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Discussion Paper



Prepared by the ICC Commission on
Banking

Frequently Asked Questions – Banks

Prepared by the Commission on Banking's BPO Education Group

Highlights

- The Bank Payment Obligation is an instrument designed to provide risk mitigation and the basis for financing of transactions between buyers and sellers who chose not to use documentary instruments but rely upon the exchange and validation of data to effect payment.
- With the adaption by the ICC Banking Commission of the Bank Payment Obligation this discussion paper has been developed to answer questions that result from Banks becoming increasingly aware of the BPO. Though not viewed as a competing instrument to the traditional documentary instruments, the frame of reference of parties interested in the instrument leads to logical comparisons between the L/C and the BPO.
- This guide can be used in conjunction with the Bank Payment Obligation Presentation developed by the Education Committee or on a stand-alone basis.

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If a bank is interested in becoming a participant member immediately for BPO (Bank Payment Obligations), how do we go forward?

A bank will first register with the SWIFT Trade Services Utility (TSU). The bank can register on-line via www.swift.com. The registration fee varies according to the global tier of the bank. Once registered, Swift will assist the bank to go live. For further information please email SWIFT at supplychain@swift.com. With ICC Approval of URBPO, other services providing Transaction Matching Applications, similar to the TSU, are eligible to support BPO transactions.

What are the operational savings one could expect from enrolling in the TSU or similar Transaction Matching Application?

Operational savings will include first a reduction in the expense of document examination. Secondly, there will be a reduction in the number of discrepancies thanks to an improvement in the matching rate that can be achieved by electronic data presentation. By reducing the number of discrepancies, banks and corporates will be able to reduce the investigation effort, avoiding disputes, delays etc. The impact will vary from business to business.

What is the difference between an L/C and a BPO?

An L/C requires physical presentation of documents through the banking system. Under a BPO those physical documents will be sent directly from seller to buyer, as in an open account transaction. However, selected elements of data which have been extracted from the documents will be routed through the banking system for the purposes of automated matching in order to mitigate risk and to support the value proposition for a financial service e.g. supply chain finance pre-or post-shipment financing. Also, the BPO is issued in favour of the Recipient (Seller's) Bank and not in favour of the exporter.

What is the risk differential between BPO & L/C?

The BPO is an inter-bank instrument to which the corporates are not a party and is designed to mitigate the risk for the Recipient Bank. Any risk mitigation by the Recipient bank in favour of the seller is separate from the BPO. The BPO thus enables a bank (Obligor Bank or Recipient bank) to provide risk mitigation in the context of an open account and supply chain financing solution. Both the L/C and the BPO can therefore act as a) a means of mitigating risk; b) providing the exporter assurance of payment; c) a form of collateral for financing. As the BPO is focused on open account transactions, it is conducive to support a broader range of financing options including pre-export and supply chain finance.

Under the BPO scenario, presumably banks expect to charge fees to their customers?

Yes. The banks will set their own tariffs when charging the corporate customer. Those charges will vary from bank to bank. Fees paid to the Obligor Bank would typically reflect the transaction processing costs of managing data input/ exchange with the Transaction Matching Application (TMA) as well as a risk premium for the buyer based upon their credit worthiness. The Recipient Bank would charge fees for transaction processing costs of managing data input/ exchange with the TMA on behalf of the seller and possibly, a risk premium associated with the credit worthiness of the Obligor Bank if the Recipient Bank is offering some form of risk mitigation to the exporter.

How will BPO fees compare to L/C fees?

Each bank will set its own tariff and charges will thus vary from bank to bank. One would expect that the use of a Transaction Matching Application would reduce the transaction processing costs compared to L/C fees. Risk fees are expected to be at the same rate as for an L/C but may be charged for a shorter period as a BPO can be added at any point in the trade cycle, so exposure duration is likely to be shorter than with an L/C.

What message types and data are supported in BPO?

