White Paper

The Bank Payment Obligation: a new payment term to secure and finance trade

A new start for Supply Chain Finance

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In recent years, the banking industry released a unique set of legal and technology standards to address the needs for growing digitisation of commerce and finance processes. These standards enable banks to provide their corporate clients with risk and financing services as from the very start of trade transactions, for example, when the sale contract is agreed by the buyer and the seller. They also address the needs for on-demand risk mitigation and financing services whilst inter-linking with electronic trade documentation platforms. This innovation offers local banks and development banks an opportunity to increase their role in supporting a vital segment of the economy: the Small and medium-sized enterprises (SME) market.

Key benefits for corporates

- Working Capital and Cash Flow Improvements
- Easier Access to risk mitigation, pre-shipment and post-shipment finance
- Increased automation of payment, reconciliation and forecasting processes
- Win-win relationships between buyers and suppliers

Key benefits for banks

- Reduced costs thanks to digital process
- Shortened transaction time thanks to accelerated data matching
- New transactional revenue and increased customer satisfaction
- Focus on core competencies

Industry standards are a critical foundation for any competitive eco-system

For decades, technology has been impacting our lives on a daily basis. In order to maximise the benefits, various industries have identified the need to define standardised ways to structure data and facilitate efficient exchange of information between counterparties. Also called “industry standards”, these technical and business protocols have been as critical as the role of language in communication between people.

Over the last 40 years, industry standards have proven to be an essential foundation for many industries including financial services. Firstly, standards provide end-customers with a baseline to compare commercial offerings. Secondly, they facilitate competition between such offerings whilst enabling them to interoperate. Competitive players are naturally reluctant to interoperate given their short-term commercial goals and their preference to lock customers in their fully proprietary solutions. In emerging industries, commercial players therefore often try to postpone the interoperability discussion. However, agreement on common interoperability rules and standards is proven to develop the total size of an industry. Interoperability should therefore be considered as a key milestone for an industry to grow to the next level of maturity. A good example is the Global System for Mobile Communications (GSM) standard which is embedded in our mobile phones and interlinks the mobile phone operators across 212 countries. Thanks to this standard, a GSM mobile phone user can reach any person in a network of more than 5 billion people.

A key aspect when setting up industry standards is the need for such definitions to be owned by non-commercial industry organisations and to be available in the public domain. In financial services, 40 years ago, banks decided to create a cooperative standardisation body to take up this role and SWIFT was born.

Today, SWIFT’s standards cover a wide range of financial services such as payments, foreign exchange, trade and securities in both the bank-to-bank and corporate-to-bank segments. SWIFT’s standards provide major interoperability benefits to all parties involved in financial transactions, including corporate clients. SWIFT’s standards are used by more than 10,000 institutions in more than 210 countries.

In supply chain finance, banks have also decided to develop new legal and technology standards to address interoperability challenges and to grow the size of this emerging market.

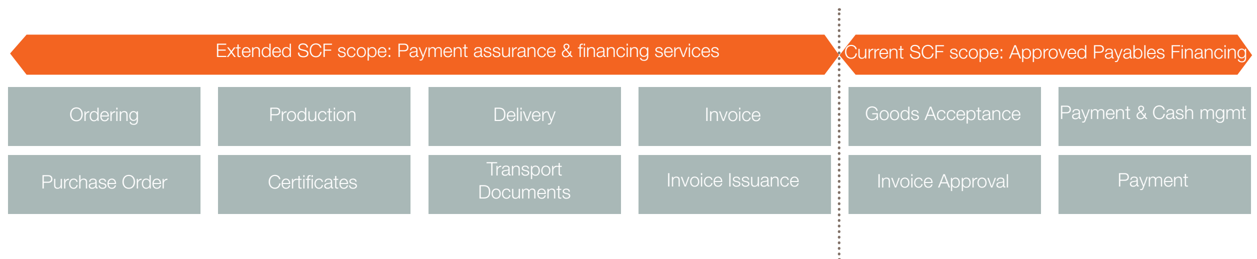

Figure 1 - Today's SCF offerings start when invoices are approved whereas buyers and sellers need risk and financing services as soon as the Purchase Order is agreed.

