Accelerating Global Trade Finance

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The partnership between the International Chamber of Commerce (ICC) and SWIFT will revolutionise global trade finance practices by leveraging electronic transaction data available from dematerialised business-to-business (B2B) processes and by establishing paperless inter-bank practices.

In an opinion piece, entitled "Collaborative Supply Chain Finance: A Few More Steps to Go", published in SWIFT's Dialogue magazine on October 2010, I advocated that the time had come for "the ICC [International Chamber of Commerce] to embrace the BPO [bank payment obligation] rules and help the industry establish best practices in supply chain finance". I also suggested that a set of ICC rules governing collaborative supply chain finance will be "a key milestone" for the trade banks, as such rules will offer a legally binding, valid and enforceable risk mitigation instrument for financing open account transactions.

One year on, at Sibos 2011 in Toronto, the ICC and SWIFT confirmed their joint ambition and action plan to provide the global trade industry with new rules and tools in support of the development of international trade in the 21st century.

The ICC was established in 1919 to facilitate the flow of international trade. It was in that spirit that the Uniform Customs and Practice for Documentary Credits (UCP) were first introduced in 1933 to alleviate the confusion caused by individual countries' promoting their own national rules on letter of credit practice. The objective was to create a set of contractual rules that would establish uniformity. The ICC rules on documentary credits - UCP 600 - are the most successful privately drafted rules for trade ever developed.

SWIFT is a member-owned co-operative through which the financial world conducts its business operations. SWIFT provides a worldwide communications platform, products and services that allow customers to connect and exchange financial information securely and reliably. SWIFT also acts as a catalyst to bring the financial community together to collaboratively shape market practices, define standards, such as the ISO 20022 financial messaging standards, and develop global technology solutions, such as SWIFTNet messaging and transaction matching services.

The recently signed partnership is now well underway with an ambitious timetable aiming to establish the new BPO rules by 2Q13. The goal of both industry-owned organisations is to enable banks to extend the benefits of the letter of credit (L/C) to the open account world by re-using electronic transaction data available from their corporate customers. Using the BPO, sellers will benefit from timely payments whereas buyers will be able to support pre-shipment finance of their strategic suppliers without conceding advance payments.

Opportunity for the Trade Finance Industry

The physical supply chain has significantly increased efficiency through the use of new technologies and business models. By doing so, trading counterparties have accelerated their industry-specific processes, reduced handling costs and inventories, increased visibility and improved forecasting and planning. Some industries have succeeded to shorten order and delivery processes from an average 20 plus days to same-day execution. However, on the banking side, most of the supporting global trade finance processes have not been optimised sufficiently due to paper-based practices slowing down key processes, such as discrepancies handling.

The time has now come for the trade finance industry to link the delivery of financial services to what is actually happening in the physical supply chain in a more efficient way: i.e. using electronic transaction data. The emergence of trading hubs (e.g. South Korea, Taiwan and Hong Kong) and business-to-business (B2B) e-commerce/e-invoicing platforms (e.g. Ariba, GXS, PayModeX, Peppol and Tradeshift) has significantly increased the dematerialisation of B2B processes, such as sourcing, negotiation, quotation, ordering, shipping, invoicing, etc.

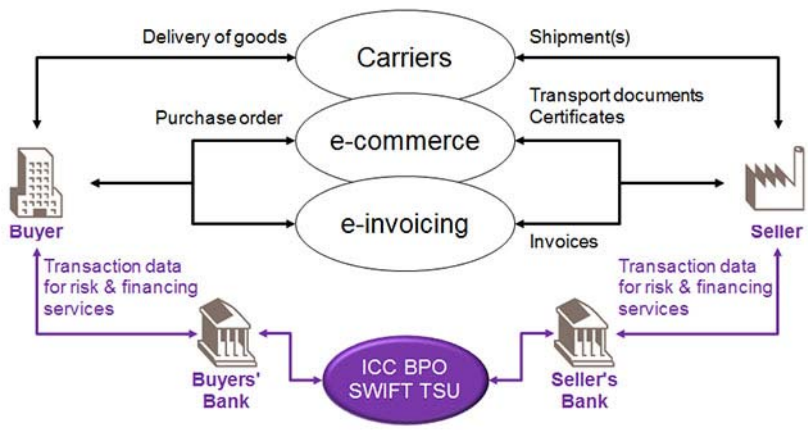
Such new electronic B2B processes have created a new paperless world where efficiency gains and cost reduction are achieved to the benefits of both buyers and sellers. Buyers and sellers now expect their banking partners to follow suit.

