



EURO BANKING ASSOCIATION

Supply Chain Finance

EBA European market guide

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Abstract and Management Summary

The Euro Banking Association (EBA) is a country-neutral banking association for payment and transaction banking practitioners with a pan-European mind-set and vision. In 2011, the EBA Board launched a new EBA Supply Chain Working Group (SCWG). The initial objective of the SCWG was to carry out a study of the Supply Chain Finance (SCF) market as represented by this Market Guide.

This document represents the second edition of the Market Guide and includes the work of the SCWG over the last few months as well as latest market developments.

The intended audience for the Market Guide is the European transaction banking community, both specialist and those with a general interest in SCF.

In addition to providing a wide range of descriptive and explanatory materials, the Market Guide makes a number of recommendations and expresses a number of positions developed by the EBA SCWG.

The key focus areas elaborate on the layers of work specified in the SCWG Terms of Reference, and are as follow:

- 1.** Describing the ecosystem for supply chain management and SCF and what drivers are propelling or constraining take-off and adoption.
- 2.** Raising issues relating to market terminology and conceptual language. In describing the various instruments of SCF the Guide proposes a 'holistic' approach and discusses some key definitions that need to be aligned in common industry parlance.
- 3.** Identifying and explaining the key risk and regulatory issues impacting SCF.
- 4.** Linking SCF to the trend towards automated supply chain processes and describing how it is benefiting and could benefit further from the application of technology and business-to-business (B2B) platform capabilities.
- 5.** Making recommendations on managing financial industry collaboration and partnerships at all levels.

A Market Guide of this nature must necessarily be focused as the topic is large and complex. The key categories of SCF instruments or enablers in focus are as follows:

Accounts Payable or Buyer-centric – called ‘Approved Payables Finance’ or sometimes ‘Reverse Factoring’, ‘Supplier Finance’ or ‘Confirming’, and sometimes (confusingly) simply ‘Supply Chain Finance’, and based on the discounted payment of accounts payable in favour of suppliers by accessing a financial institution’s or a buyer’s own liquidity. Another related instrument is Dynamic Discounting, through which a buyer itself provides variable discounts for early payment of supplier invoices.

Accounts Receivable or Supplier-centric – such as Receivables Finance (the category term used in this guide), Receivables Purchase and Invoice Discounting (all three being common names for similar financing instruments) and Factoring, which is a form of Receivables Finance but different in character from those previously mentioned.

Inventory-centric (or ‘pre-shipment’) – such as Purchase Order (P.O.)-based finance and Inventory Finance.

Bank Payment Obligation (BPO) – an interbank instrument developed initially by SWIFT (as a development arising from its SWIFT Trade Services Utility) and now adopted by the International Chamber of Commerce (to be governed by ICC rules set out in Uniform Rules for the Bank Payment Obligation (URBPO) on the basis of which a variety of SCF transactional structures can be enabled).

Traditional documentary trade finance – such as Letters of Credit, and documentary and related trade loans – summarised in an Annex.

Complemented by other instruments and enablers, e.g. other types of asset finance, longer term export and project finance, and hedging and payment instruments – not described in detail in this Guide.

The ecosystem

Following a short introduction, the Market Guide starts with an overview of corporate supply chain management and SCF trends and characteristics – the **ecosystem**. A summary of the essential conclusions of the analysis of the ecosystem is provided in the chapter entitled **Description of the market ecosystem**, which covers the rapid evolution of corporate supply chains and their mission-critical processes.

Working capital management is now an urgent and pressing issue and, with the

availability of automation and Internet technology, practitioners are able to offer a rich array of supply chain management techniques and to trigger a range of ‘event-driven’ financings. Large buyers are often seeking to lengthen payment terms and suppliers are subject to liquidity pressures arising from this and general credit constraints.

On such a basis, a new market for SCF is growing rapidly. The point is made that SCF is currently a ‘niche’ activity (outside the traditional domains of factoring and documentary

trade finance). This niche largely engages larger buyers and suppliers, but has yet to apply its potential to the SME segment, where there is considerable demand for new sources of finance and liquidity generation.

Further analysis is provided in the four main chapters that follow, which address the four key issues of: definition, risk and regulation, automation and collaboration.

More clarity is needed on definitions of Supply Chain Finance and its components

There is a need to take great care with the language used by practitioners and drive towards much greater clarity of definitions, conceptual language and commonly used terms. This is illustrated by the definition of Supply Chain Finance (SCF) itself, which sometimes is an umbrella term for a whole range of financial instruments and sometimes denotes a specific technique or component of the SCF portfolio as mentioned already above.

SCF is most commonly described as “a portfolio or series of financial practices and technologies that support the trade flows and financial processes of end-to-end business supply chains”. This is a holistic definition including a broad range of traditional and evolving financial techniques. The EBA SCWG supports this description and further proposes that Supply Chain Finance is defined as

“the use of financial instruments, practices and technologies to optimise the management of the working capital and liquidity tied up in supply chain processes for collaborating business partners. SCF is largely ‘event-driven’. Each intervention (finance, risk mitigation or payment) in the financial supply chain is driven by an event in the physical supply chain. The development of advanced technologies to track and control events in the physical

supply chain creates opportunities to automate the initiation of SCF interventions.”

Whereas the categories of SCF and trade finance set out above are generally well accepted, the market for SCF is still evolving and the next levels of definition for SCF structures and components are not well established.

In response, banking associations and other organisations have already started to build glossaries and bodies of knowledge to support their membership and associates in adopting common definitions and terms. The most noteworthy and active is the Bankers’ Association for Finance and Trade ([BAFT](#)), the US-based global association for organisations actively engaged in international transaction banking.

The EBA SCWG has concluded that with the exceptions set out in [Chapter 3](#), the terms and definitions elaborated by BAFT for trade finance and supply chain finance instruments are worthy of support and do indeed reflect the experience and acceptance of a large community of organisations actively engaged in international transaction banking and finance. The International Chamber of Commerce ([ICC](#)) has created the industry standards for definitions of traditional documentary trade finance instruments, which command

universal respect and adoption. ICC has recently been working with SWIFT on the definition of a Bank Payment Obligation (BPO) and this is to be welcomed. For other open account based supply chain finance areas, ICC had not until recently embarked on any official work in the area.

Other bodies in the factoring and forfaiting markets employ other terminologies and there is a plethora of proprietary language in use. At a working level there appears to be a real need for more consensus on definitions and the development of a cogent market

terminology, which can evolve over time. Following a number of discussions between SCF practitioners, it has now been decided to create a Global SCF Forum to develop a set of standard market definitions for the range of SCF instruments offered by the market. It is expected that all stakeholders, e.g. customers, banks and non-bank finance providers, regulators and investors will benefit from the clarity that these definitions will deliver. See **Annex 5** for further details.

Risk and regulation – a number of issues need to be addressed

There are four issues that deserve discussion within the headings of risk and regulation as summarised below:

1.

Internal risk management for SCF

For a better understanding and to assist the thought process, this section provides a full discussion of the risk characteristics of SCF and its essentially short-term self-liquidating nature. Measures are proposed to adequately manage SCF business lines and risks, together with a number of searching questions that bankers could usefully ask themselves. In structuring financing transactions, there is a discussion of the difference between credit and performance risk and the relative value of transaction controls and collateral security.

2.

Regulation and Basel III impacts on SCF

It is a common view of bankers that the perceived level of risk arising from trade and

SCF as seen by regulators does not always match economic reality. Basel III and its European counterpart, the Capital Requirements Directive IV and related Regulations, had proposed tighter risk and capital allocations than its predecessor Basel II, and many concerns had been expressed as to the possible impact on the availability of finance to underpin growth in world trade.

As a result of continuing dialogue a number of concessions and reliefs have been achieved in the area of maturity floors, capital treatment for contingent trade-related liabilities, and in relation to liquidity rules treatment. Without constituting a complete explanation of a complex subject the main regulatory approaches are briefly described and reference made to industry sources for further information.

The EBA SCWG proposes no role for itself in relation to Basel III other than to monitor the issue. There is clearly a need for the financial

industry and its customers to document in a transparent way its representations and back this up with evidence of loss experience and credit quality indicators, an initiative that is underway at the ICC Banking Commission.

3.

Compliance and Anti-Money Laundering in relation to SCF

Reference is made to a set of proposed guidelines in relation to Anti-Money Laundering, Terrorist Financing and Sanctions compliance under discussion within the BAFT community.

4.

Accounting aspects of SCF

Issues arising in relation to accounting treatment are discussed. Achieving the correct balance sheet treatment in particular for the Approved Payable Finance structure is important to avoid the re-classification of trade indebtedness as bank debt on the balance sheet under certain transactional structures.

These four areas are discussed in **Chapter 4**.

Automation enables Supply Chain Finance and e-invoicing automation is a ‘game-changer’

Automation refers to the range of IT-based and business tools that support the management of Supply Chains and SCF. Several categories of automation tools are identified and explained.

With the increasing use of fully automated end-to-end solutions, the transmission of dematerialised business documents over a B2B network can now mean that SCF offerings can be substantially automated. A key aspect is the ability to accelerate cycle times especially invoice, payment and other approvals in order to trigger event-driven SCF interventions. The growing popularity of business-to-business networks, which support e-invoicing and supply chain automation, is creating capabilities and benefits to end-users and other intermediaries such as financial institutions. Through its dematerialisation and the acceleration effects, e-invoicing is clearly demonstrating its potential as a ‘game-changer’ for the SCF business.

The development of platforms and networks that directly support the provision of SCF itself is also accelerating. Some of these are proprietary and potentially quite limited in scope; on-boarding of suppliers is a particular challenge. Collaborative platforms have the potential to create substantial value.

Collaboration and competition – there is a collaboration space in SCF

In a networked industry, a debate usually takes place about the relevant roles of competition and collaboration between market participants. Up to now, outside the framework of traditional trade finance and the areas of payments and financial trading (foreign exchange and derivatives), SCF has largely been conducted as a purely competitive activity with industry cooperation limited to syndication/asset distribution and the activities of some successful collaborative finance platforms.

Industry collaboration is recognised as a growing need and the EBA SCWG has identified or confirmed numerous areas of potential collaboration among financial institutions and other stakeholders.

The following breakdown of relevant spaces is identified:

- 1.** Competitive space, where collaboration has no role. This will certainly cover the value propositions of individual competitors, pricing and customer specific information.
- 2.** Collaboration between business entities undertaken on a bilateral basis through partnerships or commercial contracts, covering areas such as geographic coverage, four corner models, technical outsourcing and cooperation with B2B networks and SCF-enabling platforms.
- 3.** Collaboration on a collective basis between market participants in areas defined in advance as being non-competitive, non-infringing of competition law and having the effect of creating the basis of overall market development to the benefit of individual competitors. This section covers governance and joint industry initiatives promoting collaboration on areas such as regulation, standards and infrastructural development.

Specific changes included in this edition of the Market Guide

The following sections have been subject to major updates or changes:

- some new material on the analysis of stakeholders is included in **Chapter 2**
- reference to the formation of the Global SCF Forum to develop standard market definitions is made in **Chapter 3** and in **Annex 5**
- a comprehensive analysis of the Bank Payment Obligation (BPO) is included in **Chapter 3**
- an update on regulatory developments has been brought to **Chapter 4**
- **Chapter 6** on industry cooperation models has been expanded
- a new **Chapter 7** summarising the corporate value proposition has been introduced

Additionally, minor corrections and improvements have been made throughout the document. As appropriate the abstract and management summary section has been amended.

Summary of the specific recommendations and ideas for the future role of EBA in relation to SCF mentioned in this Market Guide

The following propositions have been broken out of the body of the Market Guide, where they are developed as part of the fact-based discussion of the issues involved. At this stage they represent an initial list of action areas, which EBA and its member community will take forward in a manner and at a pace developed by the membership:

EBA will

- actively contribute to the clarification of definitions and market terminology in cooperation with other stakeholders.
 - reach out to other stakeholder organisations with an interest in SCF.
 - participate in any emerging Global SCF Forum.
 - monitor the evolving risk and regulatory framework and provide its members with information and updates.
 - keep abreast of automation and technological developments and continue to participate in the EU Multi-Stakeholder Forum on e-Invoicing.
- continue to undertake further research and analysis of SCF topics on a phased basis.
 - bring its skills and experience to bear in the collaborative space and support its members to develop the SCF component of the transaction banking business together with its related payment, liquidity and transactional elements.
 - support the above activities with its education and communication activities.

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1

Purpose of this Market Guide

1.1 Introduction

The Euro Banking Association (EBA) plays an important role in the European financial industry as a forum established to discuss and drive pan-European payment-related initiatives. As a country-neutral banking association for payment and transaction banking practitioners with a pan-European mindset and vision, EBA is well positioned to support banks in their continuing migration to the Single Euro Payments Area (SEPA) and in other bank-driven initiatives requiring hands-on co-operation at a pan-European level.

Since 2006 the EBA Board actively supported its new EBA E-Invoicing Working Group in assessing the market opportunities for banks. The Group worked on analysing the potential role of banks in activating customer engagement, the linkage to internet banking and on the development of concepts for a pan-European network model for the delivery and processing of e-invoices based on exchanges between banks and non-bank service providers.

As part of its market monitoring activities, two market guides on e-invoicing were published in conjunction with Innopay in 2008 and 2010, and a service description and draft rulebook proposal was released in 2011. Externally, EBA made a significant contribution to the European Commission's Expert Group on E-Invoicing and participates in the European Multi-Stakeholder Forum on e-Invoicing.

In 2011, the EBA decided to enlarge the scope of its e-invoicing initiative to encompass related supply chain processes and launched a new EBA Supply Chain Working Group (SCWG). The initial objectives of the SCWG are to carry out a study of the Supply Chain Finance (SCF) market and its opportunities, based on four layers of work:

- 1.** provide a common basis for the EBA community to understand the ecosystem of supply chains (physical and financial) and provide a picture of the market and opportunities for related SCF services
- 2.** analyse and make recommendations for common definitions, terminology and conceptual language related to the financial supply chain and SCF
- 3.** explore the explicit link between e-invoicing and SCF and how dematerialisation in general supports the process of better working capital management, optimal financing structures, and the control of payables/liquidity
- 4.** describe possible model(s) for the integration of SCF-related messaging in a four-corner service context, and on the assumption that a cooperative space for market development is identified and supported.

This guide is the first deliverable of this work program and is intended to be a ‘living’ document that will evolve. It is certainly not a manual of procedures, practices and detailed product descriptions. Reference is made to convenient sources of information for these areas where these are readily identifiable. Nor is the work based on a systematic data collection of transaction volumes, country differences or forecasts of future developments. It simply reflects the aggregation of general research, the views of members of the EBA SCWG, the perspective of guest speakers and external sources and the current body of written materials on the subject. In addition to providing a wide range of descriptive and explanatory materials, the Guide makes a number of recommendations and expresses a number of positions developed by the EBA SCWG. It is recognised that this brief description is the beginning of a process in contributing to better understanding of the practical issues and may raise more questions than answers in the mind of the reader. If that is the result and further discussion and solution-finding is encouraged then its objectives will have been achieved.

The key focus areas of the Guide elaborate on the layers of work specified in the Terms of Reference, and are as follows:

- 1.**
Describing the ecosystem for supply chain management and SCF and the drivers that are propelling or constraining take-off and adoption.
- 2.**
Raising issues relating to market terminology and conceptual language. In describing the various instruments of SCF the Guide proposes a ‘holistic’ approach and discusses some key definitions that are mainly aligned with common industry parlance.
- 3.**
Identifying and explaining the key risk and regulatory issues impacting SCF.
- 4.**
Linking SCF to the trend towards automated supply chain processes and describing how it is benefiting and could benefit further from the application of technology and business-to-business (B2B) platform capabilities.
- 5.**
Making recommendations on managing industry collaboration and partnerships at all levels.
- 6.**
Summarising work on the corporate value proposition.

The intended audience for the Guide is the European transaction banking community, both specialist and those with a general interest in SCF.

1.2

The SCF instruments in focus in this Market Guide

A Market Guide of this nature must necessarily be focused as the topic is large and complex. The key categories of SCF instruments or enablers in focus are as follows:

Accounts Payable or Buyer-centric – called ‘Approved Payables Finance’ or sometimes ‘Reverse Factoring’, ‘Supplier Finance’ or ‘Confirming’, and sometimes (confusingly) simply ‘Supply Chain Finance’, and based on the discounted payment of accounts payable in favour of suppliers by accessing a financial institution’s or a buyer’s own liquidity. Another related instrument is Dynamic Discounting, through which a buyer itself provides variable discounts for early payment of supplier invoices.

Accounts Receivable or Supplier-centric – such as Receivables Finance (the category term used in this guide), Receivables Purchase and Invoice Discounting (all three being common names for similar financing instruments) and Factoring, which is a form of Receivables Finance but different in character from those previously mentioned.

Inventory-centric (or ‘pre-shipment’)

– such as Purchase Order (P.O.)-based finance and Inventory Finance.

Bank Payment Obligation (BPO)

– an interbank instrument developed initially by SWIFT (as a development arising from its SWIFT Trade Services Utility) and now adopted by the International Chamber of Commerce (to be governed by ICC rules set out in Uniform Rules for the Bank Payment Obligation (URBPO) on the basis of which a variety of SCF transactional structures can be enabled).

Traditional documentary trade finance

– such as Letters of Credit, and documentary and related trade loans – summarised in an Annex.

Complemented by other instruments and enablers, e.g. other types of asset finance, longer term export and project finance, and hedging and payment instruments – not described in detail in this Guide.

1.3

Why is Supply Chain Finance important to banks and why should transaction bankers take an interest?

There are a number of key strategic reasons and imperatives that are today driving the interest by banks in SCF:

1.

Meeting essential customer needs is recognised to be vital in the 'post-crisis' financial markets and customers expect banks to be more 'customer-centric' in the supply of core working capital finance.

2.

Payments, cash management and traditional lending services are maturing and represent challenges in terms of the development of new sources of value-added services. For example, the development of SEPA, the squeeze on payment fees and the pressures on Risk Weighted Assets are impelling bankers to engage in new ways of supporting customer working capital processes.

3.

Corporate customers are managing the risk in their supply chains holistically as a source of enhanced efficiency and liquidity and expect their banks to engage in an area of real importance to them.

4.

One of the benefits of SCF is its close and meaningful alignment with the actual movement of goods and payments throughout the supply chain, based on the introduction of improved and automated supply chain management monitoring and event-driven processes. An additional benefit of the close alignment between supply chain finance

interventions and events in the physical supply chain is that there is greater visibility and control of bank exposure and earlier warning of potential repayment problems.

5.

There is therefore an opportunity for banks to profitably intermediate or re-intermediate themselves using tried and tested techniques in the core working capital arena even as traditional trade finance products are apparently in relative decline. The increasing automation and dematerialisation of supply chains are creating new attractive financing opportunities that are short-term 'self-liquidating', open account-based, and triggered by identifiable supply chain events.

6.

In a tough economic and credit environment it is less easy for customers to access funds through traditional channels; SCF provides a new opportunity to unlock new sources of finance and liquidity for many corporate segments including SMEs.

7.

There is a requirement and an opportunity to partner with vendors and B2B platforms, which bring new solutions and sources of value.

A recent EBA questionnaire demonstrated that a large number of banks have a strong interest in Supply Chain Finance (SCF) service offerings and such findings were very consistent with the above points.

2

Description of the market ecosystem

This chapter explores some important themes in the development of SCF within the context of rapidly evolving supply chain management (SCM) practices. Supply chain management can be described as a disciplined blend of practices, information, organisation and technologies that support users in the design, planning, sourcing, manufacturing, delivery, and return of goods and information delivered to customers in the global market. The rationale is to perform such activities in a way that contributes tangibly to profitability.

The physical supply chain is defined as the series of business processes by which goods and services are purchased, transformed, and delivered, whereas the financial supply chain covers the series

of financial processes that support the physical supply chain such as credit assessment and control, deployment of financing and risk mitigation instruments, supply chain automation processes including purchase orders, e-invoicing and payments.

The material in this chapter is primarily descriptive and details how the physical and the financial supply chains interact with each other. A critical role is identified for a range of physical supply chain 'events and triggers' in activating responses in the financial supply chain. This builds the case for SCF. The part played by various stakeholders engaged in SCF is discussed.

2.1

Description of the ecosystem of physical and financial supply chains

Globalisation has created internationally dispersed supply chains as production has been relocated to emerging markets, logistics have become more cost-effective and global communications easier and pervasive. The recent downturn is not likely to do long-term damage to the growth in global trade, although protectionism and contractions are always downside risks. Global trade tends to grow faster than aggregate GDP.

Supply chain management techniques and proactively managed procurement have become key disciplines of effective corporate management. Larger buying organisations are much more sensitive to the inherent risk and resilience of their supply chains, as mission-critical product components are frequently dependent on third party suppliers. In this interconnected global environment the following factors are driving concerted supply chain management practices:

1.
The demands of operating in global markets are transformational and businesses have major incentives to identify and better utilise sources of precious liquidity within their own operational processes.

2.
It is widely acknowledged that strong SCM practices will reduce operating costs and help organisations control their logistics expenses. Managers of the physical supply chain have responded by taking the lead in delivering billions of dollars of savings in inventories, freight costs, procurement and other costs associated with supply chain logistics.

3.
For Chief Executive Officers (CEOs) focused on profitable growth, working capital control has become a key metric. Working capital represents the amount of day-by-day operat-

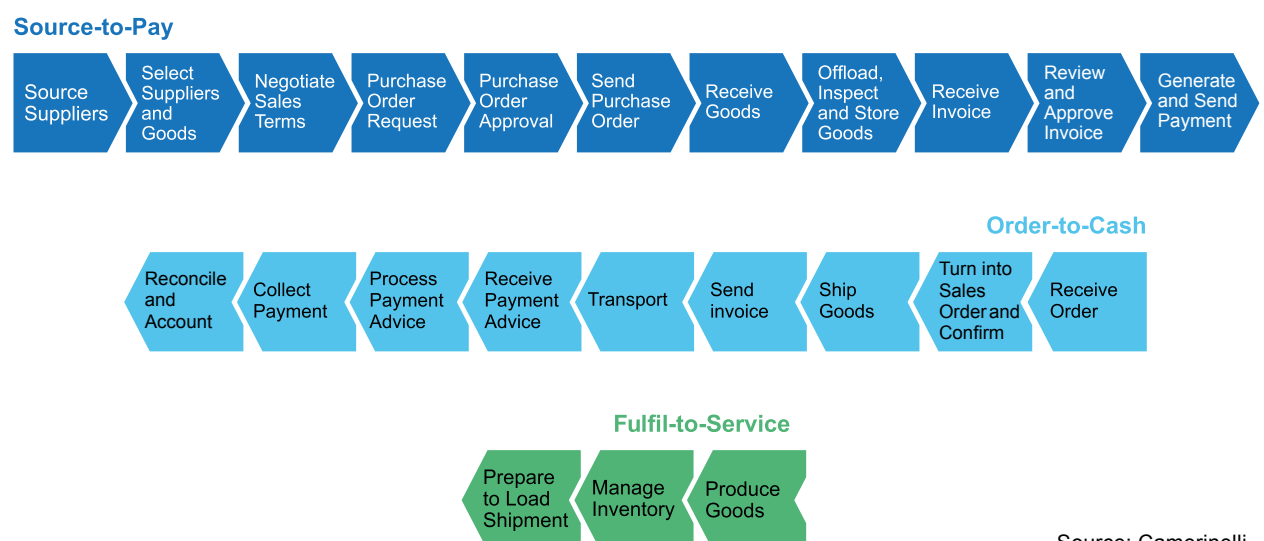
ing liquidity available to a business. In numerical terms, working capital is calculated as:

$$WC = (AR) + (Inv) - (AP) + (Cash)$$

(AR) stands for Accounts Receivable, the amount that customers owe a business. **(Inv)** is the Inventory value calculated as the total amount of inventory held by the business in raw materials, work in progress, and finished goods. **(AP)** is Accounts Payable, payments due to suppliers for goods and services purchased. **(Cash)** is self-explanatory.

4.
Significant value can be derived from the optimal use of management processes in the supply chain: Source-to-Pay and Order-to-Cash process flows (**Figure 1**), with banks supporting working capital management and the improvement of their clients' cash utilisation.

Figure 1
'Source-to-Pay', 'Fulfil-to-Service' and 'Order-to-Cash' macro-processes



Source: Camerinelli

5.

Many executives are beginning to understand the intrinsic connection between competency in physical supply chain management and corporate performance measured in financial terms. For that reason supply chain

professionals must be ready to deliver value through their own local initiatives in order to support their companies' strategic visions and overall performance. Collaboration between procurement and treasury professionals is essential.

2.2

The impact of the physical supply chain on the components of working capital at a detailed level

It is relevant to examine the financial components of working capital and analyse how they are affected – positively or negatively – by management practices in the physical side of the supply chain.

1. Account receivable element

First let's take the accounts receivable element (**AR**). To more accurately assess the impact of SCM operations on receivables, it is useful to use the time-related figure for Days Sales Outstanding (**DSO**). This figure represents the average time interval required to collect an outstanding receivable and, therefore, measures the speed with which customers are invoiced and payment is received. The crucial control responsibility sits with the sales and credit control functions in terms of interpreting changes in DSO and its relationship to sales.

An obvious problem that may arise in the physical supply chain is when the product is not delivered, or it is delivered in the wrong quantity, with the wrong specifications or in the wrong package, or is damaged and is eventually returned in full. Attention must also be paid to the activities of distributors in linking with the end-customer, delivering product and receiving/remitting funds. Additionally, poor performance in the invoicing process due to incorrect information will

extend the time period between sales and the collection of funds. Ultimately AR is affected by the ability or willingness of a buyer to pay on time or at all (credit risk). Customer relationship management and credit control procedures are keys to this process.

A good way to illustrate this is to differentiate between the 'can't pay' scenario and the 'can pay/won't pay' scenario. The former is all about credit risk whilst the latter is about performance risk. An effective credit control process should mitigate the first and will provide early warning of the second. Credit control and effective management of collection of receivables can significantly speed up the process, shortening DSO and reducing finance costs.

2. Inventory

Inventory (**Inv**) is the second component of working capital. We can take a similar time-based approach as with DSO to measure SCM's impact on inventory value using the Days in Inventory indicator (**DII**).

There are many events that can occur in the physical supply chain processes that will increase inventory, in particular time required to receive inward supplies, factory movements, time for order processing, preparing goods for shipment, and poor performance of

the distribution channel. Further issues can arise from failures in management processes such as forecasting and requirement sizing, order cycles being commenced too early in the cycle and purchasing based on price factors rather than paying attention to what is really required.

There may, of course, be legitimate reasons why a buyer might need to hold inventories in greater quantity than might be required using a 'just in time' principle: for example, a factory might need to gear-up/set-up machinery to make a production run efficient. A series of low volume product runs might be impractical and excessively expensive. A single large run might be the only option, resulting in a build-up of inventory either with the supplier or with the buyer.

Transit costs might be such that a low volume shipment is far more expensive at unit level than a high volume shipment. The practical impact of logistics might mean that there is a minimum practical size of consignment (e.g. one container-load or one tanker). A significant unit price advantage may be possible with a larger consignment, although this would have to be offset against the higher finance requirement and associated cost and the practical implications of holding, securing and insuring physical stock.

Some types of stock are subject to urgent call-off demands (e.g. aerospace spare parts) so that stock levels will tend to be disproportionately high. Incidentally, a possible remedy here in the physical supply chain space is the collaborative inventory-holding model, in which the trading parties agree to share inventory holding and which has certain parallels with the collaborative approach to SCF.

3. Accounts Payable

The contribution of supply chain practices to working capital in its third component, Accounts Payable (**AP**), can be appreciated as in the previous cases by focusing on its time-based equivalent, Days Payables Outstanding (**DPO**), and by applying concrete measures to the management of the supplier base and flow of in-bound goods and services. In the following paragraphs the tension between imposing longer payment terms by buyers to maximise DPO and the need to ensure stability and liquidity within the critical supplier base is discussed.

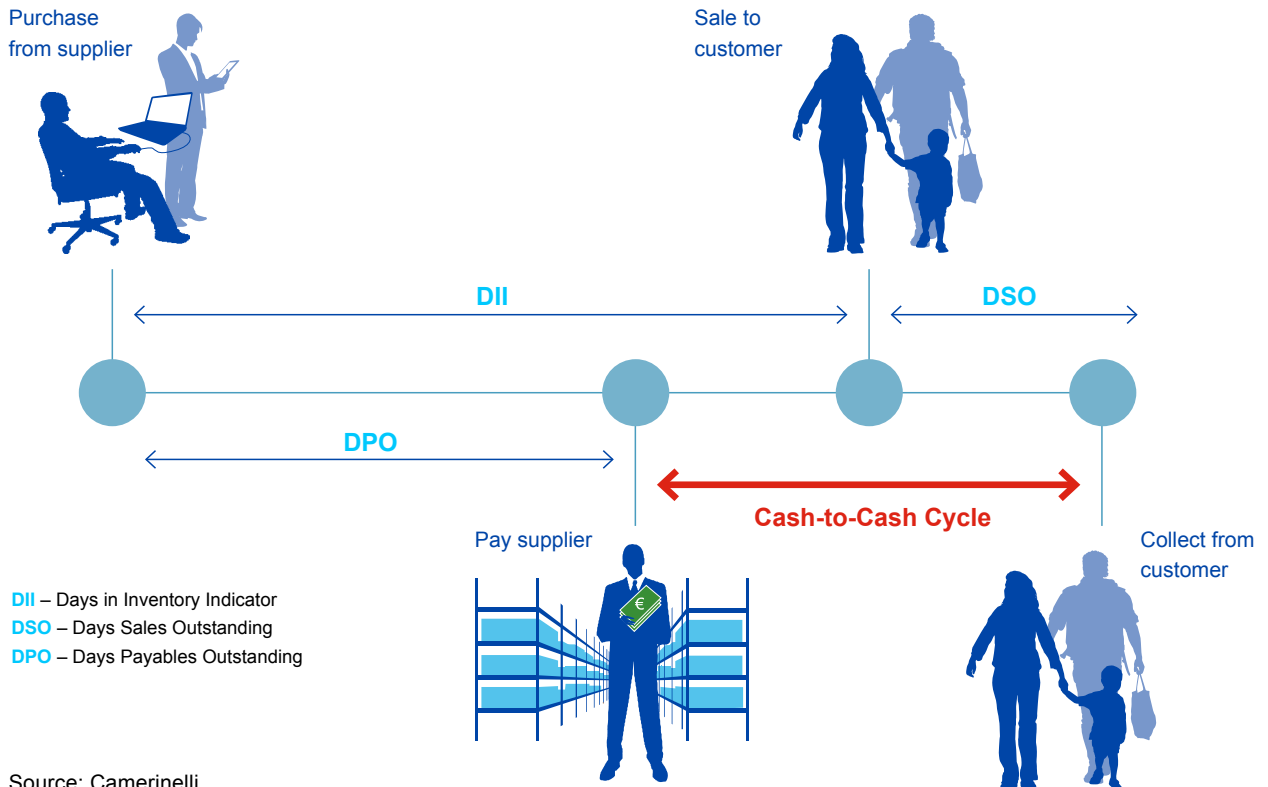
By focusing on the practices in the physical supply chain that impact DPO we can also compute a further metric for the financial supply chain – **cash-to-cash cycle time** – that has already become a significant ingredient of successful SCM.

Cash-to-cash cycle time = [(DSO + DII) – DPO] and represents the interval between payment for raw materials and the receipt of cash generated by selling final goods.

If the cash-to-cash cycle time is short then a company can reasonably consider itself to be managing its working capital well. If the cycle time is long a company must conclude that it could have too much working capital tied up in its business operations, which means it cannot be used for other purposes such as investing in growth projects.

This is another way of saying the aim of efficient SCM is to shorten DSO and extend DPO whilst minimising DII. **Figure 2** graphically illustrates the cash-to-cash cycle components and their correlation.

Figure 2
The Cash-to-Cash Cycle Time Illustrated



The link between SCM operations and cash-to-cash cycle time becomes clear when a company realises that the longer its cash remains tied up in inventories (**DII**) the greater the time required for its production process and consequently the longer the delay in receiving payment from customers. A common response is to increase the value of **DPO** to counterbalance the increased combination of (**DSO + DII**).

Leaning on suppliers to increase their payment terms is not usually a valid or advisable long-term strategy and will create a natural tension between trading parties. Suppliers will suffer if they are forced to wait for payment as a result of decisions taken on a unilateral basis and this particularly impacts smaller

or more vulnerable suppliers with limited bargaining power. The key point here is that by extending **DPO** a company can indeed reduce the cash-to-cash cycle time, but this merely passes the problem onto the suppliers unless there is also a commensurate improvement in the efficiency of the SCM process.

Longer terms of payment can be reasonably negotiated only if there is an appealing counter-offer to the supplier, such as certainty of payment date or an SCF facility with the support of a financial institution releasing cash on behalf of the buyer.