Supply Chain Finance: today's offerings start at the end of supply chains

The supply chain finance (SCF) market - the term used by banks to refer to approved payables financing or early payment services – has grown significantly over the last ten years. Such services have proved their relevance and value to large buyers and their suppliers. The now widely available SCF offerings offered by banks and non-bank technology providers have been built on the fact that buyers and sellers wish to work in a win-win spirit as large buyers aim to support their suppliers' working capital needs. Typically buyers facilitate early payments to their suppliers via one of their banking partners acting as liquidity provider. Buyers therefore approve invoices as early as possible in the process in order to maximise the financing opportunity for suppliers in need of working capital. Such services have also validated the fact that banks are ready to extend financing to their clients using electronic and automated transaction flows as they do in payments and cash management services since more than 30 years.

Figure 1 shows the current scope of SCF services which are triggered very late in the transaction lifecycle, i.e., once the invoice has been approved whereas the customers' needs start as soon as the Purchase Order is agreed, i.e. when the physical supply chain activities start.

Bank proprietary offerings are reaching their limits

The progress made by banks so far in the SCF market has not been without challenge. Most of the services have been developed independently by each bank and do not make use of any common foundations. Typical drawbacks reported by practitioners can be summarised as follows:

Late start
Approved payables financing services begin at the penultimate stage of trade transactions when the invoices are approved whereas the corporates' needs for financing and mitigating risk start much earlier, i.e., when the Purchase Order is raised. The real opportunity for banks is to get involved as early as possible in the transaction cycle so as to offer pre-shipment financing.

Buyer-centric
Today's SCF offerings are rolled out as buyer-specific programmes and mainly address the working capital needs of critical suppliers whereas the SCF opportunity extends to large and smaller sellers in need of payment assurance and receivables financing.

Supplier on-boarding raises costs
Current offerings require, in most jurisdictions, the buyer's counterparties - the suppliers - to be enlisted on the buyer's bank portal. The multitude of SCF platforms generates operational issues for suppliers wishing to benefit from various SCF offerings via their buyers' banks. Suppliers would be best served by their chosen – often local – banking partner, not by their buyers' banking partners; there is a need to involve the banking partners of the suppliers to avoid those onboarding costs.

Know-Your-Customer (KYC) costs
Most banks require KYC checks to be performed on such suppliers being enlisted as new customers, which is increasing the total onboarding cost and putting the business case for the buyer's bank at risk.

Proprietary formats
Today's offerings make use of proprietary formats which makes it more complex and costly for corporate clients to integrate in their internal applications (e.g., ERPs) whereas all players want to benefit from end-to-end automation to limit processing costs.

Proprietary product definitions
The naming and definitions of the various SCF services vary from one bank to the other which makes it difficult for clients to compare offerings and consider switching from one provider to another. The industry has, however, addressed this issue and delivered global SCF definitions via the ICC organisation.

Despite the above shortcomings, the SCF market has grown, but it did so without relying on strong foundations. The market is beginning to face some difficulties due to the absence of interoperability standards. This is why banks have decided to develop specific ICC and SWIFT standards for this market.

Industry standards will help banks grow the size of the SCF market

Given the limitations of the single-bank proprietary SCF set-ups, banks have developed new legal and operational standards that will help bring the market to new levels both in market size and in product scope. By introducing such standards, banks aim to move the market from the 3-corner (or single-bank closed model) to the 4-corner model (or two-bank interoperable model). Banks also intend to extend their offerings beyond the current early payment services.

Here is how:

Involving the supplier's bank
Moving from the typical 3-corner to the 4-corner model will allow large banks to extend their SCF services by involving local banks. The 4-corner model will enable correspondent banks to reach out to a larger number of suppliers including SMEs. This needs to be done by relying on local banks which can best assess their clients' performance risks. It will also eliminate the need for the buyers' banks to on-board suppliers, as well as the related KYC costs as the two-bank model relies on the relationship between the supplier and its own local bank.

