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MAEC SBLCs in Context of Wells Fargo Guide

A Guide to Standby Letters of Credit vis-à-vis MAEC Project Funding.

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A GUIDE TO STANDBY LETTERS OF CREDIT VIS-À-VIS MAEC PROJECT FUNDING (2023).

In this extremely comprehensive guide to standby letters of credit (SBLC), we cover:

- What a standby letter of credit is.
- Risks and considerations to be aware of when using standby letters of credit. An overview of the different types of SBLC available.
- The differences between SBLCs and other similar instruments.

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MAEC COMMENTARY IS ADDED IN *BLUE FONT* TO GIVE CONTEXT TO HOW TREAT SBLCs THAT ARE USED TO KICK START PROJECT FINANCING.

Preamble

It has been argued that a form of documentary credit (also known as a letter of credit) has been in existence for thousands of years and dated back to Babylonian times in Mesopotamia (present-day Iraq)[ref] Rufus Trimble (The Law Merchant and the Letter of Credit, 1947) [/ref], when Babylon was a key centre on the Silk Road, the ancient trade route between the Mediterranean Sea and China.

A documentary credit can be defined as a written undertaking given by a bank (issuing bank) to the seller (beneficiary) on the instruction of the buyer (applicant) to pay at sight or at a determinable future date up to a stated amount of money. Such undertakings are conditional upon the beneficiary's compliance and are satisfied by a 'complying presentation' of documents. [ref] https://www.tradefinance.training/blog/articles/the- principle-of-autonomy/[/ref].

What type of industry contracts can an SBLC support?
SBLC undertakings can support "any" type of underlying contract, agreement, or obligation between an issuer's client or applicant and the applicant's client/counterparty - the beneficiary - provided the issuer is willing to support the nature of the underlying contract.

How does a SBLC benefit an issuer's clients?
The SBLC obligations supplement and are in addition to any other underlying contract/agreement between the issuer's client, the applicant, and the beneficiary. When the issuer bears a strong credit rating, a SBLC is also a credit enhancement tool.

What drawing requirements can add protections to an issuer or an applicant?
An applicant could require that a beneficiary must inform them of an intended drawing XX days in advance. The SBLC could require the beneficiary to make this certification and provide some form of documentary evidence, e.g., a copy of an email to ensure it was completed. This notification could allow an applicant to resolve the contract issue negating the need for a drawing.
Conversely, a trusted neutral third party or an applicant could require that a beneficiary's drawing statement be countersigned or attested by a third- party neutral to the applicant and beneficiary; or the applicant or their representative to help ensure that the drawing is warranted.

Can a SBLC be discounted or paid before its expiry date?
Most SBLCs have a sight tenor and as will be noted throughout this guide, in most cases a SBLC will never receive a presentation or drawing so there is no need to make a payment.
Discounting or prepaying a sight SBLC can be associated with fraud and as such, caution is needed when considering such a possibility.

Can an issuer issue a SBLC to support its own needs?
Yes, and as cases in UCP 600, ISP98 (and URDG 758) and when allowed by applicable law, in certain cases the issuer may issue a SBLC on its own behalf. In these cases, the issuer becomes the applicant and the issuer. This is commonly known as a two party SBLC.

What is a Standby Letter of Credit?

The global rule sets which govern standby letters of credit (SBLC) - both the Uniform Customs and Practices current revision 600 (UCP 600) and International Standby Practices current revision (ISP98) - define a SBLC as an "undertaking". An undertaking provides the named beneficiary with an "independent" assurance of payment from the undertaking's issuer (issuers are most often banks).

MAEC does not require a bank to undertake the payment of a loan. This loan repayment is a separate contract between borrower and MAEC.

The obligations of the SBLC or "undertaking" **supplement, and are in addition to, any other underlying contract/agreement** between the issuer's client (In SBLC terms, the client is most often referred to as the applicant) and the client's contract counterparty (In SBLC terms, the counterparty is known as the beneficiary).

The underlying contract is the loan funds given to a borrower by the lender. MAEC indemnifies the issuer through this supplement of terms and conditions of the SBLC in order to remove all risk and liability from the issuer/ bank.

When the issuer bears a stronger credit rating, **a SBLC is also a credit enhancement tool**. An applicant's ability to obtain a SBLC from an issuer reflects good faith as the SBLC supports an applicant's credit quality.