A set of ISO 20022 messages has been developed for the BPO. The relevant ISO 20022 tsmt messaging standards and related documentation are available on the iso20022 web site (www.iso20022.org), page “Catalogue of ISO 20022 messages” tsmt.001-052. Data elements which are part of a Transaction Matching Application (TMA) transaction represent the following document types: purchase order, commercial invoice, transport and insurance documents, and certificates.

Are there limitations to the data fields in the baselines supporting BPO? Of concern is the availability of data for compliance screening.

There is an incorrect perception in the market that BPO baseline messages are always very complex, while in fact the number of mandatory fields to complete a BPO is very limited. This does not prevent banks from including other data elements as and when required in order to satisfy e.g. regulatory compliance as the ISO 20022 message set underlying the BPO can represent most data elements found in documents associated with L/Cs.

Is there an internationally accepted standard for the BPO e.g. similar to UCP 600? Does the legal enforceability of the concept need to be checked in each jurisdiction?

Unless otherwise specified in the BPO the governing law and jurisdiction will be that of the Obligor Bank. The ICC has published rules governing the BPO, the Uniform Rules for the Bank Payment Obligation Publication 750 which are expected to have the same effect as UCP 600 has for L/Cs.

What is meant by "ICC adoption of BPO"?

The ICC Banking Commission has developed rules which recognize the Bank Payment Obligation as an accepted market practice in much the same way as the L/C has become an accepted market practice with the support of UCP. The BPO adoption process has resulted in the publication by the ICC of a set of rules governing the usage of the BPO called the Uniform Rules for Bank Payment Obligation (URBPO) 750 which are similar to but much shorter/simpler than UCP. The only material difference between URBPO and SWIFT rules articulated in the TSU Rule Book is that SWIFT rules were TSU-specific whereas URBPO supports market adoption of the BPO regardless of any underlying technology.

What is the status of the ICC rules for the BPO?

The ICC Banking Commission has approved the Uniform Rules for Bank Payment Obligation (URBPO 750) at the Banking Commission meeting of April 2013. The URBPO was officially launched in mid-May with effect as of July 1, 2013. These rules will be technology-independent. The only material changes that need to be made relate to the availability of the BPO through alternative technology platforms i.e. de-coupling the BPO from the mandatory use of the TSU.

Does the Seller's Bank have an obligation to pay, or only the Buyer's Bank?

Under a BPO, the Obligor Bank (which is often but not always the Buyers Bank) carries the obligation to pay the BPO Recipient Bank (which is always the Sellers Bank). The obligation of the Seller's Bank to pay the seller is outside the direct scope of the BPO and may be covered separately in the related agreement between the bank and the customer.

If the Buyer's Bank goes bankrupt, would the Seller's Bank be obligated to pay?

The only obligation arising from a BPO is that of the BPO Obligor Bank to pay the BPO Recipient Bank. The Seller's Bank (Recipient Bank) is under no obligation to pay the seller under URBPO. If a baseline has been successfully established between the Buyer's Bank and the Recipient Bank (Seller's Bank) and the payment has yet to be effected (deferred payment BPO) then in the case of bankruptcy of the Buyer Bank (Obligor Bank) the Recipient Bank may agree outside of the URBPO to pay as it has accepted the risk of the Obligor Bank.

If the Buyer's Bank does not perform in a timely manner, is there an obligation on the part of the Seller's Bank to pay the seller?

No. The URBPO relates only to the obligation of the Obligor Bank (often but not always the Buyer's Bank) to pay the BPO Recipient Bank (always the Seller's Bank). However, under the service agreement between the Seller's Bank (BPO Recipient Bank) and the seller, the former may have taken on certain commitments which go beyond the URBPO.

If the buyer does not pay, who is responsible to pay the seller? Obligor Bank or Recipient Bank?

The only obligation arising from a BPO is that of the BPO Obligor Bank to pay the BPO Recipient Bank. The obligation of the BPO Recipient Bank to pay the seller as ultimate beneficiary will be covered in the underlying agreement between bank and customer.

