FEBRUARY 2013

INTERNATIONAL COMMERCE

Strategic, regulatory and operational insight from Holman Fenwick Willan

TRADE-OFF: THE DEARTH OF FINANCING

INSURANCE CAPTIVES: A CHANGING ROLE

P&I INSURANCE: MUTUAL BENEFITS

UNFAIR ADVANTAGE?

HONG KONG'S NEW COMPETITION LEGISLATION

holman fenwick willan hfw

WELCOME

As high street insolvencies mount in the wake of the financial crisis, the use of liens is likely to increase. A landmark judgment offers some clarity, but care and advice is still needed, we explain on page 18.

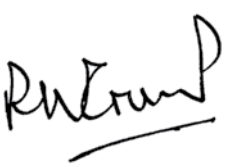
Wary banks are retreating from trade finance. Yet, crisis often conceals opportunity – on page 10 we look at who could take up the slack.

In protection and indemnity (P&I) insurance, too, operators are looking to alternative models, as we find on page 12. Mutuals, however, are not a new concept, but offer advantages increasingly relevant in today's shipping industry.

Insurance captives are also receiving more attention, as we report on page 6. Organisations are thinking again about how best to use captives to increase efficiency and avoid regulatory headaches.

Indeed, regulatory issues are coming to the fore in many parts of the world, probably as a consequence of the ongoing economic crisis. We look at Hong Kong's proposed competition legislation on page 16. Criticised as not tailored to the territory, the rules are still to be implemented, offering valuable time to ensure compliance.

We hope that *International Commerce* offers useful insight in dealing with these emerging issues.



RICHARD CRUMP
SENIOR PARTNER
HOLMAN FENWICK WILLAN

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If you have any questions about the issues raised in this publication, please contact Tania Phayre, Holman Fenwick Willan, on +44 (0)20 7264 8546

Produced by Grist,
21 Noel Street, Soho, London W1F 8GP
Publishing director: Mark Wellings
Editor: Tania Phayre
Deputy editor: Sam Campbell
Art director: Andrew Beswick
Commercial director: Andrew Rogerson
T: +44 (0)20 7434 1447
Website: www.gristonline.com

Holman Fenwick Willan LLP
Friary Court, 65 Crutched Friars, London EC3N 2AE.
T: +44 (0)20 7264 8000 F: +44 (0)20 7264 8888

INBRIEF

Emerging legal and commercial issues for international business

Eurozone collapse

The challenges facing the eurozone are legal as well as economic and political. The consequences for assets held in a country seeking to exit the euro are uncertain.

During Argentina's 1999–2002 financial crisis, the currencies of international contracts were converted to pesos, as were US dollar domestic bank balances. A torrent of litigation followed, with the Argentine government condemned to pay many hundreds of millions of dollars in compensation. Many claims are still under way and Argentina has never paid a cent of any of the awards.

Under international investment law, sovereigns retain the prerogative to legislate, but this is tempered by the obligation not to undermine an investor's legitimate expectations. Changing the currency in which a contract is denominated is an archetypal example of this.

Damages are typically quantified by investment tribunals using the discount cash flow method: unprofitable investments are not compensated and an investor's recovery is not the size of his lost investment; it is the size of his anticipated returns.

The public international law defence of 'necessity' – in circumstances of dire national danger, a state may be justified in departing from its usual international obligations for reasons of exceptional exigency – would likely surround an exit from the euro.

GETTY IMAGES/AFP

Necessity may become a defence for countries exiting the eurozone

Energy regulation intensifies

Regulators are changing the landscape for energy traders across the world.

In Europe, the EU's proposed Market Abuse Regulation (MAR) will update the 2003 Market Abuse Directive (MAD), and is part of a package (often referred to as MAD II) including a new directive imposing criminal sanctions for market abuse. In power and gas (including LNG), implementation of the Regulation on Energy Market Integrity and Transparency (REMIT) is well advanced.

Three other EU measures will seriously impact on energy and commodities markets: the European Market Infrastructure Regulation (EMIR), MiFID II (the package of a new directive and regulation to update the 2004 Markets in Financial Instruments Directive (MiFID)), and CRDIV (another directive and regulation package, this time to update 2006 banking directives and implement Basel III). EMIR requires reporting of derivatives, clearing of designated OTC derivatives and collateralisation of all uncleared OTC derivatives. It also regulates central counterparties (CCPs) and trade repositories. MiFID II will require more energy firms to be licensed and many derivatives to be traded on organised venues, and will introduce new transparency and position requirements for commodities.

Regulation and supervision is getting hotter elsewhere, too: regulations similar to EMIR are being introduced around the world, including Australia, Hong Kong, Singapore, Switzerland and the US. Many reforms flow from G20 agreements, so are in principle global even if in practice the details vary significantly from one state to another.

Disclosure of government payments

Legislation is tightening for natural resource extraction in both the USA and the EU.

In a bid to combat corruption and make governments of resource-rich nations more accountable, the US Securities and Exchange Commission (SEC) is forcing oil and mining groups with US listings to disclose details of their payments of $100,000 or more to foreign governments. The rules, adopted in August 2012, will also affect manufacturers such as Apple, which will have to verify whether they use so-called 'conflict minerals'.

A European parliamentary committee voted in September to require EU oil, gas, mining and timber companies to publish their payments to foreign governments. The EU rules would specify a minimum payment threshold equivalent in value to the SEC minimum of $100,000. "These measures are intended to tackle corruption from the 'demand' side. Companies will need to update their existing anti-corruption policies to ensure they understand and comply with the disclosure requirements," says Daniel Martin, an HFW Associate.

Tax evaders grounded in Brazil

In June 2012, a task force of Brazilian tax and federal police, in collaboration with the Brazilian Civil Aviation Agency (ANAC), seized 21 business jets for alleged tax evasion and since then they have been targeting a number of other aircraft.

The aircraft were apparently being used regularly in Brazil, but were registered overseas. Investigations revealed that usage patterns consistent with Brazilian ownership and use were established through monitoring of flights and passenger lists.

Banks financing business jets have been carefully monitoring the situation, working with owners and operators to avoid becoming embroiled in any future clampdown by the Brazilian authorities. They are also focusing on structures that would see any aircraft flown for a substantial number of hours within Brazil registered in that country and properly imported, with customs clearance documentation confirming that the current rate of tax has been paid. This will be an expensive outlay for owners.

In recent months Brazil has been inching closer to ratification of the Cape Town Convention on International Interests in Mobile Equipment and the attendant Protocol to the Convention on Matters Specific to Aircraft Equipment. The ratification is widely seen as a step forward for Brazil in raising its profile in the aviation industry and sending a message that the country is adhering to international standards for aircraft finance. But it remains to be seen what owners will do when it comes to paying the taxes currently required to import business jets.

