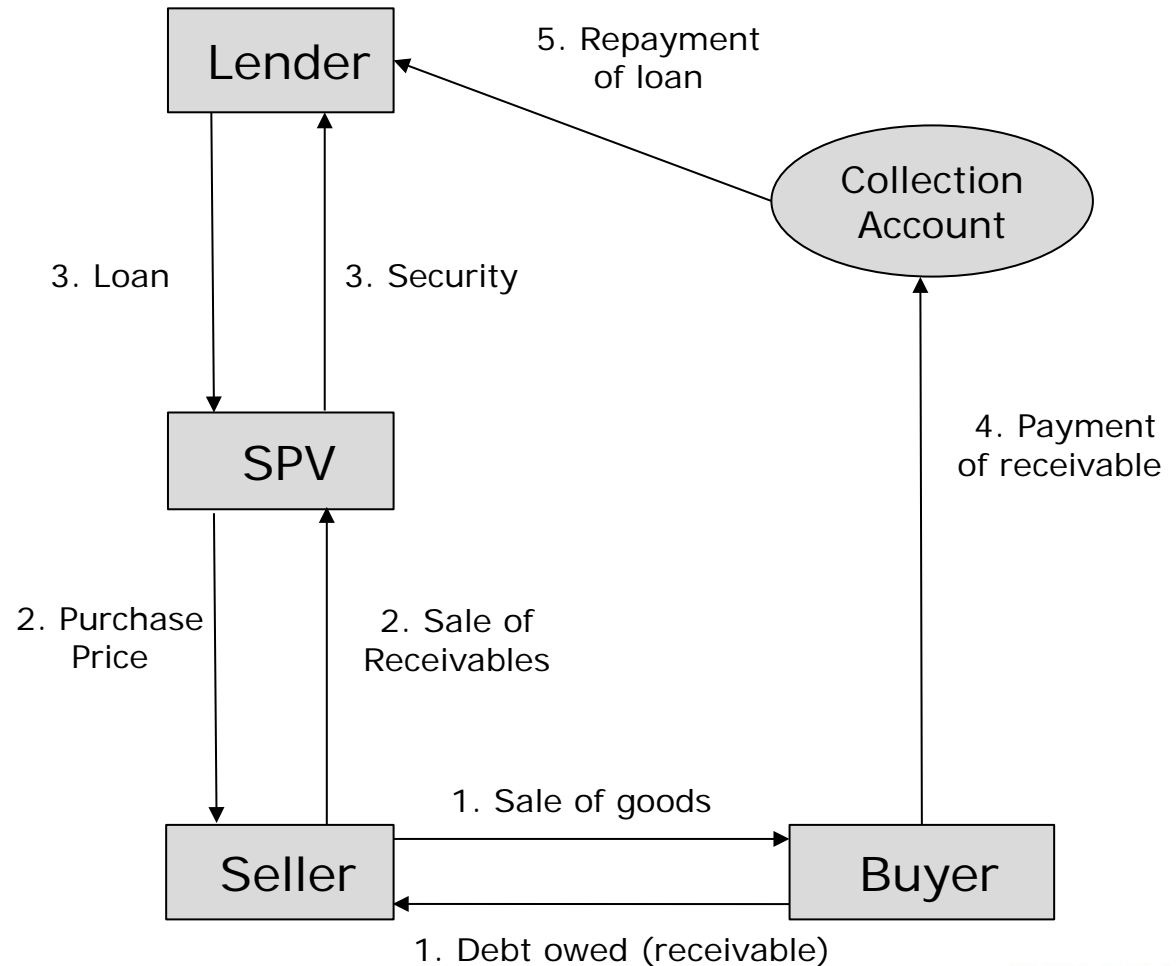
# How does it work (at its simplest)?



