



International Chamber of Commerce

The world business organization

Discussion Paper



Prepared by the ICC Commission on
Banking

Frequently Asked Questions – Corporates

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 of the Bank Payment Obligation as URBPO 750 by the ICC Banking Commission this discussion paper has been developed to answer questions that result from Corporates 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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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.

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.

What exactly is agreed in the establishment of the baseline?

The buyer and seller need to agree on the use of the BPO, the payment terms and conditions, the banks involved and what data elements of the trade transaction are necessary in order to effect payment. They then instruct their banks to create the appropriate baselines: The enforceability of a BPO ultimately depends upon the matching of data. The establishment of the baseline will determine exactly what data elements need to be matched in order for the BPO to be enforced. The baseline will normally include information extracted from the purchase order, details of the BPO (if any), payment terms and any other processing requirements.

Who decides the amount of data to be matched?

The amount of data to be matched is determined by mutual agreement between the buyer and the seller who instruct the involved banks.

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.

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.

Who in the chain of the BPO banks guarantees the correctness of the shipment of the goods as is the case in an export L/C where the exporter's bank verifies the truth and validity of the shipping docs?

According to the URBPO, an involved bank assumes no liability or responsibility for the accuracy of the data. However, a financial institution must ensure that the data it submits to the Transaction Matching Application accurately reflects the data and information it received." In the case of an L/C, the bank does not verify the "truth" of the documents. It checks that the documents are compliant "on their face". Under a BPO, the bank's responsibilities are much the same.

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 the URBPO. If a baseline has been successfully established between the Buyers Bank and the Recipient Bank (Sellers 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 Buyers Bank) to pay the BPO Recipient Bank (always the Sellers 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 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.

Do providers of 3rd party documents such as bills of lading need to agree to the BPO format?

The party which contracts with the shipper, agent, freight forwarder or other third parties (buyer or seller) could arrange that the data provided is in ISO 20022 format for entry into the Transaction Matching Application to satisfy the baseline requirements of the BPO. However this data can only be submitted by one of the banks who are party to the transactions. Alternatively one of the banks who are party to the transaction may provide as a service the necessary data conversion under a separate agreement.

How are disputes between buyers and sellers handled? What if there are disputes after payment has been executed?

Disputes between buyers and sellers are outside the scope of the BPO and would be settled through the normal course of business as all other commercial disputes are resolved. The BPO is a bank-to-bank obligation only.

How would a BPO prevent a fraudulent shipment?

The BPO does not by 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.

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 an L/C can be confirmed. However, the exact terms of payment would normally be 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 “confirms” payment to the seller if agreed separately.

I am a seller. If I wanted to ask a buyer to commence using BPO versus L/C, what are the key features of a BPO which would make it attractive to the buyer to use the BPO versus an unconfirmed L/C i.e. how do costs compare etc?

Commercial pricing of competitive offerings is a matter for the banks to decide. It will vary from bank-to-bank. If you are a seller, the BPO discussion with your customers is likely to revolve around processing efficiency. For example, physical documents will not be required to pass through the banking system as they do today under an L/C. Data matching is performed electronically reducing the related risks of discrepancies, disputes, delays, demurrage charges etc. With less paper the transaction processing costs may be reduced. Buyers and sellers will only have to focus on a limited subset of data or elements which will be digitized, electronically exchanged and matched. Electronic matching of elements of information will improve the quality and objectivity of the information, reduce the number of discrepancies and accelerate the process. This will reduce significantly the processing costs related to the trade data compliance verification.

Fees for risk mitigation will remain the same as the Obligor Bank will charge typically the buyer the same fee to assume the buyer’s risk under the BPO as they would under an L/C. If the Recipient Bank were to provide financing or “confirmation” of the Obligor Bank’s ability to pay (outside of the URBPO) the risk fees would also be similar to those under an L/C.

Unlike a conventional L/C arrangement, is it correct that no documents will be sent to the banks?

Correct. No physical documents are required to be routed through the banking system. With a BPO, the banks deal in data, not documents.

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. pre-or post-shipment financing.

Does BPO allow use of software from third party providers?

Software companies have developed applications that are complementary to TSU or the eventual TMA. Those providers can process the data on behalf of the banks/corporates but the data must go through the TSU/TMA submitted by a bank who is party to the transaction for the purposes of matching and report generation. With the issuance by the ICC of rules governing BPO (URBPO), third party systems can perform the data match function on behalf of the buyers and sellers who in turn will invite banks to participate in providing the BPO functions. The participating banks need to agree on which TMA is being used.

What is the difference between BPO and TSU?