MAEC's target market for our loans is mostly the developing world, we therefore offer the opportunity to un-rated or poorly rated banks to access our lines of credit by issuing SBLCs which we credit enhance to high grade instruments that attract project funding. We disburse loans from 10 days to 30 days maximum for the first tranche as described in the term sheet we give you.

Additionally, we do not require the issuer to block any bank's cash or borrowers' cash to simply write the SBLC. The SBLC therefore is no-cash blocked.

In most cases and depending on the nature of the type of SBLC being issued, a beneficiary is typically only authorized to claim payment from an issuer in situations where the applicant is unable to successfully conclude the underlying contract.

This claim will never happen in MAEC loan scenarios. The SBLC validity period expire long before the applicant is required to perform repayments. This undertaking will be captured in the supplement indemnity signed by issuer, applicant and MAEC. This instrument will never be called upon.

*(**Please Note: The Supplement or Indemnity Agreement, does not remove the need for the ICC Standard Verbiage Of The SBLC to be worded differently. Therefore, creating phrases such as "Not Cash Backed And This Instrument Is Not Callable", will Render the SBLC unacceptable and we will reject it for Credit Enhancement Or Loan Funding).***

While a SBLC may include a reference to an underlying contract between an applicant and a beneficiary; ***(the loan in the case of MAEC)*** the issuer's obligations remain fully independent of any underlying contract to which it may be supporting.

MAEC cross references the SBLC to the loan agreement. The SBLC becomes subordinated to the underlying agreement and the terms of the agreement and supplement indemnity will take precedence. The issuer's obligations under the SBLC are therefore never required to be invoked.

Most SBLCs never receive a drawing, (also known as: claim or demand for payment) and simply expire in accordance with a SBLC's stated expiry date/period. This is because most applicants will successfully complete their contractual obligations and as such, the beneficiary will have no reason to demand payment under a SBLC. Upon a standby letter of credit's expiry, it will simply cease to exist and be unavailable for drawing and closed by the issuer.

A bank's obligations expire at the end of the SBLC tenure. Such obligations are indemnified in a supplementary agreement. If the borrower still needs the SBLC, this new SBLC is strictly an MAEC/Borrower responsibility. If the original issuer wishes to issue another SBLC, they can simply do so on the same terms and indemnities for another year. This isn't compulsory and as stated, the loan agreement and obligations are between lender and borrower and never the bank's responsibility.

Unless otherwise stated in a SBLC, standby letters of credit are deemed: "irrevocable" meaning they cannot be changed or cancelled prior to its stated expiry date without the agreement of all parties.

The exception to the above, would be if the SBLC issuance fees have not been paid to the issuer. By the rules, a bank can flag the SBLC and cancel it for failed contract reasons.

Benefits of using SBLCs

- A bank's SBLC substitutes and may enhance or replace the creditworthiness of the applicant for that of the issuer of the standby letter of credit.

- ***Creating lines of credit or finding alternative finance is the responsibility of any bank in a community, public or business society. MAEC exists to provide such an alternative through credit enhancement of poorly rated banks which would hardly get 5% LTV if they wrote such SBLCs on an ordinary day. MAEC gives 100% money to match the SBLC face value, minus our 6% business fees that we utilise for insurance through Lloyds and Redbridge and similar AAA insurers.***

- SBLC undertakings support/collateralize "any" type of underlying contract, agreement, or obligation between an issuer's client/applicant and the applicant's client/counterparty, the beneficiary.

- ***A bank has the prerogative to request physical or intrinsic assets that can be banked into treasury as the underlying reason to issue a cash backed SBLC. Such assets can be accepted, and a Safe Keeping Receipt issued to a client of the bank. MAEC does not require such collaterization of securities and neither do we investigate the basis of an issuer providing an SBLC. Such use of client assets is purely the bank's own choice as a measure of encouraging stewardship, but we do not expect borrowers in our market to afford the 100m Euros threshold in assets or creditworthiness. We therefore interpret cash or assets as follows:***

A financial instrument is always backed by something and in MAEC instances, we back it with our cash lines of credit to make it effective. It's not done by the borrower's bank **(*hence the meaning of non-cash *)** but the bank guarantee or SBLC is all that's required to unlock **blocking** a loan for that bank or any private client of the bank.