ISTOCKIMAGES

Restrictions and poor harvests affect grain exports

Uncertainty over the actual terms of the Ukrainian wheat export ban and the dwindling of Russia's exports after a drought, combined with strong demand from Egypt – the world's biggest importer – and a poor 2012 US corn crop, is creating concerns over grain supplies.

Legal uncertainty is inevitable. Buyers with Russian-origin supply contracts will be worried about reliability of supply and, conversely, higher prices may tempt sellers to find ways to escape existing contracts in search of new ones on better terms.

In the event of an outright ban, sellers can generally rely on a prohibition clause in their contract. The standard GAFTA prohibition clause allows a seller to cancel a contract as a result of prohibition of export or an executive or legislative act.

Force majeure clauses and the common law doctrine of frustration should be considered. However, where rising commodity prices have simply made it more difficult or expensive for one party to perform the contract, this will not be regarded as a force majeure or frustrating event, unless such conditions are expressly referred to in a force majeure clause.

EVENTS DIARY

Trade Finance Conference
Geneva, 28 February 2013
HFW is co-sponsoring this trade and shipping forum. A number of HFW Partners will present at the conference, which will focus on the key issues affecting global trade.

HFW Commodities Breakfast Briefing
London, 12 March 2013
HFW is hosting the second in its spring series of Breakfast Briefings. HFW Partners and Associates will present on a range of topics.

Global Grain Asia
Singapore, 12–14 March 2013
HFW is again sponsoring this annual event, during which HFW Partner Stephen Thompson will be presenting.

CHC Safety and Quality Summit
Vancouver, 18–20 March 2013
HFW is sponsoring this annual conference which focuses on improving aviation safety worldwide. HFW Partners Nick Hughes and Peter Coles will attend.

Mining Claims Seminar
London, 19 March 2013
HFW is hosting a seminar focusing on insurance and reinsurance issues in the mining sector. HFW Partner Paul Wordley will chair the event and Harry Riley, Editor of *Riley on Business Interruption*, will give a keynote presentation.

Sea Asia 2013
Singapore, 9–11 April 2013
HFW is sponsoring the offshore session. HFW Partner Paul Aston is part of the panel, which will focus on the development of the the Asia Pacific offshore sector.

International Arbitration Seminar Series
Australia, Hong Kong & London, March & April 2013
HFW is hosting a series of International Arbitration Seminars focusing on key considerations for choosing an arbitration jurisdiction. HFW Partners Julian Sher, Chris Lockwood, Nick Longley, Peter Murphy and Damian Honey will be presenting.

For further details, please contact
Sarah Vertanness, Events Manager:
Telephone: +44 (0)20 7264 8324
Email: events@hfw.com

UNLOCKING CAPTIVE POTENTIAL

Captive insurers are a far from new concept, but some companies have taken a fresh look at how they use them: to gain financial and tax efficiencies, release capital, and drive more focused risk and insurance management.

WORDS STUART COLLINS

Traditionally, captives have been formed in response to periods of market hardening, when a shortage of capacity saw cover limited or withdrawn, and the cost of commercial insurance rocket.

A buyers' market for commercial insurance is, thus, generally not conducive to growth in the captive market. However, as companies have grown in size, complexity and geographical spread, captives have proven to be an important risk management and risk transfer tool. The past 30 years have seen a trend towards captives.

Undoubtedly, captive use has matured, evolving steadily to reflect changing risk management practices, insurance regulation, the vagaries of the insurance market and international tax legislation.

Tax benefits are no longer the key reason for establishing a captive. The tax benefits associated with the offshore domiciles favoured by most companies have been eroded by controlled foreign corporation (CFC) legislation, although the high water of CFC restrictions is now receding. Yet, captives still offer tax benefits through the treatment afforded an insurer with regard to loss reserves for incurred but not reported claims.

Captives remain a prudent safeguard against violent shifts in insurance pricing, but most companies today view them in a wider context, as part of their overall risk

> *For many companies, captives are not on their urgent list of things to do, but they need to think smart about how they use their captives, and not just allow them to drift along.*
>
> **RICHARD SPILLER, HOLMAN FENWICK WILLAN**

management and controls, and to optimise their insurance purchasing whilst making cost savings.

"There are two big trends in the captive sector at the moment – increasing levels of self-insurance and captive rationalisation," says Paul Wordley, Global Head of HFW's insurance and reinsurance group. "As large organisations rely less on insurance they tend to retain more risk. We also see a number of companies looking to rationalise their captives to reduce costs and free up capital and management time where possible."

Changes in the business environment and regulatory landscape may require occasional changes in captive strategy, says Richard Spiller, Partner in the insurance transactions and regulation team at HFW. Right now, companies are looking for efficiencies and cost savings, and this has implications for captives. "Companies need to think smart about how they use their captives, and not just allow them to drift along," Spiller adds. "For many companies, captives are not on their urgent list of things to do, but they do need a regular spring clean to ensure that they are being used in the most effective way and that they meet the company's risk management and financial objectives."

Consolidation

Mergers and acquisitions, for example, have left many large corporates with more captives than they need. "Companies do not need five captives when only one or two will do," says Wordley. A number of large companies, including Shell and GlaxoSmithKline, have restructured their captives in recent years, consolidating, merging, migrating and closing captives.

The ease of winding-up a captive is dependent on the jurisdiction and the state of the captive's records, says Spiller. Some jurisdictions allow assets and liabilities to be transferred through court- or regulator-sanctioned mechanisms, while reinsurers are increasingly offering products targeted at captives. "There is now a market for buying captives and there are a number of products and techniques that can release capital." One insurer has even developed a virtual captive concept that provides a degree of risk transfer but without the administrative burden of owning a captive, he says.

"There is an increasing trend to move captives to domiciles which have tax treaties with the parent's home territory or where they are able to underwrite onshore without the need for fronting insurers," says Spiller. Captives are unable to underwrite risks in countries that insist insurance contracts be issued locally, requiring fronting insurers to provide local policies and administrative services for a fee. "The frictional costs of using fronting insurers are increasing, driven by higher regulatory costs. Fronting fees are increasing and insurers require greater security in the form of collateral for reinsurance risks ceded to the captive. Where long-tail risks are involved, the collateral costs can be substantial."

Regulatory pressures

The changing regulatory environment for insurers is also having an impact on captives, especially those domiciled within the EU, such as in Dublin, Gibraltar and Luxembourg.

Europe's proposed new capital and risk management regime for insurers, Solvency II, will, in principle, not differentiate between captives and commercial insurers, potentially increasing the cost of capital and administration for captive insurers. "Like insurance companies, captives

What is a captive?

Captives have been around in some form since the 1920s, and the principles of pooling risks can be traced back to maritime traders in the 1500s. But the development of the modern captive market is credited to Frederic M. Reiss, a US insurance broker. He coined the word 'captive' in the 1950s and took the concept to Bermuda, which from the 1960s became the leading offshore domicile for captives.