# Additional securitisation structures

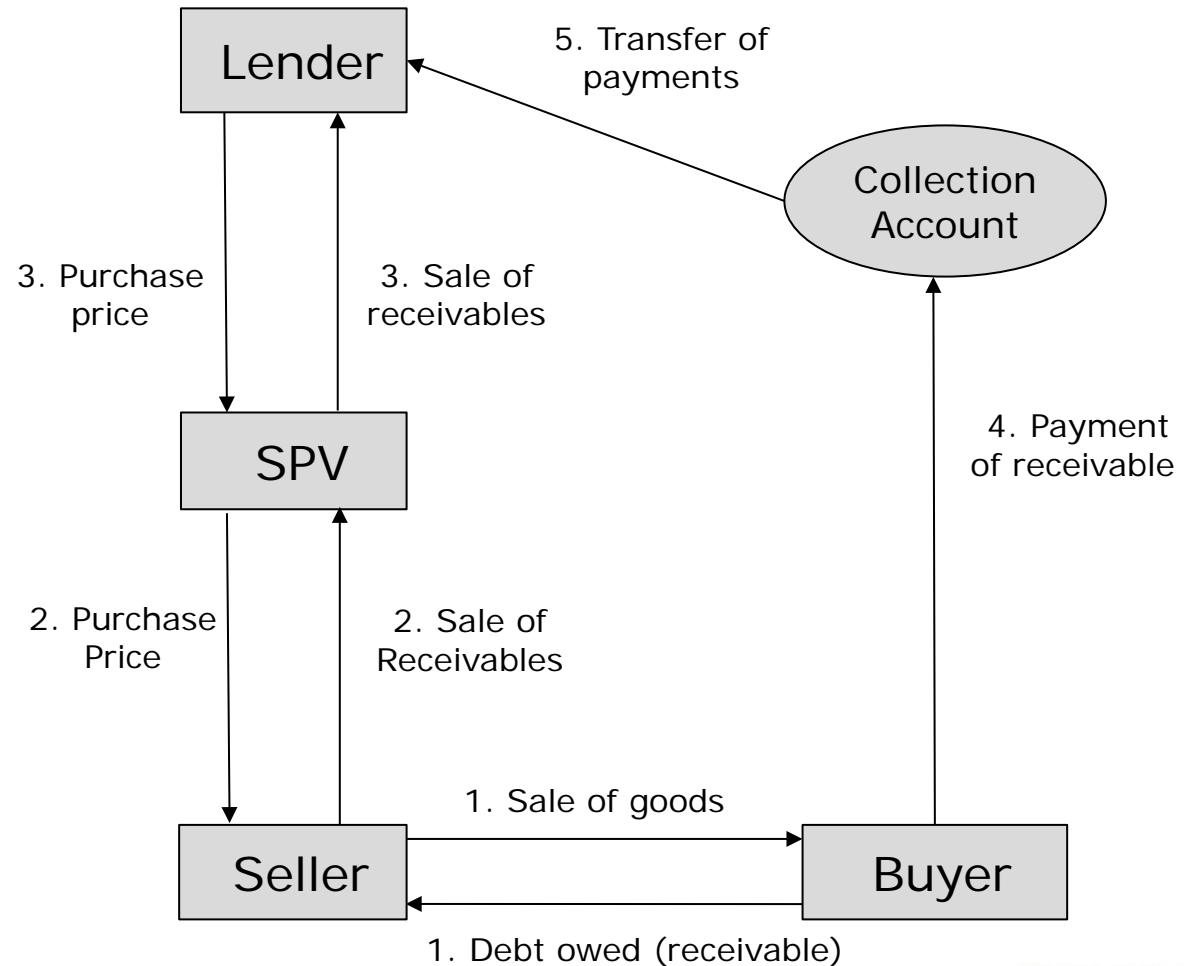
- More complex structures can be created, for example, involving both an offshore SPV and an onshore SPV
- This is likely to be driven by a combination of tax, accounting and legal issues
- Requires additional due diligence and increased focus on cash flows and funding of reserve accounts to meet instalment payments to investors