Could BPOs be provided which act in a way similar to Standby L/Cs?

No. BPOs are primary payment obligations linked to an underlying trade transaction between buyer and seller. In this respect, they are similar in nature to commercial letters of credit and not Standby L/Cs.

How would a BPO prevent a fraudulent shipment?

The BPO does not in itself prevent fraud. Of course, banks will be required to carry out their standard KYC & due diligence checks for their customers before engaging in any transactions. However, banks submitting data are not required to validate the data they submit to the TMA but are only expected to ensure that the data received from their customer is the same as the data submitted.

How would the BPO handle the sanctions clauses that are so common in L/Cs nowadays?

Sanctions screening must be performed on all BPO transactions as required under local, international and European regulations, even when there is no sanction clause in the instrument. This is outside the direct scope of the TMA and should form part of the banks' standard operating procedures. All parties to a BPO transaction will have access to the same level of information for screening purposes. Furthermore, each bank should take a view as to how it wants to behave towards sanctions clauses in its contracts with its counterparties.

eUCP was developed to facilitate the exchange of electronic documents. Is there any intention to integrate eUCP with the URBPO?

The scope of the two sets of rules is different. The eUCP is a supplement to UCP designed to accommodate the presentation of electronic documents (e.g. scanned images) under a letter of credit. The eUCP will continue to exist in its own right alongside URBPO. An additional advantage of the BPO is that it is underpinned by ISO 20022 messaging standards enabling fully automated data

processing rather than the reliance upon documents in either conventional or electronic form.

What is the difference between a BPO and a L/C using eUCP? How can transport documents like a bill of lading be handled under BPO?

The letter of credit and the BPO represent two alternative methods of payment. Where a letter of credit allows the presentation of electronic records the related terms of payment will be governed by eUCP as a supplement to UCP. If a BPO is used, the related terms of payment will be governed by the URBPO. In this case, the proposition is enhanced by the automated matching of data. Transport documents like bills of lading will provide a source of such data to populate the fields that are included in the transport data set. The information in the transport data set is matched against information in the baseline and other data sets. In this case, the transport (routing) information in the transport data set is matched against the corresponding transport (routing) information in the baseline. Physical documents will move between seller and buyer outside of the banking channels unless otherwise agreed by the parties.

Is it necessary to have an agreement between banks?

All banks participating in a BPO/TSU transaction must be subject to the URBPO and in so doing accept the terms set out in the rules. The establishment of a baseline represents the agreement between banks for any given transaction. There is no need for bilateral agreements to be negotiated separately between banks. Under the URBPO banks who subscribe to the rules are governed by them as is the case under UCP or other ICC publications. In addition, if the banks choose the TSU as their TMA, the bank will be subject to the SWIFT TSU Rulebook.

Similar to the L/C, is it possible to have a BPO “confirmed”?

The BPO is a bank-to-bank obligation. As such a BPO Recipient Bank may be taking on the risk that the BPO Obligor Bank does not pay. Since the BPO is bank-to-bank only the BPO cannot be “confirmed” in the same way as a L/C can be confirmed. However, the exact terms of payment are covered in the Bank/Customer Agreement. This means in effect that in all cases the seller’s own bank (which is always the BPO Recipient Bank) will be the bank that “silently confirms” payment to the seller if agreed separately.

Can a BPO be transferred or assigned like L/Cs? Is there such a thing as a transferable BPO, as in L/C?

No. A BPO is a bank-to-bank obligation. As such, payment will be made from a BPO Obligor Bank (often but not always the Buyer’s Bank) to a BPO Recipient Bank (always the Seller’s Bank). The beneficiary of a BPO will always be the Seller’s Bank not the seller so transferability is not an option. The seller may instruct the BPO Recipient Bank separately to execute payment in favour of a third party assignee who may have been responsible for the actual delivery of goods

Will the BPO be a good alternative for documentary collections as well? If yes, what about physical documents?