The concept was slow to take off, but accelerated in response to shortages of insurance cover and increased rates during the US liability crisis of the 1980s and 1990s, and again following the September 11, 2001 terrorist attack.

Ratings agency AM Best estimates that there are in excess of 5,000 captives worldwide today, compared with 1,000 in 1980.

Captives are typically formed to provide insurance to a parent company, although they can offer insurance to third parties such as contractors, suppliers and customers. Captives are also sometimes owned by multiple companies that have common risks, such as a group of energy companies or charities.

Traditionally captives have been located offshore – Bermuda, Cayman Islands, Barbados and Guernsey have historically been the most popular – but in recent years the trend has been towards onshore domiciles in the USA and Europe as jurisdictions pass specific captive legislation.

The vast majority of Fortune 500 companies own at least one captive, and are most prevalent in finance, healthcare, real estate, construction, energy and manufacturing.

> *Like insurance companies, captives are subject to Solvency II requirements and principles.*
> **PIERRE-ETIENNE KUEHN, HOLMAN FENWICK WILLAN**

are subject to Solvency II requirements and principles, such as the Solvency Capital Requirements (SCR) and the Minimum Capital Requirements (MC)," says Pierre-Etienne Kuehn, HFW insurance and reinsurance Consultant.

"A recent study underlined the fact that 28% of captives were not Solvency II compliant in terms of SCR. In addition to the financial criteria, Solvency II rules also apply to governance processes with an increase in the management costs of an onshore captive from 20% to 40%."

The yet-to-be-defined principle of proportionality gives some scope for regulatory discretion in Solvency II, but risk managers are increasingly seeking support to comply with these new rules.

Filling the gap

Nonetheless, efficiently run captives continue to offer many benefits, including access to insurance cover that may otherwise be hard to find, too restrictive or prohibitively expensive.

A competitive insurance market means cheaper insurance, but in recent years the industry has become more selective and appetite for some risks has waned. For example, insurers have recently shied away from offering professional liability insurance to large banks and are growing wary of business interruption (BI) exposures linked to supply chains, catastrophes and cyber risks.

Large companies are also finding insurers less relevant to their businesses, as loss of revenue or loss of service becomes more important than traditional property/casualty exposures for service sector companies.

Captives can be used to pick up some of these risks, either through risk sharing with open-minded insurers, or by writing the risks wholly in the captive.

Previously, pharmaceutical companies have stepped up the use of captives as insurers were unable to provide meaningful levels of product liability cover, while large energy companies have used captives to self-insure and provide high limits of property and casualty cover, as well as fund pollution liabilities.

More recently, banks and financial institutions have been able to transfer asset operational and trading risks from the balance sheet and into captives, where they receive advantageous accounting treatment.

Some companies used captives to provide trade credit insurance when insurers pulled cover in certain regions following the financial crisis. Other innovative uses of captives include employee benefits risks and life insurance, political risk, equipment warranties, environmental liabilities, and to manage gaps in cyber cover or contingent business interruption and supply chain exposures.

"By using a captive, an organisation can develop insurance products which are specifically tailored to the needs of their business and which simply might not be available in the market," says Richard Jowett, HFW insurance and reinsurance Partner. "They can approach complex risks and situations in a different way, perhaps using non-traditional techniques such as a parametric trigger that pays for loss of revenue based on the amount of a rainfall. These solutions are readily available, but will need to be carefully considered to make sure they comply with insurance regulations."

Technical issues

Corporate governance and areas of uncertainty, highlighted by large complex claims, have encouraged those with active captives to focus on key technical legal issues, says Paul Wordley, Global Head of HFW's insurance and reinsurance group.

Top of the list is the issue of the jurisdictions in which captives provide insurance and compliance with local regulations governing the provision of insurance. Failure to comply can lead to regulatory sanctions, contract invalidity and in some jurisdictions criminal sanctions.

There is commonly a resultant necessary requirement for local fronting – this not only entails a significant cost, but also creates issues with claims control, especially where the fronter insists on having such control, which can cause significant problems when dealing with claims locally.

Next on the list is whether the local and reinsurance contracts are back-to-back with the captive's core or master wording, and what mechanisms are used to deal with gaps or expansions in cover locally, for example difference in conditions (DIC) and difference in limits (DIL) clauses.

Finally, the core terms and conditions that regularly give rise to problems should be checked. Perhaps the most important is jurisdiction and proper law –inadequacy of the provisions can give rise to arbitrage opportunities.

A proactive review of all policy forms and key terms, conditions and exclusions, and making sure that these are consistent throughout all the captive and related market risk transfer documentation is now a must for all captive owners and operators.

> *Companies are looking to rationalise their captives to reduce costs and free up capital and management time.*

PAUL WORDLEY, HOLMAN FENWICK WILLAN

Case study – captives in mining

The past five years have seen an unprecedented level of large losses in the mining sector, in particular relating to flooding in Queensland Australia in 2008, 2010 and 2011. In 2011 alone, there were an estimated $3 billion of insured losses from some 60 catastrophe and operating claims, which included earthquakes, floods, explosions, fires and machinery failure.

Several claims since 2007 have ended in protracted disputes, prompting a reaction from both insurers and insureds.

High commodity prices have led to a ballooning of business interruption (BI) costs, which historically account for a significant proportion of mining property claims. As a result the insurance market has stepped back and the supply of insurance cover has become limited and more onerous clauses or exclusions are being applied, especially for certain perils and risks such as large BI exposures resulting from natural catastrophes.

"Large mining companies have had to reflect on their appetite for risk retention, which has resulted in the greater use of captives in some instances," says Richard Jowett, HFW insurance and reinsurance Partner.

Mining companies can use captives to provide BI insurance cover that insurers are no longer willing to provide, at least at adequate limits and at acceptable terms.

Contract certainty and claims handling have become important issues: by self-insuring through a captive, mining companies are able to reduce the potential for conflict and misunderstandings over cover. Captives can tailor insurance to better meet specific needs, for example, policies focused on the impact of weather, such as the many different ways flooding can effect a complex operation like mining.

Captives can also help miners gain more control of the claims process, which can reduce or eliminate the risk that an insurer or reinsurer – with just a small percentage of the risk – can drive the claim.

We are also seeing some companies using captives to encourage operating units to take greater responsibility for risk and to encourage ownership of risk issues, says Jowett.

"For example, a captive might provide a high level of cover, but it only kicks in at a high level. The individual business units have very high deductibles, so are effectively self-insuring for all the smaller claims," he says. "The captive is operating like an insurance company, but is very much part of the organisation's enterprise risk management. The high deductible cover the captive is offering becomes a driving force to encourage risk management rather than risk transfer."

