
International Trade

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Walter (Buddy) Baker

Walter (Buddy) Baker has over 30 years of experience in international trade finance. In May 2009 he joined Fifth Third Bank as the head of their International Trade Services Sales team. Fifth Third is one of the 20 largest banks in the US and provides a full range of risk mitigation and financing products for exporters and importers. Prior to Fifth Third, Buddy worked for Atradius Trade Credit Insurance, ABN AMRO Bank, Bank of America, Wachovia Bank, and The First National Bank of Chicago.

Buddy is a recognized expert in trade finance and author of numerous magazine articles and the books *Users' Handbook to Documentary Credits under UCP600*, *Documentary Payments & Short-Term Trade Finance*, and *The Regulatory Environment of Letters of Credit and Trade Finance*. He owns the consulting firm *Global Trade Risk Management Strategies*, which specializes in educational training, and makes frequent presentations for national associations of exporters, importers, bankers and lawyers. Mr. Baker serves as a member-at-large of the National Letter of Credit Committee of the International Financial Services Association and is actively involved in establishing national and worldwide standard practices for LCs, such as the recent revision of the Uniform Customs and Practice for Documentary Credits (referred to as UCP600), the official ICC guide for examining letter of credit documents, called the International Standard Banking Practices for the Examination of Documents under Documentary Credits, the eUCP supplement to the UCP dealing with electronic documents, the International Standby Practices, and Article 5 of the Uniform Commercial Code. He acts as an advisor to the Wolfsberg Group, an international group that includes most of the largest banks in the world whose purpose is to set standards for combating money laundering, and to the Institute for International Banking Law and Practice. Buddy also serves on the Advisory Council of the Finance Credit and International Business Association (FCIBA), a multinational association of export credit managers.

Buddy earned his undergraduate degree at Yale University and his MBA at Northwestern. He can be reached at (312) 704-6942 or buddy.baker@53.com.

Identifying Export Risks

Identifying Export Risks

What might go wrong

- Commercial risks
 - Political risks
 - Transfer/economic risks
 - Foreign exchange rate fluctuation risks
-

Identifying Export Risks

Slow payment/default	Financing risk	Commercial risk
Bankruptcy		
Contract repudiation	Contract risk	Commercial risk
Contract dispute		
Abusive bond drawing		
Foreign exchange control legislation	Political risk	Country risk
Discharge of debt legislation		
Government repudiation of debt		
Payment moratorium		
Insurrection/overthrow/domestic turmoil		
Non-payment due to war		
Non-payment due to natural disasters	Transfer/economic risk	Country risk
Currency inconvertibility		
Currency fluctuation/devaluation	FX risk	

Identifying Export Risks

What might go wrong

- Commercial risks
- Political risks
- Transfer/economic risks
- Foreign exchange rate fluctuation risks

Depending on the goods, it may make a big difference whether things go wrong before or after shipment

Choosing Credit/Payment Terms

The spectrum of credit/payment terms

- Extended terms, installment notes
- Open account, clean drafts
- Time draft (D/A)
- Consignment/retention of title
- Sight draft (D/P, C.A.D.)
- Cash against goods, C.O.D.
- Advised letter of credit: sight & time
- Confirmed letter of credit
- Cash in advance

Risk Mitigation Techniques

Risk Mitigation Techniques

Letter-of-Credit-related techniques

- Unconfirmed L/C
- Confirmed L/C
- 'Silent L/C confirmation'
- Standby L/C

Guarantees

- Independent/demand guarantee
- Accessory/contract guarantee, surety bond

Documentary-Draft-Collection-related techniques

- Sight draft, 'documents against payment'
- Avalized draft & forfaiting

Open-Account-related techniques

- Factoring
- Non-recourse sale of receivables
- Credit insurance
- Credit derivatives