A documentary collection may be regarded as a more secure alternative for the seller compared to trading on open account, but less secure than a L/C. The BPO would be more secure than a documentary collection since there would be an obligation to pay. This obligation would be based upon the presentation of data through the banking system rather than physical documents. The documents would be sent directly to the buyer.

What has been the experience in the Proof of Concepts from the point of view of requirements to change the bank operational organization when moving to BPO ?

The BPO offers a new instrument in support of trade settlement. As a result the implementation of BPO is a business paradigm shift from paper handling to electronic processing that impacts sales, legal, accounting, credit management, risk management and operations. It will require a change in the existing processes as well as in the underlying IT infrastructures. Banks will need to update their trade portal to support the BPO flow and offer reporting and tracking services, similar to the services provided for L/Cs and guarantees. Back office applications need also to be connected to the TMA interface and support ISO 20022 XML standards. Fortunately, many banks already deal with XML messaging so the changes may not be dramatic. However, in the proof-of-concept, the process requires at the minimum the integration between the front and the back office at the bank to guarantee the expected “prompt” response time. Full STP will be required on the long-run to cope with transaction volume increase and multiple bank relationships: data transfer automation will be required between the trade platform at the client and the bank’s infrastructure. Offsetting these costs are anticipated savings in operating costs with the elimination of document examination and related manual process steps associated with these types of transactions.

Does the BPO work with the MT798?

No, the MT798 standards offer multi-banking standards for L/Cs and Guarantees; the ISO 20022 standards support the BPO. Both MT798 and ISO20022 standards work in parallel achieving different objectives.

Assuming that a customer of my bank wants to join BPO settlement who can find a counterparty willing to work on BPO settlement?

Over time, all trade banks will adopt the BPO. Today, more than 100 banks are registered to the TSU to support BPO transactions. Please email SWIFT at supplychain@swift.com to receive updated lists of banks offering BPO.

Can a multilateral or an ECA act as an Obligor bank?

In order to issue a BPO the Obligor will need to issue the instrument using an ISO 20022 compliant Transaction Matching Application, such as the TSU. SWIFT can provide you with updated information on who can get access to the TSU. Though ECAs at this time are not directly engaged in the BPO process, most are adjusting their agreements to support BPOs in addition to the traditional documentary means.

Is it possible to check for negative clauses (i.e. boycott clauses)?

The TSU does not do negative clause checking. It is the responsibility of each of the participating banks to enforce any of the local compliance requirements outside of the TSU/ BPO structure

In order to keep industry terminology consistent, instead of referring to a “silent confirmation”, would it not make more sense to call them “silent obligation” or “silent undertaking”?

The concept of “adding a confirmation”, i.e. the Recipient Bank of the BPO adding their undertaking to pay upon presentation of a compliant data set in favour of the exporter, is part of each bank’s own value proposition. A common terminology has thus not been defined for this concept and will be left for each bank to decide. The reason that the industry keeps referring to “silent confirmation” is merely because the market is familiar with the concept of a silent confirmation in the documentary Trade world. As to whether “silent obligation” or “silent undertaking” would be a better term, it completely depends on the bank’s value proposition and what agreement has been signed with the exporter.

The term “acceptance” is increasingly used in combination with BPO examples. Given that the definition of the BPO is an “independent undertaking of an Obligor Bank to pay or incur a deferred payment obligation”, can the BPO be available by acceptance at all?

The word “acceptance” in this sense does not refer to the same concept we are familiar with in the documentary Trade world, i.e. the acceptance of a bill of exchange. The BPO is based around presentation of data – the equivalent to an acceptance in the L/C world would be a clean data match report generated by the TMA or an acceptance message generated by the Obligor bank in case a data-mismatch has been accepted. In the BPO world the “acceptance” is more for negotiation purposes.

Is there any guideline for silent confirmation on the BPO?

There are no guidelines – the relationship between the seller and the Recipient Bank (as the beneficiary of the BPO) has not been defined as part of the URBPO and thus been left in the competitive space of each bank. Banks will determine their own BPO value propositions and the corresponding legal framework and contract with the counterparty (the seller).