Going global

As companies have gone global, captives have proven to be a useful tool for centralising risk management and underpinning an international insurance programme. As part of a global programme, captives can help provide consistency of cover – between local subsidiaries and the corporate centre. "There is also a trend toward companies introducing a mechanism that deals with core wordings versus those used by policies issued by fronting insurers," says Wordley.

Claims protocols can also be established within a captive to better suit the characteristics of the organisation, and to reduce the likelihood of disputes, says Wordley. "Policies need to reflect the desire to avoid conflict and embrace the spirit of cooperation. Escalated dispute resolution is key – by setting up a dispute resolution process for management and making clear what is and what is not insured, it is possible to avoid unnecessary disputes and confrontation."

Captives also have an important role in managing retentions by providing in-fill cover to parent organisations where the insurance market does not provide a solution. For example, if the market insurance contained a deductible of $5 million per claim subject to an aggregate deductible of $10 million, the captive could insure $4.5 million per claim up to an aggregate of $9 million. The captive could then purchase aggregate reinsurance protection in the market of $5 million excess of $4 million, thus limiting the group's aggregate annual retention to $5 million. As the surplus within the captive builds up, the captive can reduce its reliance on reinsurance and retain more of the risk itself.

The largest companies in sectors like energy, finance and now mining are buying insurance more selectively, limiting insurance purchase to compulsory classes and risks where insurers provide value-added services such as specialist claims-handling expertise. Since they are much larger than their insurers, the levels of catastrophe risk cover required by such companies are beyond the capacity of the insurance market to provide it. For example, the world's five largest companies each have a market capitalisation greater than the combined US property/casualty insurance industry.

In the current business environment, it is even more pertinent for risk and insurance managers to undertake a regular review of their captive operations.

Captives will continue to evolve with changing approaches to risk management, tax and regulation, so risk managers need to periodically assess their captives in terms of fitness for purpose, asking if they are operating efficiently and achieving their risk management, financial and fiscal objectives.

For more information, please contact
Paul Wordley, Partner,
Holman Fenwick Willan,
+44 (0)20 7264 8438
paul.wordley@hfw.com

• **Stuart Collins** is former Managing Editor of *Insurance Day* and Deputy Editor of *Business Insurance Europe*.

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TRADE-OFF?

An estimated 80% of world trade is dependent on trade finance, but those seeking to access funding are facing a potential perfect storm of obstacles. As banks and export credit agencies retreat, who will step in?

WORDS SIMON WATKINS

The USA faced the prospect of falling off a fiscal cliff at the end of last year and at the eleventh hour postponed the problem to February 2013 rather than address it; China's economic growth rate has been dwindling; and the eurozone often seems on the brink of collapse – liquidity in the global markets has rarely been tighter.

New regulations on capital requirements for financial institutions that were originally due to come into force at the start of this year also complicate the situation: although the EU and a number of countries are late in implementing the regulations, once they are in force there will be far-reaching consequences for capital allocation in general, and trade finance in particular.

The Basel III accord will have a significant impact on trade finance, says Robert Finney, HFW Partner. The accord, which was scheduled to apply from 1 January 2013, lays out much more stringent rules for financial institutions' capital adequacy, leverage and liquidity risk. Basel III rules are general and apply to various kinds of banking activities including such safe activities as trade finance and activities widely perceived as risky, such as exotic derivatives trading. "Basel III largely standardises the treatment of on- and off-balance sheet assets in calculating the new leverage ratio that will apply from 2018, but be reported on from 2015," explains Finney. "This is way too pessimistic a view for most trade finance deals."

In fact, the 2008–11 default rate for letters of credit (LOC), which are the foundation of trade in many emerging markets and low-income countries, was around 0.8%, and the rate of loss was around 0.08%, but the view of the Basel Committee on Banking Supervision is that the leverage ratio should be simple and rely on gross- rather than risk-weighted exposures.

Pushing players out

Basel III's goal of preventing financial institutions from building up leverage beyond a certain point, both on and off their balance sheets, presents further obstacles. "Trade finance deals are grouped in with much riskier asset classes for leverage ratio purposes, so all off-balance sheet trade finance deals have to be converted at a rate of 100% for on-balance sheet capital requirements, compared to the 20% rate that applies in calculating risk-based capital requirements," says Finney. "If you have $1 billion in off-balance sheet trade finance deals, this will count as $1 billion of on-balance sheet exposure for the purposes of calculating the leverage ratio requirements."

"Swiss Cantonal Banks and some in the Middle East have been notable exceptions."

DAMIAN HONEY, HOLMAN FENWICK WILLAN

This will particularly hit LOCs, which, of course, are off-balance sheet items. The requirement that certain banks must calculate risk-based capital requirements as if these credit exposures last at least one year only worsens the overall treatment of trade instruments. The time risk of trade finance deals is typically only around 90 days. This means that, in so far as leverage ratio will drive their capital requirements, banks will need to keep capital for exposures which are considered longer than they actually are, that is they will need to keep more capital in reserve. Vitaliy Kozachenko, HFW Associate, explains that the effect of this rule was mitigated in late 2011 when the Basel Committee decided to waive the 'one year maturity floor' for those banks that use the advanced internal ratings based (AIRB) approach to weighting assets for credit risk purposes. Following intense industry pressure, the Committee agreed that it is inappropriate to apply this floor to short-term, self-liquidating trade finance instruments and that calculation of capital requirements should be based on the effective maturity.

Fortunately, the recent changes announced by the Basel Committee to the short-term liquidity coverage ratio (LCR), will also help trade finance. The changes, widely reported as a weakening of the Basel III liquidity framework, will allow domestic regulators to apply 'relatively low' run-off rates (or outflow assumptions) to contingent funding obligations

For more information, please contact
Robert Finney, Partner,
Holman Fenwick Willan,
+44 (0)20 7264 8343
robert.finney@hfw.com

arising from certain credit and liquidity facilities including trade-related obligations directly underpinned by movement of goods or the provision of services, documentary trade LOCs and shipping guarantees.

Regional refusal

Basel III's global reach is accompanied by related legislation (the US Dodd-Frank Wall Street Reform and Consumer Protection Act 2010, and the upshot of the UK's Vickers Report 2011) that all imply greater capital requirements, less leverage, and more transparency. Many big banks are having to choose between putting capital towards their trade finance operations or moving it to other areas, which have the potential to make greater returns. US, European, Asian and Middle Eastern banks are all under the same Basel III-type strictures; trade finance is not an area that many wish to prioritise any longer. The rising price of commodities over the past few years ties up increasingly large amounts of capital, especially for Asian banks.

Rabih Bleik, Head of Trade Finance for National Bank of Abu Dhabi in Geneva, says the effect of Basel III on European banks has been exacerbated by the broadly deteriorating euro–dollar exchange rate. "Global trade finance is basically US dollar-denominated so when that strengthens, as it has been doing broadly over time against the euro, then the strain on European banks' capital is even greater, as they suffer from rising exchange rate costs, as well as rising cost of capital. Major Middle East banks who have dollar-pegged currencies and available liquidity are becoming more prominent players and increasing their market share," he says.