# Receivables purchase using SPV

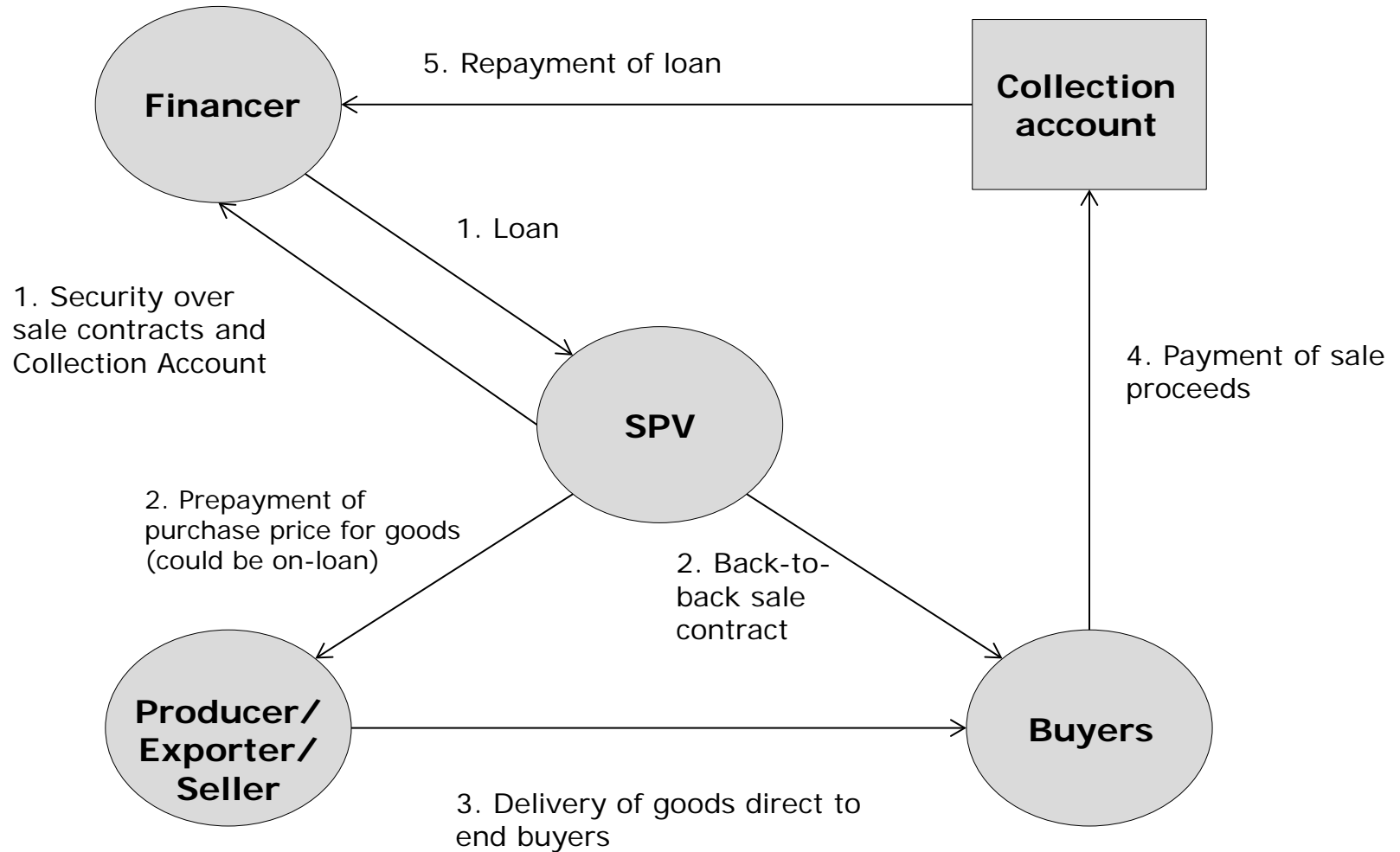




# Receivables purchase using SPV (2)



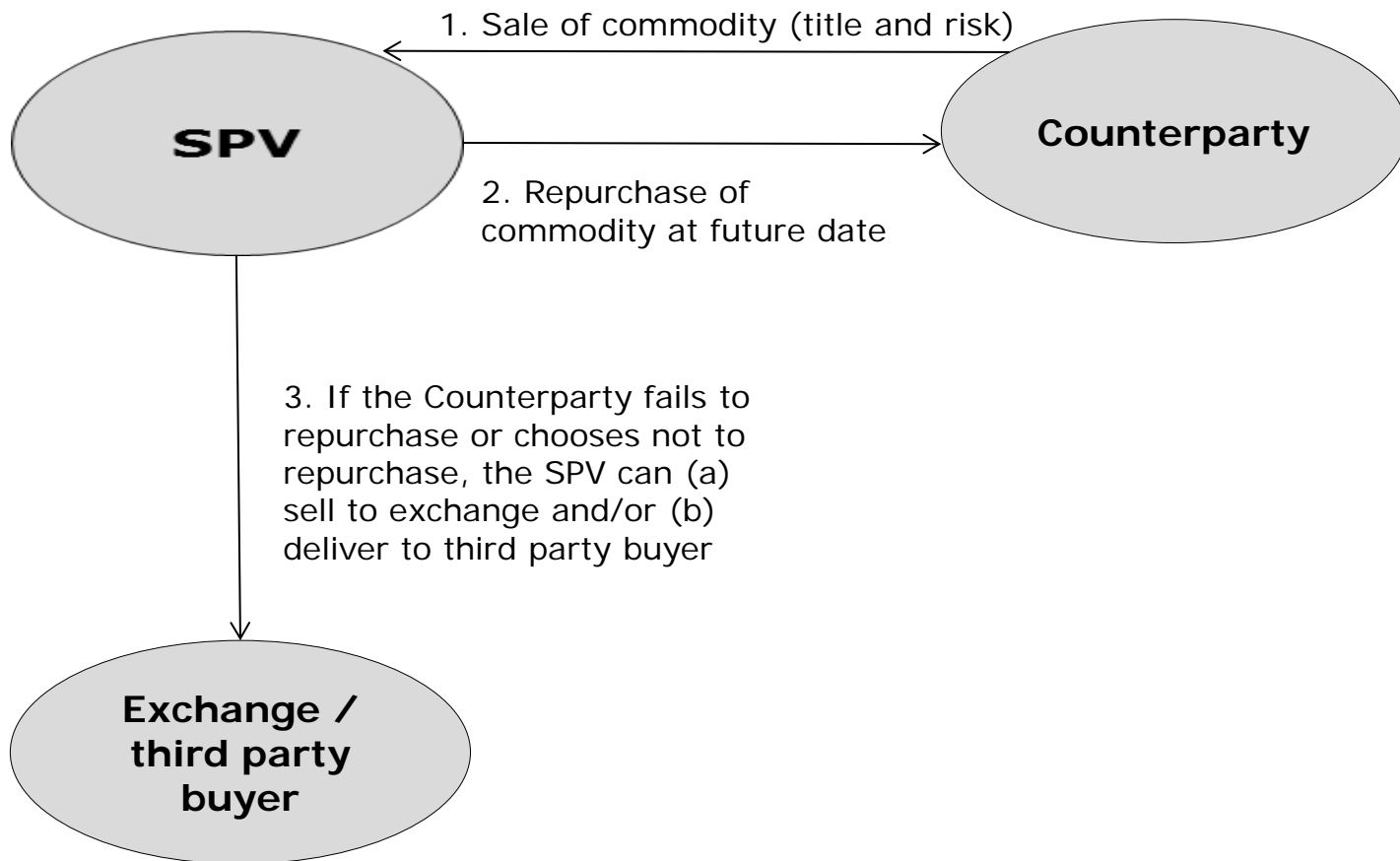
# SPVs in Financings



# Pre-export financing

- Although the structure is very similar to a normal PXF structure without an SPV, there are additional issues to be dealt with
- Additional sale contract required as goods sold first to SPV and then to end-buyers – the relevant sale terms should be back-to-back
- Performance risk still with the producer/exporter (the “real” borrower)
- If SPV has been established solely for this transaction, the financier may decide not to take security over the SPV’s assets