ICC BPO Leverages Electronic Transaction Data

The dematerialised B2B processes offer banks the opportunity to extend today's paper-based trade finance services to new services based on electronic transaction data.

The co-operation between the ICC and SWIFT is delivering a complete package made of new rules (the BPO), as well as new messaging standards (ISO 20022 standards) and a new SWIFT cloud application for supply chain finance (Trade Services Utility (TSU)). The new rules and messaging standards enable banks to leverage electronic transaction data available from the B2B world. Using data representing the purchase order, invoice, certificates and transport documents offers banks the ability to accelerate global trade finance processes, as well as increase visibility on transaction details (e.g. line items) in order to better mitigate risk and finance transactions.

Figure 1: ICC BPO Rules and SWIFT's TSU



Source: SWIFT

ICC BPO: A Modern Instrument

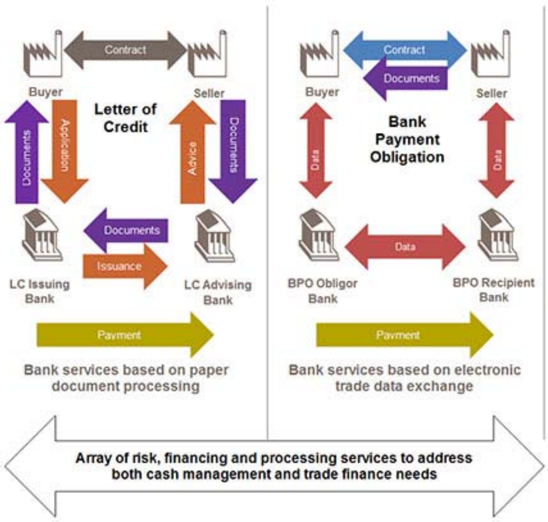
There has never been an equivalent instrument to enable an exporter to trade on open account terms with the same degree of confidence that a payment will be executed in accordance with the terms of an L/C. The BPO is an irrevocable undertaking given by one bank to another bank that payment will be made on a specified date, after a specified event has taken place. This 'specified event' is evidenced by feeding the relevant data elements taken from a range of associated open account documentation, such as purchase orders, commercial invoices, advanced shipment notices, bills of lading, etc, into a shared matching application that then generates a 'match' report to show that the description of goods shipped matches precisely the description of goods ordered.

The BPO places a legal obligation on the issuing bank to pay the recipient bank subject to the successful matching of compliant data. In short, the BPO delivers business benefits and security equivalent to those previously obtained through a commercial L/C, while at the same time eliminating the drawbacks of manual processing typically associated with traditional trade finance.

Certainty of payment not only facilitates access to flexible forms of financing but also supports the more efficient management of working capital, enabling the release of substantial volumes of cash which might otherwise be trapped in the supply chain.

Whereas banks have attempted in part to plug the gap, for example through the issuance of conditional payment guarantees or standby L/Cs, the BPO acts as an electronic inter-bank conditional promise to pay offering a comprehensive and cost-effective risk mitigation and financing tool to all trading counterparties.