Damian Honey, HFW Partner, confirms that the major Middle East banks alongside the Swiss Cantonal Banks have been noticeable exceptions to this general trend. These banks did not dabble so extensively in the credit derivatives that decimated many other regions' banks (in the Swiss case due to general prudence, and in the Middle East because of prudent risk management and also for some Islamic banks due to Islamic finance rules forbidding speculative activities), and consequently have sound balance sheets from the Basel III perspective. Also, they have been able to hire staff leaving banks that are downsizing their trade finance departments.

40% is the possible drop in trade in the post-Basel III world.

Global trade could drop by at least 2% in terms of volumes and by 6% in terms of trade finance available.

Global GDP could fall by 0.05% to 0.15% per year in the medium term, according to the OECD.

A way forward?

The cost of trade finance as a whole could increase significantly without other sources of finance. Export credit agencies (ECAs) currently finance or underwrite about $430 billion of business activity abroad. However, Matthew Parish, HFW Partner, says that there is no sign of their taking up the slack left by the banks – they are caught up in the new regulatory malaise.

The quick reactions demanded by trade finance and the OECD regulations, which often take the view that ECAs should avoid concentrating in one area for fear of providing unfair advantages, complicate the situation.

Spencer Gold, HFW Associate, says there are signs of increasing activity from other institutional players, such as trading houses, insurance companies, pension funds and hedge funds, as they seek to fill the gap which is left by more traditional finance providers. Through appropriate structuring and security arrangements, the market hopes to see more activity from these entities, who may not be as constrained as fully regulated financial institutions. This, of course, will involve the scaling-up of investable trade finance packages, and a broader and deeper secondary market. But there are opportunities in tapping this sector for liquidity.

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• **Simon Watkins** was named Freelance Journalist of the Year 2012.

UK P&I CLUB: MUTUAL BENEFITS

Hugo Wynn-Williams, Chairman of the UK P&I Club managers Thomas Miller, says the organisation's legacy offers expertise that continues to benefit its members today.

WORDS SAM CAMPBELL

The UK P&I Club is one of the oldest in the world, having built expertise across the globe since being founded in 1869. Of course, shipping has changed considerably in that time, moving away from sail and steam to today's much larger high-tech ships. The cover has changed too – in Victorian times, crew liabilities were small and environmental responsibility an almost alien concept. Liability regimes have gradually increased the pressure on shipowners.

Nevertheless, "ships are still carrying cargo from one end of the earth to the other," says Hugo Wynn-Williams, Chairman of the UK P&I Club managers Thomas Miller. "The liabilities created have always been around: injuries, damage to cargo, collisions."

He says that complexity has grown but draws attention to some enduring legacies, such as paper bills of lading. "Despite the incredible sophistication of some ships, the electronic age still has yet to take over – at the heart of most cargo voyages, the documents are much the same as 100 years ago.

"At its heart, insurance is about keeping ships trading. That hasn't changed, although the amount of insurance needed and the amount of reinsurance we have to buy has increased exponentially."

Common interest

Insurance, especially protection and indemnity (P&I) cover, is vital. P&I insurance offers owners or operators of ships protection from the third-party liabilities and expenses from incidents such as personal injury, cargo liabilities, loss of personal effects and property (other than cargo), diversion, environmental pollution, collision, wreck, fines and legal costs.

The sums covered can be enormous and the cover extremely complex.

Some choose to source this protection from fixed premium insurers but mutual insurance offers advantages. "A mutual is an insurance company owned by the assureds, as opposed to shareholders. At the UK P&I Club, the board is drawn from our members so the cover that is provided should be adapted to meet the need of the members," says Wynn-Williams.

Mutual insurance means that risk is shared with like-minded individuals, Wynn-Williams explains.

Chauncy Maples

The *Chauncy Maples*, a ship almost the same age as the UK P&I Club and with a fascinating back story, offered a "near perfect way to celebrate our anniversary", says Hugo Wynn-Williams, Chairman of Thomas Miller (see photo essay over the page). "We saw that if we could renovate this ship, we had the opportunity to do some real good in Malawi – a country that ranks among the poorest in the world."

Both the ship and the bishop it is named after are well known in Malawi. Soon to be reborn as a floating clinic offering the priceless gift of health to thousands, the ship will help locals avoid the risks of travel by dugout canoe, including attacks from crocodiles and hippos. With a shallow draft of only two metres, the *Chauncy Maples* can access most areas of the lakeshore, carrying a crew, a medical team and equipment for primary healthcare.

Thomas Miller and the clubs it manages (including the UK P&I Club) have donated over £500,000 in cash and services to the project. Holman Fenwick Willan, for example, is one of the top three donors, having passed more than £60,000 in cash and £40,000 in ongoing pro-bono work.

The *Chauncy Maples* project should be finished in early 2014.

"The liabilities created by carrying cargo have always been around: injuries, damage to cargo, collisions."

HUGO WYNN-WILLIAMS, CHAIRMAN OF THE UK P&I CLUB MANAGERS THOMAS MILLER

"Members may be competing with each other but in terms of liability exposure they have a common interest.

"We are able to provide levels of cover that would otherwise not be available in the commercial market at cost and, because we are not driven by the profit motive, we can be more flexible in providing covers that would otherwise be unprofitable."

A striking example of this is 'omnibus cover': the discretion to pay claims that are not expressly covered. Wynn-Williams notes that this "distinct advantage" has its roots in the historical need for such cover. "Our organisation is based on a nineteenth century model and it continues to work well," he says.

Size and strength

Yet, the incoming Solvency II directive could change the face of mutual insurance. "Mutuals have actually begun to talk about capital rather than reserves. Traditionally, a mutual wouldn't have had capital," Wynn-Williams says.

The best remedy may be size: "As a mutual, the greater your scale, the more efficient you can be with your capital. Size also allows greater flexibility in risk appetite and more risk retention before buying reinsurance."

The UK P&I Club is one of the largest mutual marine protection and indemnity organisations, currently covering around 118 million tons of owned ships and 80 million tons of chartered ships from more than 50 countries. The Club is financially strong; its current S&P rating 'A-' with a 'positive' outlook.

Members enjoy the lower premiums this stability brings but Wynn-Williams emphasises that the advantages of scale are about more than just money. The UK P&I Club has developed specialist skills and expertise to a level of sophistication seldom seen in the field. It can also offer diverse opportunities, helping it attract talent. But there are potential downsides to be guarded against. "We have to ensure that, while taking those economic and financial advantages, we are not throwing away the personal service. We have the most extensive network of regional offices, for example."

