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Documenting to Improve Regulatory Compliance

By Geoffrey Wynne, Partner and Head of the Trade and Export Finance practice at Sullivan & Worcester in London

In a world of ever increasing regulation, are there areas in trade finance documentation where parties can show they are addressing the concerns and taking steps to protect their position against a review by Regulators of what they are doing? This article looks at some areas where this might be possible. It looks at the position under English law and in light of current and future UK regulations.

Sanctions and the Anti-money Laundering Act 2018

This Act gives the UK Government broad powers to make sanctions regulations in a number of key areas. Sanctions could cover financial sanctions including asset freezing and trade restrictions. The good news is that the UK has agreed to keep within EU sanctions policy until 2020, except if the UK adopts new foreign policy before then. Brexit could make sanctions very different. This would, at the very least, increase compliance costs relating to additional sets of sanctions.

It is common when documenting transactions to insert representations and/or undertakings of a general nature to the effect that parties are in compliance with all applicable laws and regulations with perhaps an undertaking not to use facility proceeds in breach of relevant sanctions. But is this sufficient? This depends on careful drafting to ensure that all sanctions regimes are covered and, more importantly, that the financer is protected in knowing that that its customer has verified all parties to its commercial transaction as well as matters such as the use of goods being financed and how they are transported. Increases in due diligence requirements on financers make this essential.

However, sometimes a financer in its letters of credit may go too far to protect itself. There seems to be a growing move, from certain financers, to make protection against being involved in any potential sanctions breach a subjective test. A dangerous effect of this is to limit a letter of credit from being an irrevocable undertaking to pay. The ICC (International Chamber of Commerce) Guidelines say that a party should not do anything to call into question the irrevocable nature of the payment undertaking. The law should be sufficient to protect the paying party from breaching sanctions by allowing it not to pay in those circumstances. That, together with a well drawn facility agreement, should suffice.

Due diligence worries

Apart from sanctions themselves, the current trend appears to require sanctions clauses to cover anti-money laundering, anti-corruption and anti-terrorist financing. Thus, changing the general "no breach of laws and regulations" to cover all of these areas specifically, is important. There is guidance from the UK Joint Money Laundering Steering Group in 2017 on what financers should be doing. This advice should be followed by increasing the due diligence wording in agreements. The wording should refer specifically to all these areas of law and regulation and be coupled with references to all likely sanctioning bodies such as United Nations, EU, UK and US. It may not be sufficient to deal with these at the commencement of the agreement but instead to have regular repetition and monitoring.

Other examples of regulation include The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 which lists requirements as to when due diligence (enhanced and simplified) should be carried out. One area to consider is when a financer can rely on its own customer's due diligence and where it has to be seen to conduct its own. This is important in cross border transactions where the financer may not have access to information other than through its customer's own dealings. In these circumstances building up a case for why reliance on the customer is sufficient may make a transaction doable or prohibitively expensive.

The advice is to take note of the underlying commercial transaction including the parties, jurisdictions and goods (for possible dual use) and then demonstrate that due enquiry has been made. This can be a mixture of provisions in the documents themselves and outside. Doing this properly is a defence to internal compliance and the Regulator.

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What to worry about less

There has been much discussion about the replacement of LIBOR. The market awaits a solution. However, the problem is not likely to arise until 2021 and the Regulators are aware of the need not to disturb the market unduly. Given that most trade finance transactions are of a short duration why not keep it simple and leave things as they are? Await the official announcement and do not try to guess a solution – you might be wrong!

> "Most increased cost clauses impose the right to claim compensation for increases arising from compliance with capital adequacy requirements"

In December 2017, the Basel Committee announced what was to be the last but possibly most contentious version of the Basel III accord or Basel IV as it has been named. The aim of the restrictions is to restore credibility in the calculation of risk weighted assets (RWA) and improve the comparability of banks' capital ratios. Much has been and will be written on this subject. It is not helpful in a trade finance context where more needs to be done to make trade finance assets more attractive. Do you need to deal with this issue in the documentation? The short answer ought to be no! Most increased cost clauses impose the right to claim compensation for increases arising from compliance with capital adequacy requirements and allow for them to change. Thus, this change should already be accommodated. There are issues to be considered in the exact wording, so a quick look is worthwhile.

More provisions to look at

2018 has seen a growth in data protection with GDPR (General Data Protection Regulations) and this is repeated in jurisdictions beyond the EU. However, is there any need to reflect this in financing documents? Remember, it is limited to personal data so perhaps a more relaxed attitude in this area is allowed.

What do we do about Bail In (Article 55 BRRD - Bank Recovery and Resolution Directive 2014)? Perhaps nothing so long as English law governs the agreement and in Brexit there is provision for this to continue. In any event, market practice seems to have found a way not to include the wording in many documents.

Summary

There is much to be aware of, but careful reviews of documents and their updating should lead to peaceful days and nights!