FX contracts

- Forwards & futures
- Options

Risk Mitigation Techniques

Method of Risk Protection	Risk	Slow Payment Default	Bankruptcy	Pre-shipment Contract Repudiation	Contract Dispute	Government Legislation	War/Comp. Civil Unrest	Disruption due to Natural Disaster	Currency Inconvertibility	Currency Fluctuation/Devaluation
Unconfirmed, freely negotiable L/C										7, 8
Unconfirmed, non-negotiable L/C				1						7, 8
Confirmed L/C				1						7, 8
Silent L/C Confirmation										7, 8
Standby L/C		2		1	3	3	3	3	3	7
Independent Demand Guarantee		2		4	3	3	3	3	3	7
Accessory Contract Guarantee/Surety Bond		2	5							7
Forfaiting										7, 8
Factoring										7, 8
(Debtors) Non-Recourse Sale of Receivables										7, 8
Credit Insurance (Compensation)			6							7
Credit Derivatives										7
FX Contracts (Forwards & Options)										

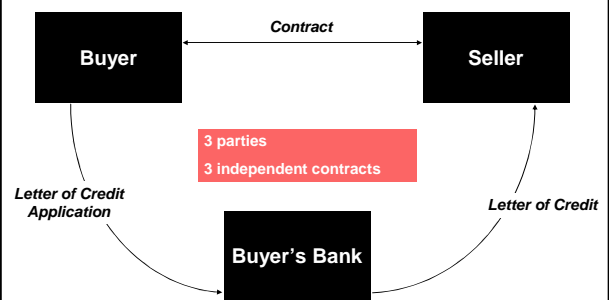
[see handout for footnotes]