In fact, this regional approach is vital, Wynn-Williams says. "There is no doubt that a Japanese shipowner's priorities may look different to a Greek shipowner's priorities so it is very important that P&I clubs continue to provide a non-commoditised service. One way to do that is bring service to their doorstep and speak their language, seeing them both on a business level and on a social level."

Heading off claims

Moving forward, Wynn-Williams says mutuals are having to deal with fewer attritional claims but more large, 'spiky' claims. He adds that, with around 80% of claims due in some way to human error, risk management and prevention, such as the UK P&I Club's high-level loss prevention programme, is taking a more central role.

The present economic climate means advice that helps reduce costs and insurance premiums, such as in-depth risk profiling tailored to a fleet, is well received.

Anticipating and reacting to future changes in the market is crucial. "There is a paradox: in the short term recessions seem to bring claims down as there seems to be less commercial pressure and people make fewer mistakes. But in shipping booms P&I clubs see more claims. P&I clubs have to be careful that, when claims pick up, they aren't left unprepared. You need to be alive at this point in the cycle."

The *Chauncy Maples* story

1 In 1874, a 22-year-old Chauncy Maples arrived in Central Africa (today divided into Mozambique, Tanzania and Malawi). He continued his work as a missionary until 1895, when he returned to the UK and was made a bishop. On the return journey, at the very last stage, as he crossed Lake Malawi to the headquarters of the mission he was to head, his boat sank in a storm. Perhaps weighed down by his heavy bishop's cassock, Chauncy Maples was the only one of 15 passengers to drown.

2 An eponymous ship was built in his memory in Glasgow in 1899 by Sir John Barrie and Henry Brunel, son of Isambard Kingdom Brunel, also the engineers of Tower Bridge. The ship was constructed in a factory, not a shipyard, and dismantled before being shipped to Africa and taken up the Zambezi and Shire rivers on a barge.

3 The 3,481 boxes, each around 25 kilos, were then shouldered by porters who walked the 350 miles of uncharted land to Lake Malawi. The boiler, which weighed 11 tons, was pulled by 450 people. Unfortunately, the carefully numbered parts had been galvanised over, meaning the precision assembly became a painstaking jigsaw puzzle that took two years to complete.

4 From 1901 until the mid-1950s, the *Chauncy Maples* was a mission ship, featuring a floating school, a church and a clinic. An interlude in the First World War saw the ship become a troop/gunship when Tanzania became German East Africa, but the biggest change came when the ship was sold in 1953.

5 *Chauncy Maples* was used as a fishing trawler before being bought by the Malawi government. In 1967 she was refitted as a passenger and cargo vessel: many Malawians still remember travelling on her to school or work. A lack of maintenance saw her slip into obscurity until the Chauncy Maples Malawi Trust was formed to transform her into a floating clinic.

6 Phillipe Stark and Martin Francis, the well-known yacht designers, have helped redesign the *Chauncy Maples* for the 21st century. Only the hull will be reused, complemented by an aluminium superstructure that will be sent to Africa as a 'flat pack'.

7 *Chauncy Maples* will visit 20 villages on the north-west shore of the lake in a monthly rotation, sending a medical team ashore in a smaller boat to offer GP-style services: curative and preventative medicine, especially treatment for HIV/AIDs, malaria and TB. They will also provide ante-natal care, distribute condoms and mosquito nets and give inoculations. There are a mere 250 doctors in the whole of Malawi for around 15 million people, so the *Chauncy Maples* will be staffed by nurses.

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• **Sam Campbell** writes for clients including *The Guardian* and *The Economist* and specialises in editing business publications.

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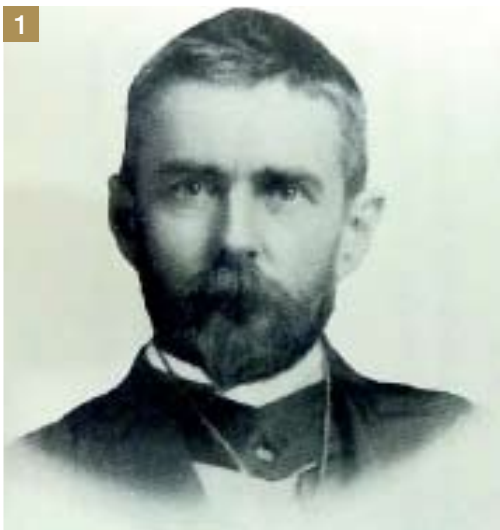

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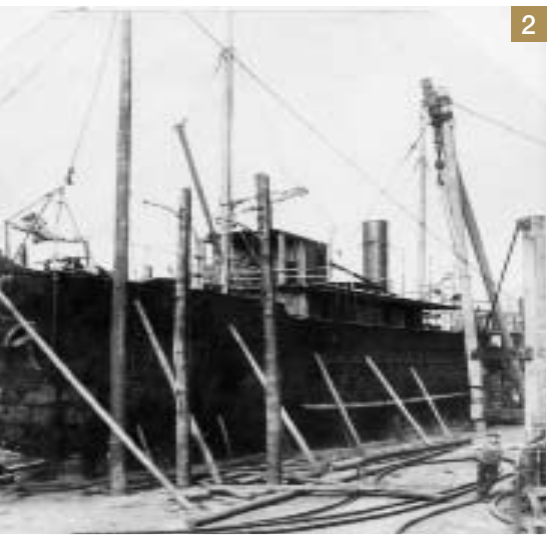
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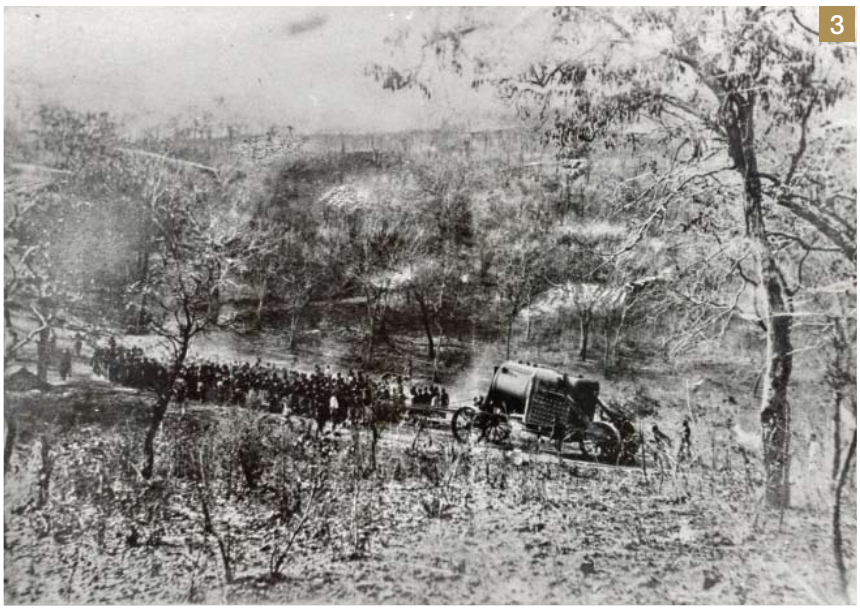
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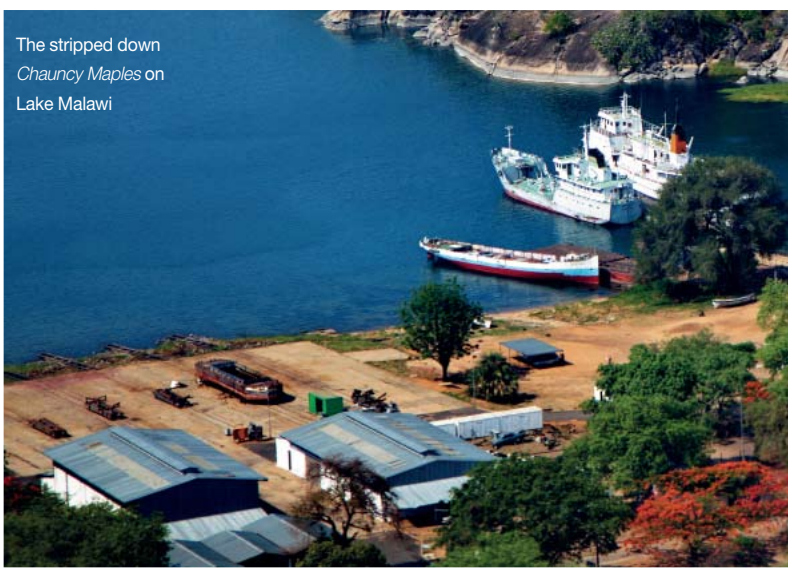
The stripped down *Chauncy Maples* on Lake Malawi