2.3

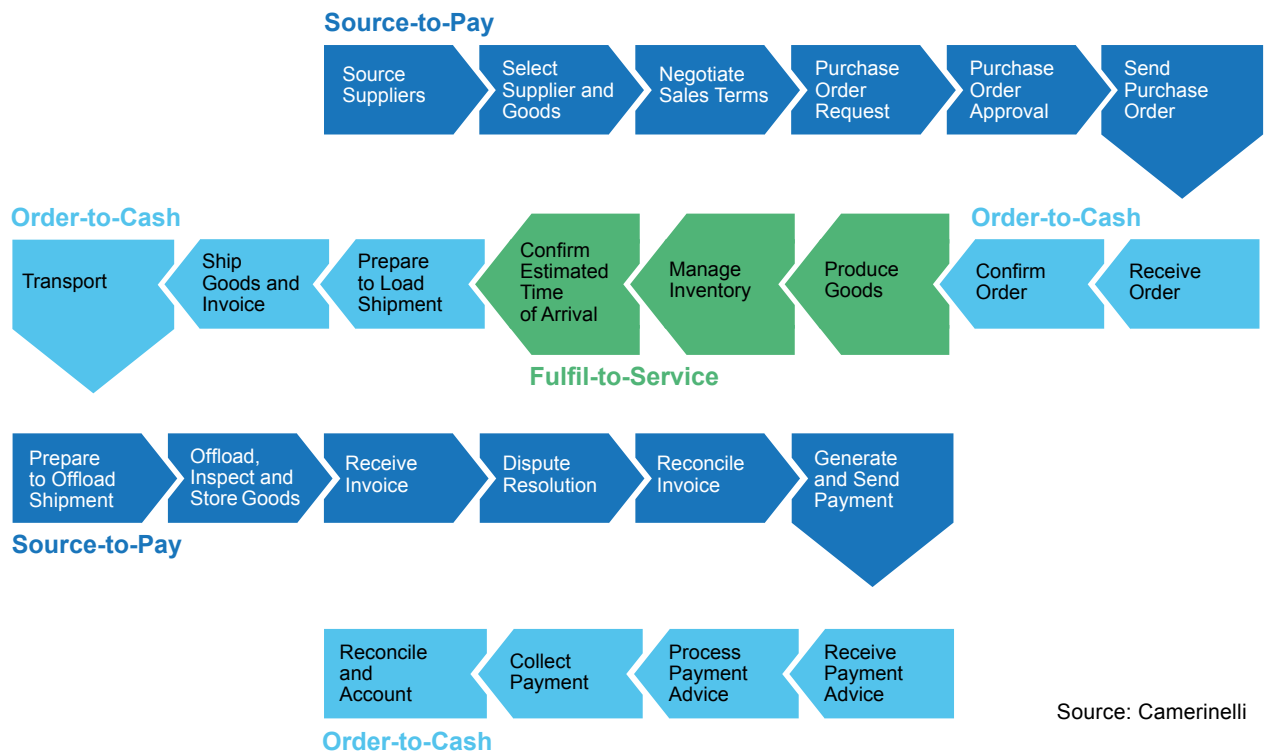
How the physical and the financial chains connect

It should now be clear that there are many ways in which businesses can influence the values of working capital with their time-based components of DSO, DII, and DPO utilising pro-active management of the physical supply chain.

– It is important to recognise that supply chain management is much more than purchase orders, logistics, and inventory management. While these are, indeed, a key part of the scope of supply chain management, there are many more additional activities (**Figure 3**) such as production and procurement planning, the management of suppliers, inventory control, sales and distribution planning, and the pro-active management of the receivables portfolio.

Figure 3:
The Flow of the Physical Supply Chain Processes

Plan

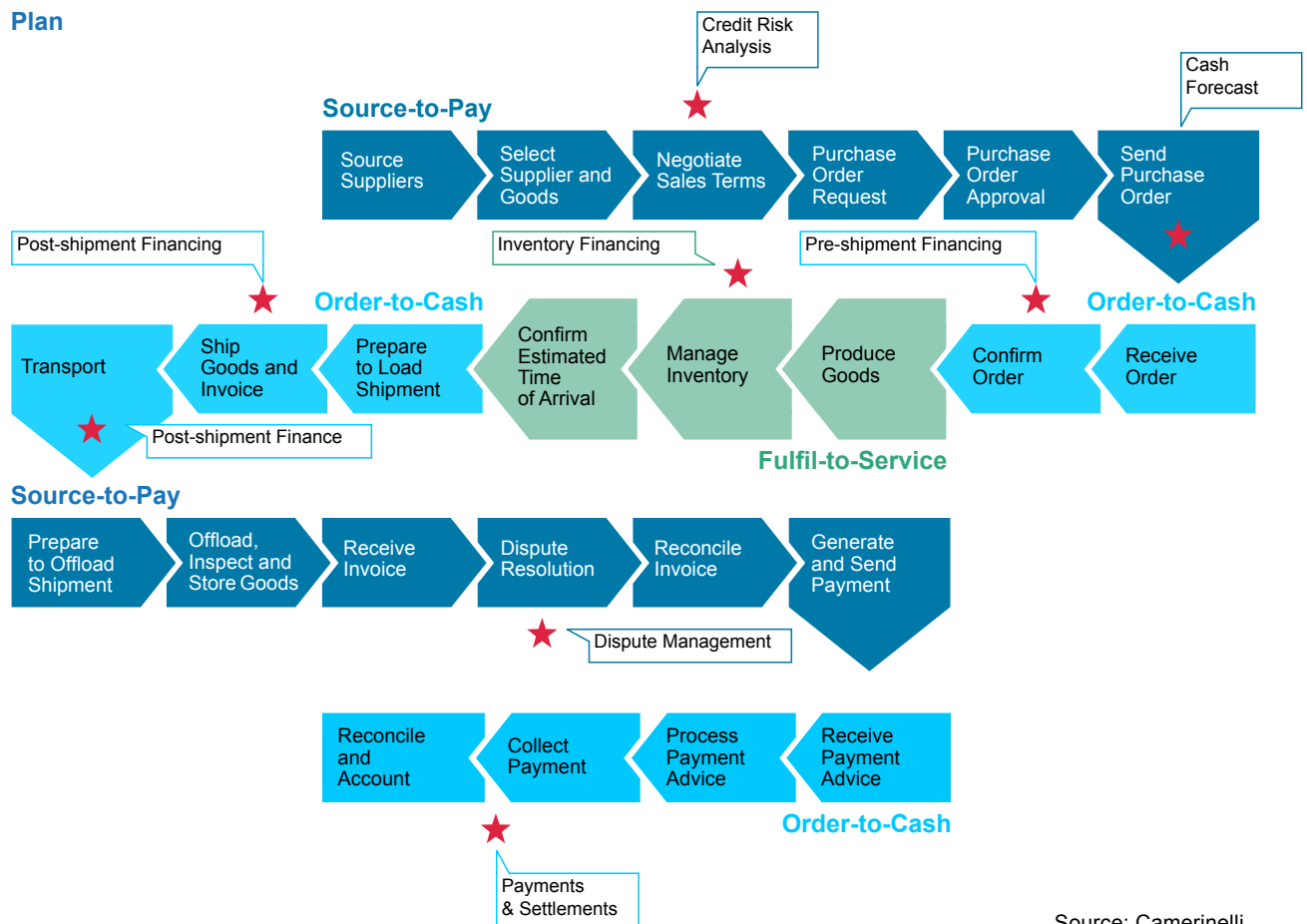


Source: Camerinelli

- A forward-looking perspective for a bank's SCF offering should be based on an event-driven process mindset. As soon as the bank is able to pinpoint when a financially significant event is triggered by the physical supply chain process (see 'Trigger

Points' in Figure 4), it will be in a position to offer a rich range of value-added services well beyond the domain of traditional trade finance and in a way that fully engages with open-account trade.

Figure 4:
Supply Chain Finance 'Trigger Points' (examples)



- As noted in the illustration, there are many 'trigger points' that may activate these value-added SCF services. The bank can detect them – and therefore increase its

value-added offer – by learning to integrate its SCF value proposition with its customers' physical supply chains.

– **Examples of these triggers are as follows:**

A / The evaluation of counterparties for supply and sales requires credit analysis and due diligence. From the ‘trigger point’ of *negotiate sales terms* support of credit risk analysis by the bank could be activated.

B / *Send purchase order* can be supplemented with a financing proposition based on the purchase order.

C / *Supplier management* triggers a financial supply chain response such as improved cash forecasting for future cash outflows and optimal management of DPO referred to above. Assistance with cash forecasting could be a bank service triggered by the whole SCM process.

D / Inventory planning, purchasing and tracking demands an ability to manage purchase order and inventory financing and, perhaps, letters of credit, or forward foreign exchange (FX) transactions.

E / *Production planning* may trigger an analysis of available capital equipment finance and asset-based lending services.

F / *Post-shipment finance* may be offered once the goods have been shipped. Electronic invoicing and management of residual or related paper documents are all services that could be offered.

G / Supply chain management creates the context for the use of a wide range of payments and cash management services.

- In addressing the above it is important to recognise the necessity to deploy both business and technological capabilities in order to exploit the value of event-driven SCF. An example of this is the use of developing technologies such as RFID¹ tags. These might include monitoring of: raw materials on site, production in progress (tracked against key stages), independent/buyer inspection pre-shipment, goods loaded on vessel, unloaded, in warehouse or delivered to buyer.

¹ Radio-frequency identification (RFID) is the use of a wireless non-contact system that uses radio-frequency electromagnetic fields to transfer data from a tag attached to an object, for the purposes of automatic identification and tracking.

2.4

How is supply chain management changing²

It is likely that collaboration will become an even more intense feature of SCM touching all aspects of manufacturing, procurement, logistics, finance functions and related enterprise information and automated applications at every level. As competition in international markets becomes progressively more dependent upon the reliability and quality of deliveries, this collaboration between suppliers and buyers has become an important characteristic of the supply chain. It has become more important to have knowledge of the availability of products (i.e. inventory levels), price fluctuations (i.e. tendering) and existing contracts (i.e. orders) than the mere information about the physical shipment of goods.

The benefits of a collaborative perspective can be further appreciated given the current situation of liberalised and globalised international trade: the analysis of the processes underpinning production, and sourcing consumer products from across the globe are enhancing the interdependence between producers and wholesalers in globalised supply chains. The distribution of competitiveness in physical exchanges with the rest of the world is now crucial for economic prosperity, and has given rise to new forms of electronic transactions and methods of collaboration.

Electronically-based manufacturing supply chains have created digital business ecosystems which deliver collaboration and transparency. The adoption of communication standards (e.g. RosettaNet) further improves the opportunities for success. These elec-

tronic chains transform the supply chain from the buyer sending orders and the supplier fulfilling the request into integrated supply chains, in which buyers and suppliers continuously exchange many types of information regarding forecasts, production plans, capacity constraints, and performance objectives. Thus, they have evolved from traditional supply-side concerns (i.e. supply chain) to demand creation by providing attractive features, which support the generation of demand (i.e. demand-supply chain). These processes are managed by cross-functional teams, including participants from logistics, production, purchasing, marketing, and research and development. The benefits made possible by reviewing supply chain management activities under the process-focused lens can be replicated and transferred to the financial flows that constitute the financial supply chain. This requires new concepts for the management of the instruments that make up the SCF portfolio and enable a shift from financing order-to-cash activities to financing a more information-intensive and event-based collaboration.

²
With the kind collaboration
of Usva Kuusiholma, Aalto
University – School of Science

2.5

From SCM to SCF – trends and drivers

It is important to understand the key trends and drivers in the SCF market:

1.

SCF practices initially focused on cross-border east-west trade where the relationship between buyers and suppliers was typically characterised by a balance of power in favour of the former. Large international buyers offered financial support to their small suppliers in exchange for a better purchase price. The application of supply chain finance instruments is now more widely used including at domestic and regional levels with the main objective of securing business continuity and flows of supplies as well as financing sales growth on the side of the supplier.

2.

Orders-to-cash cycles have lengthened in many cases and large buyers have sought to squeeze suppliers by increasing payment terms. SME and emerging market suppliers are consequently vulnerable to constraints in the availability of finance and working capital through traditional channels.

3.

The SCF market is still evolving – it is a competitive business and business undertaken is covered by customer confidentiality and therefore sources of information are constrained and not widely in the public domain.

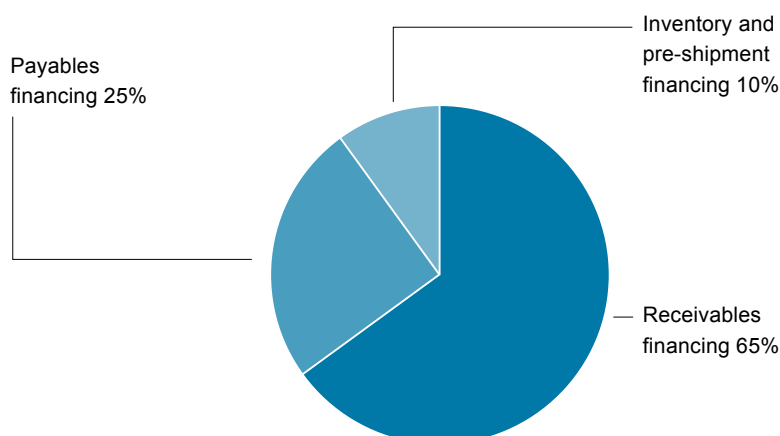
4.

The receivables financing segment including factoring, invoice discounting and receivables finance in all its forms remains the largest segment with an estimated³ 60–70 percent market share (**Figure 5**). It is primarily domestic (although there is a growing cross-border segment), and is likely to experience steady growth. Banks, bank-owned subsidiaries and a variety of non-bank financial institutions are the main providers. Country practices vary widely.

3

Estimates derive from results collected through e-mail survey, the views of the EBA SCWG and the authors' experience.

Figure 5:
Distribution of SCF Instruments



Source: Bryant, Camerinelli,
EBA Member interviews

5.

Buyer-centric SCF techniques, such as Reverse Factoring or Approved Payables Finance, represent less than 15 – 20 percent (estimates vary) of the market but have strong growth potential. Global banks are today mainly concentrated on the large buyer side of the trade equation and this is the heritage of the cleverly structured solutions engineered and provided by banks for large international trading companies. It will need a ‘tipping point’ to see these instruments take-off on a broad scale and eventually encompass SMEs. In particular the value of this SCF technique in stabilising the supply chain, directing liquidity to where it is needed, and creating a win-win situation for buyers and their suppliers is increasingly recognised.

6.

Inventory and pre-shipment finance are more specialised and not widely practiced outside certain industries and the commodity markets. These practices hold perhaps a 5 – 10 percent share in market size.

7.

The development of ‘four corner’ models may enable a further acceleration of volumes of SCF transactions as providers cooperate to extend reach into new groups of potential users.

8.

International trade finance based on classical documentary instruments is in relative decline, but should not be underestimated in terms of importance in Asian and emerging markets. LCs still have a key role to play in respect of ‘big ticket’ transactions, especially where control of goods as collateral is critical

to the acceptability of the risk. The LC business has benefited from greater automation and the use of electronic processes.

9.

Banks provide funding and payment/transactional support, although liquid customers and non-bank financial institutions also provide financing services and create market liquidity – a secondary market is strongly developing.

10.

Collaboration services, e-invoicing service providers, automation platforms, software and ERP vendors are proving themselves to be a valuable complement in supporting market growth. Partnering is common.

11.

It has been already demonstrated that there are many opportunities stemming from supply chain management activities such as production planning, forecasting customer demand, inventory management, and distribution planning, that can expand the reach of the supply chain manager’s responsibilities and which can trigger opportunities for SCF.

12.

Banks are increasingly motivated to investigate SCF based on a contraction of traditional payment fees, the need to optimise the use of Risk Weighted Assets and identify additional sources of revenue in the working capital cycle.

2.6

SCF key statistical indicators

According to market research⁴, the aggregated European invoice finance market was worth over EUR 1 trillion in 2011. The invoice finance market includes factoring and invoice discounting, supply chain finance (equating to approved payables finance as defined herein) and trade receivables securitisation as well as other techniques such as forfaiting, and distributor finance. This market value represents some 8 percent of EU GDP and more than 8 percent of total bank lending. It is five times the volume of leasing transactions. Growth of the market has been over 10 percent p.a. since 2009 and is expected to continue.

Another market research publication recognised the importance of optimum liquidity management and estimated that SCF (approved payables finance) growth rates in developed countries range from 10 to 30 percent and in developing countries from 20 to 25 percent p.a. (source: Aite Group).

In a presentation to the ICC Supply Chain Finance Conference in October 2012, a speaker noted the consistently low impairment rates experienced with invoice-based finance compared with conventional corporate loans. At the same event Factors Chain International reported that its Import 'Two-Factor' (cross-border) business grew strongly in 2011 in the U.S. and Europe (except in the UK and Spain, which are already mature factoring markets). Looking at Export Two – Factor activity, Asia shows huge growth, especially in Turkey, Taiwan, Hong Kong and China (the latter at over 200 percent in the first half of 2012, as China increasingly adopted the factoring model).

⁴
Demica Reports,
issues n.15,16,
May-October 2012.

2.7

Factors driving SCF adoption

A large number of drivers are encouraging the growth of SCF:

1.

Open account trading and lengthened supply chain cycles are promoting SCF demand as are often quoted constraints on traditional bank finance such as overdraft. These two factors are highlighting the need for alternative sources of finance and efficient credit structures.

2.

As credit spreads have widened there is more scope to develop new approaches to pricing these alternative structures. On both the supplier and buyer side, the availability of working capital throughout the supply chain is a key issue. Manufacturers and retailers operating towards the end of the physical supply chain are able to act as a catalyst for enhancing financial supply chain efficiency for upstream supply chain participants involved in raw material sourcing, processing and refining functions. Dynamic markets especially in emerging countries in Asia and Latin America represent further opportunities for SCF adoption given their trade focus, especially those in high interest rate environments. Indeed it will be a litmus test for open account based SCF instruments that they find favour in Asian markets in particular, but also across the spectrum of emerging economies.

3.

Receivables finance is already well-established and growing – some mature markets such as USA, UK and Italy being ahead, of

markets such as Germany, where other forms of finance are more common and many developing economies where capability is not evolved. There are opportunities for technology transfers to new markets.

4.

Buyer-centric SCF supports the objective of de-risking the supply chain and relieves suppliers, many of whom are SMEs, of the complexity of arranging their own SCF solution. Leveraging the credit strength of highly rated buyers seems a sensible and untapped opportunity.

5.

Pre-shipment finance can be facilitated through SCF, although this is largely an aspiration at this stage outside specialised commodity finance structures.

6.

Although traditional documentary trade finance is in relative decline, the benefits of its related globally standardised risk mitigation, finance and settlement infrastructure remain valid. This infrastructure can be leveraged and further developed in the open account space through the emergence of SCF enablers such as the Bank Payment Obligation.

7.

Supply chain automation techniques, transparency and routine data availability can be transformed into valuable information or ‘triggers’ for SCF offerings.

8.

Many of the institutional ingredients are in place well-connected supply chains, willing financial institutions and other essentials such as B2B automation platforms and

networks. The latter are capable of supporting a widening out from a niche business based on large value transactions to a widespread SME support based on automation, especially e-invoicing.

2.8

There are some constraints and challenges for SCF growth, but they are not insurmountable

There are a lot of potential constraints and challenges, but provided they are actively managed they are not insurmountable:

1.

Most businesses are still attached to core banking relationships and to traditional forms of credit, which dwarf SCF transaction volumes. Gauging the real and feasible demand for alternatives such as SCF remains elusive, although growth trends are encouraging.

2.

There is lack of a clear market terminology and standards for key concepts and definitions need to be addressed. There is confusion as to what SCF encompasses making widespread SCF adoption difficult to measure. There is no well-articulated generic value proposition for SCF in a highly fragmented market.

3.

Leaders in a growing field are less likely to support moves to integrate 'laggards' through market cooperation, even if overall market enlargement would benefit them. There is a trade-off to be made between tailored solutions and standard market products.

4.

Risk, regulatory, tax, VAT, and accounting issues need to be understood and managed so as to remove uncertainty. The risk-based capital allocation rules applicable to SCF are still evolving. Accounting treatments need to be carefully planned to avoid reclassification of trade obligations into bank debt.

5.

There is a challenge to onboard suppliers onto automation platforms and to meet KYC requirements. There is a danger inherent in too many proprietary platforms and more attention could be paid to the collaborative space and open models, so as to save users the complexity of managing too many platform connections. This raises an issue of scalability of SCF solutions based on so many existing platforms.

6.

Credit availability and balance sheet capacity remain key requirements and are subject to uncertainty. Confidence in continuing credit availability needs to be built if SCF is to attract regular users.

7.

There is a complexity factor with many individuals needing to collaborate and coordinate the 'moving parts' within finan-

cial institutions; various product silos, and management relationship groups need to be coordinated – a challenge in large and complex organisations especially with the global dimension demanded by SCF. Customer education, long sales cycles and systems integration are demanding areas especially if short term profit goals inhibit investment.

8.

Corporate buyers and suppliers need to work together and share the benefits – in so doing they must try to eliminate the tension often present in supplier/buyer relationships; this is a pre-condition for success. Both supplier and buyer need to perceive a tangible benefit from such interactions.

2.9

Impact of SCF for SMEs

Small and medium-sized enterprises (SMEs) are facing tough credit constraints and yet require sources of credit and liquidity. Recent developments such as the latest Late Payments Directive (2011/7/EU) and measures taken at country level to accelerate supplier payments testify to the seriousness with which this problem is regarded. SCF has a potential role to play.

1.

SMEs credit risk is typically more challenging to assess than that of larger businesses. Consequently many have struggled to gain access to traditional forms of finance.

2.

Banks' willingness to lend to small businesses has diminished, as a result of deteriorating credit quality caused by the economic downturn. This has had a fundamental impact on the ability of small businesses to grow.

9.

Industry collaboration and governance is presently quite fragmented and requires improvement to address non-competitive issues such as standards, infrastructure, and market rules.

10.

There is not yet a deep secondary market for SCF assets that are generally heterogeneous, unrated and not well understood by potential institutional investors. There is clearly growing activity and there is a growing appetite for such assets. Most secondary market activity is bilateral or accomplished through specialist intermediaries, both evidence of an 'early stage' market.

3.

Through supply chain finance and logistics, it is possible to achieve a win-win situation between core enterprises and their SME partners.

4.

SCF enables banks to support SMEs at a level that is more commensurate with their trading activity. By contrast, traditional forms of bank finance are primarily dependent on the SME's balance sheet strength, security values and the value of supporting guarantees. Finance availability is, therefore, constrained by factors that are unconnected with an SME's trading activity.

2.10

Stakeholder landscape

The objective of the following brief description of the main market segments involved in SCF is to frame the market in terms of what solutions are currently available, what players are involved, and what roles they play. An illustrative listing of the most active players in the

SCF ecosystem is provided. The companies quoted are assigned to the category where major activities are undertaken, although they may also carry out other functions. The lists are illustrative and non-exhaustive.

2.10.1

Corporate customers

The types of corporate customers with an interest in SCF – Approved Payables Finance will be first class credit risks and represent many sectors including, consumer goods, retail, pharmaceuticals and health care, information/communications technology, electronics and automotive, for which supply chain management and supplier stability are key issues. They will often have regard for the liquidity needs of their SME suppliers. At the very least they will have a number of strategic suppliers where collaborating on raising liquidity will be fruitful to both buyers and their suppliers. Some of these customers will also cooperate with lenders to create pre-shipment finance programmes.

segments that the core market for receivable finance is common through many varieties of receivables purchase, factoring and invoice discounting facilities.

Leaving aside financing opportunities, corporate customers are increasingly cooperating through B2B connections for the conduct of electronic trading and post-contract award processes such as order generation, inventory management, logistics, and invoicing/payment. These practices are spreading from the large company environment to other corporate sectors.

The types of large corporate customers interested in receivables finance in all its various guises will often be exporters in the capital goods field who wish to raise sales finance for their buyers in emerging markets and/or where extended terms are required. Other sellers of intermediate goods such as vehicles and construction machinery may put in place distributor finance programmes. It is in the broad swathe of SME market

2.10.2

Banks

SCF instruments are not new to banks as the vast majority have been inherited from trade finance practices.

The added value of financial institutions is not so much in creating new product structures, but in understanding how they can be best combined and offered in the specific conditions of their corporate clients' supply chain. Financial institutions are also expected to be able to estimate and communicate the overall benefit to the corporate customer of a particular SCF solution.

Financial institutions are evidently the most advanced and mature players in the SCF arena. The analysis of how they are shaping their SCF strategy proves that SCF requires continuous improvement in three specific ways:

A.

Definition of value proposition

(i.e. creating the business opportunities arising from the processes of the physical and financial supply chains being impacted)

B.

Organisation (i.e. the role and functions, and the performance criteria of the people involved).

C.

Deployment of technology

(e.g. the portal and supporting platforms)

The leading bank players in the SCF market are those global and international banks who onboard onto their platforms both suppliers and buyers and/or orchestrate a network of correspondent banks and/or partners to

support one or more elements of the transaction chain.

These institutions are complemented by a large number of local and regional banks who provide SCF solutions on a stand-alone basis or in partnership with other banks and non-bank providers. Much SCF will be structured to support cross-border trade but there is also a growing market for domestically based SCF, for example invoice-based finance and where the banks involved may provide an invoicing service directly or deploy a white-labelled service.

The following is a (non-exhaustive) list of globally active banks in the SCF market:

- ANZ
- Bank of China
- Bank of Tokyo-Mitsubishi
- Barclays
- BNP Paribas
- Citi
- Deutsche Bank
- HSBC
- ING
- J.P. Morgan
- RBS
- Santander
- Scotia Bank
- SEB
- Standard Chartered
- Unicredit

These institutions are complemented by a large number of local and regional banks who provide SCF solutions on a stand-alone basis or in partnership with other banks and non-bank providers. Among these, examples are Nordea, KBC Bank and Commerzbank.

2.10.3

Non-bank financial providers

A number of multinational groups have financial arms active in the SCF space, e.g.:

- GE Capital
- Siemens Financial

Other active players are:

- Factoring companies, such as Bibby Financial Services, and CIT, although the vast majority of factors are bank-owned or affiliated
- Insurance companies, mainly as secondary lenders and investors
- Credit Card providers based on the Purchasing Card and related services.

There is a new breed of ‘peer-to-peer’ lending operators. These new providers allow their clients – especially small businesses – to obtain access to finance through a web portal.

- Funding Circle
- Market Invoice
- RiverRock
- The Receivables Exchange
- Platform Black

2.10.4

Solution Providers

These players are generally known as software application and IT vendors, with experience in payments, cash management, workflow automation, and systems integration.

Vendors are close to the pulse of the market and are automation-centric by nature. For this reason, financial institutions seek their advice and partnership to address market opportunities, such as paper-to-digital transformation. Examples of these solution providers are provided below:

- ACI Worldwide
- Bottomline Technologies
- CGI/Logica
- Fundtech
- IBM
- Misys
- Oracle
- Polaris
- Premium Technology
- SAP
- SIA / RA Computer
- SunGard
- Taulia
- Tieto

2.10.5

B2B networks and e-invoicing service providers

Collaboration is a key aspect in the success of SCF programs. The possibility of electronically exchanging purchase orders and invoices dramatically enhances the opportunity. These operators may offer solutions in their own right but more commonly in partnership with banks and financial institutions.

A short (non-exhaustive) list of players in this space is provided below:

- Ariba/SAP/B-Process
- Basware
- GXS
- Itella
- Tungsten/OB10

See **Chapter 6** on collaboration for further discussion of this market sector.

2.10.6

Marketplaces and hubs

Some vendors go beyond the development of enterprise applications and deploy platforms that enable collaboration among all players in the SCF ecosystem: users, buy-side and sell-side financial providers, and other supportive actors. The platforms provide the necessary 'hub' that interconnects the systems of the various constituents in a 'plug-and-play' fashion (even though such ease of connectivity is yet to be fully accomplished).

A few names of players in this domain:

- Asyx
- Bolero
- Corporate Linx
- Demica
- GSCF
- GTNexus
- Lighthouse BCS
- Orbian
- Prime Revenue
- Syncada

2.10.7

Consultants and analysts

Historically, this family of players has been involved in consulting and implementation services in relation to strategy, market research, business models, marketing and systems development.

They include:

- Aite Group
- Bain
- Capco
- CapGemini
- Gartner
- McKinsey
- Oliver Wyman-Celent
- Tower Group

2.10.8

Logistics services providers (LSP)

These players have visibility of the goods in the physical supply chain, which can dramatically reduce the risk associated with their financing. This permits tracking, transparency and visibility, and collateral evaluation. As effective operators they are sometimes seen as having the potential to disintermediate banks, although in most instances they are seen as valuable partners. In particular, they can be the source of the triggers that enable SCF to be 'event-driven'.

2.10.9

Industry associations

In traditional trade, rules and practices have evolved over many years, providing an established framework (e.g. UCP600⁵) for banks to work with one another, and helping to reduce the risk of fraud and dispute. Industry and trade associations provide a shared cooperative infrastructure for market participants to exchange information, and develop standards and market practices. In open account, which constitutes the usual trade exchange condition for SCF, the market has so far lacked established rules, practices, infrastructure, and standards or at least these have been fragmented and inconsistent. There is a recognised market need for more formal rules and market practices, technical specifications and exchange standards for various business messages.

Leading industry associations in SCF are:

ICC

The Banking Commission of the International Chamber of Commerce (ICC) is a global rule-making body for commerce and the banking industry and has become a world-wide forum for trade finance experts whose common goal is to facilitate international trade finance.

ICC and SWIFT signed a cooperation agreement in September 2011 that will enable industry-wide adoption of the Bank Payment Obligation (BPO). A first output of the cooperation between the two associations is a series of common financial product definitions adopted by corporations in their trade operations. The objective is to provide standard rules and market practices for open-account products.

BAFT

The Bankers' Association for Finance and Trade (BAFT) operates under the umbrella of the American Bankers Association. BAFT is a global financial services association providing advocacy, education, and community-building opportunities for financial services institutions and suppliers around the globe. In December 2010,⁶ the association published two documents: BAFT Product Definitions for Traditional Trade Finance 2010, and BAFT Product Definitions for Open Account Trade Processing and Open Account Trade Finance 2010. The purpose of the papers was to build a framework of definitions that provided structure and common terminology for key processing and financing services. The association also conducts a Global Trade Council, various regional groupings and organises conferences and seminars.

⁵ UCP 600 is the latest revision of the Uniform Customs and Practice that governs the operation of letters of credit.

⁶ Subsequently revised in May 2011.

SWIFT

The Society for Worldwide Interbank Financial Telecommunication (SWIFT) is a member-owned cooperative through which the financial world conducts its business operations with speed, certainty and confidence. More than 10,000 financial institutions and corporations in 212 countries trust SWIFT every day to exchange millions of standardised financial messages. This activity involves the secure exchange of proprietary data while ensuring its confidentiality and integrity.

It provides the proprietary communications platform, products and services that allow its users to connect and exchange financial information securely and reliably. It also acts as a catalyst that brings the financial community together to work collaboratively to shape market practice, define standards and consider solutions to issues of mutual interest.

Aside from handling messages for the execution of traditional trade transactions SWIFT has created the TSU, a matching and workflow engine for open account transaction data. Since March 2009, it includes the Bank Payment Obligation (BPO), an irrevocable conditional undertaking to pay given by one bank to another.

International Factors Group

The International Factors Group (in short: IFG or IF-Group) was founded in 1963 as the first international association of factoring companies. The original mission of IFG was to help factoring companies to conduct cross-border business acting as correspondents for each other. This is still the core activity of IFG today, which acts primarily as the representative trade association for the factoring and the asset based finance industry, with an important focus on education and events, industry information and regular news and newsletters. Both IFG and Factors Chain International below have developed a set of rules (GRIF), which govern international factoring.

Factors Chain International

Factors Chain International is a global network of leading factoring companies, whose common aim is to facilitate international trade through factoring and related financial services. Currently the FCI network counts 264 factors in 72 countries, actively engaged in more than 80 percent of the world's cross-border factoring volume.

EU Federation For The Factoring and Commercial Finance Industry

The EUF is the representative body for the Factoring and Commercial Finance Industry in the EU. It comprises national and international industry associations that are active in the EU. The EUF seeks to engage with Government and legislators to enhance the availability of finance to business, with a particular emphasis on the SME community. The EUF acts as a platform between the factoring and commercial finance industry and key legislative decision makers across Europe bringing together national experts to speak with one voice. It publishes glossaries of relevant terms and concepts.

International Forfaiting Association

The International Forfaiting Association (IFA) is the worldwide trade association for commercial companies, financial institutions and intermediaries engaged in forfaiting. Founded in August 1999 and with more than 140 members the IFA aims to foster business relationships and enable best practice among those engaged in the ever-expanding, global forfaiting community.

Other Associations and Initiatives

Other noteworthy industry organisations and associations that contribute to the development and awareness of SCF-related matters are:

- ACT (www.treasurers.org)
- EACT (www.eact.eu)
- EBA (www.ab-e-ea.eu)
- EESPA (www.eespa.eu)
- ISCFC (www.scfcommunity.org)

2.10.10

Role of governments and public sector in SCF

Governments in both developed and emerging economies often take specific policy actions to support SCF development. The availability of bank credit to support businesses has become a political issue and the techniques of supply chain finance have been mentioned in that connection.