Does the Recipient Bank need to conserve a paper copy of commercial invoice or other docs ?

In its strict definition, the URBPO does not require the banks to keep any paper documentation at all. Each bank will have to make a decision as to whether a paper record might be required for reasons such as audit, sanctions etc.

Why is the BPO marketed as a different product and not treated as a further development of the Letter of Credit?

Whereas the L/C is part of a traditional documentary Trade proposition, the BPO would be as part of bank-assisted Open Account trade and thus be somewhere between documentary Trade and Open Account. The L/C is based on paper documentation whereas the BPO relies on the presentation of data sets. The aim of the BPO is to enrich the portfolio for banks and to enable banks to provide more options for risk mitigation and financing in the open account space. The BPO proposition was therefore developed based on limitations with existing bank offerings in that space. There is no reason that the BPO and L/C cannot co-exist. The BPO takes over the best practice of the L/Cs but provides the banks with full visibility on the transactions. It also takes over the best practices of Open Account since the original documents are exchanged between the buyer and the seller. The BPO allows the banks to extend Supply Chain Finance services and make them based on international standards. With BPO, banks can be involved at the right stage, starting with the purchaser order, and can finance the invoice before the approval of the invoice. The BPO is there to extend Supply chain Finance practices and provide opportunities to move the market from 3-corner model to 4-corner model.

How do I integrate the BPO into my existing Trade and Supply Chain product set?

The BPO enables a bank to offer Purchase Order Commitment to Pay, Pre-Shipment Finance, Warehouse Finance, Post-Shipment Finance, Approved Payable Finance and Receivables Purchase in a ‘four corner model’. Today most banks offer these open account risk mitigation and financing services in a ‘three corner’ model.

Is the BPO an effort to make SCF better internationally regulated?

No – the BPO is not directly affecting the regulatory control of SCF but may be another means to offer supply chain financing.

There is a risk that the supplier creates a data set that is different from the content of the actual documents. Will this not affect the uptake of the BPO?

The integrity of both the buyer and seller/ supplier is obviously very important. The BPO aims at increasing efficiency. This is only possible if there is a certain level of trust between the seller and buyer as well as the respective banks. Each bank will follow their usual client selection, control and KYC processes and will have to ensure that the client will respect the contractual engagement and provides data extracted from the original documents only. The BPO was not designed to support transactions between two corporates (and banks) dealing with each other for the first time.

Letters of Credit are known to be subject to high costs. Will BPO help in lowering these costs?

Because BPO is based on electronic flows, banks will have lower costs in the bank-to-bank space. The electronic flows can also be used with corporates, so there are some costs that can be removed as well. However, the uptake seen by corporates in the market so far has not necessarily been to just reduce bank fees. The focus is clearly on increasing efficiencies: suppliers will get paid faster and all parties benefit from the bank-to-bank efficiencies.

In the documentary credit world, lately a so-called synthetic L/C becomes increasingly important with regards to facilitating financing (rather than facilitating a trade settlement). So is there any tendency to make BPO synthetic as well?

The concept of the BPO is still in its infancy and there is no concept of using a more synthetic structure at this stage. All BPOs have to be related to underlying transactions. The banks can then offer financing solutions for the exporter or importer based on the BPO.

Accounting & Capital Treatment

What is the view of large accounting firms on the BPO treatment?

The BPO Education Group has published a document on BPO Accounting & Balance Sheet treatment to provide some guidelines. Banks who have been examining the BPO have been reviewing the capital treatment or asset classification that and individual banks may have engaged accounting firms but there is not an official accounting industry opinion being developed to our understanding and awareness.

Are the accounting and capital treatment that are talked about today being proved right?

The treatment proposed in the white paper was endorsed by banks part of the Education Group, some of which are already active with the BPO.

For the time being, we have had no contradictory opinions received from other banks or regulators. Fortunately, we do not have any experience of losses and defaults with BPOs.