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CHAUNCY MAPLES

LAKE MALAWI'S CLINIC

COMPETITION LAW IN HONG KONG

There will be winners and losers with Hong Kong's new competition laws. But companies still have time to ensure compliance and seize a valuable opportunity to influence the final regulation.

WORDS POLLY BOTSFORD

Every year, the World Bank ranks the world's economies according to the ease of doing business there; in the 2013 Doing Business report Hong Kong was second only after Singapore. A new competition law introduced in Hong Kong should ensure that the city retains its leading edge. But the laws are complex and sanctions for non-compliance are heavy – the Bill has been hotly debated inside and outside Parliament since it was first introduced two years ago.

Though not yet in force, the Competition Ordinance will prohibit anti-competitive practices between businesses, such as price-fixing, bid-rigging or allocating customers, and any abuse by a company of its substantial market power in its sector, such as limiting production or so-called predatory behaviour towards competitors.

Wrong fit?

The Hong Kong law is based on existing tried-and-tested EU and Australian competition laws, enabling Hong Kong to conform to internationally recognised standards. But this also means that the rules have not been tailored to suit the Hong Kong economy.

"Companies have a good opportunity to get their message across about concerns on a particular aspect of the law or its impact on their business."

NICK LUXTON, HOLMAN FENWICK WILLAN

The British Chamber of Commerce in Hong Kong raised this potential issue during the Bill's gestation period, says Timothy J. Peirson-Smith, Chair of the Business Policy Unit at the Chamber. "The EU and Australian laws are highly complex and for large and complex markets. Hong Kong is a small city state and the law is not bespoke, and has not been thought through to suit Hong Kong's needs."

For multinationals operating in Hong Kong, new rules may not be such a problem because these companies also operate in those jurisdictions where competition legislation is well known so they are familiar with the laws and their interpretation, and will already have systems in place to ensure compliance.

But there are plenty of businesses that do not operate in other markets and are unversed in competition law. Indeed, the Hong Kong General Chamber of Commerce, which represents 4,000 Hong Kong businesses, has called the new law "far from desirable".

The vast majority of Hong Kong's businesses are local small- and medium-sized enterprises: the government estimates that 98% of all operations are SMEs. Many will have had little exposure to the rigours of competition jurisprudence and there has been confusion about whether or not they fall into one of the Ordinance's exemptions. The government did make concessions during the passage of the Bill exempting certain categories of business, but the exemption is qualified.

Peirson-Smith explains: "The government gave the impression that SMEs were exempt from the law completely. They are not. They are only exempt from action being taken against them in relation to non-serious, 'non-hardcore', anti-competitive practices, but only then if their annual turnover is below

The science of compliance

Three steps can help ensure a business is compliant with competition rules:

1. Risk assessment – undertake a full audit of the business to analyse all practices and arrangements with competitors and other players in the sector regarding price, distribution and other factors.

2. Take early action – if the audit raises any particular concerns, change practices.

3. Implement robust compliance policy – the policy must be tailored to the risk areas and 'red flag' key issues. Training on policy is key.

Towering advantage? Some claim the rules give big firms the upper hand

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HK$40 million (US$5 million)." Peirson-Smith predicts that many of these businesses will be significantly impacted and may even have to rethink their business model completely to be competition compliant.

There is also concern about whether a business's particular practice will fall within the definition of anti-competitive behaviour. Clearly, arrangements such as price-fixing or bid-rigging will be deemed anti-competitive. But there is an area where it is not clear on which side of the line a practice will fall. In the international shipping and aviation industries, for example, there may be pricing agreements for reasons of market efficiency, or research and development agreements in the absence of which R&D would be prohibitively expensive. Then the question turns on whether or not such agreements may be exempted from the rules.

Getting it wrong has serious repercussions. The Competition Tribunal will have considerable sanctions available to it. Fines can be levied, which are up to 10% of turnover in Hong Kong for the whole time during which the infringement occurred (with a three-year maximum). It can also take away any illegal profits that have been made. Directors and other officers can be separately fined or disqualified from office for a period of up to five years. A person who obstructs a competition investigation is at risk of a fine or imprisonment. On top of all this, there may be follow-on actions by private parties once a Tribunal has made a finding of an infringement – as has been seen in the airline industry in the EU.

For more information, please contact
Nick Luxton, Associate,
Holman Fenwick Willan,
+852 3983 7774
nick.luxton@hfw.com

Malleable

Nevertheless, in some respects, the Hong Kong government has taken a conservative approach to the concept of competition law, as Nick Luxton, an HFW Associate observes: "Elements of competition law have not been introduced – the rules do not include merger activity except in the telecoms sector, where there were already rules in place, nor do they allow for independent litigants to bring cases other than as follow-on actions to the Competition Commission, the investigating body. The government is cautious in enacting new legislation and doesn't come to it lightly."

Some of the issues will be clarified during the next stage of the process. In order for the Ordinance to be brought into force, the Commission needs to be established, as does the tribunal that will decide cases and enforce them. The Commission must also publish more detailed guidance.