Public authorities may intervene to meet the challenge faced by many small and mid-size enterprises in raising working capital finance for example based on their accounts receivables from creditworthy customers or other qualifying assets. Bank loans secured by accounts receivable (a primary source of SME financing in the United States and Europe) is often unavailable in emerging markets as the latter may lack the necessary infrastructure or access to commercial credit information. Encouraging developments are happening.

Governments often take a lead by improving liquidity in the corporate credit market through special funding programs or acting to enhance credit quality or by making purchases of high-quality, private-sector assets. These securities could be transaction-specific under export/import programs and may be evidenced by a variety of underlying instruments, such as letters of credit, trade-related promissory notes, and bills of exchange. Suppliers can develop confidence that businesses that sign up for these programs will be more likely to pay within clearly defined terms and that there is a proper process for dealing with any payments that are in dispute.

Special local and state initiatives support trade credit insurance at rates of premium that are normally available only to companies with significant trade volumes. This provides additional capacity for short-term trade credit insurance against a buyers' default in order to promote trade flows.

Governments are also active in promoting automation such as e-invoicing both in general and for public procurement, and in taking measures to encourage prompt payment and remove late payment especially to smaller suppliers.

The most noteworthy examples of constituents of this segment of SCF players are:

- Central and regional government authorities
- Export credit agencies
- Small business guarantee programs
- Government e-procurement and e-invoicing projects

3

Towards a clear conceptual language and common set of definitions for Supply Chain Finance

This chapter describes and evaluates the main categories of SCF instrument and makes a number of recommendations for improvement of the common conceptual language and definitions.

3.1

More clarity needed on definitions of supply chain finance and its components

There is a need to take care with the language and terms used by practitioners and drive a move towards much greater clarity. Clear terminology and a common conceptual language remain elusive starting with the definition of SCF itself:

1. One variant describes SCF as simply the “interaction” of physical supply chains for goods and services with the financial supply chain of decisions and financial processes such as credit, invoicing and payments
2. Another talks about optimising “working capital management, cost and transactional efficiency” along the supply chain
3. Others talk about the “portfolio” of transactional supply chain finance structures

More recently, others refer specifically to buyer-led programs to provide liquidity to their critical supply chain partners as being the sole definition of SCF.

Supply Chain Finance is usually described as “a portfolio or series of financial practices and technologies that support the trade flows and financial processes of end-to-end business supply chains”.

The EBA SCWG supports this description and further proposes that Supply Chain Finance is defined as ‘the use of financial instruments, practices and technologies to optimise the management of the working capital and liquidity tied up in supply chain processes for collaborating business partners. SCF is largely ‘event-driven’. Each intervention (finance, risk mitigation or payment) in the financial supply chain is driven by an event in the physical supply chain. The development of advanced technologies to track and control events in the physical supply chain creates opportunities to automate the initiation of SCF interventions.’

Within this definition of the SCF, the following financial instruments are included:

Accounts Payable or Buyer-centric – called ‘Approved Payables Finance’ or sometimes ‘Reverse Factoring’, ‘Supplier Finance’ or ‘Confirming’, and sometimes (confusingly) simply ‘Supply Chain Finance’, and based on the discounted payment of accounts payable in favour of suppliers by accessing a financial institution’s or a buyer’s own liquidity. Another related instrument is Dynamic Discounting, through which a buyer itself provides variable discounts for early payment of supplier invoices.

Accounts Receivable or Supplier-centric – such as Receivables Finance (the category term used in this guide), Receivables Purchase and Invoice Discounting (all three being common names for similar financing instruments) and Factoring, which is a form of Receivables Finance but different in character from those previously mentioned.

Inventory-centric (or ‘pre-shipment’) – such as Purchase Order (P.O.)-based finance and Inventory Finance.

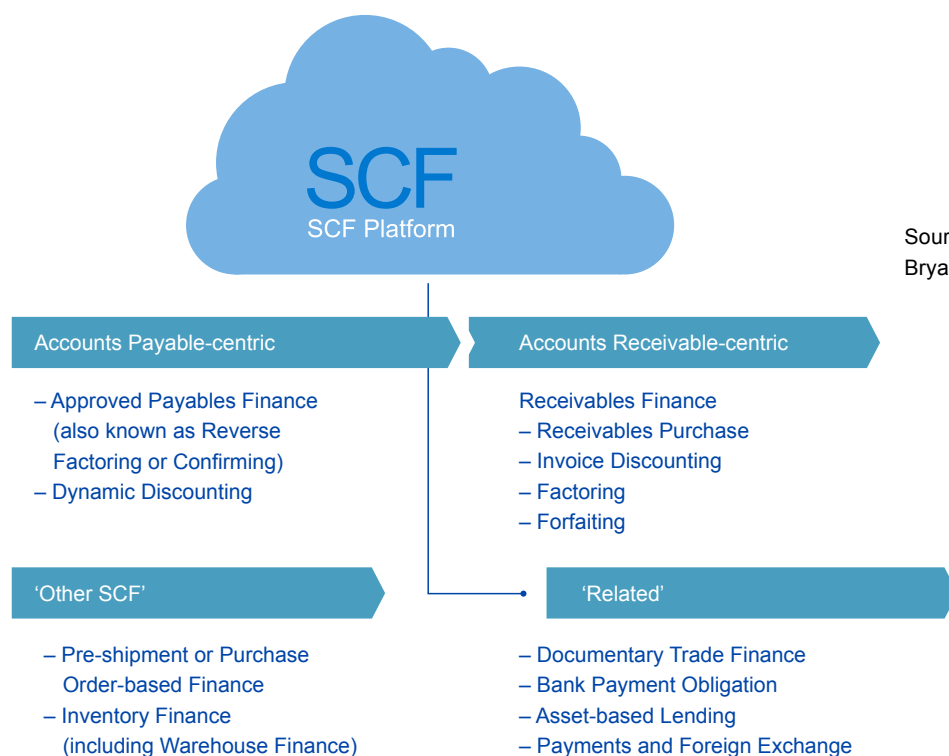
Bank Payment Obligation (BPO) – an interbank instrument developed initially by SWIFT (as a development arising from its SWIFT Trade Services Utility) and now adopted by the International Chamber of Commerce (to be governed by ICC rules set out in Uniform Rules for the Bank Payment Obligation (URBPO) on the basis of which a variety of SCF transactional structures can be enabled).

Traditional documentary trade finance – such as Letters of Credit and documentary and related trade loans – summarised in **Annex 4**.

Complemented by other instruments and enablers e.g. other types of asset finance, longer term export and project finance, and hedging and payment instruments – not described in detail in this market guide.

All of the above instruments are illustrated in **Figure 6** below.

Figure 6:
The Complete Supply Chain Finance Portfolio



Source:
Bryant, Camerinelli

Whereas the categories of SCF and trade finance set out above are generally well-accepted, the market for SCF is still evolving and the next levels of definition for SCF structures and components are not well-established with the following consequences:

- 1.**
Even though similar solution structures are offered by leading banks, a truly common market terminology and joint understanding of their essential product features is an important requirement if SCF is to become widely adopted.
- 2.**
The lack of a generally accepted and consistent nomenclature complicates the

understanding of the offered solutions by users and creates confusion among potential customers.

- 3.**
There must also be sufficient room to allow individual competitors to create differentiated products within a common market terminology; both are necessary.

In response, banking associations and organisations have already started to build glossaries and bodies of knowledge to support their membership and associates in adopting a common language. The most noteworthy and active is BAFT, the US-based global association for organisations actively engaged in international transaction banking.

The EBA SCWG has concluded that, with the exceptions set out below, the terms and definitions elaborated by BAFT for trade finance and supply chain finance instruments are worthy of support and do indeed reflect the experience and acceptance of a large community of organisations actively engaged in international transaction banking. Therefore, the EBA proposes the adoption as far as possible of the existing terms and references developed by the BAFT community members. A glossary of the most common terms used developed by BAFT for SCF is set out in **Annex 2 – BAFT Definitions of SCF Instruments**.

At a second level of detail, there is scope for a more precise convergence between the BAFT definitions and the way this Market Guide has described the relevant financial instruments and the way other market participants use the terms. An important example is the European use of the expression Reverse Factoring to the exclusion of the term Approved Payables Finance; the latter is clearly a preferable description but it is not well-known. Reverse Factoring is a common expression but not very accurate or descriptive of the real context. Approved Payables Finance should become the favoured terminology.

The International Chamber of Commerce Banking Commission (ICC) has created the industry standards for definitions of traditional documentary trade finance instruments, which command universal respect and adoption. ICC has recently been working with SWIFT on the definition of Bank Payment Obligation and a set of Uniform Rules for the Bank Payment Obligation and this is to be welcomed. For other open account

based supply chain finance areas, ICC could no doubt apply its recognised rule-making capabilities to further areas of opportunity; a by-product could be greater ‘portability’ of solutions without impinging on competitive aspects.

For Factoring, the International Factors Group (IFG or IF-Group) body provides definitions and common terms, as does the Factors Chain International Group and the EU Factoring Federation. The EBA SCWG accepts the terminology of these organisations as industry standard. There may be some scope however for the convergence with other industry strands as different parts of the finance industry delivers SCF solutions.

Value exists in describing the various categories of SCF techniques and this Market Guide attempts to provide these descriptions at some length. The EBA SCWG believes that such descriptions will support the process of market convergence.

Following a number of discussions between SCF practitioners, it has now been decided to create a Global SCF Forum to develop a set of standard market definitions for the range of SCF instruments offered by the market. It is expected that all stakeholders, e.g. customers, banks and non-bank finance providers, regulators and investors will benefit from the clarity that these definitions will deliver. See **Annex 5** for further details.

There now follows a description of the main categories of SCF instruments, which are open account based and most particularly event and data driven:

3.2

Approved Payable Finance

Description

Approved Payables Finance (also called 'Reverse Factoring') allows a Supplier to receive a discounted payment of an invoice or account payable due to be paid by a Buyer. The Buyer approves the invoice for payment and separately finance is raised against the payable by the Supplier from a bank or other finance provider, who relies on the creditworthiness of the Buyer without recourse to the Supplier. The Buyer pays at the normal (or an agreed) invoice due date, although the Supplier has received a discounted payment through the financing facility.

The bank relies on the creditworthiness of the Buyer and the attraction to the Supplier is based on an 'arbitrage' between the higher credit rating of the Buyer and the typically higher cost of financing for the Supplier, as well as the attraction of the availability of the finance.

The Spanish market regards itself as the 'home of confirming', which resembles Approved Payables Finance in all significant respects. In Spain, confirming transaction volume exceeds that for traditional factoring and is mainly carried out for domestic transactions. Its advantages are held to include simplicity, minimal documentation and no need to include whole turnover as is the case with traditional factoring. Given the exclusion of confirmed transactions from whole turnover factoring, there can be some tension between providers of the two instruments.

How it works

There are two main models for the provision of Approved Payables Finance:

In the first model, a Buyer will establish an umbrella Approved Payables Finance program with a bank or other finance provider and agrees what payables will be eligible for financing and what payables information will trigger the process.

Invoices are presented either in paper or electronic form to the Buyer in the normal way. The Buyer approves the invoice for payment and creates the usual entries in the accounts payable ledger. The Buyer then provides the bank with a schedule of accounts payable due and approved. In the latter connection either the Buyer establishes a specific list of approved payables/future payments due, or makes available its accounts payable invoice database in a web portal. At this stage, the Suppliers who are the creditors for the invoices due may be offered finance (often through an automated SCF platform, either built in-house or white-labelled) and the Supplier identifies the accounts payable it would like the bank to finance. Suppliers may be given discretion as to which individual approved payables to be financed or to elect an automatic finance option for all its approved payables (subject to an availability control).

The bank then purchases the payable on a sale (or assignment) basis without recourse to the Supplier. The bank becomes the trade creditor to the Buyer and relies on the Buyer's responsibility to settle with the bank at maturity. The Buyer is not usually a

party to the financing arrangement, but may indemnify payments under invoices due. The bank agrees the discounted amount to be paid, makes the payment to the Supplier and arranges for its settlement by the Buyer on the agreed due date of the payable.

A typical Buyer requirement is that the Approved Payable Finance solution is structured from a legal and accounting perspective such that the treatment of trade creditors remains unaltered (i.e. the liability does not become reclassified as 'bank debt'). This is often referred to as being 'balance sheet neutral'. It is usually important, therefore that the financing of the Supplier is at 'arms-length' from the Buyer. The finance usually has to be requested by the Supplier – hence the need for an onboarding process to ensure that the eligible Suppliers are configured on the SCF platform and have been subject to an appropriate 'Know Your Customer' (KYC) check.

Whenever the financing value is particularly large the instrument may leverage the financing capacity of several banks/financiers to meet the overall funding requirement. Financings for the same ultimate obligor and conditions may be syndicated among a number of banks and finance providers. Such syndications are a growing feature of the market.

In this first model, banks are typically the main providers and work with a creditworthy buyer to identify a list of strategic suppliers falling within the top 10 percent or perhaps 20 percent of the supplier base. These suppliers are offered finance in the way described above and onboarded onto the bank's SCF platform. In doing so, the bank meets the needs of the most critical suppliers, minimises onboarding and KYC challenges, and

undertakes transactions of sufficiently profitable size and quality. This model appears to be gaining traction among the main SCF providing banks.

In a second model, the process is supported by an e-invoicing service provider or third party B2B platform, which provide services to the Buyer and Suppliers based on a service platform through which, following submission and safeguarding of suppliers' financial data, approved invoices are displayed in the e-invoicing portal and appropriate messages are generated between the parties involved. Under such an arrangement the financing program is very much tied to the ongoing invoicing process and the various information flows are 'joined up' and fully integrated in the e-invoicing portal. An attraction to the financier of this model is that large numbers of suppliers will already be onboarded for the invoice process and be available for SCF subject to any additional KYC process. Basing the process on an e-invoicing service creates some advantage in that the invoices are likely to be approved on an accelerated basis thus offering an enlarged 'window of opportunity' for a longer tenor financing.

Under this second model, proponents see the potential to extend it to support the liquidity needs of a much broader base of SME suppliers including the 'long tail' of small suppliers. This has the advantage of supplying credit to a sector where credit capacity remains constrained, and where political demands for the supply of increased lending is called for repeatedly, and where lengthened credit terms are 'squeezing' the suppliers concerned. Despite issues of onboarding, KYC, sub-scale transaction size, unknown demand (many SMEs saying "we just want

to be paid, not pay a discount for money that is legitimately ours already”), suggests a more complex environment, but based on the use of automation, there are those who are beginning to offer this service. There have been recent announcements from e-invoicing networks, such as OB10, and from the UK arm of Santander, and it is also of interest to the factoring industry, which is much more geared to the provision of finance to this segment. Clearly, where interest rates for core lending products are already high, the room for manoeuvre is greater and in addition, the increasing availability of official funding schemes for SME lending may also stimulate growth of this market.

Operational processes

To support this market enlargement, the importance of having an automated accounts payable process at the Buyer is a key success factor, as is the integration and scaled-up on-boarding of suppliers. The latter includes the onboarding onto the platform that is used to communicate details of approved invoices/payables, and which enables the supplier to select which to finance and instruct the financing bank accordingly (including the perfection of the security).

There must also be an effective KYC process, as the financing bank will need to accept instructions from the supplier to undertake the discount, and such discounting will involve the assignment of the receivable, resulting in a need for a documented agreement between the supplier and the financing bank. The challenge here is that the supplier may not or

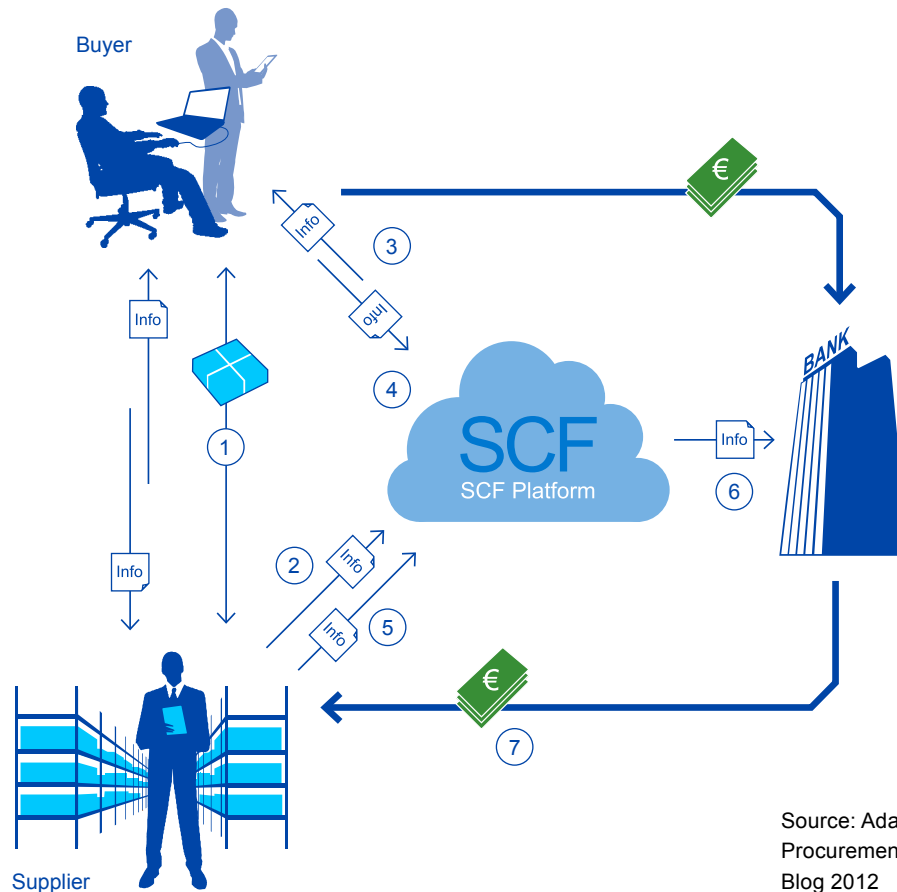
will not usually have a banking relationship with the financing bank (other than by coincidence). From a compliance perspective, most banks will adopt a prudent stance and treat the supplier as the instructing party. In addition to executing appropriate documentation they will need to undertake a limited amount of company research (not full KYC) on each and every onboarded supplier.

Figure 7 illustrates an Approved Payables Finance flow.

The main source of information in Approved Payables Finance is an approved payable.

As discussed above, the models require the Supplier to submit invoices to the Buyer. In the first model described above, the Buyer provides a listing of amounts due to its Suppliers to the financing bank, who then independently assesses the transactions and makes an offer of finance to the Supplier.

Figure 7:
Approved Payables Finance Flow



Source: Adapted from Cap Gemini,
Procurement Transformation
Blog 2012

The example illustrated in **Figure 7** above is based on the second model described above and the use of an automated B2B platform, which could be provided directly by the financing bank or a third party or in combination. The processes described could support both the models described above. The basis for the approved payables finance is the underlying transaction between the Buyer and the Supplier **(1)**. The invoice for the transaction is submitted to the Buyer by the Supplier **(2)**, enabling the buying party to receive it into its enterprise resource planning (ERP) system **(3)**. Electronic communication between the Supplier and Buyer is supported.

As soon as the Buyer has approved the invoice/account payable, the approval is communicated via the SCF platform **(4)**, allowing the Supplier to see it. It is then up to the Supplier to either wait until the payment term expires and the Buyer pays the invoice, or to request finance from the bank **(5)**. The bank receives this request via the SCF platform **(6)** and pays the Supplier for the invoices, withholding the agreed discount **(7)**. When the agreed payment term expires, the Buyer makes a payment to the bank, after which all obligations have been met.

Benefits

The benefits of Approved Payables Finance to Suppliers can be summarised as:

- 1.**
Additional and flexible source of timely funding (liquidity).
- 2.**
Reduction of debt and Days Sales Outstanding (DSO).
- 3.**
Acceleration of accounts receivable at favourable rates.
- 4.**
Cash flow optimisation due to earlier receipt of funds (meeting Prompt Payment rules and expectations).

The benefit to Buyers can be summarised as follows:

- 1.**
Strengthening of relationship with suppliers by ensuring certainty of supply (avoiding shortages of essential stock/components due to a supplier's failure to deliver as a result of a lack of finding credit lines), and enabling the buyer to negotiate better terms, knowing that the supplier has access to finance at favourable rates.
- 2.**
Enhanced working capital effectiveness, integrated accounts payable, bundling payments and improved reconciliation processes.

- 5.**
Improvement of liquidity planning due to transparency (Cash Forecast).
- 6.**
Existing credit lines are not affected, although to the extent that receivables disappear from the balance sheet lenders may result in the adjustment of the level of facilities by lending bankers, especially as certain very credit worthy credits may disappear from the receivables portfolio.
- 7.**
Potential reduction in the overall cost of credit, since it is based on the credit risk of the Buyer.
- 3.**
Incremental value creation from freeing up internal credit lines or internal risk limit.
- 4.**
The buyer can benefit from the savings possible by consolidating shipments. Using the available finance, the supplier can afford to ship larger consignments and the resulting savings may be shared with the buyer.
- 5.**
The trend towards even more intense globalisation has meant that buyers have a strategic dependency on their suppliers and are now more inclined to treat them as partners. The provision of such a SCF solution supports such a partnership approach.

Important issues for consideration

To make an Approved Payables Finance program successful the following additional considerations need to be addressed:

1.

The need for (an) international scalable platform(s) either deployed by banks directly or based on a partnership model to assure appropriate geographic coverage relevant to the location of the suppliers in scope.

2.

The need to clarify the accounting treatment of accounts payable financed (to avoid being re-classified as debt on the Buyer's books) and therefore balance sheet neutral.

3.

Legal clarification needed on the nature of the irrevocable payment instruction at maturity, the assignment of the invoices to a third party, confidentiality and tax issues.

4.

Avoidance of the risk of 'Double Finance'.

5.

A complex sales process is required in view of the multi-party nature

6.

It is important to identify the value creation and arrive at a value distribution acceptable to the parties who are collaborating.

7.

Onboarding as a key success factor needing careful management as described above.

8.

The increasing prevalence of e-invoicing networks has far reaching implications for the supply chain finance market as there will be a critical mass of business transactions dematerialised and available in electronic form to feed SCF services supported by messaging and status/approval updates. E-invoicing is a 'game changer' and will permit more generalised use of Approved Payables Finance.

9.

Similarly there is potential to integrate the process into electronic payment systems and take advantage of new platforms for SEPA payments (Single Euro Payments Area). In that sense SEPA is also a 'game-changer'.

BAFT definition

EBA SCWG accepts the BAFT definition of Approved Payables Finance and states a preference for this term, whilst recognising that the European market makes common use of the terms 'Reverse Factoring' and 'Confirming'. It would be helpful for the global market development if the single term Approved Payables Finance is used.

3.3

Dynamic Discounting

Description

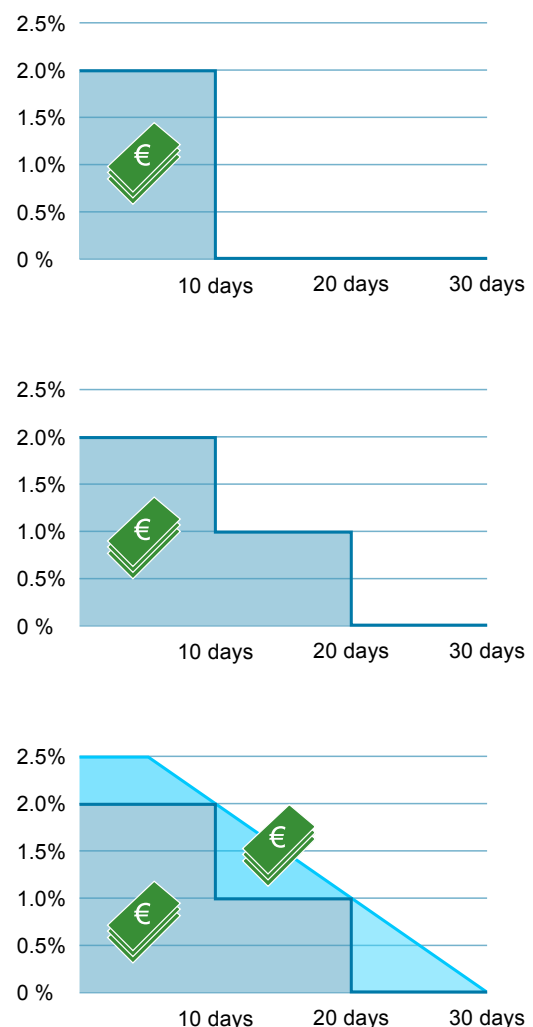
Dynamic discounting offers suppliers the early receipt of accounts payable due from a buyer in return for a variable discount. Typically, the funds are provided by the Buyer from its own liquid resources.

Discounts on invoices due offered by Buyers have usually been based on a 'fixed' combination of discount value and payment date; the most frequently cited invoice discount scheme is '2/10, Net 30': For an invoice due for payment in 30 days, the supplier offers a 2 percent discount on the invoice face value, receiving in return an early payment in 10 days (i.e. 20 days earlier than contracted). The potential rewards for early supplier payments are great as the standard discount of 2 percent for payment within 10 days translates to an annual percentage rate of 36 percent as a return to the Buyer. This arrangement could be termed 'static' discounting and can be contrasted with 'dynamic' discounting discussed below.

Dynamic discounting eliminates the problem inherent in the cited '2/10, Net 30' arrangement where Buyers face the risk of not being entitled to a discount if the invoice approval takes longer than 10 days. The alternative solution to static invoice discount is dynamic discounting: This new form of invoice discount allows both buyers and suppliers to propose terms by putting them on a sliding scale and opening them up to negotiation, as shown in **Figure 8** below. Buyers have the benefit of supporting and stabilising their supply chain and achieving a return on liquidity that under current market conditions will exceed returns on money market deposits.

At any point in time the Supplier and the Buyer may agree on the discount to be applied to an applicable advance payment date, taking advantage of a range of discounts depending on the interval selected. Clearly the addition of electronic invoicing, which permits an acceleration of the invoice approval process, will allow the Buyer to take advantage of the maximum discounts offered. The underlying IT system takes care of providing visibility to

Figure 8:
Dynamic Discounting



Source: Camerinelli, adapted from Taulia

the parties involved as well as ensuring the contractual parameters (e.g. maximum discount allowed, minimum early payment days) are met. This instrument requires a robust technology platform to run the necessary calculations and negotiation process.

There are a number of technology providers that have created systems to support this functionality which may also be integrated into ERP systems and e-invoicing platforms.

How it works

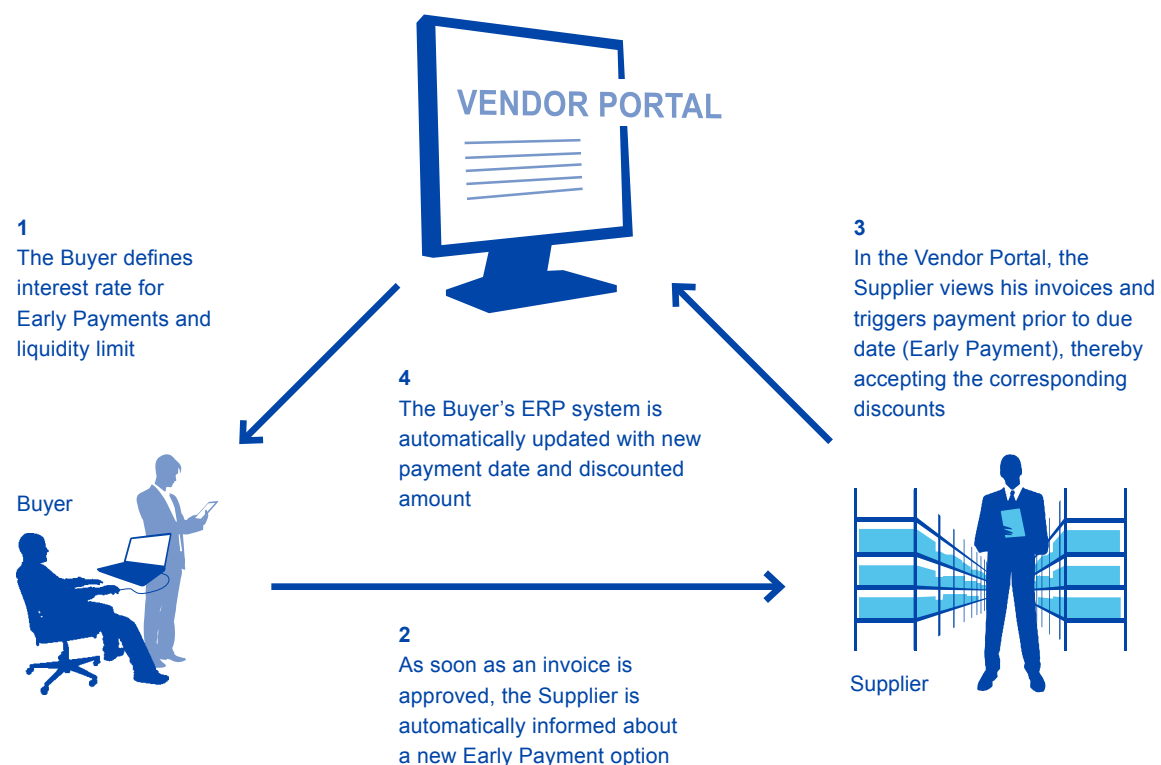
The main steps in a typical dynamic discounting arrangement are depicted below in **Figure 9**.

Even though Dynamic Discounting is not a distinct SCF instrument offered by banks, the existence of the technique is of interest to them. For example, a bank might integrate into its cash management capabilities such as a dashboard for the management of dynamic discounting and the related liquidity, especially bearing in mind that a Buyer may have a seasonal trading pattern and require funding at some stage and being able to deploy its own liquidity at another.

Comparison with the definition from BAFT

BAFT does not provide any definition for this SCF instrument.

Figure 9:
Dynamic Discounting Process Flows



Source: Taulia

3.4

Receivables Finance

Description

Receivables Finance allows suppliers to raise finance on the basis of their receivables relating to one or many buyers and thereby receive early payment, usually at a discount to the face value although various pricing structures are used.

Receivables Finance arises in many forms and is subject to a wide variety of practices based on jurisdiction, country or industry practice and choice of instrument selected. The underlying receivables may variously be purchased, assigned, the subject of a security interest such as a pledge, discounted or otherwise structured as a financial transaction. The terms used by the industry are often overlapping and imprecisely defined.

Some key terms are:

Receivables Purchase

is an instrument in which a bank enters into a financial agreement to purchase or discount receivables from a supplier typically without recourse to the latter. The purchase may or may not be disclosed to the obligor depending on circumstances. The supplier may remain responsible for collecting the proceeds at maturity. Such purchases may be made on a 'silent' basis or disclosed to the obligor, and there are a variety of pricing mechanisms.

With the receivables purchase model, the financing bank is usually dealing with one supplier (the bank's customer) and one or multiple buyers. The financing bank purchases or takes an assignment of the receivables when the supplier's invoices are created. Receivables purchase programs are typically structured on a 'true sale' basis to ensure

off-balance sheet treatment for the supplier (i.e. the receivable is extinguished when the bank purchases the receivable, avoiding the recording of bank debt on the supplier's balance sheet). In view of the performance risk issues, however, most receivables purchase programmes involve limited recourse to the supplier for example in the event of contractual dispute or insurance invalidity.

Many obligations are covered by bank guarantees, credit insurance or represent investment grade corporate risk, thereby permitting a 100 percent non-recourse transaction. Other transactions are based on a margin such as 80 – 90 percent of the invoice face value. There is often a focus on international or big-ticket business (>EUR 100,000) with maturities varying from 30 days to 7 years. New non-bank players are addressing a 'small ticket' market.

Forfaiting

is invariably an internationally orientated activity, whereby a financing party purchases promissory notes, drafts, bills of exchange or other paper claims on a Buyer and offered by a Supplier to a financier for discounting on a non-recourse basis. There is a secondary market for such claims and a quoted pricing system. Clearly since the receivables are 'unapproved' at the time of discount, considerable skill is needed to ensure the validity and provenance of such obligations in terms of risk of non-payment at maturity.

Invoice Discounting

is often applied to a financing facility whereby a supplier offers receivables evidenced by an invoice for discounting by a bank or factor. The receivables concerned remain under the control of the supplier who collects the proceeds at maturity, and the arrangement is therefore undisclosed to the Buyer. The bank obtains title to the receivables and will usually advance a proportion of the face value (75 – 90 percent). Discounts are calculated with reference to the current level of interest rates plus a margin. 'Invoice Discounting' may be a term applied to the above described Receivable Finance/Purchase transactions, or may be used to describe business of a repetitive nature, which shares some characteristics with factoring (see below) and is often provided by the same financing entity.

Factoring

varies in scope but in its commonest form involves the factoring of the 'Whole Turnover' or at least a significant element of a seller's portfolio of open account trading receivables representing typically corporate risk, as evidenced by invoices with payment dates not exceeding 180 days and on average much less. In such an arrangement, the factoring of debts is disclosed to the Buyer because the latter is required to pay the proceeds of factored invoices to the factor. Factoring may be provided on a recourse basis or with the benefit of credit protection, which places the risk on a non-recourse basis. Factors apply a number of practices and rules to establish the 'factorability' of a given portfolio and in order to set the margins of advance (75 – 90 percent) They charge fees for both the management of the receivables portfolio, any value-added services and the cost of funding. The level of cost is related to the quality of the parties and the scale of transactions.