MAEC regards all projects as **having cash potential when executed**. That potential is the cash that is used to write an instrument. All worthwhile projects are regarded as **Near Cash** in financial circles and therefore receive bets through being funded. MAEC ensures that all projects are funded and with the bank's help we can turn around multiple economies using our inexhaustible cash disbursed from the top 9 Banks that include Barclays, Wells Fargo, Raiffeisen, HSBC, Deutsche Bank, Citi Bank, Bank of America and others.

We view assets (whether the asset is gold, cattle, agricultural production, **a business idea,** IP etc), these asset classes are cash in situ. Therefore, in essence, this SBLC does have that backing and that cash potential is tied into that asset that will perform within the horizon of our funding and grace period with **no liability to the issuer**. We therefore need to align on the **meaning of cash backed** and I would welcome any questions from the issuer or bank to help clarify why that phrase must be included on a standard SBLC or BG.

Cash in a bank includes liquid, illiquid, MTNs, LTNs, Assets that are real or intrinsic, SKRs, Land, in-ground minerals, above ground plantations, JORC reports, 43 101 mining reports, **business plans, private project plans, new ideas** and more. All these asset classes represent cash.

Coincidentally, as MAEC, we have the prerogative to allow any bank to offer *non-cash blocked* instruments on the back of these assets mentioned above. We use that prerogative to offer a gift to **the world's deserving projects** through accessible loans on easy terms without needing to block cash.

We **solved the chicken and egg situation** that always results in projects failing to be funded by risk-averse institutions.

We are ready, willing, and able to receive 1000s of instruments for 1000s of business plans and we will monetize all of them with loans instantly. This is the privilege we are offering banks, project owners and governments. We are accepting of such **asset basis created SBLCs** *without blocking any cash* .

The bank can receive these plans into the treasury in very much the same way that you may receive property title deeds and create a loan. As an example, a landowner with tree saplings standing at 30cm height, can leverage that acreage into a loan by banking that future production with their bank. That bank has the power to issue an SBLC against that **deposit of that future production**. And MAEC WILL PROVIDE THE LOAN AGAINST THAT SBLC.

MAEC supplies you with the money to support these businesses purely based on your SBLCs without blocking any cash, The bank is accessing our credit line and therefore effectively receiving money based on a ***contingent instrument*** which is backed by the underlying future performance of the proposed plan.

MAEC further removes the risk from the business by offering JV Partnerships where MAEC contractually agrees to take over the repayments of the loan after the 5-year grace period.

It must be understood that MAEC has the full ability to accept such a nature of asset classes rather than withholding money to deserving businesses by demanding to see cash equivalent. Such a day will never arrive for most countries where security or cash equivalents will be found to miraculously support business loans.

MAEC is receiving instruments from any country, based on our trust in the potential of projects that may never be supported by any lender in this lifetime, except lenders like MAEC and a few others around the world.

How are SBLCs commonly used?

Banks following BASEL or Dodd-Frank requirements will classify their issued or confirmed SBLCs as supporting either a “financial” or a “performance” obligation. These two classifications are defined as:

- “Financial” SBLCs are issued to back financial obligation or some form of indebtedness, such as loan repayment, and irrevocably obligate the Issuer in the event the Applicant fails to honour their payment obligation.

- ***Such an obligation is not required nor necessary for SBLCs issued to MAEC as beneficiary. This is due to the indemnity and nature of the transaction where the borrower has a direct lender/borrower with MAEC, where the bank has not blocked any funds to provide the SBLC and where the actual money was disbursed by MAEC and not the bank. The bank or issuer is therefore not liable under any circumstance. The SBLC issued by the bank was merely used for project finance creation through enhancement of their instrument.***

- “Performance” SBLCs are issued to back a company’s performance related duties. These are contractual, non-financial obligations such as: completing the building of a road or wind farm, etc. and irrevocably obligating the Issuer in the event the Applicant fails to perform as agreed.

Who are the parties involved in a Standby Letter of Credit?

Advising bank –The beneficiary will typically request that a SBLC is sent to a bank in their country or one with which the beneficiary has a relationship. If the beneficiary does not request a specific bank, the issuing bank will either: send the SBLC directly to the beneficiary or choose to send the SBLC to the beneficiary through a bank with which the issuer has a relationship.