Until these agencies are up and running, however, it is hard to predict how robust their attitudes will be. But businesses would not be advised to take a wait-and-see approach. Anthony Woolich, a HFW Partner, says thinking ahead is crucial. "Companies need to ask themselves some questions about their practices, about any joint ventures or associations they have entered into. Then they have time to change things internally."

Also, given that there is still so much that has to be worked through, such as on the guidance, there is a window to try to engage with the process and influence the outcome, Luxton says. "Companies and sectors have a good opportunity to get their message across about concerns that they have on a particular aspect of the law or its impact on their business, or whether their particular agreement is efficient rather than anti-competitive."

Nor is it all bad news for everyone. Competition should deliver benefits to consumers and the economy as a whole, and should also attract new entrants to markets in some of Hong Kong's busiest sectors such as real estate, construction and retail, and enable barriers to be broken down. As Woolich concludes: "The new rules need not be bad for business; they are an opportunity."

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• **Polly Botsford** is a legal and current affairs journalist.

LANDMARK JUDGMENT ON LIENS GIVES SUPPORT TO TRANSPORT OPERATORS

Focus on liens will increase as high street insolvencies mount, warns Holman Fenwick Willan associate Matthew Wilmshurst. While a recent judgment has provided some clarity, liens need to be set up properly and legal advice sought.

ISTOCKPHOTO

Liens, which give rights over a debtor's property when in the possession of a creditor, can help logistics providers, but could be an obstacle for logistics buyers. The use of liens has been increasingly common in the past 18 months as the number of retail collapses rises in the current harsh economic climate, causing problems for both logistics buyers and providers.

If goods are in transit when a retailer goes into administration, a lien may be the best route for the logistics provider to ensure payment. Liens became headline news with the recent notable success for the freight forwarder in the landmark English High Court case *Re La Senza*.

Administrators had initially demanded that Uniserve, who handled the carriage of goods bought from overseas by La Senza, deliver up goods with a value of about £2.2 million, without an indemnity for third-party claims or the immediate payment of Uniserve's charges. However, the ruling gave Uniserve permission to enforce its general lien and sell La Senza's goods in accordance with its terms and conditions. The judge awarded costs against La Senza, the lingerie chain that was once owned by Theo Paphitis of BBC's *Dragon's Den*.

Clarity

This judgment finally gives freight forwarders, carriers and road hauliers clarity as to when they can enforce their general lien clauses against administrators. Most such disputes end in negotiated settlements but, for those who have to litigate in similar circumstances, two lingering areas of doubt have been cleared up: a court can enforce a general lien under the moratorium imposed on liens by the Insolvency Act 1986, and a court will not order administrators to deliver up goods without an indemnity protecting the forwarder or carrier from consequent costs and third-party claims.

"A lien may be the best route for a logistics provider to ensure payment."

MATTHEW WILMSHURST, HOLMAN FENWICK WILLAN

Overseas, laws relating to liens vary. Courts in some jurisdictions tend to give shippers more rights than they would have under English law, and can be reluctant to recognise liens. This year we have encountered several cases where a supplier from the Indian subcontinent or Asia has signed up to English law contracts with a UK retailer and also with the logistics provider; the lien is undoubtedly valid under English law but the local courts have thrust those matters aside and, using various technicalities, ruled in favour of the shipper rendering the lien ineffective.

Seek advice

Is there a threat from banks with fixed and floating charges over the insolvent company's assets? Not much: the lien is a type of security over assets that are not permanent features such as buildings, which are normally the subject of fixed and floating charges. It is not permitted to enforce any type of security (including a lien) against a company once it goes into administration without the permission of the court but, as some of the legal points relating to exercising liens still remain undecided in law, they could arguably be considered to put the logistics provider in a better position than banks and corporate lenders with fixed or floating charges.

It remains unarguable, however, that each case hangs on its own facts; liens need to be set up properly. Legal advice should be sought at the first sign of difficulty.

For more information, please contact Matthew Wilmshurst, Associate, Holman Fenwick Willan, +44 (0)20 7264 8115 matthew.wilmshurst@hfw.com

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HFW AROUND THE WORLD

A snapshot of developments involving Holman Fenwick Willan's lawyers.

1 Singapore

Obituary: Bill Kerr

HFW is deeply saddened to announce the death of Bill Kerr, a Partner in the firm's Singapore office. Bill was killed on 30 December 2012 in a traffic accident in the Philippines. An ex-mariner, he specialised in handling all forms of marine casualties and insurance, and was recognised by leading legal directory Chambers as 'one of the top wet lawyers in the business'. Our thoughts and condolences are with Bill's family and friends at this very sad time.

2 London, Dubai and Hong Kong

HFW wins important industry awards

James Gosling and Richard Neylon were awarded the *Lloyd's List* Global Maritime Lawyer of the Year Award, a reflection of their team's pioneering work in resolving issues relating to marine piracy. *ALB The Brief* awarded HFW's Dubai office the Shipping Law Firm of the Year 2012 Award and also, for the eighth time in nine years, the firm has been awarded the *ALB* HK Shipping Law Firm of the Year Award in recognition of excellence and outstanding achievements.

3 Serbia

HFW advises Serbian state-owned gas company Srbijagas on loan deals

A HFW team led by Partner Alexis Kyriakoulis has advised the Serbian state-owned gas company JP Srbijagas on loans to be provided by Deutsche Bank and Amsterdam Trade Bank, part of the Alfa Group. The loans, backed by Serbian state guarantees, are being provided following a formal tender run by the company to secure a total of €190m from domestic and international banks.

4 London

HFW advises Sonali Bank (UK) Ltd on financing for Biman Bangladesh Airlines

A HFW team of corporate and regulatory lawyers has advised Sonali Bank (UK) Ltd on financing pre-delivery payments for two Boeing 777-300ER aircrafts for Biman Bangladesh Airlines. HFW's team, led by Partner Adam Shire, advised on a number of regulatory aspects from an FSA perspective and liaised with local counsel on Bangladeshi requirements.

5 Paris and London

HFW strengthens insurance and reinsurance practice

Pierre-Etienne Kuehn, formerly the Head of Legal and Compliance at AXA Group, joins the Paris insurance and reinsurance team as a Partner, while John Barlow, a specialist in financial institutions insurance and reinsurance, joins as a Partner in London. Both add an extra dimension to HFW's international service.

6 Sydney and Singapore

HFW strengthens shipping capability in Asia Pacific

Nic van der Reyden and Dominic Johnson have been promoted to Partner. Van der Reyden relocates from Melbourne to Sydney and will continue to grow HFW's shipping capability on the east coast. Johnson moves from London to Singapore and joins a team with an excellent reputation in the region for shipping and offshore energy work.

Holman Fenwick Willan has offices in São Paulo, London, Paris, Rouen, Brussels, Geneva, Piraeus, Dubai, Hong Kong, Shanghai, Singapore, Melbourne, Sydney, Perth.

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