Factoring is largely a domestic or regional service for SMEs, traditionally those drawn from certain industries where factoring is common or those with a reduced access to conventional bank lending. Historically the use of factoring has indeed carried a certain 'stigma' but in recent times factoring has grown substantially and has extended to cross-border factoring through chains such as Factors Chain International. Factoring techniques have also been broadened to accomplish very large transactions, some way away from the traditional factoring core and perhaps reflecting a desire for alternatives to traditional trade finance and bank lending at a time of credit constraints. Many factors are themselves part of banking groups.

Factoring deploys a large number of control and anti-fraud measures because at the time of financing (unlike with Approved Payables Finance) the likelihood of full payment of a particular receivable is not known with certainty. The considerations below can in many cases also be applied to the other categories of Receivables Finance described above.

The key risks are

- Goods not yet shipped but invoices are presented for factoring/financing
- Invoices issued together with credit notes (effectively a cancellation of the invoice), of which the Bank/Factor is unaware
- Invoices are paid into another bank account and the Bank/Factor is not informed
- There is a commercial dispute between parties of which the Bank or Factor is not aware.

- Inaccurate information is transmitted, e.g. an invoice of € 10,000 is reported to be € 100,000.
- A client fraudulently transmits a mix of correct and false invoices.

These are mitigated by the control of invoices presented and assigned by sampling and review of large amounts, by direct contacts with the buyer on a random basis; the active follow up of the collection of the portfolio of invoices and monitoring of amounts paid and received, and various dilution, ageing and concentration controls.

‘Factorability’ is an important concept. This relates to the ‘sell it and forget it’ nature of eligible products. Any debt in respect of on-going service or support contracts is usually not acceptable. A factoring company would also exclude ‘sale or return’ contracts or any contract that allows the buyer to offset return from previous orders from the current invoices being financed.

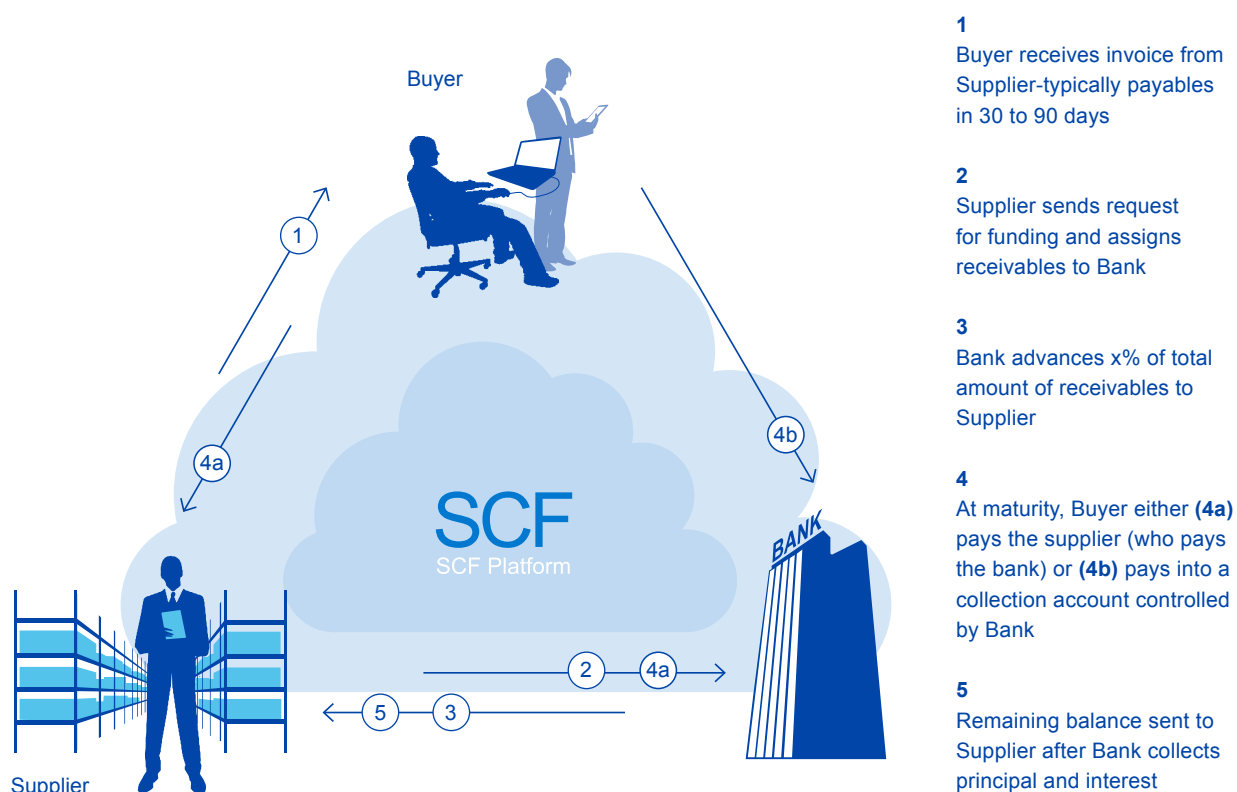
Operational process

In view of the wide variety of instruments presented in this Receivables Finance section the following transaction presents the operational process from a simple single transaction.

Figure 10 provides an example based on Receivables Purchase of the flows involved.

The bank makes cash advance to the borrower at the time of shipment and invoicing against a percentage of the receivable value (80–100 percent).

Figure 10:
Receivables Purchase Process Flows



Source: Adapted from
IIG Capital

The bank is repaid at the maturity of each individual transaction. All payments flow through the collection account controlled by the Supplier in accordance with the terms defined in the invoice. The maximum payment term for each transaction is contractually established from the agreed date. Funds repaid may be re-borrowed depending on submission of new receivables and the availability under a revolving credit facility.

Similar operations processes can be illustrated for the other types of Receivables Finance mentioned above but are not provided in this Market Guide as they are commonly available through the relevant industry associations.

Important issues for consideration

The scope of supplier-centric receivables finance is very broad and is an area where banks have been present for a long time. As a guide to the process of establishing soundly based receivables finance programs, the EBA SCWG suggests the adoption of a decision-tree framework based on a number of parameters/attributes. An example of such a decision tree is provided below.

In some circumstances the receivables might be sold into the secondary market where investors seek to play in new funding opportunities. Receivables Finance has an attractive value proposition due to the nature of the collateral represented by acceptable receivables.

Receivables Finance Decision Tree – parameters to be taken into consideration

Initiator of the program	Quality and standing of the Supplier
Risk	<ol style="list-style-type: none"> 1. With recourse to the Supplier or 2. Wholly on the Buyer risk without recourse to the Supplier 3. Not just a matter of credit risk, performance risk of both parties also must be evaluated.
Underlying instrument used for the financing	<p>Open Account (OA) receivable, Bill of Exchange, Promissory Note</p> <p>This Guide concentrates on OA receivables</p>
Recurring nature of the requirement	Is there a continuing flow of activity or is it on a one-off basis on specific transactions only?
Credit enhancement	Are there options to enhance the credit risk so as to provide additional guarantee/confirmation/credit insurance to give comfort to the bank?
Type of legal instrument for collateral	Purchase, Assignment, Pledge or other type of security interest?
Flexibility	Does the supplier wish to finance all receivables (whole turnover) or is it at the option of the parties transaction by transaction?
Geographic scope	Domestic, Regional or Global/Cross-Border
Notification to the buyer	<p>What is the level of interaction with the buyer?</p> <p>Silent or non-silent. In some jurisdiction there are specific rules covering disclosure and non-disclosure.</p>
Type of collection	<p>Who and how:</p> <p>Is the supplier acting as a collection agent for the bank?</p> <p>Or does the bank undertake the collection or a combination?</p>
Financing margin	To establish initial advance against the receivable, e.g. 60 – 90 percent?
Technology	Could be on a manual basis or automated/semi-automated?

Comparison with the definition from BAFT

The description in the BAFT document reads that ‘Receivables Purchase allows suppliers to sell their receivables/drafts [...] to their bank to receive early payment’. EBA SCWG finds that this description is perhaps too specific and narrow, as there are many jurisdictionally specific methods for securing a bank’s interests including purchase, assignment,

pledge and executing another type of security interest. Therefore, the BAFT description is accepted with a proposed amendment that ‘sellers to sell their receivables’ is replaced with ‘sellers to sell, assign or otherwise create a security interest in their receivables’. The generic term Receivables Finance may be more useful than Receivables Purchase as an overarching term.

3.5**Pre-shipment or Purchase Order-based finance****Description**

‘Pre-shipment finance’ is made available to a Supplier based on a Purchase Order (PO) received from a Buyer. This financing covers the working-capital needs of the Supplier, including raw materials, wages, packing costs, and other pre-shipment expenses in order to allow it to fulfil delivery against the relevant Purchase Order. The Supplier’s bank provides finance to the Supplier treating the Purchase Order as evidence of a good source of repayment.

Benefits

This service allows the Supplier to raise finance against a specific order created by a Buyer. It requires a significant evaluation of the performance risk which is placed squarely on the Supplier. The source of repayment is the Supplier’s ability to perform against the Purchase Order, together with the Buyers undertaking to pay on delivery of the goods. The benefit to the Buyer is to have certainty that a Supplier will be financially supported during the production and delivery process.

Commentators on the SCF market expect this instrument to grow in importance as the necessary information flows and monitoring tools are put in place to form the ‘events’ and ‘triggers’ required in such an open account situation.

Operational process

The events that trigger the need for a PO-based financing solution (**Figure 11**) are:

- When the PO is issued by the Buyer
- When the PO is approved by the Supplier

Figure 11:
PO-Based Finance Process Flows



Source: Bryant, Camerinelli

- ① The Buyer issues a Purchase Order (PO) to the Supplier
- ② The Supplier accepts the PO and advises the Buyer
- ③ The Supplier submits the PO to its bank and requests financing
- ④ The Supplier's bank evaluates the proposition and evaluates the amount of finance to be offered, the relevant terms, and the monitoring process to be applied (i.e., 'events' and 'triggers'). The Supplier's bank may or may not seek security over the assets being transformed by the Supplier.
- ⑤ At the request of the Buyer, the Buyer's bank may establish a Letter of Credit (LC) (or a Bank Payment Obligation, BPO) to cover the payment for deliveries under the Purchase Order when they are made. This is not a prerequisite for PO-based Finance as the Buyer's ability and willingness to pay for deliveries may be sufficient.

Important issues for consideration

This form of SCF presents a relatively high risk due to the material nature of the performance risk represented by the Supplier's inability to deliver. This requires a high level of monitoring by the Supplier's bank during the production and delivery cycle.

The risk of non-payment after successful delivery can be mitigated by the use of a LC or a BPO. In any case, if the Buyer is a strong credit-worthy entity, its ability to pay will not be questioned. From a risk evaluation point of view, a solid business partnership between Buyer and Supplier will improve the likelihood of the positive outcome based on the high level of trust and reciprocal business inter-dependency between parties. The banks involved need to have sound business relationships with the parties involved as well as a good knowledge and visibility of the underlying supply chain processes underpinning the particular Purchase Order.

For Purchase Order-based finance the intrinsic risk is higher than invoice-based techniques because the lender is engaged with the very early stages of the supply chain transaction. The bank will need structured contract documentation with the customer to mitigate risk together with the use of instruments such as letters of credit or guarantees (i.e. standby LC) and other title instruments. It is also an area where the recently developed Bank Payment Obligation (BPO) has particular application. There must be controls to mitigate the risk of receiving inaccurate data from the customer and ensuring that the location of goods and their shipping status is always known.

Comparison with the definition from BAFT

BAFT asserts that the SCF instrument *made available to a seller based on a purchase order received from a buyer* is called *Pre-Shipment Finance*. EBA SCWG would clarify that Purchase Order finance is currently the most common example of pre-shipment finance.

The BAFT definition reads: 'The buyer's bank issues its commitment to pay the seller (at sight or at maturity) once the seller ships and makes available the required documents that match the purchase order and other stipulated conditions. This service allows the seller to take the risk of the bank issuing its commitment to pay instead of that of the buyer.' EBA SCWG finds that this definition places too much emphasis on the eventual source of payment (which could come from the Buyer's bank or the Buyer directly) rather than positioning the most critical risk as being the risk of non-performance of the Supplier. The eventual source of repayment is of course important, but the Supplier's performance risk is the defining characteristic of pre-shipment and PO-based finance.

3.6

Inventory finance

Description

Inventory (or warehouse) finance is a form of SCF in which goods (either pre-sold, un-sold, or hedged), are financed and over which the bank usually takes security interest.

Inventory financing may be used by suppliers and buyers depending on the manufacturing and transaction cycles involved, and in risk terms is based on two key variables:

1.

The intrinsic value and saleability of the inventory

2.

The use to which inventory is put in terms of a manufacturing or sales process

Inventory financing is usually confined to qualified commodities (e.g. raw materials such as minerals, metals and agricultural produce) for which a value can be readily ascertained, and for finished goods where a Buyer has already been identified and for which a PO has already been issued. Work in progress is unlikely to be a strong candidate for inventory finance due to its lack of marketability. Risk factors include the location and ability to possess the relevant inventory in the event of the borrower becoming illiquid or insolvent. A bank will typically structure its security within a warehouse or where goods can be easily identified if held on the premises of the borrower. The financing may be arranged as a straightforward advance against the inventory or by way of sale and repurchase agreement under which the bank obtains title of the goods for the duration of the transaction.

Benefits

The main benefit of this form of SCF is the ability of the borrower to obtain funding based on the security of easily realisable assets.

Operational process based on an example

A typical inventory finance transaction involves two main parties: the borrower and the lending bank. A third party warehouse may also be involved.

Let's make the example of a processor and exporter of food commodities seeking to finance its exports to major food service companies and to obtain financing from a bank by pledging the inventory of raw and processed goods.

The bank extends a facility which is repaid in a number of equal monthly instalments with a bullet payment at the end of the repayment period; payments are received through assigned receivables from acceptable buyers.

The inventory pledged to the bank is stored in a certified warehouse, monitored by a reputable third party collateral management company, and released only when the bank is repaid. The bank is issued with monthly inventory inspection certificates by the collateral management company to ensure that the facility is fully collateralised.

Important issues for consideration

The financial partner must be very aware of the supply chain and logistics processes that underpin the dynamics of the inventory levels. The logistics complexities in managing levels and flows of physical goods might limit the supply of this SCF instrument to a few expert financial institutions that rely on logistics partners for the practical material handling and storage of the goods. Furthermore, only goods that can be easily exchanged in the market in case of repayment default can represent valid collateral to the financing party. Such criterion is met by consumables and commodities and restricts the potential of the SCF instrument to a limited set of product categories. In managing such transactions, the credit and performance risk elements need to be identified and managed on an integrated basis.

Comparison with the definition from BAFT

EBA SCWG finds the BAFT definition of 'Warehouse Finance' to be capable of being interpreted to mean restricted to financing the goods stored only in a third party warehouse. 'Inventory Finance', instead, broadly covers the financing of any acceptable inventory regardless of its physical location, although the use of a third party controlled storage facility or warehouse is compelling.

3.7

The Bank Payment Obligation (BPO)

Background

This section provides a detailed description of the newly emergent Bank Payment Obligation (BPO) and discusses opportunities for creating valuable and compelling transactional structures and use cases based on its application to actual customer needs.

Although considerable efforts have been made to describe and explain the BPO in terms of its interbank obligations and the role of its central functionality, the provision of services to the end-customer are not described to the extent required, as it is regarded as part of the competitive space and therefore banks need to structure and design their own product propositions in this area.

The question arises, however, as to whether this approach alone is going to ignite use of the BPO? Following a number of conversations between banks and with corporates, it is the contention of this paper that there is room for discussion of some generic use cases and product concepts without infringing the need for the development of an active and fully competitive marketplace for services based on the BPO. The result of the exercise should be greater familiarity with BPO terminology, a better feel for comparisons with present-day practices, and greater confidence to proceed with adoption.

The preparation of this discussion paper was a work item in the EBA SCWG during late 2013/early 2014. It is based on material set out in the existing chapter on BPO in this market guide, on materials developed by SWIFT and the ICC, and many conversations within the SCWG and with other interested parties.

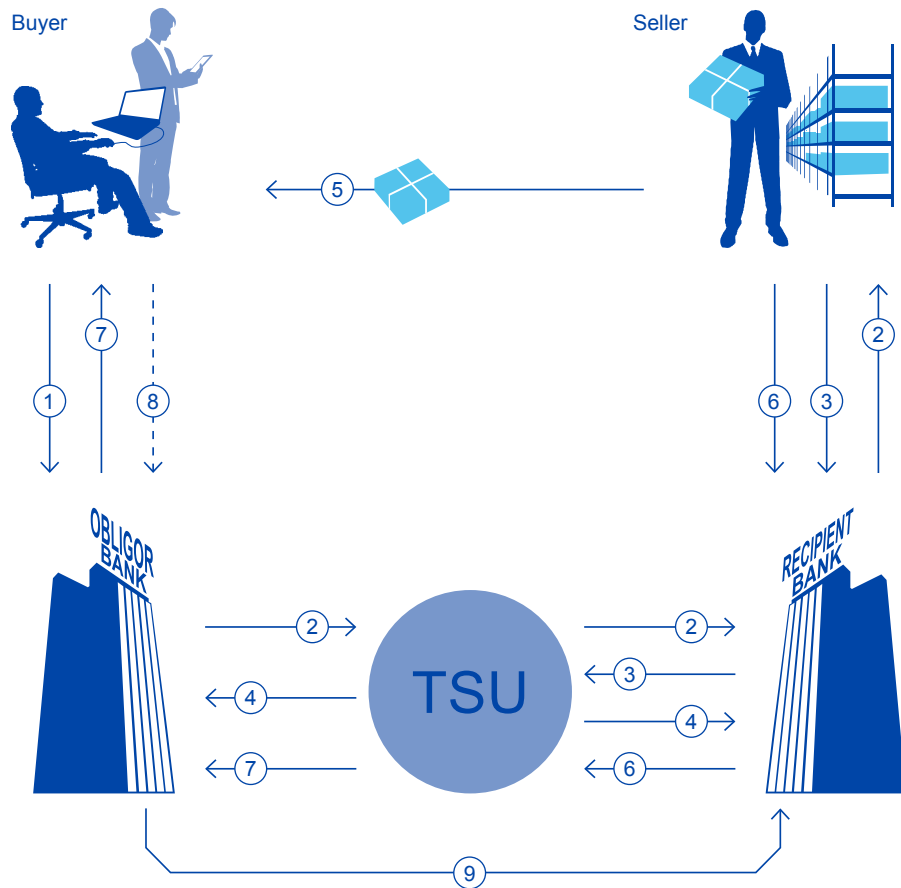
Key definitions

A well-accepted definition of BPO is:

‘Bank Payment Obligation (BPO) means an irrevocable and independent undertaking of an obligor bank to pay or incur a deferred payment obligation and pay at maturity a specified amount to a recipient bank following submission of all data sets required by an established baseline and which have resulted in a data match or an acceptance of a data mismatch. The BPO is subject to an industry-wide set of rules established by the ICC, known as the Uniform Rules for BPO (URBPO, ICC pub. 750).’

Figure 12 sets out the key parties, data flows and processing steps in the core functionality of the BPO and on the basis of which a large number of products and services from basic to complex can be created for bank customers. TSU means Trade Services Utility.

Figure 12:
BPO basic structure



Source:
Bryant, Camerinelli

- | | |
|--|---|
| ① Purchase Order Data + Request to issue BPO | ⑤ Shipment of goods |
| ② Purchase Order Advice with BPO option | ⑥ Invoice and shipping data |
| ③ Accept PO data | ⑦ Match results |
| ④ Match results and established Baseline: BPO is due | ⑧ Accept or reject mismatches, if any |
| | ⑨ Settlement of BPO: Payment at sight or deferred payment undertaking with payment at maturity (outside the TSU). |

The set of rules referred to URBPO have been developed by the ICC Banking Commission in partnership with the financial messaging provider SWIFT, and subsequently discussed and agreed with representatives of the industry and banks. The rules came into force in July 2013.

URBPO (Uniform Rules for Bank Payment Obligations) provide a framework within which the Buyer's bank and the Supplier's bank operate. If agreed between the buyer and the supplier, the Buyer's bank (known as the 'obligor bank' in URBPO) issues an irrevocable, but conditional undertaking in favour of the Supplier's bank (known as the 'recipient bank' in URBPO) to make a payment under specified conditions. The undertaking is conditional upon a successful electronic matching of trade data by a Transaction Matching Application (TMA) using the standard format ISO20022 TSMT. Currently, the only TMA that exists is the TSU (Trade Services Utility) operated by SWIFT, although any TMA that supports ISO 20022 standards can be used provided that the banks involved agree to use it. Only banks have access to the TMA.

The baseline data to be matched will be agreed in advance between buyer and supplier and entered into the TMA (this is called the establishment of the 'baseline'). This data is extracted typically from the buyer's purchase order and from the supplier's sales and processing records. Upon shipment of goods, the actual trade data, extracted from trade documents such as invoices, transport documents, and certificates, is sent by the supplier via his bank to the TMA and is then electronically matched against the baseline. If no BPO has been issued at the outset of the transaction, a BPO can also be added at a later stage to secure the payment upon the

successful matching of data, if so requested by buyer and supplier.

The BPO is a new inter-bank instrument to both secure payments against agreed conditions and is also an 'enabler' for partner bank-based Supply Chain Finance solutions of various kinds. The BPO is designed to complement and not replace existing trade finance solutions. Some have developed the view that, in essence, the BPO can be regarded as a hybrid between a Letter of Credit (LC) and a purely open account transaction.

Contractual relationships between banks involved in a BPO, and the buyer and supplier

Unlike the Uniform Rules for LCs (UCP 600) or for guarantees (URDG 758), the URBPO only provides the contractual framework between the banks and the TMA, and they do not cover the relationship between the participating banks (Obligor and Recipient bank) and the corporate buyers and suppliers.

Consequently, the contractual relationship between banks and customers needs to be agreed separately and such contractual relationships are part of the competitive space. This creates an onus on the prospective bank user to create significant product, business model and documentation materials.

Rights and obligations between buyer, supplier and banks as well as general contractual conditions need to be agreed bilaterally, such as:

- Procedures for providing and exchanging data between the customer and the bank
- Means of data transmission and communication, and the timeframes to be used

- Agreements in the case of failure or delays by the parties and/or regarding the TMA service
- Wording and conditions of any additional undertaking (of the recipient bank)

Finance solutions based on the BPO as described in sections 6–8 of this document are also placed outside the framework of the URBPO and require a separate transaction structure, documentation and contracts between the bank and its customer.

As a future development, it could be very beneficial if the URBPO were to actually provide legal and rules framework for the relationship between the bank and corporate customer, e.g. for BPO issuance and any required additional undertakings, even extending as far as ‘model agreements’. Such uniform guidelines, similar to the rules and guidelines for LCs or guarantees, might help to accelerate market adoption of the BPO and further thought in this area is recommended. A growing number of BPO transactions and an initial build-up of usage might lead the ICC to extend the URBPO in the way described.

Comparison of the Bank Payment Obligation with a Letter of Credit

A Letter of Credit (LC) is issued by order of the buyer (the ‘applicant’) in favour of the supplier (the ‘beneficiary’) creating an irrevocable, conditional undertaking by the issuing bank upon presentation of LC-compliant documents by the supplier. The advising bank, often the supplier’s own bank, may add its own conditional undertaking to that of the issuing bank. This is known as ‘confirmation’.

A Bank Payment Obligation (BPO), by contrast, is issued by the Obligor (i.e. buyer’s)

bank in favour of the supplier’s bank (known as the ‘Recipient bank’) not the supplier. The Recipient bank advises the BPO to the supplier and may offer an additional undertaking (‘confirmation’ or ‘re-obligation’) to the supplier based on its own risk and conditions. This undertaking is not mentioned in the URBPO and therefore part of the competitive space.

Both LC and BPO start out as contingent obligations. Once the conditions have been met, following presentation of compliant trade documents (LC) or a successful data-set match (BPO), the obligation becomes unconditional. Both are irrevocable (i.e. they cannot be cancelled or amended without the agreement of all the parties involved).

The conditionality in respect of an LC relates to presentation by the beneficiary of LC compliant documents. The two banks involved in the LC transaction examine the documents independently. One bank is always the issuing bank. The other, known as the nominated or advising bank, is any bank empowered under the LC to act as paying, accepting or negotiating bank. The nominated bank receives the documents from the beneficiary and is often the beneficiary’s own relationship banker. Differences in interpretation between banks arise from time to time, leading to delays in settlement and even disputes regarding the compliance of the shipping documents. The Uniform Customs and Practice for Documentary Business, revision 2007, known as UCP600 is a set of rules issued by the ICC to provide guidelines that regulate this process flow with the objective of avoiding disputes.

The conditionality in respect of a BPO relates to the need for a successful data-set match, following submission of the supplier’s trade

data by his bank (the Recipient bank). The potential for delays or disputes is eliminated with the BPO as the data is matched by an independent transaction matching application (e.g. SWIFT TSU), is entirely automated and virtually instantaneous. There is no judgement involved and so no scope for interpretation. In addition, the probability of a data mismatch is reduced as the buyer's purchase order and supplier's sales ledger data will already have been agreed to create the baseline in the TMA at the outset.

On the other hand, a significant value of the LC arises from the fact that title documents (e.g. bill of lading, or warehouse warrant) presented under the LC grant and certify a right of possession of the goods (collateral) and therefore provide high-risk mitigation. The BPO is often seen as a new instrument to replace letters of credit, but due to the fact that the matching is based on electronic data and not on checking presented documents by banks, it does not provide the same depth of risk protection as an LC through this title mechanism.

For the BPO there are significant efficiencies inherent in the automation of the matching process based on data. Of course it is conceivable that the supplier could provide wrong data in order to induce a successful match (clearly a fraud risk) and consequently in all BPO transactions the buyer and supplier need a trusting relationship or need to find ways to mitigate this risk outside the BPO transaction. This risk does not arise in the same way with an LC, although LCs are also sensitive to possible fraud (fraudulent documents may be involved, although this is very rare), and the relationship between buyer and supplier does not need to be as operationally close as is the case with a BPO.

Comparison of a BPO with open account terms

It is evident that the settlement of trade via open account mainly benefits the buyer, who decides if and when payment is effected often using his own matching process for purchase order, delivery and invoice. Moreover, the transaction does not necessarily involve any additional cost for risk mitigation. On the other hand, it is clearly the supplier who is bearing some risk, in particular not knowing whether and exactly when payment will be received.

Compared with open account trading, the BPO provides a number of advantages in particular:

Risk mitigation

The irrevocable payment undertaking by the Obligor bank and, if requested, the additional confirmation of the Recipient bank will secure payment at the due date (giving payment risk mitigation for the supplier). Based on the matching of trade data, the buyer benefits from a predetermined shipment date and a flow of information about delivery of the goods or services (giving shipment and performance risk mitigation for the buyer). In the context of risk mitigation, the BPO can also be seen as an alternative to an LC, and also to a payment guarantee, a standby LC and many credit insurance policies.

Working capital management

The confirmed maturity of payment allows improved working capital and cash management as well as less expenditure of time on tracking of outstanding payments. Possible financing of the BPO allows an increase in DPO (Days Payables Outstanding) for the buyer and a decrease in DSO (Days Sales Outstanding) for the supplier.

Liquidity

Both buyer and supplier may approach their banks to utilise the BPO to generate liquidity from the appropriate use of credit lines and available sources of liquidity and the employment of instruments of SCF described below. Consequently, the BPO can enable supply chain finance solutions to complement others such as forfaiting and factoring.

Process optimisation

Because of the electronic handling of data and electronic communication over a central platform, processes (e.g. amendment of shipping terms) and payments can be accelerated and optimised.

When compared with open account business, the BPO contains apparent disadvantages for the buyer, which loses control over his own payment process, may incur additional costs, and requires usage of a credit line for the issuance of the BPO. From the supplier's point of view these features become advantages. Of course it is open to the buyer to negotiate additional discounts or payment term extensions in return for the additional costs incurred.

An important issue related to the BPO and often the subject of discussion is the cost factor. Being a hybrid between the LC and the open account model, the BPO will almost certainly be cheaper than an LC but involve a higher cost than open account. The handling charges for a BPO will be relatively low due to electronic processing of trade data via the electronic platform. But the resulting costs for risk mitigation and use of capital will be charged by banks and will need to be reflected in the sales contract between buyer and supplier.

Use Case: BPO as a conditional payment undertaking

This and the following sections (6 – 9) establish a number of use cases for the BPO recognising the opportunity to trigger risk mitigation and financing services along the supply chain starting with the most basic payment protection features of the BPO and leading through to a number of SCF applications. As mentioned under **Chapter 3**, financing possibilities are not subject to the URBPO and therefore part of the competitive space and subject to separate agreements. It is for each bank to decide how to integrate the new BPO finance offer within the range of its SCF and trade finance solutions, supported by the effective handling under the BPO of trade and invoice data for its corporate customers.

The motives for trading partners to choose the BPO as a requirement in the sales contract will vary. The most basic motive is to use the BPO purely as a means for securing the payment. The BPO mitigates the payment risk as a result of the irrevocable payment undertaking of the obligor bank and, if requested, the additional undertaking of the recipient bank. Working capital management is supported through the predictability of cash flow and especially knowledge of incoming payment flows. As an additional benefit, the risk of non-shipment and related performance risks are mitigated to a certain degree through the matching process. Due to the electronic handling of trade data, transactions can be processed faster and amendments of trade or shipment terms agreed between the involved parties more easily.

The BPO can be issued for sight payments as well as for deferred payment periods.

Use case:**BPO for Approved Payables Finance
(also known as Reverse Factoring)**

In addition to securing a conditional payment, the BPO provides the basis for a finance of an approved invoice, if requested by the supplier. The principle is similar to the SCF instrument known as Approved Payables Finance (APF), which is already an established SCF instrument for the provision of liquidity to suppliers based on the credit rating of the buyer. APF is also known as Reverse Factoring, or Confirming.

With the Approved Payables Finance (APF) model without the use of the BPO, the financing bank (often buyer's own bank) normally receives a file of approved payables or approved invoices from the buyer and settles these directly in favour of the supplier in advance of their original due date whilst taking an assignment of or purchasing the supplier receivable. This follows the 'three-corner' model where the financing bank is dealing with one (usually) large buyer and multiple suppliers. However, the latter may not typically have an account with the financing bank and may well be located in countries where the bank has limited, or no physical presence. The model therefore creates significant challenges in respect of finalising transactions, implementation of the required e-channel capability, assignment of receivables and compliance with Know Your Customer (KYC) and Anti-Money Laundering (AML) regulations.

The BPO follows the concept of Approved Payables Finance (APF), but can address some of the challenges addressed above and the support for other business scenarios and target customers. But different processes and framework agreements are required to

be established in advance and during the financing cycle.

In contrast to the three-corner model used in the above example of Approved Payables Finance, the BPO model utilises the 'four-corner' model allowing the buyer's bank to deal solely with its own customer (i.e. the buyer) and the suppliers to interact with their own bankers locally (i.e. the recipient banks). This model significantly eases KYC and AML compliance, since the supplier's bank takes this responsibility in relation to onboarded suppliers.

The buyer's bank takes risk on the buyer and makes the BPO available in favour of the recipient bank. The BPO is conditional until successful matching of electronic data occurs. The recipient bank can then provide finance on a non-recourse basis to the supplier against the obligor bank's unconditional BPO undertaking to pay at maturity. There is also the opportunity for the obligor bank to discount its own deferred payment undertaking under the BPO in favour of the recipient bank.

The issuance of the BPO can either be instructed at the time of contract conclusion (Scenario1), or at any time later e.g. the issuance can be deferred until after the invoice/ payable has been approved, thus minimising unnecessary cost and maximising credit and capital efficiency (Scenario 2). The issuance of a BPO **follows** a successful electronic matching of trade data against a baseline agreed in advance between the buyer and supplier. Banks do not see any documents such as the invoice, as these are sent by the supplier directly to the buyer.

BPO-based APF best supports single transactions rather than a batch of invoices with the same maturity dates and issued by multiple beneficiaries. Consequently, it is reasonable to suggest that the BPO is not a suitable solution for handling a multitude of invoices with small amounts and is more suited to larger trade transactions.

Use Case: BPO for Receivables Finance

The BPO may be used to replace the risk of the buyer with that of the buyer's bank as far as the supplier is concerned. The financing bank, being the recipient bank under the BPO, may use the BPO as collateral to provide post-shipment finance to the supplier.

In the case of a BPO with a deferred payment and the additional undertaking ('re-obligation') of the recipient bank towards the supplier, the recipient bank may discount its deferred payment undertaking without recourse and without additional financing limits as a form of receivable finance.

In the event that the obligor bank issues a BPO with a deferred payment undertaking, it could also discount the undertaking in favour of the recipient bank, if requested. The buyer must pay the obligor bank at maturity whether discounted or not.