- ***MAEC always uses a forwarding bank to receive instruments mainly because Africa, Asia and Latin American banks do not have a direct corresponding relationship with major platform banks.***

- ***We call these forwarding accounts, Post Offices in the jargon of the industry.***

- ***These accounts are custodian accounts and do not necessarily bear the name MAEC but in all cases, MAEC is the beneficiary of the SBLC.***

If the issuer sends the standby letter of credit through another bank, the bank that receives the SBLC and sends it to the beneficiary will be known as the advising bank. The advising bank is not a party to a SBLC and has no authority to approve or disapprove an amendments term or obtain drawing rights.

Applicant - (also known as an instructing party or requesting party) – The SBLC applicant enters a contract with a counterparty. When the contract requires a standby letter of credit to support it, the applicant will make a request, typically to its bank, to issue a SBLC in favour of its contract's counterparty. In SBLC terms, the counterparty becomes the beneficiary.

In the underlying contract, the applicant and beneficiary terms associated with SBLCs may have very different names: e.g., lender and borrower; buyer or seller; principal and drawer; etc.

It must be noted that **a SBLC's stated applicant may or may not be the issuer's client**. An applicant may receive silent or openly known support to have a standby letter or credit issued. For example, Company AZA may have insufficient credit or collateral to induce an issuer/bank to issue its SBLC. In such a case, it can enlist its parent, a factoring company, etc. to lend support to help Company AZA be named as the applicant in the SBLC.

The parent or other company providing the support may or may not be stated in the SBLC; however, it is considered the client/applicant of the issuer versus the applicant stated in a SBLC. An applicant is not deemed a party to an SBLC. They are the party which requests an issuer to issue its independent SBLC in favour of a beneficiary.

Beneficiary – is the undertaking party who receives all the benefits of a SBLC. They are the only party who may make a drawing; receive payment against the SBLC and/or accept or reject amendments, etc. In the underlying contract, the applicant and beneficiary terms associated with SBLCs may have very different names: e.g., lender and borrower; buyer or seller; principal and drawer; etc.

Confirmer or Confirming Bank –confirmation may only be added at the request of an issuer. When added, a confirmer or confirming bank becomes like a second issuing bank because, like the issuer, the confirmer undertakes to honour (or negotiate) or pay a complying document presentation. The confirmer's undertaking is in addition to the issuers undertaking, but it may be limited in several manners, such as: a) amount; b) expiry; and c) allowable languages documents may be presented in, etc.

- ***MAEC receives instruments <u>without confirmation.</u>***
- ***An issuer does not need to have an instrument confirmed when forwarding it to our bank coordinates.***

Issuer or Issuing Bank or Opening Bank – is the party that issues a separate, irrevocable, independent SBLC on behalf of its applicant client. Because it is independent, a SBLC is separate and distinct from any underlying contract on which it may have been based. Because it is irrevocable, a SBLC cannot be amended until all parties agree to the amendment.

- ***Such occasion, to amend terms will not occur in the negotiated terms of the supplementary agreement.***
- ***The issuer will have occasion to add as much clauses as needed to satisfy de-risking requirements of the bank/issuer.***

Nominated Bank is the bank/party authorized by the issuer to undertake honour, negotiate, or otherwise make a payment in the event it receives a complying document presentation/demand. A confirmer is most often a nominated bank.

A nominated bank which has not confirmed or otherwise committed to pay in some form has no obligation to do so. Unless a confirmer is involved in a SBLC, it rare to see a nominated party as the majority of SBLCs expire and are only available for payment with the issuer.

All SBLCs issued to MAEC as the beneficiary do not need to be confirmed and are issued purely as operative instruments.

It is also important to know that the issuer banks may not necessarily need to route their instruments via a traditional correspondent bank and may be asked to route an SBLC via a prescribed receiving bank or banks.

Risks and considerations to be aware of when using SBLCs.

Applicant considerations:

There is a cost associated with SBLC transactions.
An applicant is not a party to an SBLC. The applicant is a party to an underlying contract while the issuer of the standby letter of credit is not.

