

KEY STRUCTURING ASPECTS OF A FORWARD FLOW TRANSACTION

Forward flows are relatively simple in concept, designed to provide originators with access to reliable committed funding without being directly exposed to the volatility of the capital markets, which in recent years have been challenging for originators that are reliant on more traditional securitisation structures. Such arrangements allow funders to obtain exposure to the full economic risks and rewards of the originated assets. Forward flow structures typically also have the advantage, for both originators and funders, of lighter documentation and fewer regulatory obligations.

We have advised on forward flow transactions across a range of asset types. This article explores some of the key considerations that funders and originators commonly have to address when establishing a new forward flow arrangement.

WHAT IS A FORWARD FLOW?

A forward flow is a financing arrangement where a funder, either directly or through an SPV, commits to purchase from an originator newly originated eligible receivables during a revolving or sale period up to a specified committed amount. The arrangement is typically relatively document light – in particular when compared to a traditional securitisation structure – with the principal transaction documents comprising a receivables sale agreement, a servicing agreement and a master definitions or framework agreement, which would each often be substantially based on an originator's existing securitisation or warehouse documentation.

WHAT ARE THE KEY LEGAL AND STRUCTURAL CONSIDERATIONS?

Getting the right treatment: the intended accounting treatment for the sold receivables under the forward flow will be a significant factor in structuring the terms

of the transaction. Originators seeking balance sheet de-recognition with respect to the receivables should engage with their auditors to confirm their interpretation of the relevant criteria set out in the applicable accounting standards. Those criteria and their interpretation will then need to be accurately reflected in the terms of the forward flow. Auditors will be focused on a range of factors, which in our experience include:

- **Cash flows:** which party holds the contractual right to receive the cash flows in respect of the transferred receivables (e.g. commonly these are transferred to the funder by way of a “true sale”) or whether the relevant assets are subject to a qualifying “pass-through” arrangement.
- **Control:** the extent to which the originator retains any degree of control over the receivables, such as a requirement to be retained as servicer or restricting the funder's ability to on sell receivables or demand the transfer of legal title to the relevant receivables.
- **Ongoing exposure to asset performance:** the originator's ability to benefit from the future performance of the receivables, such as a profit share arrangement or repurchase rights.

Facilitating refinancing: if a funder has any intention to use the purchased receivables to support a securitisation structure, then it may look to include certain features to ensure that the terms of the forward flow facilitate that securitisation structure. These features can include:

- **Reporting:** incorporating reporting and disclosure regimes in the servicing arrangements that are capable of satisfying the diligence and disclosure requirements under prevailing securitisation rules and regulations.

- Securitisation servicing: pre-agreeing the terms on which the originator is willing to service the relevant receivables in the event that they are securitised. This can range from upfront agreement of the detailed terms of that servicing arrangement to the originator agreeing to negotiate terms of that servicing arrangement at the relevant time in good faith and/or in a commercially reasonable manner (and possibly in accordance with a set of documented principles or high-level terms).
- Warranties: agreeing a warranty package and eligibility criteria for the forward flow that are designed to support a securitisation structure that aligns with market standards, rating agency criteria and investor expectations.

Funding certainty: a key benefit of a forward flow is the committed ongoing nature of the funding. Depending on the requirements of the originator (e.g. availability of other liquidity to fund origination) and the type of funder (e.g. bank, insurer or credit fund), the forward flow may need to include certain additional structural funding features:

- Frequency of sales: reducing the period from origination to sale under the forward flow in order to quickly replenish the originator's liquidity available for origination. For bank funders (or credit funds with back leverage from banks), we have seen daily sales to achieve this objective, but longer periods may be required for other types of funders.
- Pre-funding: to the extent that a funder has longer lead times for advancing new funding or the originator requires additional liquidity to fund origination, the structure may need to include a pre-funding arrangement. For example, establishing a secured or trust account, which is credited on a periodic (e.g. weekly or monthly) basis with funds that are available to the originator exclusively to originate receivables for the purposes of the forward flow.