After having received the BPO from the obligor bank and added its own undertaking ('re-obligation'), the recipient bank may discount the transaction amount in favour of the supplier. On maturity date, the obligor bank will reimburse the amount under its BPO undertaking. No additional limit for the supplier is needed, as no additional credit risk created.

All the above transactional structures will require specific bank-customer documentation.

Use Case: BPO for Purchase Order/ Pre-shipment finance

Pre-shipment or Purchase Order Finance may be provided in the absence of a BPO to cover trade conducted on an open account basis, although it is relatively less common than Approved Payables Finance and Receivables Finance. The financing bank would have sight of the purchase order and then provide finance to the supplier to support the manufacturing/pre-shipment processing of the order (with full recourse to the supplier). The financing bank would place reliance on both the ability of their customer to fulfil the contract and also on the ability of the end buyer to pay.

A BPO could facilitate pre-shipment finance as follows: the baseline for TMA matching would be established from data extracted from the purchase order in the normal way. The baseline could include a BPO, which could serve as collateral for pre-shipment finance by the supplier's bank instead of only relying on the direct liability of the buyer. Such finance takes place outside the scope of the URBPO.

In essence, the BPO-backed pre-shipment or PO finance model is similar to a pre-shipment finance model based on an export LC. The key risk remains **unchanged** however; i.e. the performance risk on the supplier to deliver the goods and services and the ability to deliver correct data to the TMA in order to get paid under the BPO. If the supplier is not able to do so for one reason or another, there will be no payment. The BPO provides no protection against these risks (performance of contract and provision of correct data for matching) other than to provide a transparent transactional framework. The BPO does address the second risk (payment default by the

buyer) and would certainly be advisable in the event that the supplier has any doubt about the creditworthiness of the buyer.

Suggested guidelines for banks establishing a BPO product capability utilising the above uses cases

The following general guidelines are recommended in order to establish the capability to offer the above use cases:

- Establish a clear value proposition for each product for the buyer, supplier, obligor bank and recipient bank
- Develop a step by step transaction work flow
- Establish the necessary risk and credit appetites
- Develop some ‘simplified’ starter scenarios for baselines to prove the concept, e.g.

1.

Simple PO/ Invoice match

2.

PO/Invoice match plus one
‘proof of shipment’ document

- Develop a business model including a revenue model for the obligor and recipient banks reflecting risk allocation and operational value
- Develop and deploy the requisite technology platform with the ability to support product variations including TMA connectivity, standards, customer support and exposure/collateral management

- Drafting customer documentation, including the coverage of the relevant SCF structures to be used

- Develop marketing and educational materials

- Develop a risk policy, compliance guidelines, Risk Weighted Asset model

- Determine where in the organisation the BPO should be located for handling and execution

Summary of benefits of the BPO

BPO promises to combine the security of LCs with the simplicity of open account trading.

It anticipates combining an assurance of payment with the scope for deploying finance and risk mitigation solutions.

Crucially, it supports interoperability between the participating banks, because it makes use of a standard set of ISO 20022 messages and rules-based procedures. This interoperability enables banks to collaborate with one another in a four-corner model in order to extend reach across global markets (see [Figure 13](#)), and provide a comprehensive range of supply chain services to corporate customers. The matching of data through the TMA reflects events that take place in the physical supply chain, and therefore creating trigger points for the provision of financial supply chain services.

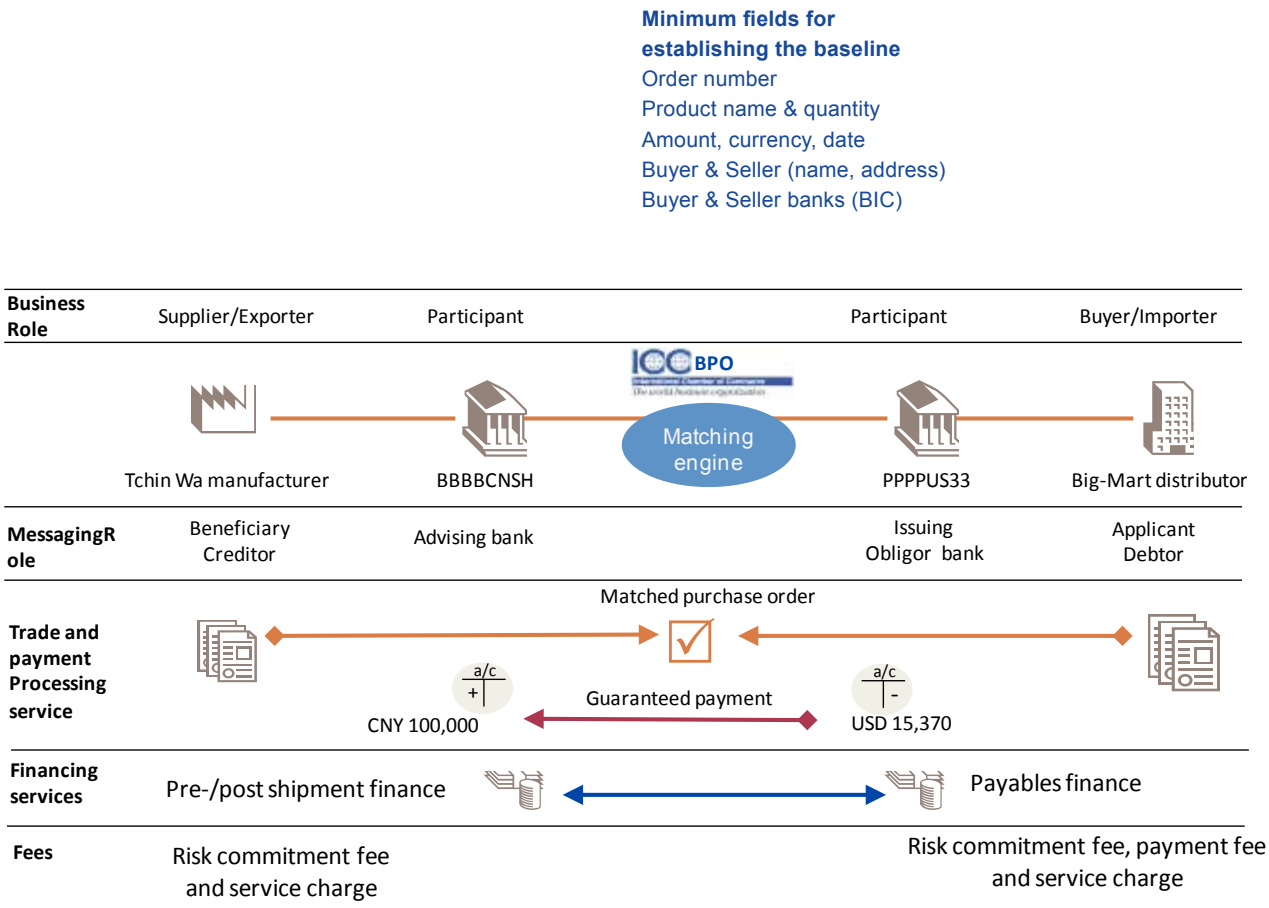
The BPO and related ISO 20022 messaging standards provide evidence of progress along the physical supply chain, reducing contractual performance risk and enabling the financing bank(s) to place greater reliance on the end-buyer as the source of repayment. Each event in the physical supply chain provides an opportunity for a bank intervention in the financial supply chain. Such financial supply chain interventions include the provision of risk mitigation, finance and settlement solutions. As the BPO deals with data extracted from the trading parties, or their third party vendors, data matching and reporting is virtually instantaneous and is not susceptible to differing interpretation, thus creating certainty, visibility and efficiency.

The BPO reflects the market demand for the handling of electronic trade data in an efficient and time-saving way, whilst still

benefiting from trade processes and finance solutions that have been established for many decades. Within this framework the open account model is enabled to generate new finance possibilities.

After development and issuance of the Uniform Rules of the BPO (URBPO), the ICC Banking Commission has begun to discuss initial experiences and open issues regarding implementation and integration of the BPO within existing supply chains in order to create added value opportunities for banks and their corporate customers. This demonstrates likelihood that the BPO will successfully take its place in the international SCF and trade services marketplace.

Figure 13:
Illustration of the BPO Process Flows



Source: SWIFT

Some open issues for the BPO

A number of interesting issues not covered in this paper are listed here for further reflection both at individual institution and industry level:

- The optimum marketing strategy for the recruitment of buyers operating on open account as potential users of the BPO
- The issues arising from working with partner banks to on-board multiple suppliers
- The role of non-bank service providers such as logistics companies, B2B networks, and factors
- Decisions about capital treatment under Basel III. See the ICC discussion paper *The Bank Payment Obligation: Capital & Accounting Treatment* (Document No. 470/1204 – 12 September 2012)
- An answer to the question as to whether suppliers invariably want to meet the costs of substituting bank risk for a prime corporate buyer risk. Should consideration be given to a ‘Corporate Payment Obligation’ (CPO), where the supplier and its financing bank take risk on the buyer, and the buyer’s bank acts as a facilitator but does not issue a BPO? This would require a change in BPO product definition at ICC level.
- As a conditional payment instrument, it is conceivable that there could be other general and specialised uses for the BPO in ‘domestic’ markets or specific industry situations where a trusted third party framework is required to certify a commercial event before a payment is made, such as property or shipping transactions, etc.

The URBPO concerns the relationship between two banks in a four-corner model. A possible initiative by the ICC to extend the URBPO to the relationship with the buyer and the supplier has already been mentioned above and might help to accelerate market adoption of the BPO (see [Chapter 3](#)).

4

Risk and regulation – a number of issues that need addressing

A number of issues falling under the heading of risk and regulation are identified and described in this chapter. They range from questions relating to internal risk management within banks, to the external regulatory environment including the emerging Basel III

framework, compliance obligations, and the accounting treatment of SCF transactions. The chapter sets the context by describing various aspects of the issues raised and then is primarily evaluative.

4.1

Internal risk management for SCF

Based on interview findings and discussions with members of the EBA SCWG, a number of questions spring to mind about the business characteristics of SCF and which need answering before a financial institution would seek to enter or grow the business:

1.

What are the fundamental risk characteristics of Supply Chain Finance and trade finance in general? Does its often cited short-term self-liquidating nature focused on the core trade cycle offer a genuinely acceptable risk profile at a time of constrained credit appetite?

2.

In practice, are the challenges and complexity of transaction structures, the implied control overhead and unclear definitions, a disincentive to adoption, and what lies below the surface in terms of having to meet the demands of customers for ever more tailored and complex solutions?

3.

Do banks face a real challenge to develop the necessary credit and transactional skills historically vested in trained individuals and increasingly replaced by quantitative techniques implemented in the interests of cost reduction and rationalisation? Where is the expertise combining supply chain knowledge and credit judgment skills going to come from?

4.

Given the need for automated tools either created within the bank or integrated from outside, what can be done about the squeeze on IT spending and the overwhelming priority of mandatory developments as opposed to new business opportunities? Does the lack of standards and market norms in any case prevent the full benefits of automation?

5.

What impact does the lack of visible market size estimates and the wide scattering of SCF opportunities have on market development?

6.

Do documentation and client/transaction initiation processes create long sales cycles and exhausting contract negotiation between corporate clients and banks?

7.

How can senior management attention be nurtured and sponsorship gained for the SCF business based on a compelling business case?

8.

Is there a problem in finding the right individuals in the corporate customer with regard to pitching the SCF value proposition? Is it the CEO or the CFO or both? Is it the treasurer, or the chief procurement officer, or both?

9.

Do the number of internal actors that require coordination militate against response times and recognition of the business value among corporate relationship managers? Are fundamental silo effects just too big a hurdle to overcome?

10.

How can the credit approval processes of institutions be sensitised to the SCF business?

11.

How can banks meet the challenge of supplier onboarding? The required suppliers are usually widely dispersed and not always easily accessed.

12.

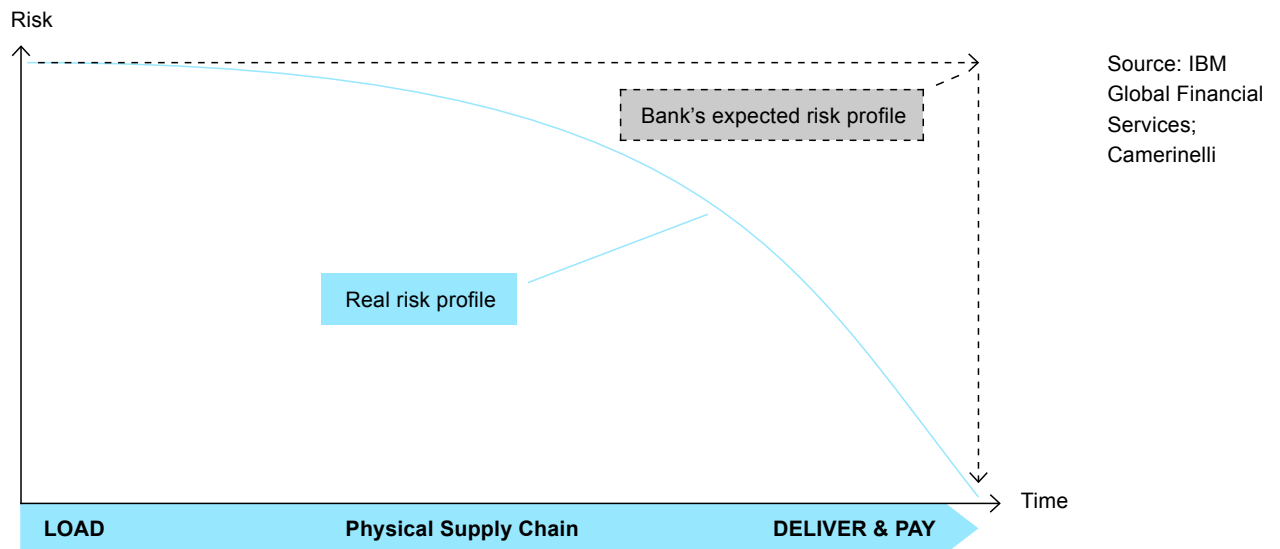
How can bank-to-bank collaboration be mobilised and do partnerships with B2B networks and e-invoicing eservice providers provide a risk-mitigated avenue for onboarding?

Many of the answers to these questions lie in the chapters and sections of the Market Guide.

Perception of risk

A first issue for this section is the perception of risk. It is often asserted that internal credit and risk management procedures apply similar criteria to trade and SCF transactions as they do to traditional balance sheet lending and do this without making an appropriate adjustment for the risk characteristics of such financings. A common response by supporters is that rather than being predicated on purely financial considerations, trade and SCF financings should be viewed more on a transactional basis and more readily on their performance and self-liquidating aspects as well as pure credit risk. An example of a physical shipment (**Figure 14**) serves to illustrate this point:

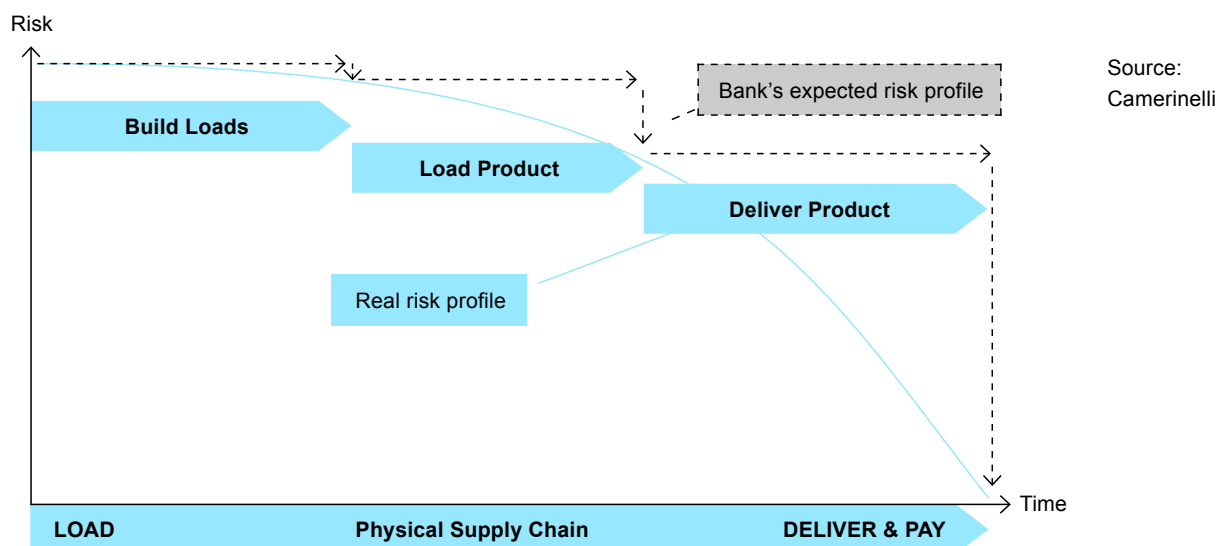
Figure 14:
Perceived and Real Risk Profile of a Shipment



Experience shows that the risk that accompanies the goods diminishes progressively with no quantum changes. The financial institution, which wishes to finance this process, should approximate the real risk profile of the supply chain trade transaction by breaking down the

generic and monolithic physical supply chain process down to its main elements (i.e. 'Build the product to be loaded'; 'Load Product and Ship'; 'Deliver Product and Receive Payment', see [Figure 15](#)).

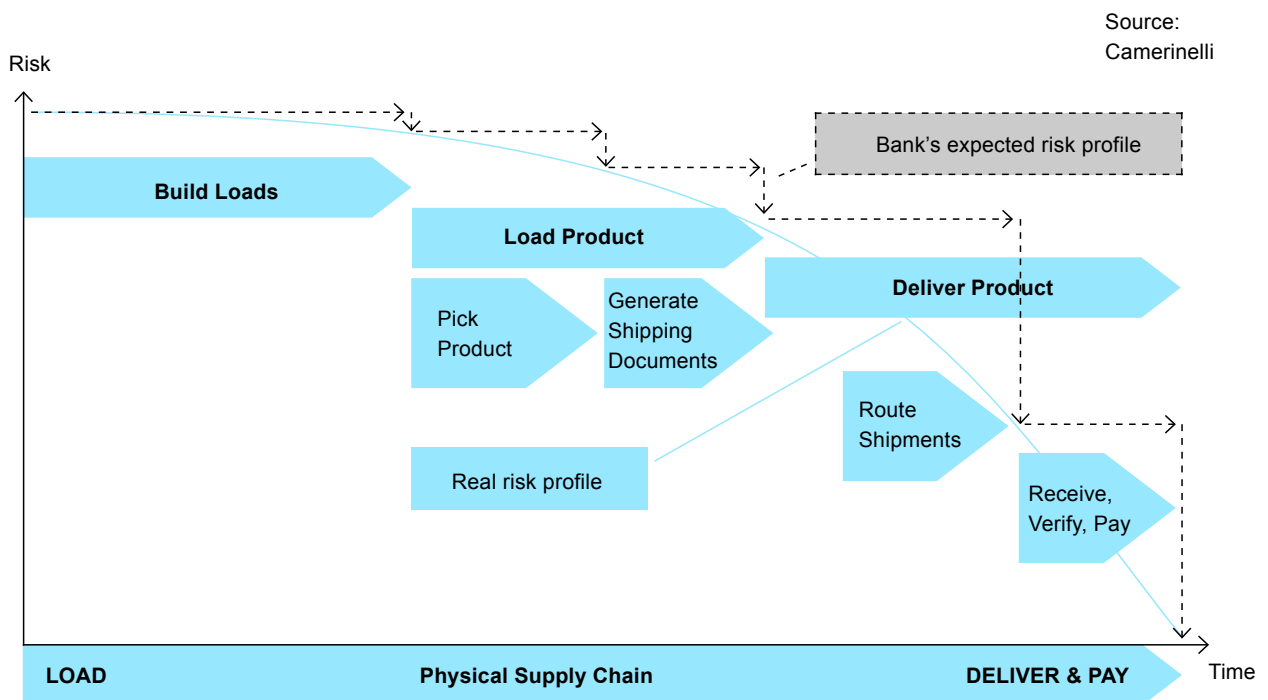
Figure 15:
Breaking Down Supply Chain Processes



Each sub-process carries a level of increased visibility – and consequent possibility of control – that lowers the level of inherent risk. At each of the connecting points between the process elements the level of risk

falls, thanks to the additional information exchanged (**Figure 16**) that becomes the communication protocol, between the process owners.

Figure 16:
Further Breaking Down Supply Chain Processes



The profile is still staircase-shaped, but with smaller leaps and closer to the real risk curve. The more granular the breakdown of the supply chain processes, the closer the overlap with the real risk contour. The key to making the perceived level of risk coincide with its real risk resides in the bank's ability to encompass an understanding of all the processes that belong to the physical supply chain. A bank must therefore break the chain into its components to establish a risk profile for each one. The more granular the segmentation of the trade chain, the closer the risk profile to the real risk profile.

Credit risk versus performance risk

As has already been described in previous chapters, a common form of SCF is the Approved Payables Finance (APF) model. The 'event' in the physical supply chain that triggers the financial supply chain intervention in this case is the approval of the payable by the buyer. Similarly, the event that triggers Receivable Finance is the raising of an invoice by supplier on shipment of goods or services. The 'ultimate' SCF offering would enable financial interventions triggered by multiple events in the physical supply chain, starting with the Purchase Order. Each

subsequent event in the physical supply chain has the effect of reducing the risk of performance failure or default.

If we consider that the rationale for SCF is the ability of the **end-buyer** to pay for the goods supplied, then it follows that this is the financing bank's ultimate source of repayment. The credit quality of this source of repayment is effectively the 'anchor' that underpins the supply chain finance business.

This leads to a number of questions:

1.

Can the Buyer pay?

2.

Will the Buyer pay?

The first is a question of credit quality. If the Buyer's credit standing is not of sufficient quality or the Buyer is simply unknown to the financing bank, credit quality may be enhanced or transferred to a more acceptable party using credit insurance, traditional trade instruments such as an LC or the new BPO.

The second is a question of performance risk on the Supplier. This is often referred to as the 'can pay, won't pay' scenario. As each event in the physical supply chain is successfully accomplished, the risk of performance failure by the Supplier can be seen to have reduced. At the extremes it can be seen that the risk is at its greatest at the stage before a Purchase Order has been agreed. At this point, relatively little reliance can be placed on the Buyer's ability to pay. At the other extreme, once the Buyer has accepted the goods and approved the payable, performance risk is effectively extinguished and total reliance can be placed on the Buyer's

ability to pay. Even here, any contract terms that allow the buyer to adjust the value of the invoice post-approval to reflect 'returns' or deficient service would need to be treated appropriately.

The interim events in the physical supply chain that progressively reduce **performance risk**, allowing correspondingly greater reliance to be placed on the ability of the Buyer to pay, include:

- Evidence of advanced work in progress in the Supplier's production cycle or evidence of finished goods awaiting despatch
- Pre-shipment inspection of inventory to verify compliance with terms of purchase order
- Evidence of shipment, arrival at destination, inspection at destination, delivery to buyer and/or acceptance of goods by the Buyer
- Storage of goods in a third party warehouse to the order of the financing bank and related price hedging

In an ideal world, each of these physical supply chain events would create a data element that could be communicated and matched with an agreed purchase order profile to provide an automated basis for a financing bank to 'model' the reduction in the performance risk relative to the credit risk. This would enable a 'borrowing base' approach to the provision of supply chain finance. The BPO has the potential to play a part in the development of a true event driven supply chain finance solution along the lines set out above.

Controls and Security

A further aspect of controlling the risk proposition is when and how to deploy solutions based purely on **controls**, and when to take and maintain a fully **secured** position, or a combination of both.

Where supply chain finance is based purely on controls, there is no security in the form of a legally enforceable title over assets such as receivables or inventory. However, under such a controlled situation the bank is fully aware of the time-cycle of the transactions being financed, the respective obligations of buyer and supplier, the location of goods at all times and will always take steps to obtain sight of relevant documentation, whilst remaining technically unsecured. In a secured situation, the lender takes legal title to assets, which in the event of failure becomes the exit route for any exposure provided that the security is properly perfected, the location of security is accessible and the value has remained sufficient.

Of course a combination of such approaches where feasible is highly desirable. The maintenance of controls as well as the enforceability of security is beneficial in secured situations, given the fluidity of the transaction cycle. Security alone is rarely sufficient. Where security is readily available such as is the case with receivables, it would seem appropriate to seek such. All solutions should take account of the nature of the transaction (e.g., volumes, underlying commodity, and credit rating of the clients). The need for legally binding security can be partially removed if the bank has a rising and experience-based knowledge of the clients to whom the SCF solution is provided. To avoid situations where delinquency or late payment is involved and generates high cost and

complexity, banks are working to create more structured selection criteria to be applied to their choice of counterparties.

The Management of the SCF business

The foregoing sections have attempted to position the essentially short term and liquid nature of the trade cycle and the opportunities inherent in the process to control and manage risk. But the questions posed at the beginning of this section raise other questions to be addressed in the context of the SCF business. Banks need to be **organised** to manage the risk profiles and inhibitors as well as the efficient deployment of SCF as a marketing proposition. Some key actions and policy steps are as follows:

Organisation: It is important to create a management structure in which the appropriate levels of expertise in supply chain management are represented, not in a monolithic structure but one that leverages the various pockets of required expertise across the institution and relies on collaboration. Some may be located in a specialist SCF team and the others located in adjacent areas within a 'matrix' organisation. Building a network of educated corporate bankers, product managers and sales representatives is key. This is a long process since bringing together various business lines (e.g. corporate banking, payments, factoring and trade finance) is not an easy challenge.

Internal education: Relationship managers and other bank team members need a practical and useful understanding of how to spot opportunities and introduce SCF product lines to clients. The role of the organised SCF team is more than transaction execution it extends to educating colleagues on the most appropriate options to select and how to

initiate an SCF program with clients. Effective education programs involve building a knowledge base and common language, creating an advisory network, preparing and delivering education workshops, and building case studies to further generate attention and momentum internally. A significant portion of the communication effort is directed to engage senior bank executives.

Developing core and required adjacent capabilities: An SCF program is as good as the sum of its parts. The various disciplines of financial structuring, credit evaluation, payments, operations, documentation, trade products and foreign exchange must be coherently developed, so that they all perform as required. A 'Middle Office' focused on the efficacy of transaction control is a useful concept. An example of a capability that will be increasingly needed for a more 'joined up' approach across the physical and financial supply chains is electronic invoicing expertise. This can be outsourced but at the same time must be integrated into the portfolio. Other areas of specialist knowledge development could be inventory management and purchase orders.

Go-to-Market Strategy: An SCF business strategy will need to be supported by the normal climate-creating activities in the form of marketing collateral, client seminars, website/webinars, media communication, attendance at external events etc. Another aspect is the building of a step-by-step approach to market roll-out. Multinational corporations (MNCs) are more aware of the attractions of SCF and may buy-in to the proposition more readily. SMEs who may form the supplier side of the proposition will need careful education and the selling of the benefits. The onboarding issue emerges clearly in this context because

it is unlikely that an SCF strategy can be based solely on targeting the upper tier of the market. Some banks are still in the stages of internal discussion to decide how and to what extent they should embark on SCF programs. As a consequence they are not actively working with clients until a fully shaped decision is reached at the senior/board level. From a marketing and risk management point of view perhaps a more forward looking strategy would embrace an incremental approach based on a few initial SCF pilots to gain vital data and experience before launching an industrial strength proposition.

Program management tasks: The demands of program management are illustrated with reference to a hypothetical example, in this case the pursuit of Approved Payables program. For a major customer this will include:

1. Ensuring that the corporate customer agrees the purpose and objectives of the program and is provided with transparency of costs to buyer and supplier
2. Undertaking a spend analysis: it is important to understand what spend categories are the most critical and what suppliers must be involved in the program
3. Developing the legal structure and documentation
4. Partner bank selection and setup (e.g. jurisdictions to cover, pricing, financial capacity)

5.

Operational setup (e.g. work flow, technical setup in selected jurisdictions, transactional banking setup), accounting treatment validation, training

6.

Supplier selection & deployment calendar, supplier segmentation, confirm goals and align finance and procurement incentives, define internal and external communication (e.g. supplier meetings / mailing campaign / webcast / individual communication)

7.

Definition and agreement on performance indicators with internal teams, providers, and banks

8.

Supplier marketing: announcing SCF program launch and supplier enablement (i.e. onboarding): actual supplier registration, bank account verification, signing supplier contracts, executing KYC policies

4.2**Regulation and Basel III**

Basel III and SCF: Trade Finance and by association Supply Chain Finance have long been regarded as safe short-term exposures tied to trade flows in the real economy. It is a common view of bankers that the perceived level of operational and credit risk arising from trade and SCF as seen by regulators does not always match economic reality and that in the aftermath of the financial crisis there was a feeling that trade-related business was badly treated.

The original Basel III framework proposed tighter risk and capital allocations than Basel II and concerns had been expressed as to the possible impact on the availability of trade finance to finance the global recovery and future growth in world trade. This is the background to the ongoing negotiations in the industry. For example, in the industry letter of December 2011 ("Joint Industry Communication on Trade Finance and the Basel Framework"⁷) it is stated that Basel III rules on the leverage ratio and on additional

liquidity requirements will imply more costs for SCF and trade finance and reduce the availability of such finance, so critical for the world economy.

The evolution of the regulatory environment for SCF is a sub-set of the ongoing negotiation of this new Basel III framework and the European Capital Requirements Directive. The Basel III Regulatory Framework is a complex and comprehensive framework, which addresses Capital, Liquidity and Leverage requirements. It is not proposed to describe the framework in any detail here.

⁷
<http://www.esf.be/new/wp-content/uploads/2011/12/Second-Joint-Industry-Letter-Trade-Finance-Final.pdf>

Recent developments have borne fruit for the industry in the sense that a number of reliefs for trade finance have been or are being agreed. These are well summarised in Appendix 5 of a publication of the Committee on the Global Financial System entitled CGFS Paper No 50 'Trade Finance: developments and issues' to which the reader is directed. These are:

1.

Waiver of the one year maturity and sovereign floors for trade finance exposures and the application of more national discretion. The waiver of the one year maturity floor has implications for both on- and off-balance sheet items and this has a benefit in terms of treatment of short-term SCF assets.

2.

The Credit Conversion factor for LCs is confirmed at 20 percent and the industry is encouraged to assemble more data as has been collected through the ICC.

3.

For the leverage ratio short-term contingent exposures have been confirmed at 20 percent for LCs and 50 percent for other contingent exposures. The industry seeks to align the leverage ratio with the credit conversion factors adopted for the various instruments.

4.

For the liquidity coverage ratio a number of reliefs have been agreed or are under development.

For the Credit Conversion Factor, there is a distinction made between off-balance sheet trade related business such as Letters of Credit and Guarantees and on-balance sheet assets such as receivables finance and trade loans. In 2010, a concession was agreed in relation to letter of credit commitments under the Basel III framework whereby undrawn LCs were given a Credit Conversion Factor of 20 percent instead of 100 percent in the original Basel III proposals. Where on-balance sheet SCF financings are concerned, commentators do not expect any movement from the 100 percent CCF weighting applied to the broad range of commercial loans, but there is scope in the off-balance sheet area for example with the BPOs to structure solutions that minimise the use of Risk-Weighted Assets (RWA). The use of the BPO as used in ways akin to the LC may offer scope for a Basel III relief.

The ICC has lent support to this process by creating a Trade Register in which market participants are providing information about trade finance transactions and any default experience arising. Already it is reported that the Register demonstrates a very low incidence of such defaults. It is also likely that ICC will issue a range of educational materials to set out the issues and provide explanations over the coming months.

Basel III as an opportunity: A noteworthy result from the interviews of bank representatives on this matter is that Basel III is also seen as an opportunity. While the allocation of additional capital in a constrained credit market indeed creates challenges, corporate clients are not very much concerned as long as credit costs are as low as possible and expect their banks need to find alternative solutions to keep credit costs sustainable in the light of the requirements for capital allocation. Trade and Supply Chain Finance, with its inherent liquidity and under one year tenor, is likely to remain attractive relative to other asset classes, despite Basel III.

An opportunity lies in the ability of banks to acquire new sources of data from clients and turn that into measures of risk evaluation of the financings against which capital must be allocated (a new form of KYC). The deployment of systems that analyse a repository of trade transactions can propose appropriate corrections to the risk grade of a particular transaction. The presence of a technical platform that provides analytics for trade transactions is an enabler for improved visibility and regulatory management: the platform not only stores the transactions but also allows the profiling of trade habits (e.g., payments, collections, and inventory) of trading parties.

Another opportunity lies in the potential for optimisation of the deployment of Risk Weighted Assets through the use of secondary market activity and structuring transactions around those instruments that minimise RWAs.

Industry collaboration: SCF executives have also been considering the benefit to their business of the possibilities for consensus building among banks and other stakeholders as to how they could suggest improvements and manage the regulatory requirements without impinging on competitive freedom. Ideally, such a consensus should encompass European, North American, Asian, southern hemisphere and other banking communities and beneficially involve service and solution providers.

4.3

Compliance and Anti-Money Laundering

SCF products and services must satisfy generic requirements for compliance with anti-money laundering (AML), terrorist financing and sanctions procedures. It is noteworthy that an industry group has recently created and circulated a set of industry guidelines issued under the auspices of BAFT and referred to as: 'Industry Guidelines Related to Anti-Money Laundering (AML)⁸ for Supply Chain Products and Trade Loans'.