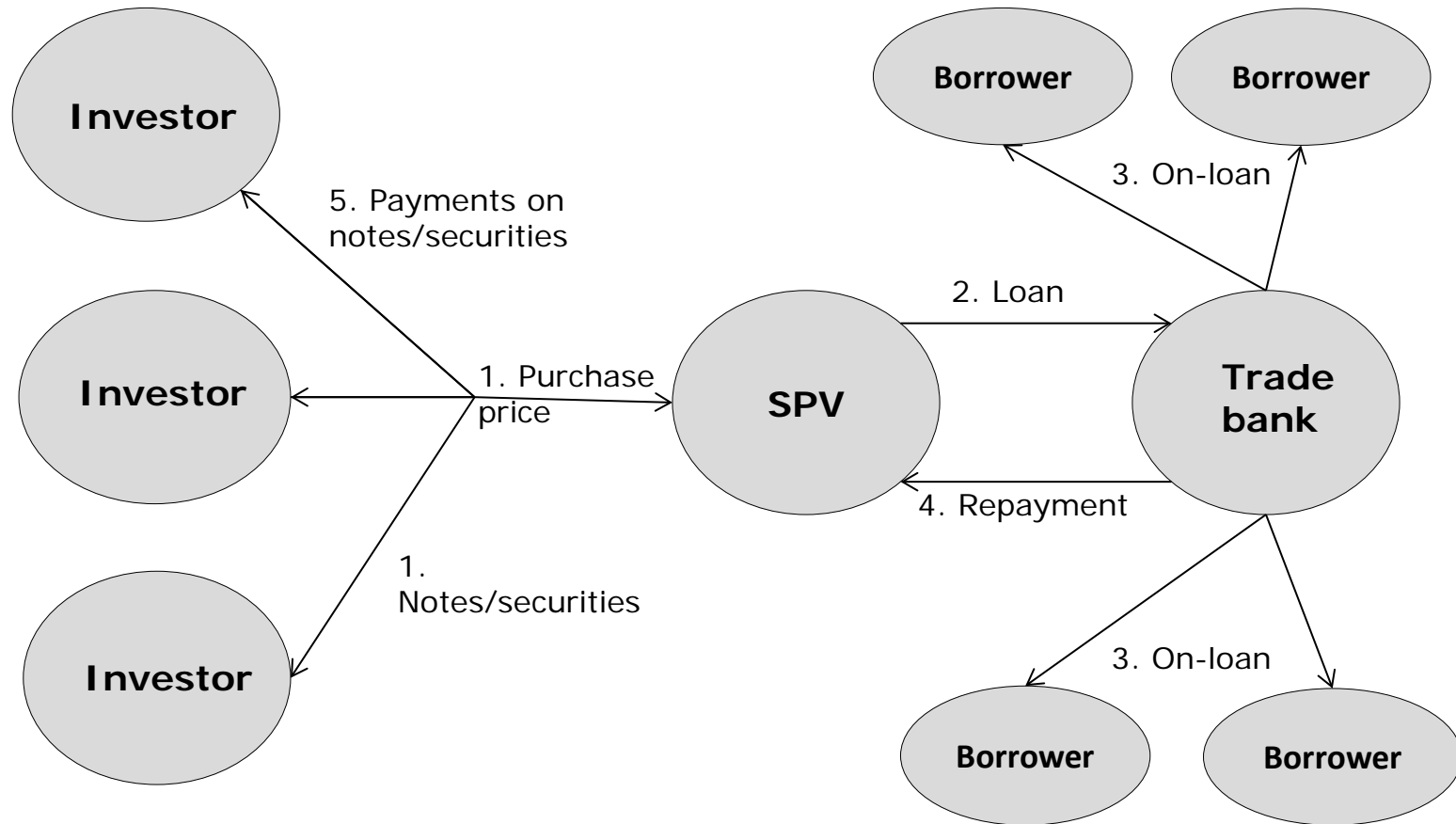
# Commodity ownership – the “repo”