The BPO may be regarded as a financial instrument (similar to a letter of credit) which can be established between banks as a means of mitigating risk, providing payment assurance and potentially to be used as collateral for financing. To make use of a BPO today banks must subscribe to a matching application managed by SWIFT. This is the TSU. The BPO forms part of a TSU baseline. The baseline specifies the data that has to be matched before the BPO becomes enforceable. The data is then matched by the TSU matching engine. Since the approval by the ICC of the URBPO, a Transaction Matching Application may be provided by third parties instead of SWIFT with banks retaining their role of providing risk mitigation through the Bank Payment Obligation.

Who has the final say for resolving a mismatch, the Buyer or the Bank?

In most cases the Buyer will have the final say to resolve a mismatch though they may delegate resolution of some mismatches to the bank.

What has been the experience in the Proof of Concepts from the point of view of "requirements to change the corporate customer's processes when moving to BPO" ?

The BPO offers a new instrument in support of trade settlement and offers a means for corporate customers to improve their efficiency by reducing paper handling in the commercial transactions. 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 starting with the underlying commercial agreements between buyer and seller as they adapt new payment terms. In many cases, both buyers and sellers have the commercial information in data format as they communicate among themselves and third party intermediaries. Under the BPO, they will include the banks in the electronic data exchange, repurposing their and/ or their third party provider's data. ERP applications need to be connected to their banks and support the ISO 20022 XML standards and workflow for BPO. Fortunately, many corporates already deal with XML messaging in the context of payments and cash management so the changes may not be dramatic.

What types of risk mitigation may be available through the use of the Bank Payment Obligation?

BPO provides a risk mitigation tool for:

- Financial risk of the parties in the supply chain such as the weak credit rating of the importer, the temporary need for working capital of the exporter and the bank financial risk. As for an L/C, the BPO can be transferred from the Obligor to the Recipient bank via a bilateral "confirmation" agreement between the Recipient bank and the exporter.

Contrary to the L/C, corporates can spread the risk among multiple Obligor Banks by requesting multiple BPO's for the same trade transaction not to exceed the value of the initial transaction.

- Commercial risk related to the fact that the importer refuses to honour its obligation to pay or forgets to pay or pays late. BPO is always an irrevocable obligation
- BPO is expected to perform better than L/C in terms of payment delays and payment default thanks to a faster processing and higher level of objectivity in the compliance verification.
- Transport risk related the shipment timing. As for the L/C, the BPO can be used to protect against shipment delays. Similar to the L/C, the BPO cannot however protect against loss, theft, deterioration as such.
- Economic risk related to fluctuations in currency rates, inflation rates and interest rates can be mitigated through the use of the home currency in the BPO or currency hedging (predictability of the cash flows).
- Political risks related to insurrections, terrorism and war are covered by the use of the BPO in the same way as for the L/C.

The use of the word “trade” in Article 1 of the rules seems to exclude “services” but in later articles it seems to include services.

This can apply to goods as well as services, as long as the product being financed can meet the terms of a commercial invoice data.

Is the BPO enforceable in all jurisdictions?

The BPO is a new instrument and will have to be tested in law. Historically, we found that local jurisdictions are willing to comply with rules that are published by a global governing organisation such as the International Chamber of Commerce (i.e. the UCP 600 for Documentary Credits) – there is no reason why we would not expect the same treatment for URBPO. In addition, the URBPO Drafting Group has received formal opinion around US law and got confirmation that the BPO is treated similarly to an L/C.

Can the BPO be transferred from an agent to a producer?

The BPO is a bank-to-bank instrument and is thus not transferable. However, as part of each bank's individual value proposition, they could potentially enter into an agreement transferring the proceeds to a third party not engaged in the transaction. So there is a possibility for assignment but no concept of a true transfer. In addition, banks could, again as part of their BPO value proposition, offer a transferability service similar to the Documentary Trade world, but this is not directly supported by the BPO.

If a bank goes bankrupt who is responsible for paying?

This depends entirely on the agreement the exporter has with the BPO Recipient Bank. If the seller has received an additional payment undertaking from the Recipient Bank, then the latter would still have to pay in case the Obligor Bank goes bankrupt.

Why is the bank the beneficiary of the BPO?

The URBPO have been restricted to the bank-to-bank space, hence why the beneficiary of the BPO is the Recipient Bank. The main commercial objective is the opportunity in the industry to develop a set of risk mitigations and financing services based on the BPO rules so that clients get what they require in terms of risk and financing using electronic data between the banks. Prior efforts to provide settlement via data exchange required all participants, banks and commercial parties, to subject themselves to the same rules and to use standard formats. Gaining conformance among all parties proved problematic. Hence the decision to enforce standardization among the banks as they currently

exchange information in standard formats (SWIFT messages). In the corporate-to-bank space any channel can be used to transfer the data (depending on the arrangement with the respective bank) reducing the demands on the commercial parties.

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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