The following is an extract from the introductory section of this document:

"Industry standards have existed since the 1920s for the processing of many types of traditional trade transactions. They consist of rules of practice as well as established standards created by industry groups. These processing standards provide the framework around which banks can effectively implement AML programs for trade finance products. This document is part of an ongoing industry effort to establish guidelines for the control of AML risks in trade transactions. It also aims to address several products that have typically not been addressed in written standards. For industry standards related to traditional trade products, see the Wolfsberg Trade Finance Principles.⁹

This document addresses two specific products that are offered by banks in the normal course of financing international trade that are generally seen as extensions of open account settlement – supply chain financing and trade loans.

The last section of the document, 'Guidelines for AML', addresses what the industry regards as the minimum or baseline information that banks require to meet regulatory requirements for effectively monitoring and screening for sanctions compliance transactions based on the amount of information that is available from the customer or in a given transaction. These guidelines do not address the requirements for KYC information that would be required in addition to the transaction specific information required by these guidelines."

8

The term AML as used in this document includes typical AML activities, Terrorist Financing and Sanctions.

9

The Wolfsberg Trade Finance Principles can be found at www.wolfsberg-principles.com. The Wolfsberg Group consists of the following leading international financial institutions: Banco Santander, Bank of Tokyo-Mitsubishi-UFJ, Barclays, Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, J.P. Morgan Chase, Société Générale and UBS.

4.4

Accounting issues

The various instruments of SCF require decisions about the accounting treatment of the transactions both in the books of the trading parties concerned and the financing bank. The latter has an impact on the regulatory aspects raised above.

The treatment of SCF transactions in the books of the trading parties has implications for balance sheet presentation of the relevant assets and liabilities. In particular commentators have discussed the potential for the reclassification of trade receivables and payables as bank indebtedness and/or adjustment of off-balance sheet treatments.

Clearly, case-by-case advice is required. In view of the sensitivity of the issues raised, the varying accounting rules and practices applicable on a country-by-country basis, and views on the reservation of this area as competitive, the issues are raised here but not further developed.

5

Automation unleashes SCF and e-invoicing is a ‘game-changer’

Supply Chain Management is now focused on the intelligent use of automated information systems in a way that moves beyond their use as a tool for efficiency towards creating competitive advantage. Automation enables information to be distributed quickly to trading

partners and internal functions, provides efficiency benefits for corporate operations and triggers a variety of financial supply chain events. Developments such as e-invoicing are potential ‘game-changers’.

5.1 Automation tools

1.

The replacement of manual business processes by automated solutions is happening rapidly but has a long way to go to be fully embraced. Since SCF solutions rely on the fast and efficient processing of supply chain data, the adoption of automated processes is important for the development of the SCF market.

2.

In the corporate environment there is a focus by leading corporations on business process re-engineering, ERP system development, and the installation of customer relationship management (CRM) systems, which facilitate the tracking of customer business relationships and the onboarding of suppliers. The most successful mechanism for such investments is through the creation of cost-effective Shared Service Centres usually deployed on a regional or international scale. B2B integration is achieved through the use of EDI platforms and networks. Substantial effort is devoted to re-engineering AR and AP processes.

3.

Improved IT-driven monitoring and control is essential to realise business benefits. The use of online data management platforms has reduced corporate inventories and brought industries closer to just-in-time production. This has meant smaller, more frequent, shipments replacing single larger orders.

4.

Internet trading can provide cost savings by eliminating ‘middle-men’, reducing administrative cost, and outsourcing the requirement to carry inventories. The Internet cannot only be used for the sales side of a business but also to manage relationships with suppliers, making it easier to synchronise supply chain operations

5.

The growing popularity of business-to-business networks, which support e-invoicing and supply chain automation, is bringing to bear capabilities and benefits to end-users and other intermediaries such as financial institutions. With the increasing use of fully

automated procure-to-pay solutions, the transmission of dematerialised business documents over B2B networks and connections now means that the SCF offering can also be automated. A key aspect is the ability to accelerate the approval cycle times especially with regard to invoices and payments.

6.

The development of platforms that directly support the management of SCF as a discrete activity are also accelerating. Some of these are proprietary and seek success based on their ability to attract a critical mass of users and financial institutions. Others such as the SWIFT Trade Services Utility have the potential to create substantial value on an industry-level basis.

7.

The future perspective of a bank's SCF offer is an 'event-driven' financial chain: As soon as the financial institution is able to pinpoint when a transaction is triggered by the supply chain process, it is to offer value-added SCF services. Such a trigger may be the approval of a previously submitted e-invoice leading to the provision of finance against such a payable. RFID tags are seen to have a role in creating event-driven triggers.

8.

We should also note the potential for supply chain services based on mobile technology and the ability to create trigger points very close to key events in the logistics and transport chain at the level of trucks, vessels warehouses, etc. Financial providers have many opportunities to integrate with such technologically initiated transactions

5.2

Challenges and constraints

This said there are a number of challenges that could prevent the widespread use of supply chain automation:

1.

The constraints represented by the existence of legacy systems are complex; for example Enterprise Resource Planning (ERP) Systems in most sizeable businesses consist of many instances and versions. Supply Chain management tools need to be carefully architected on top of legacy systems to provide an overlay of information aggregation and decisional capability. The same applies to bank legacy systems.

2.

Most companies have, at best, automated-only fragments of the supply chain and only the largest corporations have established a buyer-supplier connectivity via electronic data interchange (EDI) or B2B networks.

3.

In the traditional paradigm, the interests of suppliers and buyers are at odds: suppliers want to shrink DSO, while buyers want to extend their DPO. There has to be a move towards a more collaborative win-win approach to this issue.

4.

The migration to electronic payments for business-to-business transactions has often been influenced by country practices and behaviours. Maximum use is not made of such instruments in terms of STP, remittance data and automated reconciliation.

5.

Legal and compliance issues have often impacted the full dematerialisation of the documents used in support of SCF activities. In this context dematerialisation means the complete replacement of paper documentation, as opposed to the extraction and processing of data from paper documents that continue to exist and play a role. The latter raises fewer legal and compliance issues.

6.

E-invoicing users and their service providers are progressively addressing the legal effectiveness of dematerialisation on a country-by-country basis to ensure fully compliance with local requirements and by taking steps to protect the authenticity and integrity of transactions at every stage.

7.

Historically, there has been a lack of clarity and agreement on standards for data formats and interoperability for the key documents and datasets and processes used in supply chains. This is not usually a showstopper, because systems are able to carry out mapping, format conversion and interoperable processing, but more standardisation would undoubtedly help. Standardisation efforts are proceeding and this will be to the particular benefit of financial institutions which prefer to operate in a more standards-driven environment for a variety of reasons.

8.

SMEs have much to gain from more widely distributed SCF facilities. However, they have not yet been involved in SCF initiatives on any significant scale. Even though they are often suppliers to a Buyer undertaking SCF, their size and complexity of onboarding has inhibited their inclusion. Among a variety

of possible approaches, banks have the reach to provide services to SMEs in a cost effective manner (often outsourced to service partners) and are further able to provide financing services integrated into their SME offerings. This requires a significant shift in the mind-set.

5.3

The role of e-invoicing

Through dematerialisation and the acceleration effects, e-invoicing is demonstrating its potential as a 'game-changer' for the SCF business. Nevertheless, there are varying views on the applicability of e-invoicing to SCF. The supportive argument goes as follows:

1.

By replacing the paper document and its distribution with wholly electronic processes, a number of very significant efficiency gains and cost reductions can be achieved. Further benefits can be achieved by integrating other supply chain processes including liquidity, cash management and financing techniques.

2.

A large element of the SCF product offering relies on the invoice as a key financing 'trigger' and as a pivotal document, providing the essential linkage between the physical and financial supply chains. The invoice provides insights into the trading partners involved, the ability of the buyers to pay, and the quality of supplier receivables thus supporting the making of knowledgeable credit judgments.

3.

SCF solutions could be enhanced if they are actually embedded in or linked to e-invoicing platforms, which can handle the key information exchanged between trading partners. By also extending this 'Joined-up' approach to financial institutions, e-invoicing enables SCF to be substantially automated without having to replicate the trade process in the SCF platform itself. Once an e-invoice is submitted through the platform and approved, messages are triggered that permit access to the relevant offer of finance and the receipt of the early discounted proceeds of the invoice.

4.

E-invoicing eases the onboarding challenge since suppliers will already be present on the e-invoicing platform. As soon as SCF is bundled with e-invoicing, the campaign-driven approach to onboarding provides mutual reinforcement as SCF creates yet another incentive for suppliers to join and also strengthens the buyer's business case. KYC processes do not disappear but are considerably eased. In the latter context there is talk of 'lite-KYC' for such onboarded suppliers, who do not become full bank customers but simply the beneficiaries of finance.

5.

Currently, the onboarding of suppliers onto pure SCF platforms is manual and complex and as a consequence, only a 'top slice' of the largest suppliers is invited and the potential value in the 'long tail' supply chain is lost.

6.

E-invoicing facilitates the 3-way match cycle with all parties electronically connected. A 3-way match is a practice where the invoice from the supplier is matched against the purchase order and delivery documents.

7.

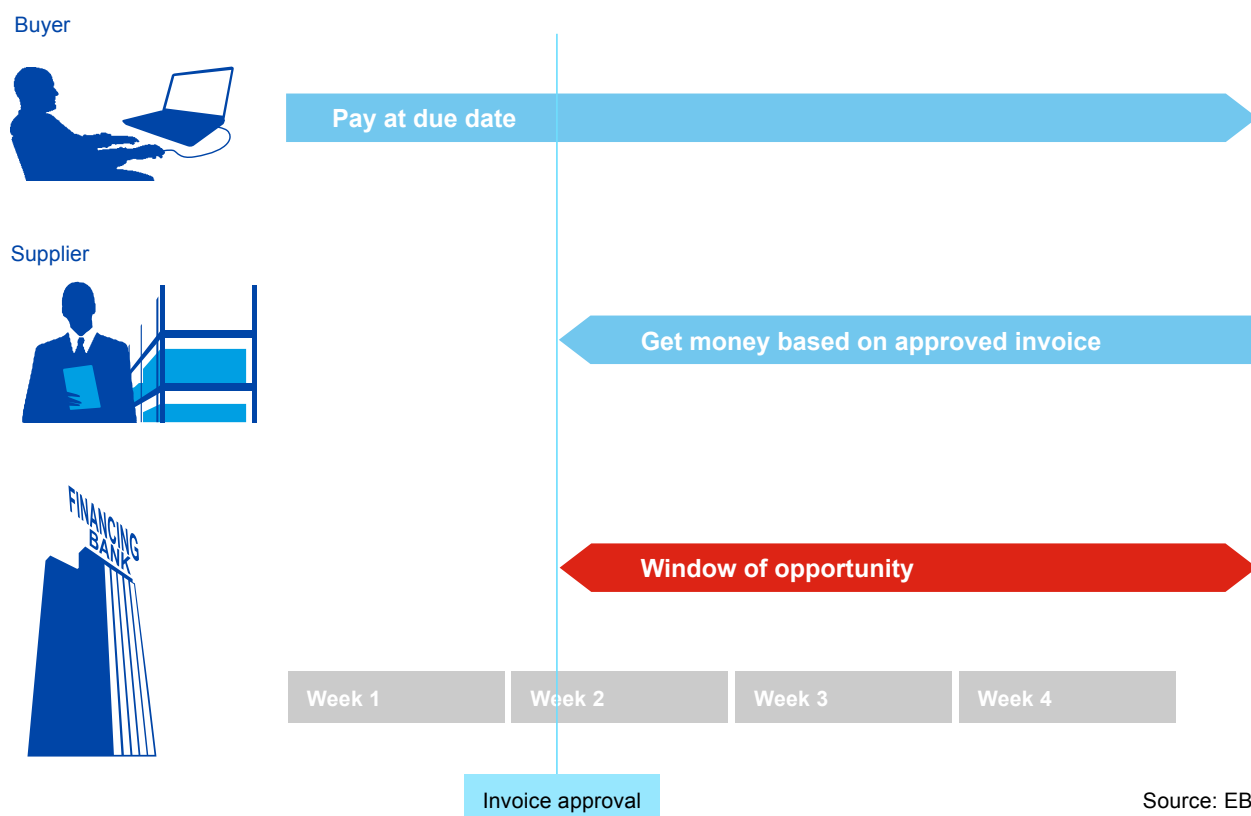
Perhaps most decisively, e-invoicing makes **earlier invoice approval** by the buyer entirely possible, increasing the 'window of

opportunity' (see **Figure 17**) for the provision of SCF. In traditional invoice management, the time taken to receive and approve inbound invoices dramatically reduces the time-interval in which financing is feasible.

8.

Proprietary SCF solutions and portals have so far struggled to achieve critical mass. There is clearly a need to create much more broadly based B2B and interoperable networks, which are now developing strongly. This in turn encourages the alignment of e-invoicing and related services with transaction-based lending solutions and makes SCF potentially available on a volume rather than a purely 'cherry-picking' transactional basis.

Figure 17:
E-invoicing expands the 'window of opportunity'



Source: EBA

The other side of the argument about the relevance of e-invoicing takes the view that:

1.

E-invoicing has yet to realise its potential accounting only for between 10 – 20 percent of total invoicing volume.

2.

SCF can be better organised on the basis of a selective approach to client participation, thus focusing scarce resources on the most profitable opportunities.

3.

The implied application of SCF to a very broad range of suppliers creates KYC challenges and costly customer engagement processes.

4.

E-invoices are not well understood and doubts remain about their validity and legal compliance in all circumstances – a key factor in a financing program requiring the highest standards of risk management.

5.

The invoice is not needed for transaction initiation or collateral, as information files listing approved payables and/or a forward dated payment instruction coupled with a receivable assignment are quite sufficient to conclude transactions.

6.

The banking and finance industry and the e-invoicing service provider community will need to work closely together in order to make SCF facilities easy to access and use in a ‘joined up’ sense.

The current status of e-invoicing and the role of banks

E-invoicing on a European scale is growing rapidly at between 30–40 percent p.a. for B2B, b2B (small business to large business), B2C (often referred to as e-billing) and B2G (Business to Government usually for public procurement) segment. Eighteen percent of the total invoice volume in Europe is currently estimated to be automated. The question remains as to the pace at which these developments will continue and deliver real critical mass, so that e-invoicing and SCF can become mutually reinforcing.

Electronic and automated invoice processes can result in savings of 60–80 percent compared to traditional paper-based processing.¹⁰ The EU digital agenda is strongly supportive and the introduction of e-invoicing into public procurement is the subject of a recent EU Directive (2014/55/EU). Substantial network effects will arise from this initiative.

There is a healthy and competitive market for the provision of e-invoicing services and solutions and their activities are driving adoption by relieving users of many of the challenges involved and creating network effects and reach.

The European Commission regards e-invoicing as an important public policy priority and has taken steps to improve the legal and VAT environment by enshrining the principle of Equality of Treatment between paper and electronic invoices in legislation, by creating a European Multi-Stakeholder Forum and a network of National Forums through which efforts to promote good practice, harmonisation and standards.

Banks have varying attitudes on their role and the business case. Many banks have experience of Business to Consumer (B2C) or B2b (Business to SME) electronic bill presentment and payment (EBPP) services and continue to introduce services in this area. On the other hand the relatively slow engagement of the majority of banks in offering Business to Business (B2B) e-invoicing services signals that few banks are at present interested in entering this business as e-invoicing processors especially as other non-bank players offering B2B platforms are already active in the market.

For banks the sheer heterogeneity of the corporate world, the lack of standards, regulatory overheads and business case issues have led to more questions than answers. Those that have entered have usually done so on the basis of alliances with established players. Those who haven't are clearly looking for a more compelling business case through attractive adjacent income streams before engaging.

The re-shaping of the landscape of digital business processes so close to the 'payment franchise', the vast potential of the SME market, and the opportunities to re-intermediate banks in transactional finance, explains why a banking debate about how to engage continues to gather momentum. A bank may tie such an offering to a 'bank-manufactured' e-invoicing service or may enter into a partnership with established service providers for the e-invoice processing (either white-labelled or stand-alone).

¹⁰

Source: Billentis e-invoicing/
e-billing report 2012

6

Collaboration and competition – identifying the collaboration space in SCF

In a networked industry, there is always a continuing debate about the relevant roles of competition and collaboration between market participants. Up to now, outside the framework of traditional trade finance, SCF has largely been conducted as a purely competitive activity with limited industry co-operation, reflecting its relative immaturity.

For the purposes of this analysis, the following breakdown of relevant market spaces is identified:

1.

Competitive space, where collaboration has no role. This will certainly cover the value propositions of individual competitors, pricing and customer specific information,

2.

Collaboration between business entities undertaken on a bilateral basis through partnerships or commercial contracts.

3.

Collaboration on a collective basis between market participants in areas defined in advance as being non-competitive, non-infringing of competition law and having the effect of creating the basis of overall market development for the benefit of individual competitors.

Motivations for collaboration among market participants

SCF has seen a rapid growth but is still at the beginning of its life cycle. Sizeable investments have been made by market players, such as banks, alternative finance providers and B2B networks.

The collaboration possibilities that have emerged so far provide a multitude of potential operational models. However, extension of the SCF value chain implies both opportunities as well as challenges such as:

Opportunities

- Opportunity for banks to focus on their core business of financing and reducing investments in infrastructure and operational costs
- Increased potential for risk distribution with other financing partners
- Higher scalability and potential for market penetration
- Additional sources of funding for corporate clients
- Price efficiency arising from competition between market players
- Potential for more innovation in areas such as ‘apps’, value added services or compliance with regulatory requirements.
- Completion of product gaps that cannot be delivered by banks
- Cost reduction on bank-owned technology investment
- Increased potential for risk distribution with other banks
- Outsourcing of client implementation tasks
- Outsourcing of client service tasks

Challenges

- Increased commercial and operational complexity for all market players
- Technical interdependency and the resultant need for well-defined standards
- Questions regarding ownership of risk and infrastructure, data protection and bank secrecy issues
- Friction between market players on revenue sharing
- Potential implications in terms of VAT being applied to service components
- Bank investments in existing platforms may not yield a return if replaced too early by collaborative investments (obsolescence issue)
- Weakened unique selling point for individual banks
- Higher risk of losing client relationships
- Banks are refocusing on their home market customers, and certainly do not want to be restricted to only being a funding provider
- Questions regarding the perfection of legal ownership / security.
- Infrastructure is an inevitable element of the service, and the regulatory environment does not allow banks to totally ‘give away’ the responsibility for infrastructure.

In the coming years, there is likely to be a process of both fierce competition and the development of a range of the commercial and technical standards and cooperation models that will be needed to satisfy all the parties involved: clients, banks, alternative finance providers and B2B networks. The latter represent the potential for a rich array of cooperation opportunities and alternatively it is open to the finance industry to also build or acquire such shared networks.

Collaboration between parties is a key aspect of contemporary electronic commerce and can be a crucial success factor for the success of SCF programs. The possibility to exchange electronically purchase orders, shipping and delivery documents and invoices across trusted and reliable B2B networks dramatically enhances the opportunity. Several types of B2B network can be identified, e.g.:

1.

EDI networks which provide corporate-to-corporate connectivity and who usually transmit very large volumes of data files. The network may or may not be 'content aware'.

2.

E-invoicing service providers, which provide e-invoicing solutions and may provide SCF solutions in their own right but more commonly in partnership with banks and financial institutions. Such networks will on-board onto their networks buyers and suppliers and will have large volume transaction flow or 'collateral' available for finance. Such networks often inter-operate with each other to create a meta-network.

3.

'Hybrid' platforms, which may have a more explicitly financial role such as proprietary finance 'brokers' who intermediate corporate users and a variety of financial providers, a number of specialist networks such as SWIFT, which now has a corporate user base and facilities such as the Trade Services Utility, and international two-factor networks.

4.

Other more specialised networks in fields such as logistics and ERP-to-ERP networks provided by the ERP industry itself.

Through such networks some players can work with banks to go beyond the development of pure B2B networks and platforms to deploy capabilities that enable collaboration among all players in the SCF ecosystem: users, buy-side and sell-side financial providers, and other supportive actors. The platforms provide the necessary 'hub' that interconnects the systems of the various constituents in a 'plug-and-play' fashion (even though a seamless ease of connectivity has yet to be fully accomplished).

Given the multitude of SCF market players, their different peculiarities and the sheer number of potential combinations of how they could interact with each other, an exhaustive description of potential co-operation models seems neither feasible nor reasonable. A few **selected operating models** that exist or could exist in the SCF ecosystem will be discussed below.

6.1

Bilateral collaboration

Bank to Bank

Geographic coverage

An important aspect related to transaction completion and risk-taking is the dimension of the geographical proximity. In general, it is usually the preference of financial institutions to provide financing facilities where the customer is close at hand or easily accessible. Clearly geographically concentrated banks need to cooperate to cover client transactions that cross geographies. Global banks also work with local banks that know the profile, for example of an SME supplier, better and are better positioned to mitigate the performance risk of the SME giving rise to a collaborative opportunity.

Four-corner models

The need for interoperability among banks, for serving both ends of a transaction, and for risk sharing are all forms of a collaborative approach. Networked four-corner models are used extensively in the payments market, where two customers use the services of two different banks or service providers. The effectiveness of the four-corner model for channelling transaction data and documents, for onboarding, for financing, for risk participation and distribution and for creating a scalable solution illustrates the relevance of this model. Reference to the BPO as an enabler for the four-corner model has been made already.

The need to collaborate using a four-corner model is particularly evident where a bank does not have an extensive branch network in the relevant markets. For example, a

buyer's bank that does not have an extensive branch network in the countries where their customer is sourcing will struggle to make the three-corner model scalable and cost effective. For global banks, local networks are typically somewhat less extensive and offer more limited services than those of local banks. In addition, the buyer's bank using a three-corner model will effectively be displacing the local banks with which the suppliers often have long-standing and broadly based relationships. The four-corner model (Figure 18) is, by contrast, scalable and leverages the capabilities of the local banks, opening up the potential for reciprocity rather than resistance and competition.

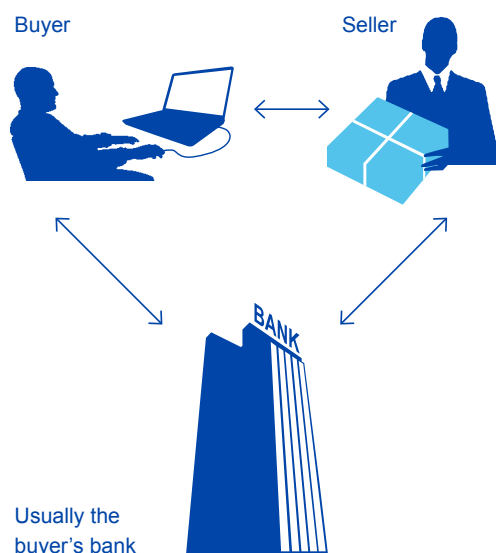
Bank to Technical Providers

Outsourcing of technology and businesses processes under partnering agreements

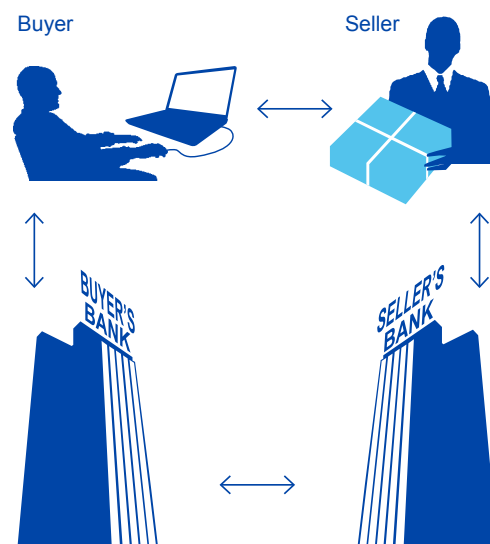
This is a typical business process and could cover many technical and business requirements and functions. Since these are well established and routine functions there is no further need to cover these types of collaboration.

Figure 18:
Three-Corner vs. Four-Corner Model

Three-corner model



Four-corner model



Source:
Aite Group, Camerinelli

Cooperation between banks and B2B networks and SCF-enabling platforms

There are many opportunities for banks and other service providers to cooperate to deliver solutions that play to each other's complementary strengths. These are usually one-to-one relationships, but there may be opportunities to explore collective modes of collaboration and working agreements on an industry-to-industry basis as covered below in the section on collective collaboration.

B2B networks and SCF-enabling platforms can and will take various forms in the future. They may provide not only tools and technology but are more and more involved in building the connections between all or key constituents of the SCF ecosystem through gateways and portals. Alongside these connections they might provide financial intermediation and other value-added services such

as process management and business transformation, multi-level transaction visibility and reporting, supplier onboarding, the assessment of the credit quality of trade partners, and the development of new applications. It would be rare for one provider to support all these functions but banks have the opportunity to enter into a variety of bilateral collaborations for discrete aspects of their portfolio.

There is also an aspect of a major customer relationship that creates a partnering opportunity beyond the conventional banking relationship. Large corporate organisations are themselves stepping onto the supply chain finance stage. They are typically multinational, cash-rich organisations with extensive supplier networks, usually consisting of medium-size companies. Such companies may find difficulty in accessing sufficient credit in a constrained credit market.

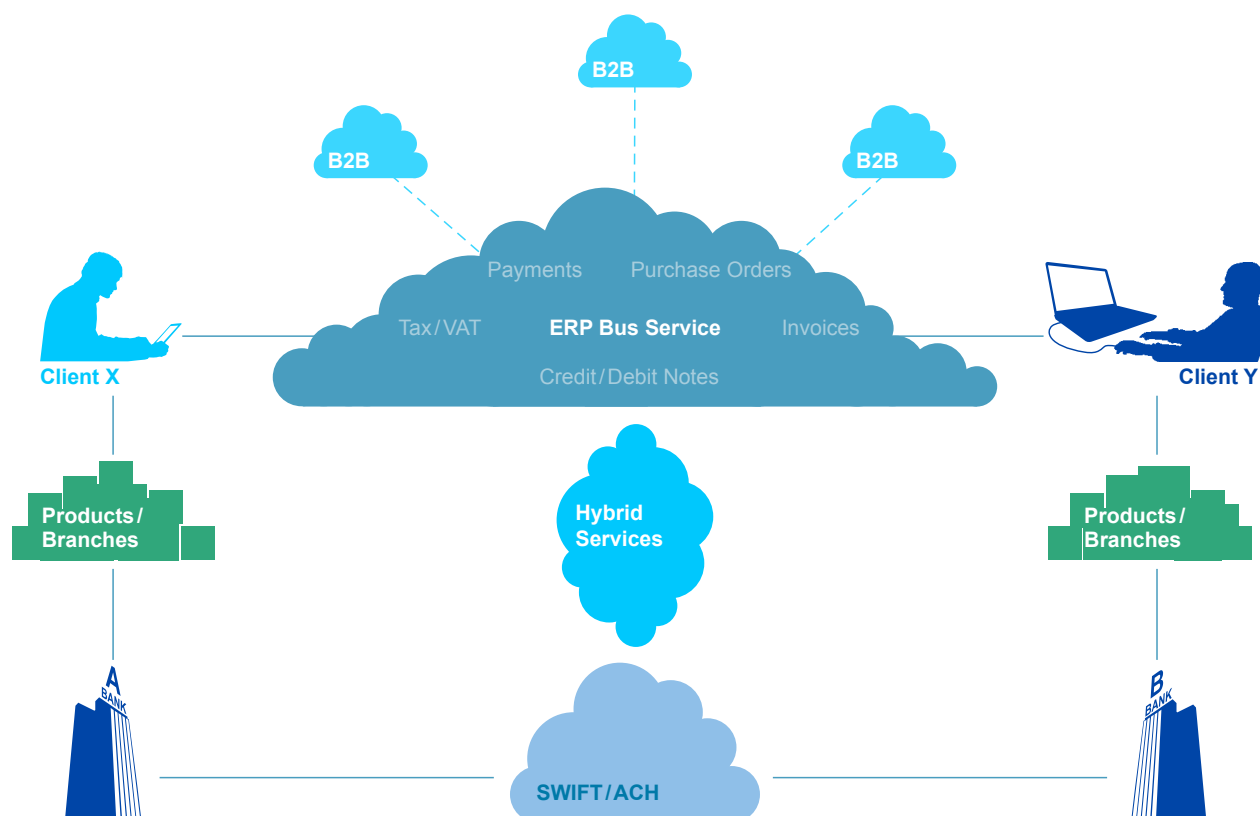
In this scenario, the cash-rich corporations are strategically utilising their available liquidity to sustain the financial health of their upstream counterparts, in order to maintain a healthy environment by ensuring that financial stress does not represent a threat to business continuity. In such a scenario, there may still be opportunities for banks to partner with the large buyer to provide additional services such as a dashboard for liquidity management, process support or additional finance to meet peak loads or seasonal requirements – in other words to ‘partner with’ the customer in a productive way.

Some selected examples of cooperation models

Given the evident diversity among the players described above, it is only feasible at this stage to provide a number of examples of potential operating models or scenarios and discuss them in terms of opportunities and challenges for the parties involved. In reality the potential for the development of models for cooperation either bilateral or multilateral is endless and the competitive forces at work will see these models developed in both predictable and unpredictable ways.

The diagram below illustrates how banks may interact with their customers and with each other, how customers interact with each other, and how all parties can interact through B2B networks (**Figure 19**).

Figure 19:
Overview: Corporate Clients, Banks, Clearing and B2B Networks

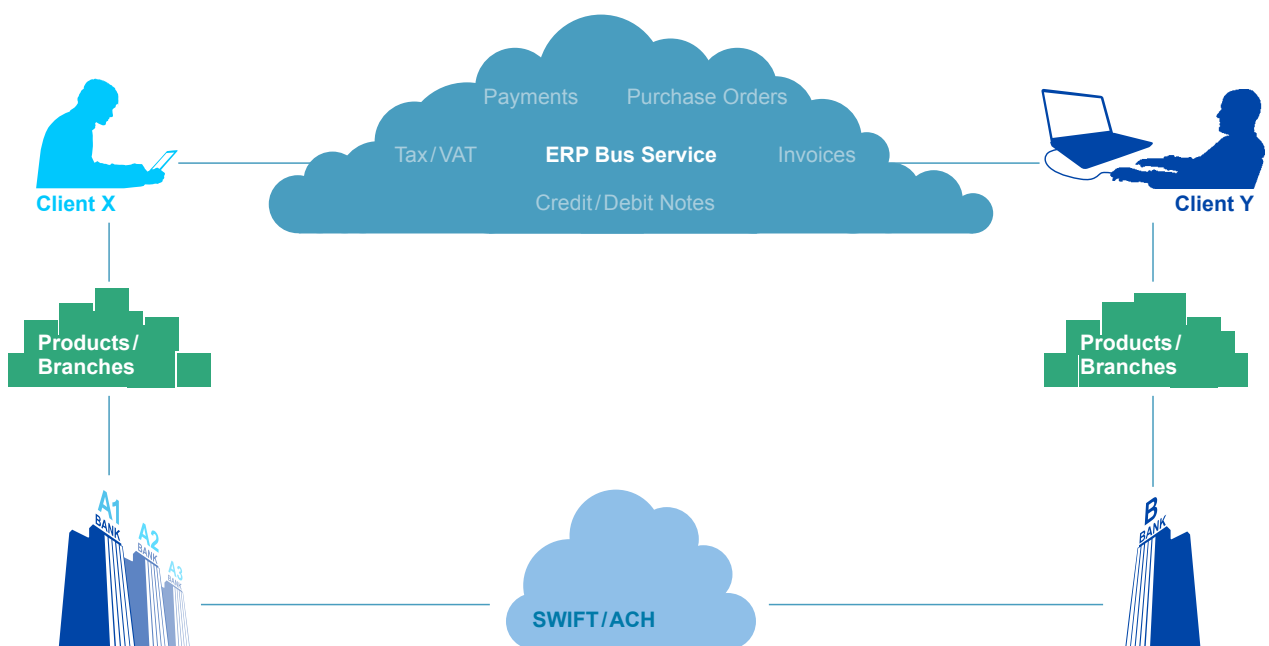


Below four basic models are described and illustrated. They may form an evolutionary path for the industry in the coming years but may also represent competing paradigms. By definition, they are illustrative and will spin-off many variants and development paths. Currently, operating models 1 to 3 are established in the market with varying degrees of success. Each model has its own challenges and drawbacks.

The first model (**Figure 20**) described below is not strictly a cooperation model at all as it is the bank-owned proprietary platform, where cooperation may be limited to development work with solution providers. Of course the model may be extended to include bilateral cooperation with partner banks where two banks' proprietary platforms are connected in the manner of a correspondent relationship.

The bank-created network model is likely to grow and find itself as a preferred model. There is likely to be a degree of hesitation and even reluctance in the adoption of the other models by banks. The reasons for this are covered below, but essentially issues of concern are control, dependence, business model, regulation and the threat of disintermediation. After all, SCF invoice exchange and financing is not in the same category as the emergence of competing payment propositions such as the impact of PayPal. The B2B environment is a much bigger animal in many respects. Only after careful consideration of the open issues, will the conditions for success and comfort level be created for the adoption of the models described and their future development.