Early start
By providing SCF offerings at the very beginning of the transaction, banks will be able to address requirements such as the provision of pre-shipment finance which may be required by the supplier when the Purchase Order is agreed. They will also be in a position to provide payment assurance, which is critical for any seller at the very early stage of the transaction. Extending the payables and receivables financing services to the pre-approval stage will also be possible, well before the approval of the invoice.

Figure 2 illustrates the current problems faced by suppliers who need to join various banks' platforms, as well as the more positive situation where their own (local) banks are involved.

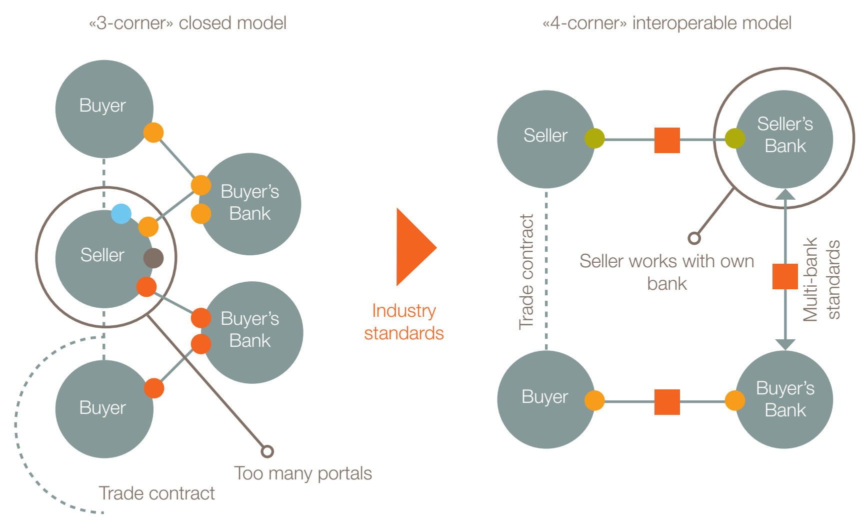

Figure 2 - Industry standards for SCF will enable the buyers' banks extend their reach to suppliers by working with the suppliers' banks (usually local banks).

Issues with the "3-corner" closed model	Benefits with the "4-corner" interoperable model
✗ Seller needs to connect to various SCF portals operated by its buyers' banks	✓ Buyer and seller work with their preferred banks; no unnecessary on-boarding of seller by buyer's bank
✗ Buyer's bank faces additional supplier on-boarding and KYC costs	✓ Seller's bank takes risk on buyer's bank, not on buyer
✗ SCF services limited to approved payables finance	✓ SCF extended to pre/post-shipment finance and payment assurance, and should target large sellers too
✗ Proprietary formats increase costs for all and limit end-to-end automation	✓ Multi-bank industry standards facilitate technology independence between all parties and end-to-end automation
✗ Lack of common legal and operational foundations limit adoption	✓ Standards accelerate adoption as initial investment is re-usable with many banks

Figure 3 - Issues of the 3-corner model versus benefits of the 4-corner model

Let's look at how standards help banks address such challenges and extend their offerings.

Corporates need more than Approved Payables Financing

In 2013, the International Chamber of Commerce (ICC) and SWIFT rolled out new industry-owned legal and technology standards for supply chain finance. These standards enable banks to interoperate through their correspondent banking agreements in order to provide risk mitigation and pre/post-shipment financing in the 4-corner model. The combination of legally binding rules with electronic messaging and matching provides unique efficiency benefits not yet witnessed in the trade industry to date.

Known as the Bank Payment Obligation (BPO), the new trade settlement instrument offers buyers and suppliers (irrespective of size, geography and industry) a new payment method to secure and finance their trade transactions. The BPO is easy to use by corporate clients as it is offered as a new payment term next to existing ones (e.g., letter of credit, advanced payment, open account payment) as documented in the ICC Model International Sale Contract.

As shown on figure 4, the Bank Payment Obligation enables banks to extend their SCF offerings to higher value services.