Risk Mitigation Techniques

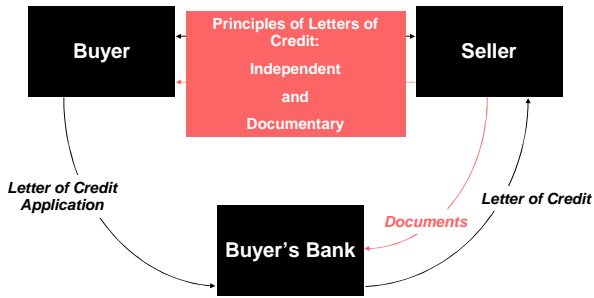
Letter-of-Credit-related techniques

- Unconfirmed L/C
- Confirmed L/C
- 'Silent L/C confirmation'
- Standby L/C

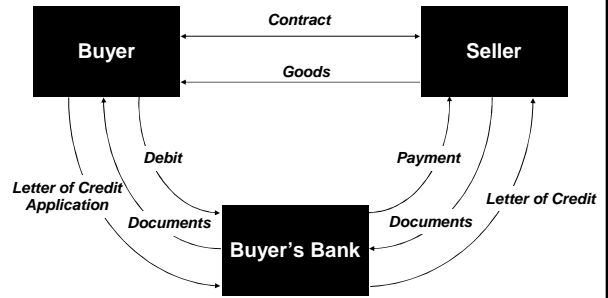
How Letters of Credit Work: Theory



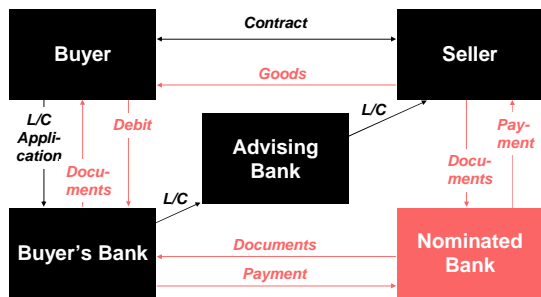
How Letters of Credit Work: Theory



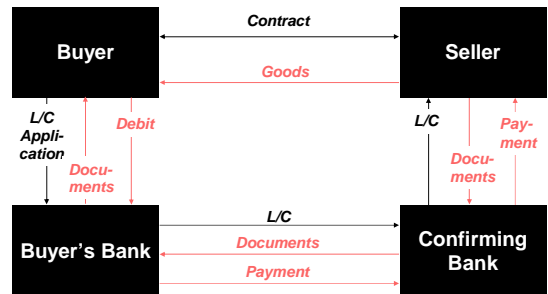
How Letters of Credit Work: Theory



How *International* Letters of Credit Work



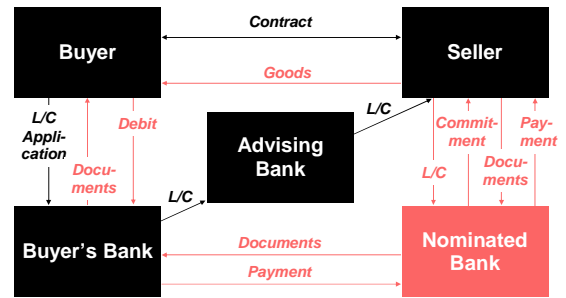
How *Confirmed* Letters of Credit Work



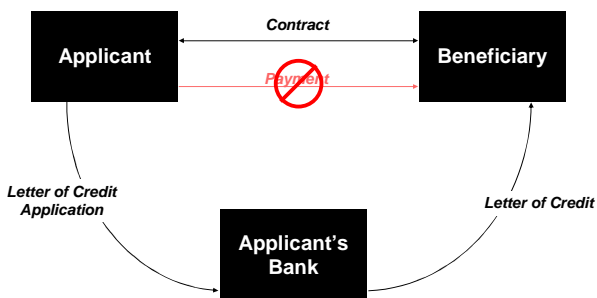
Problems with Confirming Banks

- The Confirming Bank is chosen by the Issuing Bank
- The Confirming Bank has a monopoly position
- The Confirming Bank may be an affiliate of the Issuing Bank
- The Confirming Bank can be enjoined from making payment

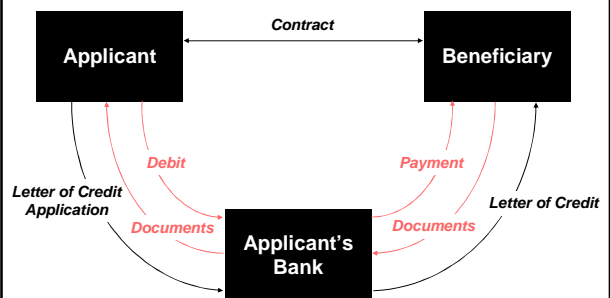
How *Silent Confirmation* Works



How *Standby* Letters of Credit Work



How *Standby* Letters of Credit Work



Risk Mitigation Techniques

Guarantees

- Independent/demand guarantee
- Accessory/contract guarantee, surety bond

Standby L/Cs vs. Guarantees & Bonds

Standby L/C	Demand Guarantee	Accessory/Contract Guarantee, Surety Bond
Independent & payable against documents	Independent & payable against documents	Payable upon occurrence of specified event
Specified amount	Specified amount	Amount of damages (usually with a maximum)
Specified expiry	Usually has a specified expiry	Expiry event
Rules: UCP or ISP (and UCC5 in the U.S.)	Rules: URDG, ISP, or local law	Rules: Local law

Risk Mitigation Techniques

Risk	Slow Payment/Default	Bankruptcy	Pre-Shipment	Contract Dispute	Government seizure	War/Coup/Civil Unrest	Disruption due to Natural Disaster	Currency Inconvertibility	Currency Fluctuation/Devaluation
Method of Risk Protection									
Unconfirmed, Freely Negotiable L/C									7, 8
Unconfirmed, Non-Negotiable L/C									7, 8
Confirmed L/C									7, 8
Sight L/C Confirmation									7, 8
Standby L/C						3	3		7
Independent Demand Guarantee						3	3		7
Accessory Contract Guarantee/Surety Bond									7

Be sure you know which kind of guarantee you're dealing with

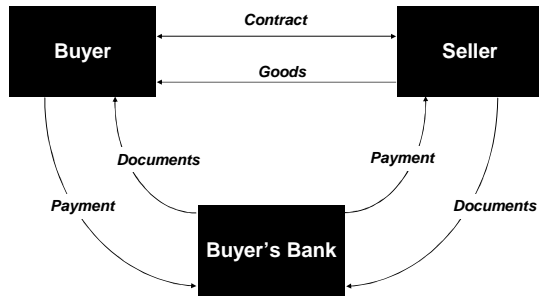
4. Country risks are covered by a 'local guarantee'.
5. If the principal repudiates the contract, the guarantor may do the same.