Managing originations: forward flows will often include periodic allocation targets and minimum allocation percentages in order to provide the funder with comfort as to the quantum of receivables that will be transferred to it under the arrangement. In addition, a forward flow may need to provide for:

- Stopping origination: (1) soft stop origination events providing for a pause in sales, for example, whilst portfolio limitations or performance triggers are being resolved, and (2) hard stop origination events which permanently end sales and effectively terminate the forward flow, for example, breach of material obligations by the originator as seller or servicer. The scope and scale of these events would be expected to be the subject of detailed negotiation seeking to achieve an appropriate balance between funding certainty for the originator and investment performance for the funder.
- Timelines: the expected timeline for origination of different types of assets can vary significantly (e.g. months for mortgage loans and days for auto loans). These variances can require different structural solutions, for example, requiring funders to commit to fund assets long before they are originated to account for long origination pipelines.

Future proofing: a forward flow should provide for the full lifecycle of the receivables sold to the funder. Features of the receivables that will require particular structural solutions include:

- Further advances or revolving accounts: any option for the underlying borrower to require or request the provision of further advances. The forward flow would need to detail whether such further advances are required to be purchased by the funder or, alternatively, may provide the funder with an option to purchase.
- Forward flow arrangements involving revolving account products (e.g. credit cards or store cards) are more complex, as the products are essentially of indefinite duration with ongoing spending, and so a solution will need to be agreed regarding what happens at the end of the forward flow period (which is likely to affect the accounting treatment, as noted above).
- Product switches: originators may be subject to regulatory requirements to offer product switches to underlying borrowers from time to time, or may wish to have the ability to offer product switches in the interests of customer retention. Terms would need to be agreed upfront under the forward flow regarding the treatment of the relevant receivables, for example, enabling the originator to repurchase

the receivable in order to effect the product switch and potentially a right to require the subsequent purchase of a post-switch receivable by the funder so long as the switched receivable still satisfies the relevant eligibility criteria and warranties.

Keeping interests aligned: the terms of a forward flow would commonly impose contractual requirements on the originator to ensure that the sold receivables are originated and serviced in a manner consistent with the originator's retained receivables. In addition, funders may look to include features in the forward flow that are designed to ensure that the originator is impacted by the ongoing performance of the sold receivables, i.e. ensuring that the originator has "skin in the game". For example, the arrangement may include some form of profit-sharing mechanism whereby, once the funder has achieved a targeted minimum return on its investment, any excess will be shared between the funder and the originator in accordance with a prescribed, and often detailed, formula. The inclusion of such a mechanism can, however, be challenging from an accounting perspective, if the originator is seeking to derecognise the assets.

Regulatory compliance: certain types of funders may have particular requirements for the administration and monitoring of purchased receivables, in particular where the forward flow is structured so that the receivables sit on the funder's balance sheet. Our experience is that these requirements can have a significant impact on the complexity of, and the timeline to establish, a forward flow structure. Therefore, parties would be well-advised to consider at the outset:

- Data: what type of data the funder will require in order to effectively monitor the receivables

and the underlying customers in compliance with its regulatory obligations and policy requirements. In particular, consideration will need to be given as to whether that data sharing will include any personal and/or sensitive data, as that will need to be properly addressed under the transaction terms (and the origination process) to ensure compliance with applicable data protection laws.

- Servicing: how a bank funder would treat the servicing arrangement with the originator. To the extent that arrangement is concluded to comprise a material outsourcing, that triggers regulatory requirements for the terms of that servicing arrangement, in particular regarding service monitoring, governance arrangements and audit rights. This can significantly complicate the terms of the servicing arrangement, and impose additional obligations on the originator's servicing platform.

WHAT NEXT?

Originator and funder interest in forward flows is expected to continue to grow over the coming years. We have helped a range of clients to establish, expand and improve their forward flow structures, which means that we are well versed in the operational features, regulatory constraints and commercial terms that are required for a successful forward flow transaction. If you are interested in forward flows, then do get in touch with your regular Slaughter and May contact, or one of our Securitisation and Structured Finance team.

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