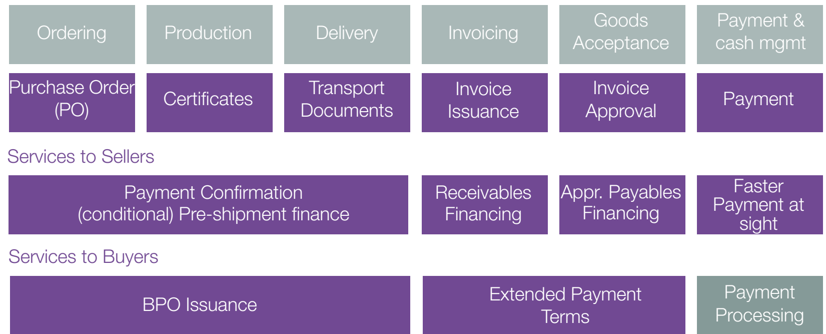

Figure 4 - With the BPO, banks can offer risk and financing services to address concerns related to use of open account agreements.

Correspondent Banking relationships will extend to process BPO transactions

In order to offer BPO-based services, banks implement the inter-bank Uniform Rules for BPO (UR BPO) as well as the underlying messaging standards. This is facilitated by SWIFT's ISO 20022-compliant inter-bank messaging and transaction matching cloud application called Trade Services Utility. For banks, the BPO is very convenient to use as it integrates into the correspondent banking agreements that banks have in place for international payment and trade transactions.

Figure 5 shows how the BPO fits into the two-bank model and re-uses the correspondent banking practices so that corporates can benefit from the BPO with their chosen banks.

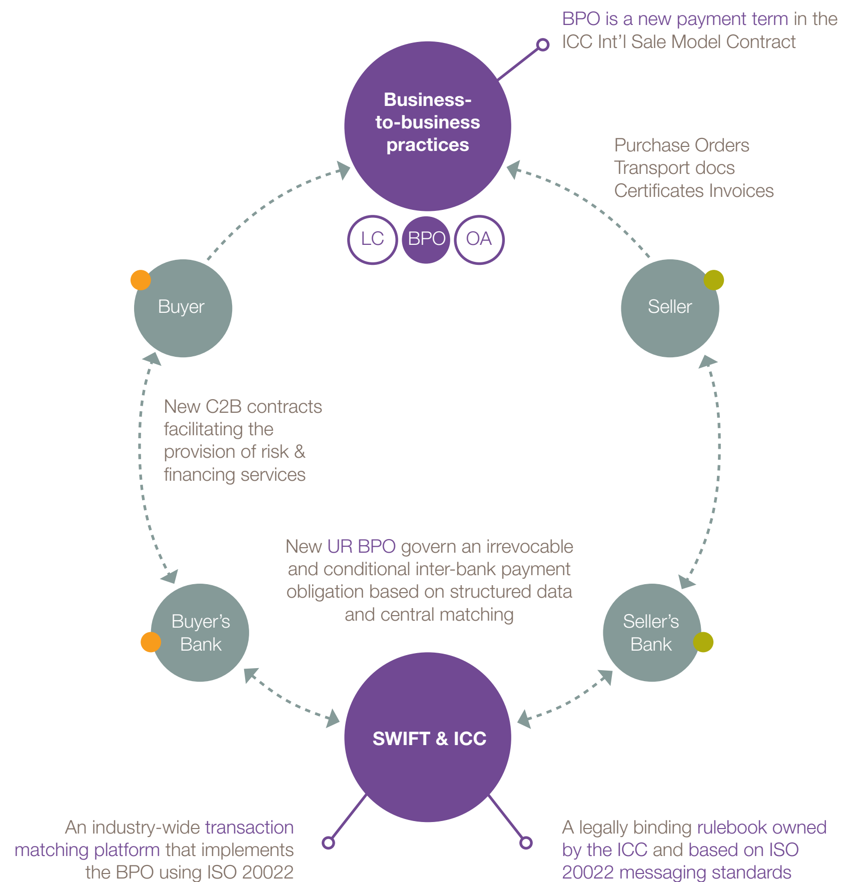

Figure 5 - The 4-corner model relies on the correspondent banking practices and enables corporates to benefit from the BPO with multiple banks.