- ***The issuer/ bank is never a part of the underlying loan contract and is not mentioned anywhere on the MAEC loan agreement.***
- ***The loan itself has a grace period of at least 3 to 5 years, thereby making the first year of the SBLC's validity impossible to breach as there as no requirement to perform by the borrower.***
- ***There is no implied or real connection of the bank/issuer to the underlying loan agreement, and none should be assumed under any circumstances nor be invented to hamper the creation of loan finance by MAEC to the borrower.***
- ***The bank is not required to block any funds nor request any funds from the lessee of the SBLC.***
- ***The MAEC loan funds are available within 10 days of issuance of the SBLC, funds that are used to pay the bank fees for the SBLC service. Banks can expect to benefit from MAEC project financing using credit enhanced SBLCs, without risking their bank or depositors' funds.***

Once a SBLC is issued, all parties must agree to any amendment or cancellation request unless the SBLC has expired.

- ***This agreement to cancel an SBLC is an extra assurance to the issuer in the early days of the SBLC should MAEC fail to honour the creation of loan funds within the 30 days maximum allowed for the first disbursement.***
- ***This cancellation agreement has never had to be exercised as MAEC will perform on its obligations to provide the loan funds which are used to pay the fees and meet obligations to the bank/issuer within the stipulated time..***
- ***Any further cancellation scenarios are not known nor necessary and are always adequately mitigated by the indemnity agreement which is created jointly with the bank/issuer.***

Beneficiary considerations:

A beneficiary must determine its credit rating of the issuer. Where an issuer's credit rating, size or country risks are unacceptable to the beneficiary, a beneficiary may require an acceptable confirming bank.

- ***MAEC is always the beneficiary of instruments under this discussion.***
- ***MAEC will accept and monetise SBLCs/BGs/SGs at full face value despite a bank's credit rating or perceived country risks.***
- ***Almost all African, Asian, and Latin American bank instruments are generally not accepted for credit or monetisation by lenders and traders. When they are accepted by rare monetizers, they barely attract 5 or 10% LTV at best. MAEC always gives 100% loan at face value of SBLC/ BG/ SG.***
- ***MAEC is one of the few exceptions accepting such instruments and enhancing them into AA grade and beyond via insurance wraps purchased from Lloyds of London and Redbridge.***
- ***A bank or issuer is never expected to comply with a presentation/ claim that does not comply with a SBLC's stated terms/conditions, they are not obligated to accept any claims nor expect to be litigated as they are covered by the indemnity.***
- ***The SBLC should be made subject to its preferred international rules such as ISP98 versus UCP600 as the rules align everyone involved with a SBLC.***

Issuer considerations:

As the issuer is supporting its applicant, it may feel the need to consider the applicant's credit rating.
This exercise is not necessary for the following reasons:

- ***All loan and business feasibility assessments are done by MAEC who are the beneficiary.***
- ***All the loan money is supplied by MAEC the lender/beneficiary.***
- ***The issuer or bank is not required to block any money and therefore risks no depositor or treasury funds.***
- ***The indemnity and extreme event of a cancellation is a last resort failsafe for the bank if any conditions are not met by MAEC.***

Reputational and/or compliance risks such as money laundering, collusion between an applicant and a beneficiary, supporting an unpopular contract/agreement, etc. should also be considered.

- ***MAEC supplies its Anti-Money Laundering declaration for the bank's filing.***
- ***We also declare our source of funds from the world's top 10 banks rising to 25 top banks in certain jurisdictions.***
- ***We use a strict bank to bank due diligence process and funds are transferred to loan beneficiaries via SWIFT MT103***.

Types of SBLC

Here is an overview of the most common types of SBLC.

Commercial

Supports an applicant's payment obligations to pay for goods or services on a one-off or ongoing basis in the event of non-payment by other methods. ***MAEC DOES NOT USE OR NEED THIS TYPE.***

Direct-pay

Direct Pay LCs are hybrid SBLCs issued to provide a credit enhancement to a bond offering. E.g. industrial revenue bond, also commonly referred to as variable rate demand bonds. These types of SBLC are most often issued in favour of the bond trustee. Unlike the majority of SBLCs, they are the primary payment mechanism for the interest and principal due on the underlying bond and will receive periodic drawings for payment. ***MAEC DOES NOT USE OR NEED THIS TYPE.***