Figure 20:
Model 1 – bank-owned proprietary SCF platform



Description

- Classic three-corner model of a bank rendering SCF services (AP / AR based) to corporate customers and their suppliers/buyers
- Technical infrastructure exclusively rendered and managed by the bank even if outsourced
- Potential co-usage of the rendered SCF services by partnering banks
- Can be described as a ‘submission’ model as clients are required to submit transactional information to the bank
- Transactional information may extend to listings of payables or payments and receivables or collections rather than actual invoices and purchase orders
- Security or title transfer may or may not be taken over by over the assets being financed
- The model can be extended to a four-corner model to mobilise the onboarding capabilities of partner correspondent banks.
- In the future, the BPO model may be mobilised.
- B2B networks play a non-existing or inferior role in this model.

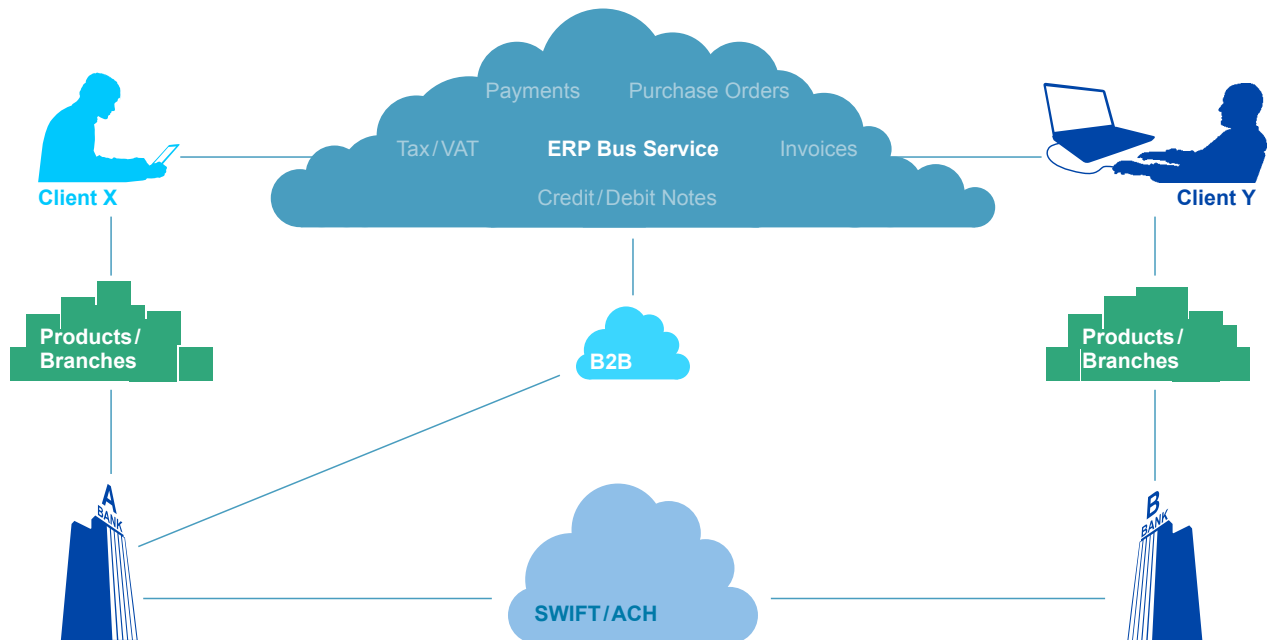
Opportunities

- Stable relationship based on trust between bank and its client
- Clear and transparent commercial model
- Continuous revenue stream for the bank
- Potential cross-selling opportunities (product-wise, client-wise)
- Apps’ and links can be provided for many different value-added services.

Challenges

- High investment into bank infrastructure (technology & operations) and management processes
- Client has to decide on the bank to cooperate with – no open model
- Potentially limited scope in terms of available product features, commercial conditions, regional availability, and transaction flows
- May lend itself to a ‘niche’ strategy rather than mass-adoption
- Onboarding customers is highly complex and long-winded

Figure 21:
Model 2 –
cooperation with e-invoicing and B2B integration networks



Description

- Predominantly bilateral cooperation between banks and one (or more) B2B platforms
- B2B platforms as primary provider for the exchange of transactional data
- Financing of invoices can be offered by the B2B platform with one or more banks in the background as financing parties or as a partnership arrangement
- Potential distinction between banks as providers of financing services and B2B platforms as providers of infrastructure for the exchange of invoices, purchase orders and other B2B documents and data.
- Can be described as an ‘extraction’ model as the transactional feedstock needs to be extracted from the flows across the B2B network or platform

Opportunities

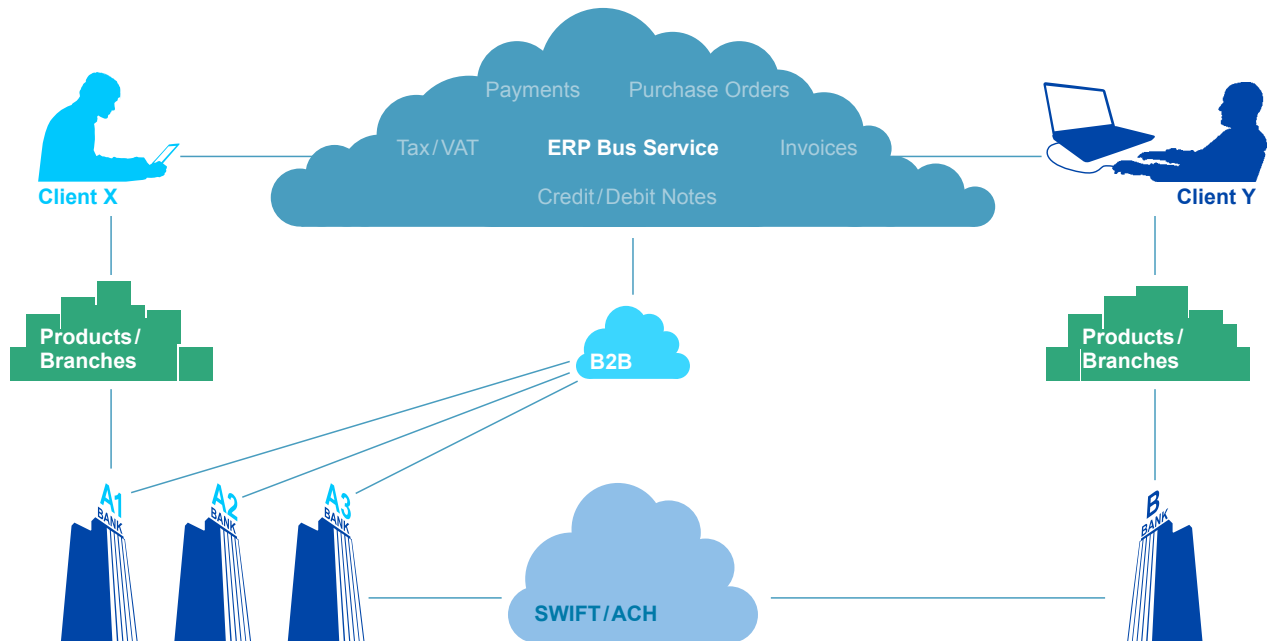
- Market players can focus on their core business (e.g. shift of client onboarding activities from banks to B2B platforms or further business partners)
- Reduced investment effort for banks
- Access to a volume based transaction flow arising from the transactions across the B2B network
- Potentially augmented product scope in terms of available product features and transaction flows

Challenges

Extension of the SCF 'value chain' with all its potential side-effects:

- Increased complexity of data-handling
- Need for a commercial model that satisfies all involved market players and requires revenue sharing
- Data protection / bank secrecy (banks being not supposed to share client data with external parties)
- KYC requirements
- Complexity of the required legal framework (e.g. legal ownership of claims)
- Tax implications (a distinction between 'Financing' and 'Data Exchange' may trigger VAT obligations for the non-bank related portion of the service)
- Banks may lose their 'USP' compared to the first model
- Mismatch in size, resources and management culture between bank and B2B platform provider
- Legal ownership/title over the invoice

Figure 22:
Model 3 – B2B platforms as facilitators of financing



Description

- Platform acts as a finance broker or intermediary – can be described as an ‘intermediation’ model
- Corporate clients and finance providers are on-boarded onto the platform
- Originates a flow of financeable transactions to be offered to banks and non-bank providers
- Can include SWIFT TSU and factoring networks, but may imply different dynamics and risk aspects

Opportunities

- Provides corporate clients with an additional source of funding and potentially more attractive commercial conditions
- Provides banks with a source of SCF experience without establishing SCF origination capacity or an additional market for diversification and distribution capability
- Potentially augmented scope in terms of available product features and transaction flows
- Market players can focus on their core business (e.g. shift of client onboarding activities from banks to B2B platforms or further business partners)

Challenges (same as in model 2, but increasingly intensive)

- Risk assessment and ownership as transactions are not directly originated
- Extension of the SCF ‘value chain’ with all its potential side-effects
- Increased complexity of data-handling
- Need for a commercial model that satisfies all involved market players, need to share revenues
- Data protection / bank secrecy (banks being not supposed to share client data with external parties)
- KYC requirements
- Complexity of the required legal framework (e.g. legal ownership of claims)
- Tax implications (a distinction between ‘financing’ and ‘data exchange’ may trigger VAT obligations for the non-bank related portion of the service)
- Banks may lose their ‘USP’ compared to the first model.

6.2

Collective collaboration

Collective collaboration is recognised as a growing need and the SCWG has identified or confirmed numerous areas of potential collaboration among financial institutions and other stakeholders.

Governance

Creation of a governance structure

a maturing industry that creates a collaborative agenda needs to create effective and united membership organisations to act as industry bodies in the non-competitive space, and take responsibility for collective collaboration. Such a collective body should have open and transparent admission criteria. Such organisations provide continuous and direct communication with governments and regulators to promote industry standards and market rules at both a regional and global level and to provide membership services. There is also scope for industry bodies representing one sector to reach out to bodies from other sectors.

Regulatory cooperation

Creating a common approach to the regulatory regime and the developing common definitions for regulatory compliance should continue to be a valuable role for collective collaboration. There is a need for an industry effort to engage in direct and continuous communication with governments and regulators on matters of collective importance to the supply side of the industry in the regulatory sphere.

Industry schemes and joint projects

Experience of market development can lead to the recognition that collective schemes,

best practice guidelines and industry rulebooks have a place in the industry and may lead to tangible projects pursued through the above mentioned industry governance structure in the non-competitive space. As a starting point the development of a common market terminology and good practice guidelines would appear to be worthwhile activities requiring attention.

Risk sharing and secondary market development

Although supply chain finance is primarily a competitive matter, collaboration is required for risk sharing for a) larger multi-bank deals and/or b) establishing standard risk measurements to allow competition for transactions with different risk profiles, and c) commonly accepted rules and procedures. A common risk model established as the result of a collaborative effort enables banks to individually decide (i.e. compete) on SCF opportunities, eventually sharing risk with or without the support of outside funding. Risk sharing is or might be organised through specific commercial intermediary organisations or by means of established inter-bank arrangements.

Communication and marketing

For the generic promotion of the benefits of supply chain automation and SCF there are potential benefits of collaboration in information dissemination, in generic marketing activities and education. Education, communication and training are seen to be critical activities as the SCF market seeks to gain further traction.

Standards

Cooperation on interoperability and technical standards

Interoperability is the ability of two or more systems or components to exchange information and to use the information that has been exchanged. To guarantee interoperability, an important aspect for collaboration relates to establishing standards and implementing them consistently.

A number of layers of collaboration have been identified including the business level, the semantic level such as data formats, and the technical or syntactical level. Interoperability represents the capability to run business processes seamlessly across organisational boundaries and is achieved by understanding how the business processes of different organisations can interconnect. Seen as a central prerequisite to establishing e-business, interoperability enables information to be presented in a consistent manner between business systems, regardless of technology, application or platform. It thus provides organisations with the ability to transfer and use information across multiple technologies and systems by creating commonality in the way that business systems share information and processes across organisational boundaries.

Whereas the supervision of standards development is often taken by the industry governance body, technical standards for data formats and message types are usually developed by standardisation organisations, such as ISO, UN/CEFACT, and SWIFT. There is a need to develop a standards strategy and development plan for those standards considered important for SCF market development. The potential for the re-use of existing standards should be explored. It is noteworthy

that the active efforts in the development of standards for supply chain management in general have so far not been accompanied by equivalent efforts to develop standards for the integration of related financing services.

Infrastructure

Collective cooperation between banks and B2B networks, marketplaces and platforms

Although collaboration with such providers is usually based on bilateral one-to-one relationships, there may be opportunities to explore collective modes of collaboration and working agreements on an industry basis. Such modes of collaboration may be on the basis of a 'club' or 'association' approach to creating a shared platform, or through industry initiatives with very wide participation.

Such opportunities could include the provision of complementary capabilities at an industry level such as e-invoicing, logistics, information services and even the collective origination and distribution of financial transactions. Corporate clients are increasingly pointing to the need for multi-bank portals and portal providers of various kinds are active in the market.

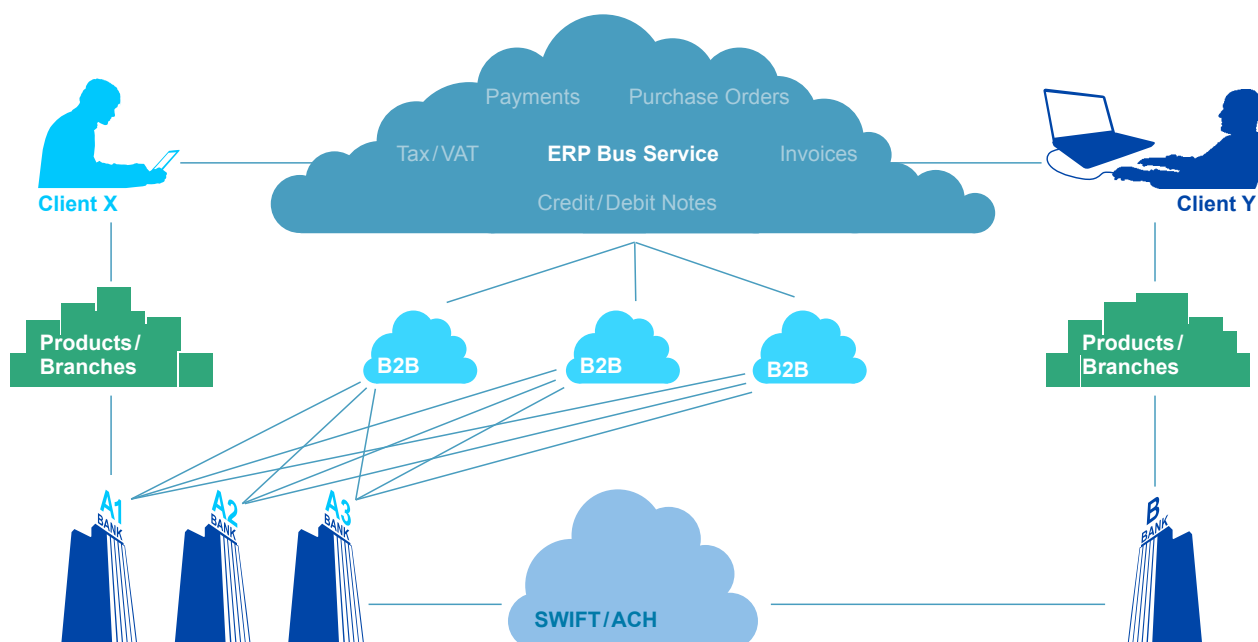
For banks, however, proposals for multi-bank platforms are often controversial and need to find their moment, a time when industry consensus emerges on the need to create such infrastructure. In the SCF marketplace, proprietary platforms are still in their early stages and the concept of abandoning such platforms is not widely accepted. It is also an understandable reaction that the challenges of managing common technology projects are not trivial. However, collaborating over the long term on a collective basis could be

an avenue worth exploring. This could be undertaken on the basis that the dialogue is confined to non-competitive propositions, such as for utility services or for services with high entry costs (e.g. where network economies have already been developed) or where individual banks cannot see a business case

for entry. The SWIFT TSU development illustrates this kind of thinking.

A possible collective cooperation model is captured in the ambitious idea described below for a fully networked environment (**Figure 23**).

Figure 23:
Model 4 – future-orientated ‘Networked Economy Market Approach’



Description

- Fully standardised and integrated marketplace for the exchange of all conceivable transactional data
- Deal-based free choice of the party rendering the data exchange and financing
- Networks are connected with pre-agreed access and privileged rights
- Standardised formats, contracts and risk distribution models
- Banks and B2B networks cooperate in a modularised, ‘plug and play’-like manner
- ‘Open’ model based on a peer to peer approach

Opportunities

- Market players can focus on their core business (e.g. shift of client onboarding activities from banks to B2B platforms)
- Stronger competition between market players and thus more potential for further innovation, optimisation and price efficiency
- Highest benefit for clients in terms of financing opportunities
- Potentially augmented scope in terms of available product features, commercial conditions, regional availability, and transaction flows
- Will support many ‘apps’ and value added services
- More a future development than a present reality

Challenges (same as in models 2 and 3, but increasingly intensive)

- Technology and governance of the network model
- Interoperability may be more theoretical than real
- Extension of the SCF ‘value chain’ with all its potential side-effects.
- Increased complexity of technical and operational data-handling
- Need for a commercial model that satisfies all involved market players
- Data protection / bank secrecy (banks being not supposed to share client data with external parties): threats to confidentiality and other denial of service activities
- KYC requirements
- Complexity of the required legal framework (e.g. legal ownership of claims)
- Tax implications (a distinction between ‘financing’ and ‘data exchange’ may trigger VAT obligations for the non-bank related portion of the service)
- Banks may lose their ‘USP’ compared to the first model
- The challenges of attracting corporate users from their comfort factor in a bank-owned proprietary platform or in using a B2B network.

7

The corporate value proposition for Supply Chain Finance

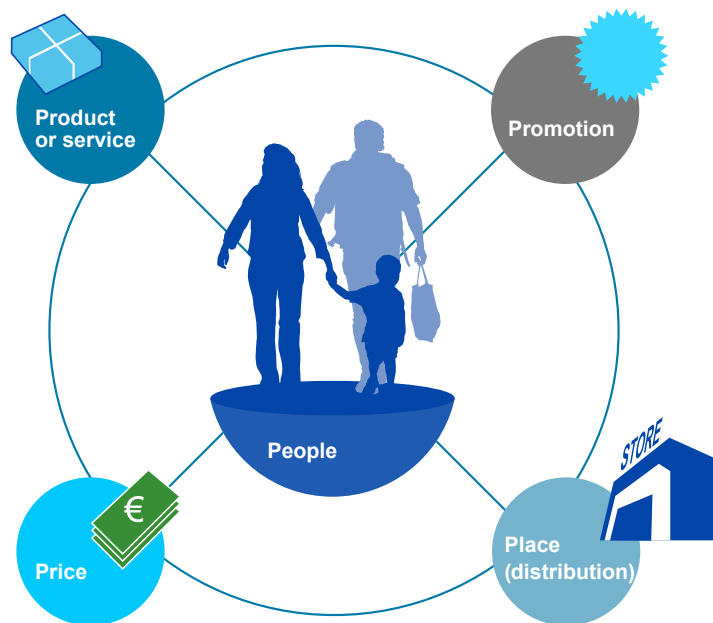
7.1

Instruments are developed into products as part of a marketing mix

The benefits of supply chain finance can be realised through the various SCF functional instruments as described already in the previous chapters of this Market Guide A

functional instrument is developed into a product by applying the 'Marketing Mix' called the '5P's model' (see [Figure 24](#)).

Figure 24:
The '5P's' Model



The bank collects its products in a product portfolio. To reduce the burden of paper-based handling and achieve (fully) automated (i.e. without human intervention) operations via computer/ administrative systems, an information and communications technology (ICT, or IT) **platform** will be mobilised.

If a bank offers products through a technology-advanced ICT platform (i.e. SCF platform) in addition to traditional paper-based means, it is not a precondition that the platform be owned and operated by the bank. The process of deciding which SCF function(s) to realise in what SCF product(s) – potentially also including decisions on platform selec-

tion and/or development – takes place in a SCF **programme**. This programme not only encompasses the development of the SCF portfolio, but also its SCF platform, jointly with the means and methods to set up a contractual relation with the client and establish (physical) connections between the SCF platform and the platforms supporting the physical supply chain and the financial supply chain. It may also develop the approach to be followed in marketing the product(s) and how to sell them to clients.

7.2

From Supply Chain triggers to meeting customer needs

SCF is largely ‘event-driven’. Each intervention (finance, risk mitigation or payment) in the financial supply chain is driven by an event in the physical supply chain. The development of advanced technologies to track and control events in the physical supply chain creates opportunities to automate the initiation of SCF interventions (i.e. the use of financial instruments).

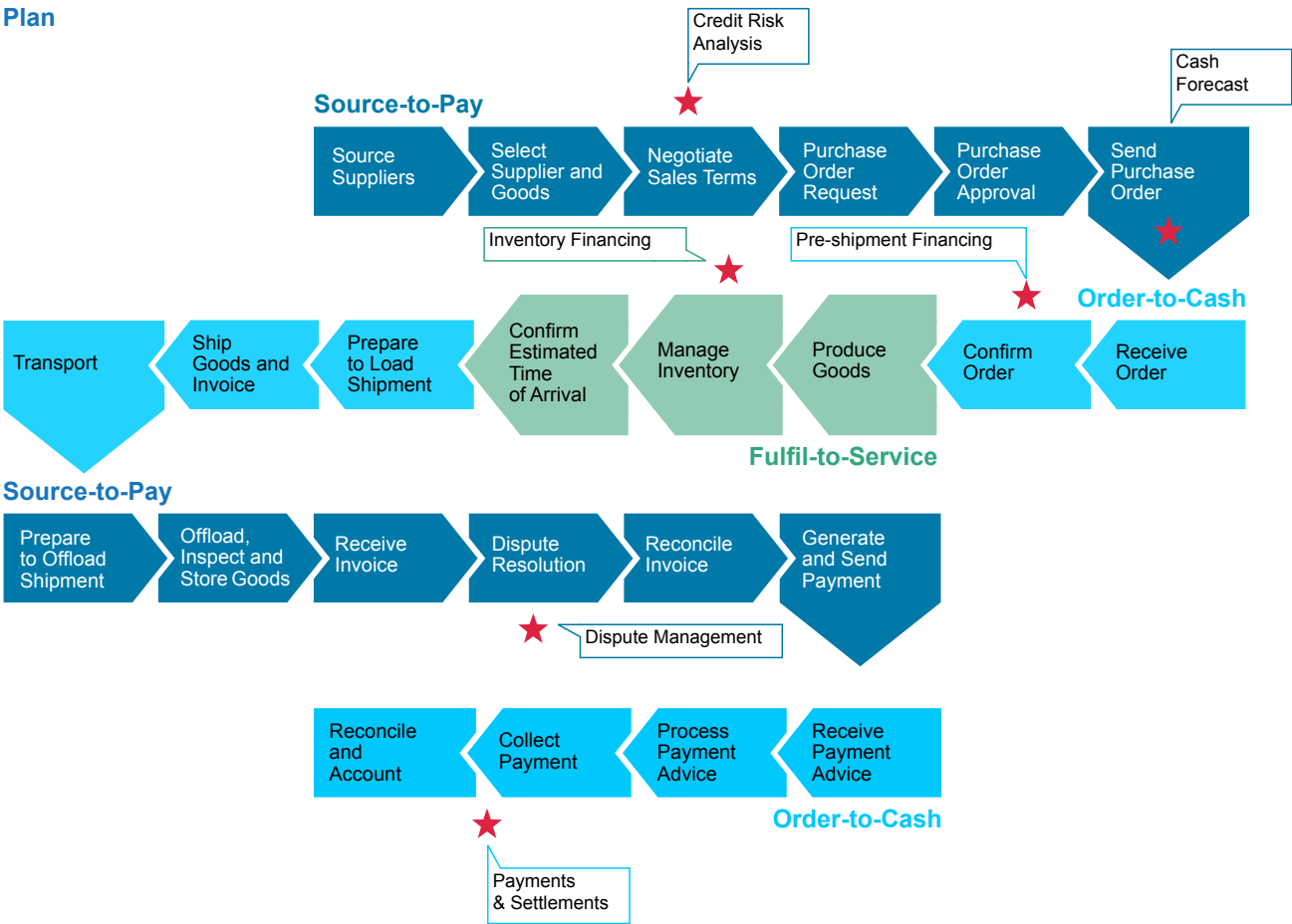
The Market Guide in particular recommends viewing supply chain process elements as ‘trigger’ points for the deployment of SCF functions. It has already been stated that: A forward-looking perspective for a bank’s SCF portfolio should be based on an event-driven process mind-set. As soon as the bank is

able to pinpoint when a financially significant event is triggered by the physical supply chain process, it will be in a position to offer a rich range of SCF value-added products.

The objective is therefore to identify what process elements of the supply chain represent the ‘triggers’, how to get access to these, and what SCF products to associate with them (see **Figure 25**).

Figure 25:
Trigger Points

Plan



While the decision of what product embedded functions to offer in the SCF portfolio belongs to the competitive sphere of each bank – and therefore goes beyond the boundaries of this document – still the SCWG was able to stimulate a collaborative effort among its member banks to provide a simple reference framework that helps to:

- Identify the trigger events for each process element.
- Verify how each trigger impacts one or more of the three main areas of concern (i.e. risk reduction, liquidity availability, working capital optimisation).
- Suggest what SCF functions are best suited to close the gap.
- Provide quantitative elements that weigh the benefit of that SCF functional instrument.

The goal of a corporate client involved in a financial supply chain is to optimise the use of liquidity and funding and to minimise inherent risk. Supply Chain Finance products support this goal by focussing on four areas:

1.

Reduction of Risk

2.

Improvement of Corporate Liquidity

3.

Improvement of Working Capital

4.

Process improvement

The product families outlined above serve to support these objectives at different points in the financial supply chain. Each one will manifest itself differently in each supply chain. In the cases of risk management and process improvement in particular there are as many different types of risk as there are supply chains. Each area is briefly reviewed below.

Risk

A supply chain is by definition ‘multi-step’ with each step strongly related to those immediately before and after. Parties in the supply chain are exposed to disruptive events at all steps in this chain – both to the direct costs of the disruption to the process itself and the downstream consequences for the rest of the supply chain. A production issue which results in faulty goods for example will have direct costs for the supplier in terms of resources (inventory, time and human capital) wasted. However, it may also have negative downstream costs on shipping and penalties for late delivery to the supplier. **Table A** below provides an indication of some of the most common supply chain risk factors and indicates whether they most impact the buyer or the supplier.

In the context of supply chain risk, SCF products aim to minimise the repercussions of unintended disruptive supply chain events. This can range from late or short shipment, late or non-payment to poor quality of goods and wrong packing. As outlined in the market guide, there is a broad suite of SCF functions to support different risks which may be applicable to different corporate supply chains.

Table A: Key Areas of Supply Chain Risk

Risk Criteria	Buyer side	Supplier side
Shipment risk	x	
Quality risk	x	
Payment risk		x
Payment not in time		x
Currency risk (market volatility)	x	x

Liquidity

The availability and accessibility of funds for both current operations and future investments goes to the heart of a corporate treasurer area of interest. A supply chain has the potential to tie up substantial assets and an efficiently managed financial supply chain aims to minimise the impact of this. **Table B** below illustrates the main areas of attention in this space for both buying and supplying companies.

Supply Chain Finance provides the opportunity to finance payables and receivables either by the initiative of the buyer or the supplier, especially when deferred payment has been agreed.

Examples

The supplier receives liquidity under an approved payables programme on an SCF platform or sells his receivables under a confirmed letter of credit to the bank (forfeiting). Both financings are done under the credit line of the buyer. The supplier can use the liquidity for the production of goods.

Table B: Areas of Focus for Liquidity

Liquidity Criteria	Buyer side	Supplier side
Liquidity for production of goods		x
Finance of deferred payment		x
Liquidity for payment of goods in time	x	

Working Capital

How can a corporate secure the right balance of cash flows relative to receivables (i.e. collecting money from clients), payables (i.e. pay debts to suppliers) and inventory (i.e. keep low stocks) without compromising the efficient and collaborative business exchanges in the supply chain?

There are a multitude of SCF products which support working capital management. On the buyer side (i.e. accounts payable), SCF products such as reverse factoring and dynamic discounting allow the buyer to extend payment terms without negatively affecting the financial performance of suppliers. On the supplier side, receivables financing solutions such as invoice discounting, receivables purchasing and factoring help suppliers to shorten days payments outstanding. Emerging products such as BPO solutions also support this objective.

Table C: Areas of Attention for Working Capital Optimisation

Working Capital Criteria	Buyer side	Supplier side
Decrease DSO		x
Increase DPO	x	
Keep Inventory levels balanced	x	x
Payment in time		x

Process Improvement

Due to the fact that supply chain financing combines processes of trade finance and cash management and also links the financial supply chain with the physical supply chain processes within the corporate's enterprise (e.g. export department, treasury, financing, controlling, and procurement) can be optimised. Consequently, different departments of the company are better interconnected along the supply chain and decisions are taken by involving all relevant parties in a more effective and comprehensive way.

Furthermore, the handling and financing of invoices on an SCF-platform provides the user with advantages of e-invoicing combined with opportunities for finance. The handling is faster, more effective and flexible. The user has extended reporting opportunities which ideally can be interfaced with its own ERP system.

General

Banks must firstly understand the corporate value proposition of SCF in a general sense. Thereafter, they must determine the value proposition for their corporate client base and build their portfolio accordingly. Banks must consider which products to include in their SCF portfolio, how to implement and deliver these products in a general sense and how to identify the right product(s) for each client.

7.3

Key considerations in establishing an SCF Programme

Establishing a supply chain finance programme represents a significant commitment on behalf of a bank. Due to differences in bank and corporate client base, each bank's journey to an established SCF programme and portfolio will be different. However, there are key steps which are largely similar and must be tackled by banks, buyers and

suppliers whichever way the programme is established.

Table D below illustrates best practice activities that EBA has collected through interviews and analysis among parties that have implemented and do successfully maintain SCF programmes.

Table D: Critical Success Factors to run successful SCF programmes with focus on approved payables finance

Key Areas of Focus	Buyer	Supplier	Bank
Understand the value proposition			
Recognise the right conditions under which it makes most sense to apply for an SCF programme	x	x	x
Obtain Internal Support			
Obtain commitment from executive management	x	x	x
Alignment between finance and procurement to review individual supplier economics and approach	x	x	
Select SCF Solution Provider			
From buyer bank pool and/or outside	x		
Formalised request for proposal (RFP)	x		
Financial stability and credit capacity/capacity			x

Key Areas of Focus	Buyer	Supplier	Bank
Cross-border applicability/ jurisdictions	x	x	x
Pricing	x		x
KYC requirements	x	x	x
Longevity of relationship	x		x
Structuring and onboarding experience	x		x
Risk management and documentation	x		x
Extended services			x
Technology and operations infrastructure	x		x
Canvass and mobilise trading partners			
Mobilise as lobbying group to move large buying groups towards the adoption of SCF			x
Consider quality/longevity of trading party relationships			x
Perform working capital analysis of trading partner	x		
Have plan to enable suppliers	x		x
Target the suppliers according to criteria (e.g. geography, currency, payment term tenor, credit risk profile) that may increase the success opportunities of the programme	x		

Key Areas of Focus	Buyer	Supplier	Bank
Understand with the bank the documentation required from the suppliers	x		x
Education/Communication programme			
Define internal and external communication	x		x
Supplier meetings/ mailing campaign/ webcast/ individual communication	x		x
Essential Preliminary activities			
Definition and agreement on KPIs with internal teams and providers and banks	x		x
Definition and agreement on KPIs with internal teams and providers and banks	x		x
Ensure accurate information between parties (i.e. buyer, supplier and bank) and make it always available			x
Establish and resolve legal/documentation infrastructure of SCF programme	x		x
Validate accounting treatments	x		x
Existence or accessibility of technical infrastructure to optimise products required			All
Relevant expertise (particularly in the case of the SCF provider/ administrator)			All

Key Areas of Focus	Buyer	Supplier	Bank
Determine internal capital/funding treatment of SCF products			x
Pilot			
Conduct a pilot	x		x
Run pilot	x		x
Evaluate pilot	x		x
Establish a project/programme			
Appoint project manager	x		x
Identify project scope and organisation	x		x
Consider critical early focus areas	x		
Identify and prioritise suppliers for programme participation	x		
Set realistic timelines with clear milestones and deadlines	x		x
Appoint dedicated resources that will			
Agree on the project scope and develop the plan	x		x
Plan tasks and identify the programme milestones	x		x
Complete all relevant documentation	x		x
Onboard suppliers and the buying company entities			x
Test and train as appropriate	x		x

7.4

SCF Enabling Technologies

One of the most significant investments for SCF resides with technology platforms and IT applications that create an infrastructure to automate the delivery and administration of SCF products. Electronic invoicing is a good example: an exchange of electronic invoices is needed to fully deploy the value of approved payables finance (also known as reverse factoring), one of the most frequently adopted SCF functions. **Table E** below provides examples of such IT applications for SCF.