The BPO integrates into eDocumentation and eCommerce platforms

Trade flows are increasingly digitised. Platforms supporting electronic commerce are proliferating around the world, enabling manufacturers, wholesalers and their clients to digitally transact with each other. Currently, the market is diverse, ranging from a handful of dominant purchase-to-payments platforms (e.g., Ariba, Basware and Coupa) with each of them connecting more than 1 million businesses around the world and handle more than USD 500 million worth of transactions, through to hundreds of industry- or country-specific e-invoicing hubs. The result is more efficient procurement, accounts payable and accounts receivable functions and also improved working capital.

Digitisation of trade flows can also be illustrated by the transformation of one of the most manual processes in world trade – the bill of lading. This document, issued by a carrier, contains shipment of merchandise details and gives the title of that shipment to a specified party. These documents are used in international trade and help guarantee that exporters receive payment and importers receive merchandise.

essDOCS has been driving the digitisation of bills of lading through its CargoDocs electronic bill of lading solution, working with the carriers and freight forwarders that issue them. Because CargoDocs electronic bills of lading are legally and functionally equivalent to paper bills of lading, they are ideally suited for faster and automated handling by bank systems. "Our Corporate users want to ensure trade flows are processed as digitally as possible in order to avoid long manual processing time required to exchange and process paper-based information", explains **Alexander Goulandris, CEO, essDOCS**. He adds: "The new BPO trade settlement instrument is an efficient way to involve banks in our electronic documentation hub for risk and financing services."

Figure 6 depicts how essDOCS CargoDOCS BPO+ solution supports BPO transactions.

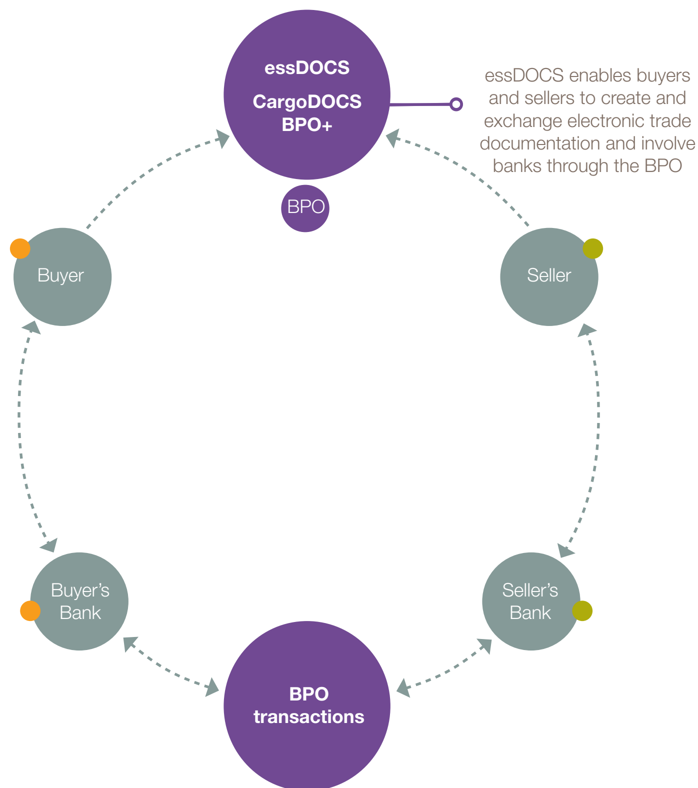

Figure 6 - essDOCS CargoDOCS BPO+ combines the use of eDocumentation with the BPO, linking buyers and sellers and facilitating the corporate-to-bank flows.

Development Banks have an opportunity to extend their roles too

Given the intended global use of the BPO and the high demand for pre-shipment finance from SMEs in emerging markets, the involvement of multi-lateral development banks (MDBs) in BPO transactions will be critical in some geographies. As the BPO shares features similar to those of the letter of credit (i.e., both commercial banks have full visibility on transaction details and BPOs are self-liquidating transactions), MDBs have the opportunity to extend their role on BPO transactions. Typically, BPOs issued by buyers' banks can be secured by MDBs using techniques similar to those established for letters of credit, i.e., by issuing guarantees on BPO transactions issued by the BPO obligor bank, which is usually the buyer's bank.