If the Recipient Bank does not add a confirmation what is the accounting treatment?

The notion 'confirmation' in the frame of a BPO does not exist in the rules Recipient Banks, as part of their commercial offerings to their sellers may develop products similar to the documentary

terminology of “silent confirmation” or “silent obligation”. If a bank does not offer a silent obligation of a BPO to its customer, the accounting treatment is similar to that of a payment. The bank will simply transfer the payment to the seller when it is received from the Obligor Bank. Since a bank does not take an engagement, it will be ‘cash in – cash out’.

What is the difference in capital / accounting treatment in case of discounting or pre-shipment finance?

Discounting:

In case of a BPO with a deferred payment undertaking, the Obligor Bank or the Recipient Bank (depending on what is in their agreement with the seller) can, after the matching of data with the Established Baseline (or after mismatches were approved if any) pre-pay or discount its deferred payment undertaking. It works just the same way as discounting or pre-paying a deferred payment undertaking or acceptance under a Letter of Credit.

From the moment of the Established Baseline until the moment of introduction of data matching the Established Baseline, the BPO is a contingent liability, off balance sheet.

From the moment there is a match, the liability becomes direct) so on balance, and if no discount is made, it remains unfunded.

If at that moment, or at a later stage in the life of the BPO the discount is made, it becomes on balance and funded (cash item). So during the lifecycle of such a BPO there might be 2 or 3 different forms of liabilities, depending of the fact that the request for discount comes at the moment of incurring the deferred payment undertaking, or later. To be considered as pure lending. The Recipient Bank can grant a loan to the seller, using the BPO of which the Recipient Bank is beneficiary, as a collateral. The risk of the Recipient Bank will be the same as with lending, be it that it also depends of the performance risk assessment on the seller. If the Recipient Bank is sure that the seller will fulfil his obligations, and will be able to present data conform to the Established Baseline, then the pre-shipment finance will be liquidated by the payment of the BPO. If the seller fails, the full risk will be on the seller.

In fact the same as a pre-shipment financing with a Letter of Credit in favour of the seller as collateral. In any case, such an arrangement will have to be mentioned in the agreement between Recipient Bank and seller (with possible pledge agreements, etc.).

Will the treatment of capital or accounting vary based on the agreement between Recipient Bank and seller?

As mentioned above, it will be dependent upon if the Buyers Bank and the Recipient Bank choses to create a direct liability or have the BPO remain as a contingent liability.

The International Chamber of Commerce (ICC)

ICC is the world business organization, a representative body that speaks with authority on behalf of enterprises from all sectors in every part of the world.

The fundamental mission of ICC is to promote trade and investment across frontiers and help business corporations meet the challenges and opportunities of globalization. Its conviction that trade is a powerful force for peace and prosperity dates from the organization's origins early in the last century. The small group of far-sighted business leaders who founded ICC called themselves "the merchants of peace".

ICC has three main activities: rules-setting, dispute resolution and policy. Because its member companies and associations are themselves engaged in international business, ICC has unrivalled authority in making rules that govern the conduct of business across borders. Although these rules are voluntary, they are observed in countless thousands of transactions every day and have become part of the fabric of international trade.

ICC also provides essential services, foremost among them the ICC International Court of Arbitration, the world's leading arbitral institution. Another service is the World Chambers Federation, ICC's worldwide network of chambers of commerce, fostering interaction and exchange of chamber best practice.

Business leaders and experts drawn from the ICC membership establish the business stance on broad issues of trade and investment policy as well as on vital technical and sectoral subjects. These include financial services, information technologies, telecommunications, marketing ethics, the environment, transportation, competition law and intellectual property, among others.

ICC enjoys a close working relationship with the United Nations and other intergovernmental organizations, including the World Trade Organization, the G20 and the G8.

ICC was founded in 1919. Today it groups hundreds of thousands of member companies and associations from over 120 countries. National committees work with their members to address the concerns of business in their countries and convey to their governments the business views formulated by ICC.



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Policy and Business Practices

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