# Regulatory issues with ownership

- Regulated activities
  - Purchase and sale of goods
  - Owning certain goods, e.g. do you need a licence to hold oil stocks?
  - Reporting obligations, e.g. REACH in the EU
- Environmental laws and liabilities
- Oil reserve obligations
- Restrictions on offshore payments
- Tax
  - Tax on profits, withholding tax, stamp taxes
  - VAT / GST and bonded warehouses
- Importance of local due diligence to structure properly and documents can address any regulatory issues
- True sale issues

# Funding structure



# Summary and conclusions

- SPVs have had a long history
  - Well recognised by regulator in project finance
- Good uses but over used?
  - Can add complexity when not needed
- Take care to lock in all the issues
  - Extra contracts
  - Trustworthy third parties
- Will future regulations inhibit use?
  - Beneficial ownership registers etc.
- Better rewards for structures using SPVs?
- Carry on using SPVs?
  - Even be more inventive?!

# Geoffrey L Wynne

## Partner

**Geoffrey Wynne** is head of Sullivan & Worcester's London office and also head of its Trade & Export Finance Group. He has extensive experience in banking and finance, specifically trade and structured trade and commodity finance. He also advises on corporate and international finance, asset and project finance, syndicated lending, equipment leasing and workouts and financing restructuring.

Geoff is one of the leading trade finance lawyers and has advised extensively many of the major trade finance banks, multilateral financiers and companies around the world on trade and commodity transactions in virtually every emerging market including CIS, Far East, India, Africa and Latin America. He has worked on many structured trade transactions covering such diverse commodities as oil, nickel, steel, tobacco, cocoa and coffee. He has worked on warehouse financings in many jurisdictions and advised on how to structure involving warehouse operators and collateral managers. He has also advised on ownership structures and repos for commodities and receivables financings.

Geoff sits on the editorial boards of a number of publications and is a regular contributor and speaker at conferences. He is also the editor of and contributor to The Practitioner's Guide to Trade and Commodity Finance published by Sweet & Maxwell and A Guide to Receivables Finance, a special report from TFR published by Ark.

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# Sam Fowler-Holmes

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# Awards & Recognition

## TFR “Best Law Firm in Trade Finance”

*Trade & Forfeiting Review* (TFR) named Sullivan & Worcester "Best Law Firm in Trade Finance" in its 2014, 2015 and 2016 TFR Excellence Awards



## GTR “Best Law Firm”

Sullivan & Worcester UK LLP was top ranked firm in the *Global Trade Review* (GTR) Best Law Firm 2015 and 2016 polls



## *The Legal 500 UK 2016*

Geoffrey Wynne and Simon Cook are listed as Leading Lawyers and Sullivan & Worcester UK LLP was ranked in the following category in *The Legal 500 UK*:

- Trade Finance (Tier 1)



## *Chambers UK 2017*

*Chambers UK* ranked Sullivan & Worcester UK LLP, along with Geoffrey Wynne and Simon Cook, in the following area:

- Commodities: Trade Finance (UK-wide)



## TFR Fellowship Award 2017

*Trade & Forfeiting Review* (TFR) honoured Geoffrey Wynne with the TFR Fellowship Award in its 2017 TFR Excellence Awards



### TFR Fellowship Award

Geoffrey Wynne, Partner, Sullivan & Worcester UK LLP

# Future breakfast seminars

- Thursday 19 July

## **No event in August**

- Thursday 20 September
- Thursday 18 October
- Thursday 22 November
- Thursday 13 December

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