Risk Mitigation Techniques

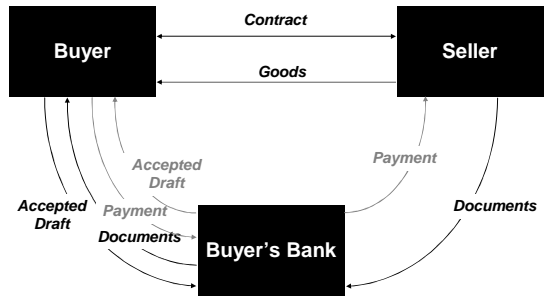
Documentary-Draft-Collection-related techniques

- Sight draft, 'documents against payment'
- Avalized draft & forfaiting

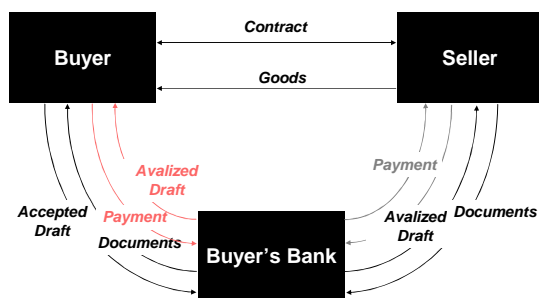
How Documentary Collections Work: Sight Drafts



How Documentary Collections Work: Time Drafts



How Documentary Collections Work: *Avalized* Drafts

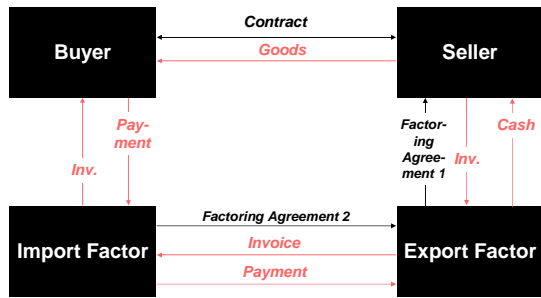


Risk Mitigation Techniques

Open-Account-related techniques

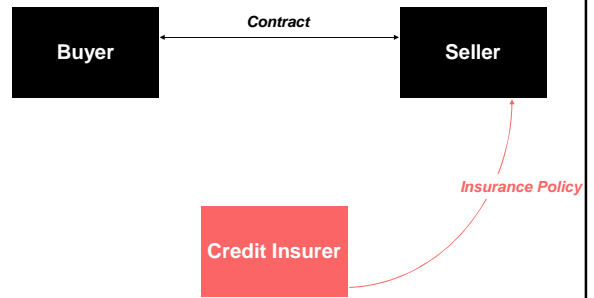
- Factoring
- Non-recourse sale of receivables
- Credit insurance
- Credit derivatives