Figure 7 depicts how MDBs can get involved in BPO transactions.

"Multi-lateral development banks aim to support local banks as well as the SME market", explains **Steven Beck, Head of Trade Finance at Asian Development Bank (ADB) and Member of the ICC Banking Advisory Board and of the WTO Working Groups for Trade Finance**. He adds: "The new BPO trade settlement instrument is an efficient way to extend export financing to SMEs in Asia and we trust this new mechanism will contribute to increasing support to this vital segment of the economy."

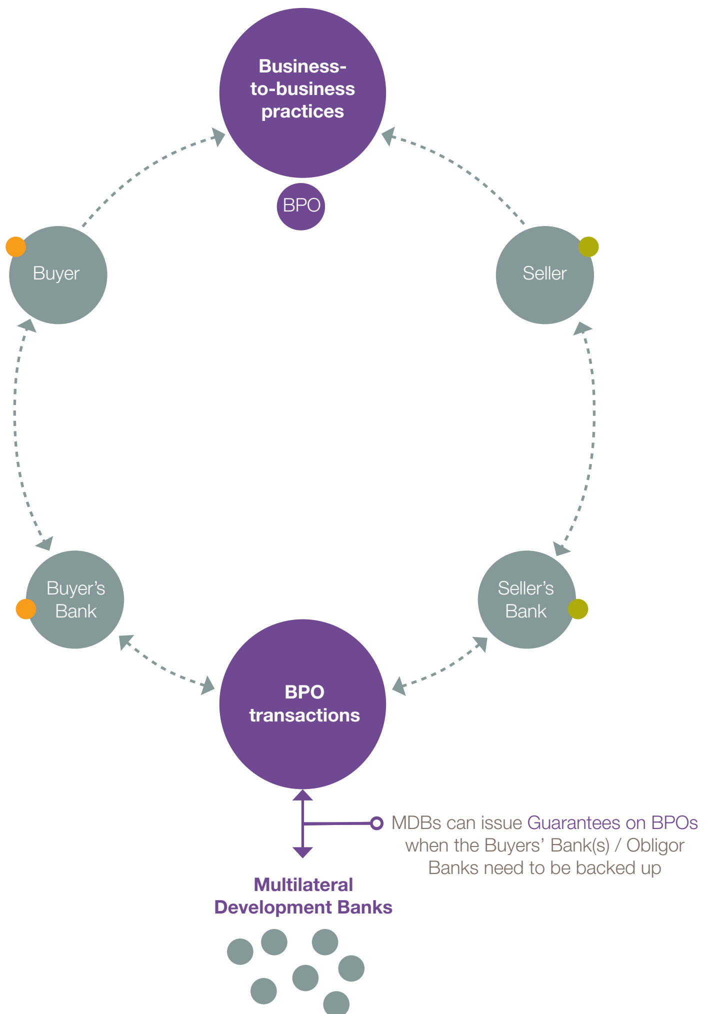

Figure 7 - Multilateral Development Banks will be able to issue Guarantees on BPO transactions, in a similar way as they do on letters of credit today

Conclusion: moving open account payments to the trade finance space

For decades, trade bankers have demonstrated that working collaboratively and leveraging the appropriate standardisation bodies (such as ICC and SWIFT), can effectively address their clients' requirements and help them develop their business. Trade banks have developed the BPO instrument and the related ISO 20022 standards in order to efficiently support the further development of international trade in a modern way. By defining legal and technology standards, banks aim to better respond to their corporate clients' desire to accelerate financial processes and optimise their working capital as well that of their most critical counterparties.

The industry has attempted to dematerialise trade several times since the 90s and many initiatives have not delivered as expected. The first BPO implementations completed over the last two years suggest that this innovation will help the trade industry address the Digital Trade challenge.

