THE PAYMENT PLEDGE

BPOs ARE WELCOME DEVELOPMENTS IN TRADE FINANCE. TONY ANDERSON EXPLAINS WHY

The International Chamber of Commerce (ICC) and financial messaging provider SWIFT jointly launched the Uniform Rules for Bank Payment Obligations (URBPOs) on 17 May 2013. URBPOs are a set of uniform rules, which are promoted as offering the benefits of letters of credit in an automated and secured environment without manual processing, while also providing a new solution to supply chain finance moving forward.

This article will focus on:

- What constitutes a bank payment obligation (BPO);
- The issues in trade finance that pre-empted the development of the URBPOs;
- How BPOs are perceived to benefit trade finance (including supply chain finance) in the current climate; and
- The implications for companies and corporate treasurers from the introduction of the URBPOs.

What are BPOs?

A BPO constitutes an irrevocable undertaking given by a bank to another bank that payment will be made on a specified date after a specified event has taken place. Evidence of the specified event having occurred is provided by a match report of electronic data generated by SWIFT's trade services utility (TSU) or an equivalent application, according to an industry-wide messaging service that has been developed (ISO 20022). The URBPOs and ISO 20022 form the basis of this new proposition in trade finance.

Matching an electronic date via an industry standard rather than through the manual matching of bilateral paper documentation, which currently occurs with letters of credit (LCs), will provide significant time savings and improvements in working capital positions for participants. Banks should be incentivised to develop complementary pre- and post-shipment finance products based on the URBPOs.

SWIFT also envisages that the messaging that will be used for BPOs will be adaptable to enable banks and their corporate customers to communicate and enable end-to-end, straight-through processing of payment transactions electronically. This is a further advantage over the manual processing involved with LCs.

What pre-empted the development of BPOs for trade finance?

Globalisation, the growth of internet commerce and liberalisation of trade in emerging markets have all changed the landscape for international trade significantly. There has been a decline in the use of LCs as a means of facilitating trade finance over the past decade. A significant degree of global trade is now being conducted between parties on 'open account'. Under open account, a supplier simply invoices the purchaser after goods have been delivered.

One of the key reasons for the shift away from LCs was the delay in payments associated with paper document processing. David Vermylen, the global credit manager of BP Chemicals, which is one of the first major exporters to use BPOs, told *The Corporate Treasurer* earlier this year that before the introduction of BPOs, BP "could physically move 150,000 cubic metres of liquefied natural gas faster than it could process 500 grams of paper".

BPOs, however, are not being positioned as an alternative to LCs, but primarily as a substitute for companies that would otherwise trade on open account. These companies should benefit from easier access to banks for secure transactions without the complexity of the paper trail associated with LCs.

How are BPOs perceived to benefit trade finance (including supply chain finance) in the current climate?

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Until they are rolled out and tested, questions will remain around the effectiveness of the URBPOs and any offerings by the banks to be developed off the back of them

The ICC is currently arguing for the carving out of short-term trade finance from the application of the leverage ratio under the capital and liquidity requirements being imposed on banks by Basel III. This argument is based on the far lower rate of default on this financing in comparison with bank loans to corporates. The ICC collected data from 21 global banks providing over $2 trillion in short-term, export-related credit, constituting 65% of the world's total. According to its *Global Risks – Trade Finance 2013* report, published in April, fewer than 1,800 of the 8.1 million transactions were found to be in default (0.021%).

Home repossessions in the UK by contrast were 0.3% (14 times higher than the default rate for short-term trade finance) and default rates for one-year, single-A-rated UK corporate loans were over 0.6% (close to 30 times higher). Longer-term trade finance loans, however, had a default rate of 1.11%.

Regardless of the success of this argument, the URBPOs can still facilitate an increase in this type of funding although the ICC accepts that the increase is not likely to be immediate. Banks still face pressure on discretionary spending, which has impacted on their ability to establish proprietary BPO platforms. According to SWIFT, there is significant interest in BPOs, with 38 banks looking to adopt them, including 14 of the leading trade finance banks globally.

The ICC and SWIFT have highlighted the following benefits of BPOs:

- ◆ Mitigation of risks in international trade for both buyers and sellers;
- ◆ Reduced costs and improved accuracy;
- ◆ Convenience, speed and reliability;
- ◆ Enhanced risk management;
- ◆ Payment assurance;
- ◆ Accessible, flexible financing options; and
- ◆ Security of supply chains.

What are the implications for companies and corporate treasurers from the introduction of the URBPOs?

In the current environment, where working capital and efficient use of balance sheets have become paramount for corporates, the use of BPOs in conjunction with an efficient cash management system would appear to provide significant opportunities for banks to develop viable solutions and new products for corporates in the trade finance space. This should be welcome news for corporate treasurers. Whether corporates will be in a position to take advantage of this new landscape, however, will depend on a number of factors.

Firstly, it is acknowledged by the ICC that the success of BPOs will depend on the uptake by trade finance banks in using this form of finance, including their investment in the platforms and other infrastructure required to accommodate BPOs. If few banks offer products based on the URBPOs, there is little that corporate customers can do. As mentioned above, this will depend in part on the discretionary spend capacity of banks, which is markedly different across institutions.

Secondly, if the ICC is successful in arguing for the exclusion of short-term trade finance from the leverage ratio under Basel III, this should increase the appetites of banks to develop and invest in their trade-financing capabilities.

Thirdly, concerns about trade finance continuing to retreat behind national borders will, among other consequences, impact upon the uptake of BPOs.

Finally, until they are rolled out in July and tested in the courts, questions will remain around the effectiveness of the URBPOs and any offerings by the banks to be developed off the back of them.

In any event, their intent in streamlining the process and creating an assured payment methodology are welcome developments in trade finance at the current time.

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