Cross-Border Factoring



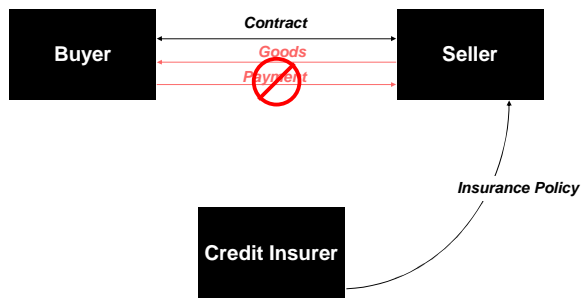
How Credit Insurance Works

Exporter holds insurance



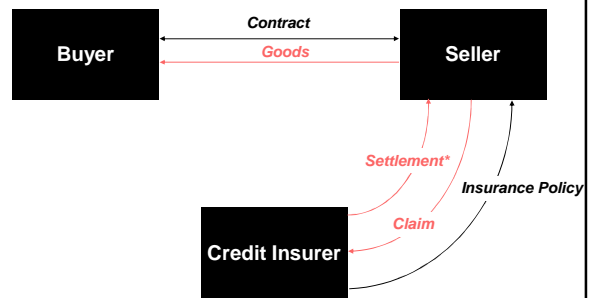
How Credit Insurance Works

Exporter holds insurance



How Credit Insurance Works

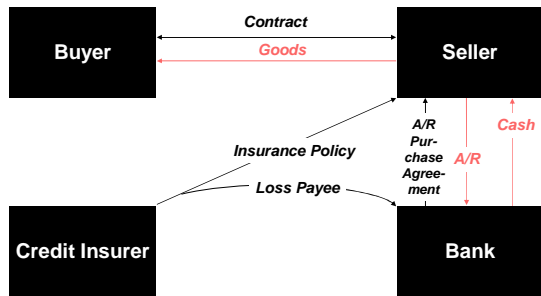
Exporter holds insurance



*Claim less deductible & co-pay

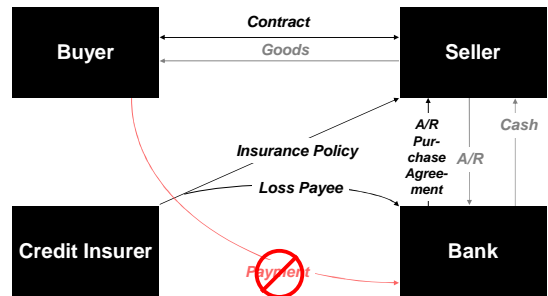
Sale of Receivable with Credit Insurance

Exporter holds insurance



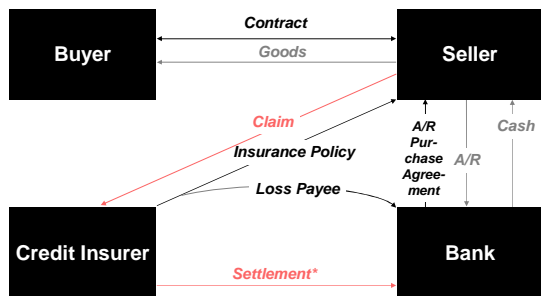
Sale of Receivable with Credit Insurance

Exporter holds insurance



Sale of Receivable with Credit Insurance

Exporter holds insurance



*Claim less deductible & co-pay

Risk Mitigation Techniques

FX contracts

- Forwards & futures
- Options

Commercial Letters of Credit

Applicability	L/C terms
Breadth	Transactional although a program can be developed to cover multiple transactions
Coverage	100%
Residual Exposure	<ul style="list-style-type: none"> Country risks and commercial risk of the issuing/confirming bank (see below) Court injunction blocking payment (see below) Discrepancies between the L/C requirements and the shipping documents
Variations	<ul style="list-style-type: none"> Unconfirmed L/C Confirmed L/C (shifts country and commercial risks to confirming bank chosen by the issuing bank) Silent L/C confirmation (shifts country and commercial risks to "confirming bank" chosen by the beneficiary and protects against court injunctions)

Standby Letters of Credit & Demand Guarantees

Applicability	Open account with standby L/C. The standby L/C may cover the full credit limit or only the amount above the seller's normal limit for the buyer.
Breadth	Multiple, repetitive sales to the same buyer
Coverage	Up to 100%
Residual Exposure	<ul style="list-style-type: none"> Country risks and commercial risk of the guarantor Discrepancies between the guarantee requirements and the documents, notably failure to present prior to expiration Court injunction blocking payment
Variations	<ul style="list-style-type: none"> Unconfirmed standby L/C Confirmed standby L/C Demand guaranty <p>Note: an accessory guaranty is NOT the same thing</p>

Forfaiting

Applicability	Time draft collection
Breadth	Transactional
Coverage	100%
Residual Exposure	<ul style="list-style-type: none"> Contract repudiation Refusal of buyer to accept drafts or of buyer's bank to avalize drafts once accepted
Variations	<ul style="list-style-type: none"> Avalized drafts Trade acceptances (non-avalized drafts)

Sale of Receivables

Applicability	Open Account Sales to companies in Western Europe, U.S.A./Canada, Japan, Hong Kong
Breadth	Repetitive sales to the same buyers; usually "whole turnover" on a country-by-country basis
Coverage	100%
Residual Exposure	<ul style="list-style-type: none"> Contract repudiation Contract dispute
Variations	<ul style="list-style-type: none"> Factoring (country risks not covered) "Delcredere" (transactional) Sale of insured receivables (coverage at insured percentage)