Early adopters confirm as follows:

Claudio Camozzo, Global Transaction Banking Co-Head at UniCredit and SWIFT Board Member:

"UniCredit worked on BPO right from the beginning and was active in drafting the uniform rules for the BPO. When we completed the first BPO in Germany and in Italy we established our leading position in managing BPO transactions in Europe. Since then we have received many client requests from both mid-caps and multinationals. UniCredit is the European banking gateway to the world, and can leverage its broad correspondent banking network and presence in more than 50 markets. As a consequence, we are able to offer services that enhance operational efficiency and mitigate payment risk for the ever growing volume of trade transactions that are managed on an open account basis."

Ural Inal, Finance and Procurement Director, CFO at Temsa Global:

"Corporates are more than ready to shift to digitized modes of conducting business, from e-invoicing to e-financing and full e-commerce models. The amount of paperwork required of us from banks still reflect twenty-year old practices and processes. Digitization is the future, the technology is well advanced and rich in capabilities: financial institutions will simply have no alternative but to catch up: we already move very quickly in concluding trade transactions through global technology and communication platforms and ERP systems – there is almost no time lag, and we can operate 24/7 as required by our business and our customers: banks must be equally responsive. The BPO is an excellent illustration of what can be done, and as next-generation managers take leadership roles, such technology-based, efficient models will be expected by bank clients."

Vivek Gupta, Global Head of Trade & Supply Chain Product at ANZ:

"ANZ's industry standard BPO transaction set the tone for the success of BPO and the ongoing technological evolution of trade finance flows. Through this structure, ANZ has innovatively addressed the critical missing gaps one encounters while approaching BPO in isolation and has thereby demonstrated that great value can be delivered through a strategic and collaborative approach across clients and various supply chain partners."

Frank-Oliver Wolf, Head of Commerzbank Transaction Services Germany at Commerzbank AG:

"After going live with the BPO in October 2014, we are pleased that our customers responded positively to the BPO and processed other BPO transactions with us. Being the leading Mittelstandsbank in Germany, we are ambitious to expand our BPO business in Germany and abroad, we see opportunities in the context of supply chain finance and the market trend for digitisation of trade flows, benefiting from our relationships with about 5,000 credit institutions worldwide."

Michaël F. Van Steenwinkel, Global Credit Manager, Petrochemicals at BP:

"In the context of digitization, our focus currently is on the Bank Payment Obligation, where we see potential and the opportunity for creative solutions. We have been doing several BPO's so far, in some instances replacing other trade finance products, in other instances allowing our buyer to benefit from working capital optimization. We complement the BPO with our own SWIFT address and an additional platform we use for our trade transactions, which is partially digitized and partially requires data entry. We may be 'kicking in an open door' by stating this, but transaction lead times in trade are compressing, and traditional L/Cs are often no longer fit for purpose: digitization is here, and the BPO is a natural channel for digitization into the world of trade."

Michael Vrontamitis, Head of Trade Products, Transaction Banking at Standard Chartered:

"Digitisation is changing how trade is being conducted globally. Whilst the industry is still more accustomed to existing traditional trade settlement methods, Bank Payment Obligation presents unique opportunities for banks to leverage SWIFT's uniform rules to provide alternative risk mitigation and financing options for our clients. This transaction reiterates Standard Chartered's commitment to supporting our clients, such as Al-Sayer, in their evolving trade and supply chain finance needs with innovative solutions such as the BPO."

Mubarak Naser Al Sayer, CEO at Al-Sayer:

"We are pleased to pioneer this trade innovation in our industry and markets. Delays in receiving title documents, which affect the timely receipt of goods, have always been a significant challenge for us. With the help of Standard Chartered, we can now enjoy much faster turnaround times by utilising the BPO for trade settlement, and in the process, avoid additional costs such as commission and demurrage charges."

It seems that getting ready on the BPO sooner than later is a wise choice for trade bankers.

Next step: getting ready on the new ICC and SWIFT SCF standards

The time has now come for the banking community as a whole to prepare for the growing ditigisation of commerce and finance processes. Banks now have the opportunity to extend their supply chain finance services from invoice-based processing services (e.g. factoring and early payment services) to purchase order-based services, such as payment assurance, pre-shipment and receivables / payables finance. By promoting the BPO payment term to trading counterparties, banks will accelerate the financial supply chain and become better financial partners.

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56238 - SEP 2015

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