Figure 2: BPO Brings Benefits of L/C to Open Account Market



Source: SWIFT

ICC BPO Extends the Scope of SCF Using Electronic Data

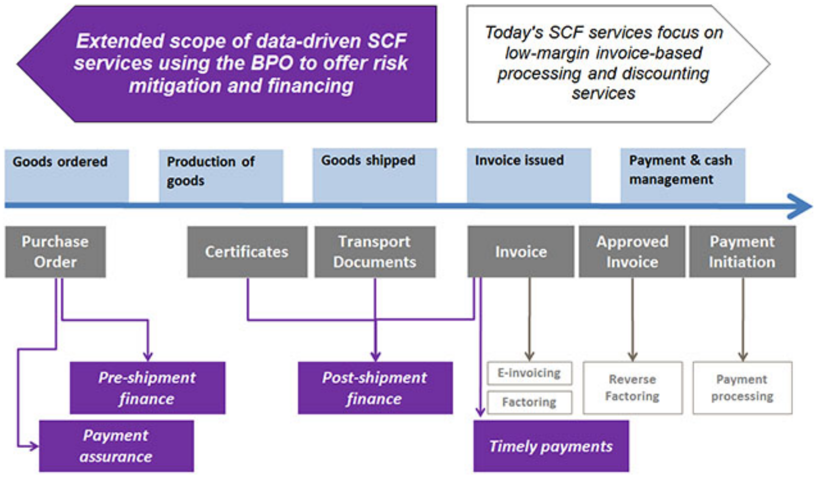
Although data-driven supply chain finance (SCF) solutions are widely available from large banks and from some third-party vendors, most are limited to the last mile of the transaction - i.e. using the invoice approved by the buyer to finance the supplier's receivables. Although addressing suppliers' working capital issues, this type of offering only represents a small - yet relevant - step when considering the real potential of supply chain finance across the full transaction lifecycle.

With the BPO, banks are involved as from the very early stage of the trade transaction, i.e. the raising of the purchase order, and at every stage of the transaction lifecycle. This is a key difference for banks that wish to provide, for example, payment risk mitigation and/or pre-shipment finance in a secure, efficient and collaborative way. Such services represent much higher value for corporates.

Both large and mid-caps sellers will enjoy timely payments when dealing on open account terms, since payment will be done by their own bank independently of effective payment by the buyers. When needed, buyers with strong credit ratings will be able to facilitate pre-shipment finance to support their critical suppliers while not using their own capital as it is often the case today.

Contrary to today's reverse factoring services which are driven by large buyers, the BPO is offering an industry-wide multi-bank instrument relevant to any type of corporate in any industry.

Figure 3: BPO Extends SCF Services to Higher Value Risk and Financing Services



Source: SWIFT

Conclusion

Both the ICC and SWIFT believe that by working together and leveraging their respective positions in the trade finance community, the BPO will have an important role to play in supporting the development of international trade in the 21st century by addressing cost pressures in the face of increased automation and changes in the regulatory environment. By using electronic transaction data, the banking industry is preparing itself to better respond to the desire of their corporate clients to accelerate financial processes and optimise working capital.

The time has now come for banks to prepare for this innovation and start extending their supply chain finance services from invoice-based processing services (e.g. e-invoicing, factoring and reverse factoring) to purchase order-based services, such as payment assurance, risk mitigation, pre-shipment and post-shipment finance. Banks will be able to better respond to key issues for sellers, such as delayed payments, whether dealing on L/Cs or open accounts. They will also be able to speed up processing and enable buyers to optimise credit lines and to reduce handling costs and inventories. Finally, buyers will be able to avoid supplier defaults by facilitating pre-shipment finance without using their own capital.

Some 19 banks have understood the opportunity offered by the BPO and last year confirmed their decision to adopt the BPO. As corporates will discover the benefits of the BPO in 2012/2013, they will be expecting their banking partners to react quickly. Waiting for the ICC publication of 2Q13 and missing the opportunity to get ready in 2012 is, in my view, a mistake banks ought to avoid making.

List of Banks Adopting the BPO (January 2012)

1. Banco do Brasil
2. Bank of China
3. Bank of Communications
4. Bank of Tokyo-Mitsubishi
5. BMO Capital Markets
6. BNY Mellon
7. China Citic Bank
8. China Minsheng Bank
9. Commercial Bank of Dubai
10. Commerzbank
11. Deutsche Bank
12. First National Bank
13. Hua Nan Bank
14. JP Morgan
15. Kasikornbank
16. Korea Exchange Bank
17. National Bank of Greece
18. Standard Bank of South Africa
19. Standard Chartered Bank

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