Credit Insurance

Applicability	Open Account, Time Draft Collection, Sight Draft Collection
Breadth	Repetitive sales to the same buyers; traditionally "whole turnover" of all export sales not covered by L/Cs or avalized drafts, but coverage can be highly tailored
Coverage	Up to 90% (sometimes 95% for sovereign buyers)
Residual Exposure	<ul style="list-style-type: none"> Contract dispute Improper documentation for filing insurance claim
Variations	<ul style="list-style-type: none"> Whole turnover Key account Single buyer <p>Credit insurance may also be cancelable or non-cancelable and may or may not provide discretionary limits</p>

Credit Derivatives

Applicability	The derivative buyer stands to lose money if the event occurs, usually because they are holding on to receivables, bonds, or other obligations of the underlying party
Breadth	Very narrow—derivative writers only follow very large companies and certain government bonds
Coverage	If the specified event occurs, the difference between the covered amount and the market value of the underlying obligation will be paid, whether the derivative buyer has actually suffered a loss related to the event or not
Residual Exposure	The derivative buyer may suffer a loss and yet not be able to collect on the derivative because the event did not occur
Variations	<ul style="list-style-type: none"> Credit default swaps A/R puts

Foreign Exchange Contracts

Applicability	Sale (or potential sale) denominated in foreign currency
Breadth	May be transactional or part of an overall FX hedging strategy
Coverage	100% of exchange rate decreases with potential to profit from upward movement in the value of the foreign currency
Residual Exposure	<ul style="list-style-type: none"> Forwards & futures: In the event the sale is canceled, the exporter is still liable to deliver the agreed amount of foreign currency to the bank and may have to purchase the currency at a higher rate than it is being sold for Options: The exporter must always pay the amount required to purchase the option, even if the option is never exercised (i.e. if the goods are never shipped or if the value of the foreign currency goes up)
Variations	<ul style="list-style-type: none"> Forwards Futures Options

Credit Policy Matrix

Customer Risk	4 Very High	Unconfirmed LC • Cash in advance • Demand guarantee or standby LC	Unconfirmed or confirmed LC • Cash in advance • Local guarantee or confirmed standby LC • Demand guarantee or security LC	Confirmed LC • Cash in advance • Local guarantee or confirmed standby LC	Cash in advance • Confirmed LC
	3 High	Unconfirmed LC • Demand guarantee or standby LC • Factoring • Credit insurance (commercial risks) • Confirmed Authority to Pay	Unconfirmed or confirmed LC • Local guarantee or confirmed standby LC • Demand guarantee or security LC • Credit insurance (political & economic risks or comprehensive) • Confirmed Authority to Pay	Confirmed LC • Credit insurance (comprehensive) • Local guarantee or confirmed standby LC • Confirmed Authority to Pay	Confirmed LC • Credit insurance (comprehensive) • Cash in advance • Local guarantee or confirmed standby LC • Confirmed Authority to Pay
	2 Moderate	Factoring • D/P collections • D/A collections w/ forfeiting • Credit insurance (commercial risks) • Unconfirmed LC • Authority to Pay	D/P collections w/ forfeiting • Credit insurance (political & economic risks or comprehensive) • Unconfirmed or confirmed LC • Authority to Pay	Confirmed LC • D/A collections w/ forfeiting • Credit insurance (comprehensive) • D/P collections • Confirmed Authority to Pay	Confirmed LC • D/A collections w/ forfeiting • Credit insurance (comprehensive) • Cash in advance • Confirmed Authority to Pay
	1 Low	Open account • D/A collections • Factoring	Open account • D/P collections • D/A collections w/ forfeiting	Credit insurance (political & economic risks) • D/P collections • D/A collections w/ forfeiting • Countertrade	Credit insurance (political & economic risks) • Cash in advance • D/A collections w/ forfeiting • Countertrade
		Country Risk 1 Low 2 Moderate 3 High 4 Very High			

Denotes "High to Very High Risk" areas which may require significant risk neutralization
 NB: This document is for illustrative purposes only, and is not intended to displace the recommendations of Atradius regarding risk associated with international trade

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