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Receivables Purchase or Secured Borrowing Base

BACKGROUND

In the UK ABL/RF market there are two main ways of financing a customer's whole book of receivables:

- whole turnover receivables purchase (**RP**) facility; or
- secured borrowing base (**BB**) facility.

Whilst the economic and commercial effects of both are substantially similar, there are some key legal and structural differences between them.

WHAT ARE THE MAIN SIMILARITIES?

Eligibility and reserves: Both facilities are reliant on the performance of the customer's book of receivables and have detailed eligibility criteria for receivables which can form part of the funding calculations and detailed reserves for amounts which may not be recoverable by the financier.

Prepayment percentages/advance rates: Both facilities calculate available funding by applying an agreed percentage rate (prepayment percentage / advance rate) to the value of eligible receivables and then deducting reserved amounts and amounts already paid to the customer.

Control of proceeds: Both facilities focus on control of the proceeds of receivables paid by debtors.

Undisclosed/disclosed: Both can be either undisclosed or disclosed to the debtors.

WHAT ARE THE MAIN DIFFERENCES?

Rights in the receivables: The primary difference is that an RP facility results in the financier owning the receivables whereas for a BB facility the lender has security over the receivables.

This means that, following the insolvency of the customer, a financier under an RP facility can collect receivables independently of the insolvency process and without the need to appoint a receiver and/or deal with the administrator of the customer (if applicable) whereas a financier under a BB facility would need to appoint a receiver and/or deal with the administrator (if applicable).

Structure of the facility agreement: Terminology in an RP facility agreement will reflect a sale and purchase, using terms such as "receivables purchaser" and "client/seller". Terminology in a BB facility agreement will reflect a loan, using terms such a "lender" and "borrower".

An RP facility agreement will contain outright assignment, back-up trust, discount and collection agency provisions and a power of attorney (requiring the facility agreement to be executed as a deed). A BB facility agreement instead contains loan, interest and repayment provisions.

Notifications / borrowing base certificates: For an RP facility, new receivables are typically "notified" to the financier with the customer confirming whether or not they are eligible.

For a BB facility, the value of eligible receivables are included in a borrowing base certificate which is submitted to the financier periodically.

Excluded receivables and receivables representations: In addition to eligibility criteria, an RP facility agreement will often include concepts such as "excluded receivables" (i.e. receivables which are not purchased by the financier) and receivables representations (breach of which allows the financier to require affected receivables to be repurchased).

Operational covenants: An RP facility agreement often contains operational covenants measuring the performance and/or make-up of the book (e.g. debt turn or debtor concentrations), breach of which may result in a reduction of the prepayment percentage, the affected receivables no longer being eligible, or the value of the affected receivables being applied as a reserve.

A BB facility agreement typically does not contain operational covenants and instead manages the make-up of the book through sub-limits contained in the eligibility criteria.

Collection accounts and access to and use of proceeds: With an RP facility, debtors are directed to pay the proceeds of receivables to collection accounts owned and operated by the financier (often called "trust accounts").

In a BB facility, however, the debtors will continue to pay to collection accounts in the name of the customer until such time as the financier instructs the debtors otherwise following an enforcement event.

A BB facility agreement will therefore contain provisions dealing with the customer's access to and use of the proceeds.

The customer may be required to periodically sweep the proceeds of receivables to the financier to repay the loan (i.e. cash dominion) or only sweep the proceeds to the financier following a specific trigger event (i.e. springing cash dominion).

If operating on a springing cash dominion basis and the financier requires fixed security over the receivables, the financier must ensure it retains sufficient control of the proceeds and collection accounts so as not to affect its fixed security.

Security: For an RP facility, no security is taken over purchased receivables (because they have been purchased) or collection accounts (because they are not the property of the customer). Instead security is taken over receivables which fail to vest in the financier (e.g. as a result of a prohibition on assignment).

For a BB facility, security is taken over the receivables and the collection accounts.

For both facilities, the financier will also require a qualifying floating charge and potentially other boot collateral.

Credit insurance: For a RP facility, if the customer has a credit insurance policy the financier will usually request to be noted on the policy as loss payee and co-insured. For a BB facility, the financier will typically take security over the policy, notify the insurer and request to be noted as loss payee.

Syndication: To the extent an RP facility will be syndicated or provided as a club deal, participation or ABFA trust provisions will be included within the facility agreement. For a BB facility, standard LMA agency provisions are used instead.

If you have any questions or require specific legal advice in respect of any of the English law matters discussed in this publication, please click here and get in touch with any of the Key Contacts.