Financial

A large majority of SBLCs will fall into this category. **These standby letters of credit will support any financial payment obligation such as loan repayments, etc.**

- ***While the definition of a financial guarantee is correct, it is also important to note that the ICC rules allow the use of supplementary agreements to describe the extent of involvement and use of the SBLC.***
- ***MAEC loan grace period outlives the validity period of the grace period.***
- ***The SBLC usage to create a credit enhanced project fund, is purely contingent to conditions, non-cash blocking and indemnified securely against any such obligations ever becoming callable.***

Insurance

These SBLCs address the **insurance or reinsurance obligations** of the applicant and are used by insurance companies to distribute insurance risks among themselves. **Rather than cash collateralizing** other insurers or beneficiaries for use of their internal lines of credit, these SBLC's are used as collateral.

- ***MAEC caters for the insurance and reinsurance of all loans and SBLCs during credit enhancement wrapping.***
- ***The first-grade insurance and reinsurance effectively create the collateral backing that makes these loans possible.***
- ***Banks and issuers are accessing MAEC's lines of credit by effectively authoring SBLCs and letting MAEC handle the banking aspects of ensuring thousands of projects get funded each month while banks collect fees and/or equity as they desire.***

What is the difference between an SBLC and a Commercial Letter of Credit?

- ***It is prudent to note that most developing world banks have never used SBLCs for project finance or credit enhancement. Most banks in this region are accustomed to LCs- Letters of Credit.***
- ***The lack of practice in using SBLCs to create funding can lead to confusion and apprehension of the apparent ease of securing hundreds of millions to billions of euros for government and private projects.***
- ***Its therefore important to examine these key differences and close the information gap and liberating developing African banks towards hypothecating assets and ideas in their own economies and supplying them with money acquired from the use of easily managed SBLCs which every bank is empowered to issue, and well within its rights to do so without blocking cash or acquiring direct debt to the issuer or government.***

Costs – Costs between SBLCs and Commercial LCs usually differ.

At a high level both types of LC typically require an issuer to consider factors such as:

Applicant/client size – ***This is not necessary for the bank to do as MAEC selects its loan applicants internally before offering them a loan.***

Collateral and required line of credit size – ***This is also handled by MAEC external to the bank or issuer.***

The issuer's internal LC processing costs – ***This is settled within the first 10 days of MAEC receiving the SBLC because most of our target clientele cannot afford upfront bank costs of SBLC fees. MAEC therefore settles bank fees from the loan funds within 10 days of receiving the SBLC.***

Where a SBLC generally covers longer term and ongoing contracts, the issuance fee is needed for the duration of the SBLC.
Commercial LCs are typically issued to support a single need e.g. to cover a payment for: a) a shipment of goods; or b) services completed. They typically expire earlier than a SBLC.
For applicants and beneficiaries which routinely transact, a longer term SBLC may be the more economical LC undertaking, instead of issuing multiple commercial LCs. The commercial LCs will be assessed multiple issuance and examination fees.

Duration - Commercial LCs are typically short term in nature and their expiry date is generally 6 months or less. SBLCs most often cover longer term contracts, and their duration may be years in length on an overall basis.

Tenors – Any LC undertaking must define the period when a complying document presentation is due for payment and this period is known as the LC's tenor.

Purpose – Commercial LCs facilitate trade and are issued with the intention that a document presentation will be delivered to a bank for payment for a shipment of goods or payment for services. **They are the primary payment vehicle** for the beneficiary.

On the other hand, **SBLCs cover any type of contract or agreement** between two parties. **Provided the issuer is willing to support its applicant, the type of contract a SBLC can support is boundless.**

The use of an SBLC is dynamic and invaluable to project financing. As stated, <u>a bank's support of an applicant is purely based on will and the trust</u> in the structured protection of the bank.
All developing world banks and central banks can unlock MAEC funding through the simple act of willing to issue SBLCs for the project owners within their economies.

When an applicant does not meet its contracted duty(ies), the beneficiary will make a claim against the applicant for payment under the underlying contract. When the applicant fails to honour the request for payment, the beneficiary will make a presentation for payment against the SBLC making it a secondary payment vehicle, or payment of last resort for a beneficiary.

This event will never come to transpire due to all the reasons already discussed in blue font above.

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