These IT applications should be considered in the context of the nature and scale of the SCF programme which is being established. Early pilot and programme phases offer the opportunity to assess the validity of product choices and implementation approaches without major infrastructural investments. At some point however, some or all of the IT applications below will be required to support a successful, growing SCF product suite.

Table E: SCF Enabling Technologies

IT Application	Description
E-invoicing	An invoice is a trade document or dataset that details the goods sent/services delivered or goods received/ services obtained with a statement of the due and payable amount together with a statement of any applicable value-added taxes. Some invoices are no longer paper-based, but rather information is made available electronically, e.g. over the Internet (e-invoice). The digitalisation of this key procurement information has a dramatic effect on the potential scalability and applicability for SCF products. Processes that previously relied on paper and took days and weeks to complete are now (potentially) instantaneous. SCF credit decisions which were previously made based on trust and relationship can now be made based on near-perfect information available to all parties in near real-time.
Purchase order (PO) invoice matching, reconciliation and approval	Automatically matches invoices to both purchase orders and contracts ('three way match'). Automates the processing of invoices within the enterprise resource planning (ERP) for final payment. The remaining partially matched or unmatched invoices are automatically routed to the correct person for handling.

IT Application	Description
Order management (sales order, purchase order issue, dispute, confirm)	Enables the initiation of the order processes – either a sales or purchase order – setting the initial terms and conditions of the commercial trade exchange. Advanced systems generate the invoice document directly from the purchase order.
Document management	Manages document production and distribution in a central, secure location. All documents are generated based on the trade transaction terms. Examples of documents: purchase and sales orders, insurance policies, customs files, shipping documents, bills of lading, invoices, and quality inspections.
Payments execution	Opening, maintaining, and closing accounts; payments initiation from all appropriate channels; monitoring payments; ensure interfaces between client-interfacing and back-office bank systems; clearing and settling payments to the parties' accounts at their respective banks.
Payments tracking	Tracks payments from initiation through clearing and settlement by invoice and invoice line item and shows real-time payment status. Integrates directly with banks or ERP financial applications for remittance notification.
Multi-bank connectivity	Enables buyers and suppliers to see all electronic financial transactions in one place instead of logging into several different proprietary systems to gather a complete picture of their transactions.
Workflow management systems	Allow buyers, suppliers, or involved third parties to define different workflows for different types of jobs or processes. Once a task is completed, the workflow software ensures that the individuals responsible for the next task are notified and receive the data they need to execute their stage of the process. A workflow management system reflects the dependencies required for the completion of each task.

IT Application	Description
Event management	Controls and assigns actions to the actors in trade. Sets alerts for automatic notification of significant PO events, for example, new POs, amendments, approvals, delays, holds, or latest shipment dates.
Securitisation	Securitisation is a modern and successful way for corporate financing to provide liquidity via securities backed by corporate assets. Securitisation is a funding source and a balance sheet management tool. It has a leverage effect on liquidity, and provides enhanced security and visibility on funded assets.

Annex 1 – Glossary of Terms

Automation	Refers to the range of IT-based and business tools that support the management of supply chains and SCF.
AP: Account Payable	AP is money owed by a business to its suppliers and shown on its balance sheet as a liability.
AR: Account Receivable	AR is money owned by suppliers to a business and shown on its balance sheet as an asset.
B2B: Business to Business	Business transactions between businesses, such as between a manufacturer and a wholesaler, or between a wholesaler and a retailer
B2C: Business to Consumer	Business transactions between a business and a consumer
BASEL III	Basel III is part of the continuous effort made by the Basel Committee on Banking Supervision to enhance the banking regulatory framework. It builds on the Basel I and Basel II frameworks, and seeks to improve the banking sector's ability to deal with financial and economic stress, improve risk management and strengthen the banks' transparency. A focus of Basel III is to foster greater resilience at the individual bank level in order to reduce the risk of system wide shocks.

BPO: Bank Payment Obligation	BPO is an irrevocable obligation of an obligor bank to pay a specified amount to a recipient bank as soon as a matching occurs between data extracted from different trade documents like invoices, purchase orders, transport documents, and certificates.
Cash on delivery	Payment is collected by the carrier/delivery agent on behalf of the supplier.
Cash-to-cash cycle time	Represents the interval between payment for raw materials and the receipt of cash generated by selling final goods. In mathematical terms, Cash-to-cash cycle time = $[(DSO + DII) - DPO]$
Letter of credit (documentary credit)	A letter of credit is a written undertaking given by the issuing bank at the request of the buyer (applicant) to honour a presentation of compliant documents, i.e. to pay the beneficiary at sight, to incur a deferred payment undertaking or accept a bill of exchange and pay the beneficiary at maturity.
DII: Days In Inventory	$\text{Average Inventory/Cost of Goods Sold} \times 365$
DPO: Days Payable Outstanding	$(\text{Accounts payable/COGS}) \times 365$
DSO: Days Sales Outstanding	$(\text{Accounts Receivables/Net sales}) \times 365$
Dynamic Discounting	Dynamic payables discounting is a process which allows buyers and suppliers of commercial goods and services to dynamically change the payment terms – such as net 30 – to accelerate payment based on a sliding discount scale. Dynamic payables discounting is ‘dynamic’ in one or more ways.

EBPP: Electronic Bill Presentment and Payment	EBPP is usually consumer-oriented bill paying presented and paid through the internet.
EDI: Electronic Data Interchange	An electronic transfer of data from computer to computer using an agreed structured format that can be read by a computer and processed automatically.
E-invoice: Electronic Invoice	An electronic invoice is a document in electronic form representing an invoice. The electronic invoice can be in a human or in machine-readable format, or in a combination thereof.
ERP: Enterprise Resource Planning	ERP systems integrate internal and external management information across an entire organisation, embracing finance/accounting, manufacturing, sales and service, customer relationship management, etc. ERP systems automate this activity with an integrated software application. The purpose of ERP is to facilitate the flow of information between all business functions inside the boundaries of the organisation and manage the connections to outside stakeholders
Forfaiting	Forfaiting is the provision of finance against receivables evidenced in the form of promissory notes or bills of exchange and is frequently used in the field of capital goods export where there is a demand for medium- or long-term credit from foreign buyers.
FSC: Financial Supply Chain	The series of financial processes that support the physical supply chain such as credit assessment and control, deployment of financing and risk mitigation instruments, and payments.

Inventory Finance	Inventory (or warehouse) financing is a form of trade finance in which goods are held in a warehouse for a buyer, usually by the supplier (could be a third party) until needed.
Invoice Discounting	Invoice discounting relies on suppliers receiving a percentage of their receivables in exchange for an earlier payment, thus reducing their DSO exposure.
ISO	International Organisation for Standardisation. A non-governmental organisation responsible for international standardisation and normalisation, consisting of representative from national normalisation institutes.
ISO 20022	ISO 20022 is the financial industries common platform for the development of messages in a standardised XML syntax, using a modelling methodology (based on UML) to capture in a syntax-independent way financial business areas, business transactions and associated message flows.
KYC: Know Your Customer	The activities of customer due diligence that financial institutions and other regulated companies must perform to identify their clients and ascertain relevant information pertinent to doing financial business with them.
PSC: Physical Supply Chain	The series of business processes by which goods and services are purchased, transformed, delivered and paid for.
Purchase Order (PO) based finance	Also known as pre-shipment finance is made available to a supplier based on a purchase order received from a buyer.

Receivable Finance

Receivable Finance allows suppliers to finance their receivables relating to one or many buyers and to receive early payment, usually at a discount on the value and is accomplished in a number of jurisdictionally different ways under a number of business models including Receivables Purchase, Invoice Discounting, Factoring and Forfaiting.

SCF: Supply Chain Finance

The use of financial instruments, practices and technologies to optimise the management of the working capital and liquidity tied up in supply chain processes for collaborating business partners. SCF is largely 'event-driven'. Each intervention (finance, risk mitigation or payment) in the financial supply chain is driven by an event in the physical supply chain. The development of advanced technologies to track and control events in the physical supply chain creates opportunities to automate the initiation of SCF interventions.

SCM: Supply Chain Management

Supply chain management is the systematic, strategic coordination of the traditional business functions and the tactics across these business functions within a particular company and across businesses within the supply chain, for the purposes of improving the long-term performance of the individual companies and the supply chain as a whole (Mentzer et al., 2001).

Working Capital

The amount of day-by-day operating liquidity available to a business. In mathematical terms, working capital is calculated as $WC = (AR) + (INV) - (AP) + (Cash)$

Annex 2 – BAFT Definitions of SCF Instruments

The following pages contain a replica of the BAFT document¹¹ that describes Open Account instruments, some of which correspond to the SCF instruments described in [Chapter 3](#).

BAFT Product Definitions for Open Account Trade Processing and Open Account Trade Finance

Section 2:

Processing/Service Definitions

Open Account Processing leverages the existing trade services processing capabilities of financial institutions. It can include purchase order upload to create transactions, document examination and/or data matching, tracing and follow up for payment and payment services. An important activity in Open Account transaction Processing is the exchange and sharing of documents and document data which can be sent to a bank via a number of methods, including paper documents and electronic records hereafter referred to collectively as documents.

These processing activities which are further defined below can trigger Supply Chain Finance opportunities. A bank may engage in some or all of these activities and/or financing opportunities.

1. Purchase Order Advice

A purchase order specifying the goods and terms is created by the buyer. The seller is then notified of the purchase order and other shipping instructions through a collaboration platform, fax, email, portal or other method. Once notified, the buyer may require the seller's acknowledgement.

2. Document Presentment and Data Matching

Documents are created and presented by the seller. Matching criteria under Open Account are defined by the buyer. They may consist of simple checking for the presence of all the required documents or detailed checking of specific data values within or among documents in an automated, semi automated, or manual fashion as defined in the Purchase Order Advice.

¹¹
BAFT Product Definitions for
Open Account Trade Process-
ing and Open Account Trade
Finance, Publication Date:
December 13, 2010 (Original) /
REVISED May 2011

3. Discrepancy Handling/Dispute Resolution

If the matching results include discrepancies between the buyer's matching criteria and the presented document data, the buyer is typically notified to determine if the documents will be rejected or approved. For efficiency purposes, the buyer can preauthorise the bank to pay documents where there are no discrepancies. Dispute resolution enables buyers and sellers to resolve disputes related to Open Account activity on-line or via other methods of communication.

Section 3: Open Account Trade Finance Definitions

As applies to Open Account transactions, Supply Chain Finance (SCF) solutions encompass a combination of technology and services that link buyers, sellers, and finance providers to facilitate financing during the life cycle of the Open Account trade transaction and repayment. The below financing opportunities fall within the overall definition of Supply Chain Finance.

1. Purchase Order Commitment to Pay

The buyer's bank issues its commitment to pay the seller (at sight or at maturity) once the seller ships and makes available the required documents that match the purchase order and other stipulated conditions. This service allows the seller to take the risk of the bank issuing its commitment to pay instead of that of the buyer.

2. Pre-Shipment Finance

Pre-Shipment Finance, also known as Purchase order financing, is made available to a seller based on a purchase order received from a buyer. This financing can cover all the related working capital needs of the seller including raw materials, wages, packing costs and other pre-shipment expenses. Once the goods are ready, refinancing or repayment can occur.

3. Warehouse Finance

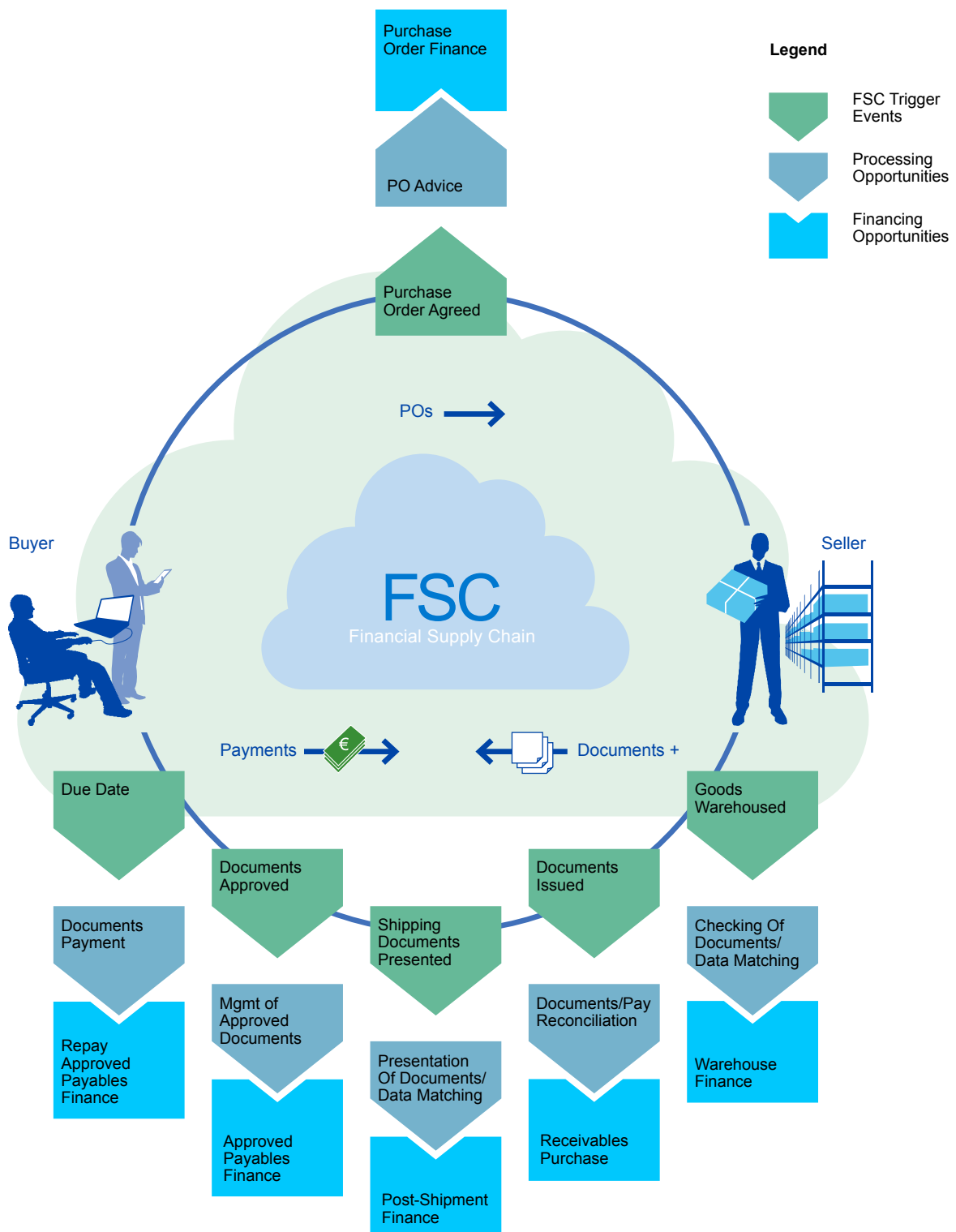
Warehouse financing is a form of trade finance in which goods are held in a warehouse for the buyer, usually by the seller, until needed. At a minimum, warehouse receipts are commonly required as evidence for the financing. Some banks may only do this under structured trade transactions.

4. Post-Shipment Finance

Post-shipment financing is provided to a seller using the receivable as collateral. The seller presents shipping documents as evidence of a receivable and the bank may also require a bill drawn on the buyer for the goods exported. The bank may prefer to purchase and discount a bill drawn on the buyer for the goods exported.

Section 4: Opportunities Diagram

Figure 26:
Open Account Processing and Financing Opportunities



Section 5: Opportunities Matrix

Supply Chain Finance Trigger Events	Bank Processing Opportunity	Bank Financing Opportunity
Purchase Order Agreed	Purchase Order Advice	Pre-Shipment Finance
Goods Warehoused	Document Checking / Data Matching	Warehouse Finance
Documents Issued	Documents / Purchase Order Reconciliation	Receivables Purchase
Documents Presented	Document Checking / Data Matching	Post-Shipment Finance
Documents Approved	Management of Approved Documents	Approved Payables Finance
Due Date	Document Payment	Repay any outstanding financing

Annex 3 – EBA SCWG expands scope to cover full spectrum of the financial supply chain

An article by Charles Bryant, EBA Advisor,
published in the EBA Insight Newsletter
in April 2014

Over the last few years, the EBA has brought together practitioners and thought leaders among its members and associate members to discuss and develop concepts in the areas of electronic invoicing and more recently supply chain finance (SCF).

The EBA E-Invoicing Working Group produced two editions of a **comprehensive guide to electronic invoicing in Europe and a white paper** detailing a scheme for the exchange of e-invoices between banks and other service providers, together with other co-operation models. Both were well received by the community and the EBA was invited to participate in the European Commission's Expert Group on e-invoicing and is now participating in the **European Multi-Stakeholder Forum on e-Invoicing**.

In 2013, the now re-named Supply Chain Working Group (SCWG) published a Market Guide to SCF. In the Guide, SCF is defined as:

'The use of financial instruments, practices and technologies to optimise the management of the working capital and liquidity tied up in supply chain processes for collaborating business partners. SCF

is largely 'event-driven'. Each intervention (finance, risk mitigation or payment) in the financial supply chain is driven by an event in the physical supply chain. The development of advanced technologies to track and control events in the physical supply chain creates opportunities to automate the initiation of SCF interventions.'

The Guide describes the current Supply Chain Finance ecosystem and analyses drivers propelling or constraining take-up and adoption of a range of financing instruments applied to open account trading. It defines and explores market opportunities for possible supply chain finance services, and identifies key risks and regulatory issues that impact the supply chain finance market. The Guide also defines a common terminology for the supply chain finance.

During 2013, the SCWG focused on aspects such as the corporate value proposition, co-operation between banks and B2B networks, the Bank Payment Obligation and the need for a co-operation space for SCF as is the case with payments. These areas will be covered in the second edition of the Market Guide to SCF due to be released in June 2014.

Expanding the scope to cover the entire financial supply chain

Recently, the EBA Board has decided to expand the mission of the SCWG to undertake a more holistic analysis of the financial supply chain meaning the complete range of risk management practices and financial transactions that facilitate the purchase of, and payment for, goods and services, such as the contracting process, purchase orders and invoices, managing liquidity, raising working capital finance and making the required payments.

Traditionally, the banking industry has tended to consider suppliers, manufacturers, service providers and end customers independently in a partitioned way, for example looking separately at funding for suppliers and buyers. As working capital management has become more important to corporates, banks are looking at the end-to-end value chain often with a view to raising finance based on the stronger credit risks present in a supply chain and feeding liquidity to key suppliers and partners.

Financial institutions have a need to increase their visibility by positioning themselves in every step within the supply chain as well as by creating insights into the underlying commercial basis of transactions. By taking this holistic view, banks have an opportunity to intermediate or re-intermediate themselves as appropriate. The increasing automation of supply chains is creating attractive financing opportunities for the financial industry to offer a wider range of services well beyond traditional trade finance. The increased transparency makes it possible for banks to provide timely financing, whilst leveraging modern technology for process automation – a win-win scenario for all parties. Banks

should view the financial supply chain (FSC) as a key virtual marketplace for transactional services powered by automation and network capabilities.

In 2014, the SCWG will focus on process mapping of the financial supply chain, a review of order-to-cash processes and the development of e-invoicing, continued monitoring of the supply chain finance market and the terminology used in this market, as well as the performance of B2B payment services in supporting the financial supply chain, specifically in areas such as remittance data. This will enable the development of a generic value proposition for banks including ways in which payments, supply chain finance and supply chain automation can be brought together in a ‘non-silo’ way to create value for corporate users.

Among the findings of the first edition of the EBA’s Market Guide on SCF was that a lack of common standards in terms of terminology for the more recent supply chain finance instruments poses a handicap for stakeholders to fully understand the SCF solutions offered by the market. Networking and discussions with other industry communities such as BAFT, the ICC Banking Commission, International Factoring Group, Factors Chain International and the International Forfaiting Association, have shown a need for an industry effort to develop standard market definitions. To take this initiative forward in 2014, a Global SCF Forum is in the process of being launched.

Membership of the EBA SCWG

- ABBL
- ABI – CBI Consortium
- AITE
- Banca Commerciale Romana
- Banco Santander S.A.
- Bank of Ireland
- BBVA
- Bundesverband deutscher Banken
- CECA
- Ceska Sporitelna
- Commerzbank AG
- Crédit Agricole
- Danske Bank A/S
- Deutsche Bank
- Diamis – Atos
- DZ Bank AG
- Equens
- Finansraadet
- Fundtech
- Helaba
- ICBPI
- ING
- Isabel NV/SA
- JPMorgan Chase Bank AG
- KBC Bank
- La Caixa - Caixa d’Estalvis i Pensions de Barcelona
- Nordea Bank Finland Plc
- Rabobank
- RB International
- Royal Bank of Scotland
- SEB
- SIA – RA Computer
- SIBS
- Société Générale
- Swedbank Foreningssparbanken AB
- SWIFT
- UniCredit

Annex 4 – Traditional Trade Finance and Payments

This section briefly describes the portfolio of traditional trade finance instruments and payment instruments.

Traditional trade finance has always sought to align the provision of financial instruments with the production and movement of goods. The expectation is that this area of finance will continue to grow albeit it is declining in relative terms against SCF.

These forms of trade finance may be classified in two main categories:

- Forms of bank-intermediated trade finance (i.e. documentary trade finance)
- Forms of trade finance involving bank support without credit or risk engagement

1. Forms of bank-intermediated trade finance

A **Documentary Letter of Credit (LC)** is a written undertaking given by the issuing bank at the request of the buyer (applicant) to honour a presentation of compliant documents, i.e. to pay the beneficiary at sight, to incur a deferred payment undertaking or accept a bill of exchange and pay the beneficiary at maturity. Such letters of credit come in many forms of which irrevocable, confirmed or unconfirmed are the most common. LCs may involve receipt of cash on shipment once the presentation of documents occurs or may include a variety of financial options including discounting of accepted bills or pre-shipment finance. The most appropriate reference to a comprehensive guide to documentary finance is the 'Uniform Customs and Practice for Documentary Credits' revision 600 (UCP 600), a set of rules on the issuance and use of letters of credit utilised by bankers and commercial parties in more than 175 countries involved in trade finance.

The importer and exporter must always remember that unlike transactions in a domestic market, the complete and timely collection of outstanding international transactions may be affected by issues related to country risk, notwithstanding the standing of the foreign trading party. Both credit and country risk are relevant in the assessment process.

The provision of bank-intermediated Documentary Letter of Credit (LC) requires the bank to undertake an assessment of the creditworthiness and performance capability of the party on whose behalf an LC is issued or confirmed – the buyer or importer, as well as understanding the credit and performance characteristics of the beneficiary or exporter, as well as meticulously executing the transaction as a process. Accordingly, these forms of finance are relatively expensive.

The exporter that decides to request the use of an LC must always be aware of the costs and operational requirements of such a transaction. It should be borne in mind that a large number of LC transactions involve discrepancies and thus the payment obligation depends ultimately on the other commercial party to accept and pay for the goods, albeit there is a structured payment process involved. The exporter must also be aware that the counterparty risk shifts from the buyer to a bank, and therefore it is important to assess the standing of the banks concerned and determine the need for appropriate confirmations.

Although 80 to 85 percent of trade transactions are estimated to be settled on an open account basis, the LC remains an important transactional instrument. A solid foundation of documentary credit-based trade will remain, especially between companies that have just started a trading partnership. They are still in the process of getting to know one another better and the level of reciprocal trust is not yet at the point where open account transactions can take the place of more risk-averse documentary credit exchanges. The passage to open account will eventually happen once the level of confidence has reached the level for which a purchase order is sufficient to ensure the fulfilment of the order and the subsequent execution of the payment against an issued invoice.

LCs are likely to retain their popularity in connection with well-defined trade flows: for example in Asian trade where the instrument is commonly used to raise pre-shipment finance as well as assurance of payment. Another example is its use by exporters into emerging

markets where factors such as exchange control rules, business habits, country risk and the credit standing of buyers and local banks motivate the use of confirmed LCs.

Standby and Performance LCs

are simpler in form but present a more complex series of risks than Documentary LCs. As a conditional payment instrument, they may be issued in advance of shipment or contract fulfilment by a supplier to secure a tender or contractual performance. A simple demand or a pre-agreed statement evidencing non-performance is usually the basis of triggering payment. For the issuing bank the open nature of the commitment requires careful assessment. In some cases these instruments are used outside the trade related area to effectively provide a guarantee for the granting of credit by another financial institution. It is important to distinguish the trade related type of standby/performance LC from the use they are put to for the credit enhancement of financial transactions.

2.

Forms of traditional support for trade without bank intermediated finance or risk assumption

In international trade there are various means of payment not guaranteed by the bank that provide value and provide some degree of protection and security for the trading parties. The choice of the degree of protection depends on the perceived credit risk as seen by the exporter and the respective negotiating powers of the trading parties.

Documentary collections

are a means of payment where the bank acts as an intermediary between the exporter and importer based on the collection of a bill of exchange and related shipping documents. It is an intermediate instrument between a transaction secured by a letter of credit and an open account transaction which is settled with a simple bank credit transfer. The costs of this service are generally lower than for a letter of credit and higher than for a credit transfer. In a documentary collection the exporter's bank, once it has received a mandate from its customer, transmits to the importer's bank the commercial documents that prove the dispatch of the goods or the provisioning of a service. The receiving bank delivers these documents to the importer only on payment of the amount due. The responsibility of the banks is therefore limited to forwarding and delivery of the documents against payment or acceptance of a draft without any responsibility and commitment to pay. The banks have no responsibility for the validity and effectiveness of the documents submitted, and no responsibility for delays, losses, or translation mistakes. A bank may consider the discount of such collections, and if undertaken without recourse can be considered as close to a forfaiting transaction.

Credit transfer

(also known as a funds or bank transfer) is the most commonly used form of payment in both domestic and international B2B transactions. The credit transfer is a transfer of funds from the account of the ordering customer into the account of the beneficiary, usually by electronic means. With regard to choosing the credit transfer as a form of payment, it is a simple payment instrument that should be used in the case of high trust and confidence between trade partners. The bank normally advises its clients that the use of this form of payment must be tightly linked to the timing of acceptance of goods. The commercial contract should specify the date of execution of the payment transfer, or establish a starting point after a fixed number of days from the date of invoice. Trading parties also often arrange for Cash (Payment) on delivery (COD) or even Cash (Payment) in advance.

The majority of credit transfer payments are usually domestic in nature and that is where the larger volumes lie. For cross-border payments the SWIFT based credit transfer payment is most common, although there are a variety of other remittance services. In Europe, the payments market is integrating based on the Single Euro Payments Area (SEPA) and further underpinned by the Payment Services Directive (PSD).

Direct debits

are collections arranged by the creditor that require prior authorisation by the debtor. They are usually adopted for recurring payment transactions. In the presence of numerous, ongoing payments, the Supplier or Exporter may open an account at a bank in the country of the Buyer/Debtor. The direct debit may have some useful features for the exporter under such an arrangement as proceeds of sales can be received with certainty. Direct debit is more common in domestic markets for recurring consumer bills, although it also has benefits for B2B transactions, including international business flows. Specific B2B direct debit services are becoming more common, e.g. in the SEPA DD B2B scheme.

Cheques and Lock Box services

for the handling of traditional paper-based payment instruments are still convenient in certain circumstances although considered increasingly slow and expensive. Trading parties may also consider the use of Bank Drafts, which are checks that are guaranteed by a bank.

Annex 5 – ICC Global SCF Forum Terms of Reference

Developing Standard Market Definitions

(Final version of 14th March 2014)

A / Purpose and objectives

The purpose of this project is to address the growing need of the trade finance industry to standardise and harmonise the market terminology for products and services in the global supply chain finance space and offered by financial institutions such as banks as well as factoring and forfaiting companies. It comprises both traditional and other products and services such as Open Account techniques generally designated as Supply Chain Finance (SCF). SCF products and services cover all risk mitigating and liquidity products a corporate client requires to optimise working capital along the entire value chain.

Especially the so-called SCF is a growing market with many opportunities identified for the near future. With the increase in collaboration from a wide range of bank and non-bank participants in facilitating domestic and cross border trade and advent of internet and new communication technologies, the industry is now developing a rich array of processing, financing and risk management techniques to support an increasingly globalised supply chain.

However, the industry has not reached an agreement to have a globally consistent nomenclature to describe the various SCF solutions. Institutions use different nomenclature to describe similar SCF solutions that

are sold by different institutions, thereby confusing the importers, exporters, regulators, experienced and new practitioners as well as investor communities. Given the rapid growth of SCF there is a need for common understanding and operationalised terminology to be used in SCF transactions.

The objectives are five-fold:

- 1.** Collect all existing SCF nomenclatures developed by various trade associations in an effort to do a precise mapping of existing efforts undertaken in this field and define the precise typology of SCF products and services to fall under these ToRs
- 2.** Harmonise SCF existing market terminology to make it operational and usable in daily practice by banks and non-banks when processing, financing and risk mitigating trade transactions. In doing so, it will be important to remove any ambiguity in the existing terminology and standardise language at a global level. We are not expected to introduce new nomenclatures as we believe that existing market nomenclatures are sufficient to meet the industry needs nor do we intend to go beyond the financial industry/create new products and services

3.

Ensure that this initiative provides a competitive platform for all market participants to continue to innovate new solutions to meet ever-changing market needs. In short, this initiative will promote competition and innovation while providing market nomenclature clarity for all stakeholders

4.

Work with various service providers to ensure adoption of these nomenclatures in their service offerings; and

5.

Educate key stakeholders such as the investors and regulators communities.

B / Core working group

A core working group will be put together to conduct the work outlined in these ToRs. It will comprise members of the following proposed organisations with ICC providing the secretariat support:

- ICC
- EBA
- BAFT
- FCI
- IFG
- IFA

Each organisation will ensure representation of its member institutions through expert practitioners. Other organisations and user groups may be added if deemed necessary.

These ToRs will be shared widely with all banks, industry bodies and media in order to harness the collective partnership across all stakeholders.

To structure the drafting under these ToRs, it is proposed to follow the ICC governance model implemented for drafting and adopting ICC standards and guidelines. In addition to the core working group, a consultative group will be set up to review all drafts and provide feedback. Such consultative group will comprise members from the industry and banking associations/other organisations (typically, such group can have a membership varying between 20 and 30 participants, whereas the core working group does not contain more than 10 members). In addition, ICC 92 National Committees will be provided with an interim draft and requested to engage business at large in their country of operations to review the proposed terminology.

Each of the above member institutions of this initiative will follow in parallel its own internal member approval processes.

C / Audience

The intended audience for the SCF market terminology is the trade (finance) banking community. Exporters/importers, corporates, institutional investors and regulators, both specialist and those with a general interest in SCF, will also be a targeted audience for this project.

D / Existing definitions

Several initiatives have been undertaken to define SCF terminology and highlight key issues in the SCF sphere, including issues relating to the conceptual language, the various instruments of SCF, regulations, the application of technology, relative riskiness, etc. One of the core tasks to be performed under these ToRs will be to collect all possible market glossaries and bodies of knowledge related to SCF as developed by various

banking associations and other organisations and review them in an effort to arrive at a precise typology of products and services to be covered. The typology may include the following: accounts payable, accounts receivable, inventory financing, pre-shipment financing, factoring, forfaiting (including discounting of DP LCs, etc.), BPO.

The most noteworthy initiatives seeking to define a specific terminology in the field of trade finance are:

- BAFT Definitions For Open Account Trade Processing and Trade Finance
- EBA European Market Guide to Supply Chain Finance released in May 2013
- ICC industry standards for BPO and the ICC Trade Register
- Definitions used by the Factoring industry
- Definitions used by the Forfaiting industry

Other associations in the factoring and forfaiting markets employ specific terminologies and there is a wide variety of proprietary language in use.

E / Approach and Outcome

Harmonisation of the market terminology can be done according to a multi-tier approach as proposed below. The core working group will need to rectify the approach.

Tier 1 – At the highest level it contains two families: (a) Documentary Trade (aka traditional trade) (b) Supply Chain/Open Account.

Tier 2 – Sub-categories including the different SCF products and services for which specific nomenclatures are needed.

Tier 3 – Sub-categories of Tier 2. Tier 3 will result in rules or standards or agreements to be developed over time.

The final outcome for **tier 1** and **2** will be a publication containing the market terminology for SCF. The name of the publication and the way to publish it will need to be defined. In addition, an ongoing effort will be made by the core group members to ensure that the new terminology is distributed to the widest possible audience so that it can become internationally recognised business terminology.

The final outcome for **tier 3** may be a publication containing rules, standards and agreements as and when needed by **tier 2** products and services. As this is a competitive initiative, it is entirely possible that different competent organisations publish different rules, standards and agreements for similar **tier 2** products and services.

Once again, this is the recommended approach and the core working group will need to ratify this approach.

F / Update of the market terminology

It should be noted that the nomenclature may evolve over time, thus making it necessary to have a process in place to update the definitions and standard practices related to SCF. Such a process will need to be articulated and plan in advance by the core working group.

G / Ownership

Ownership of the market nomenclature under tier 1 and 2 is irrelevant as the objective of the core working group is largely to standardise existing nomenclature already used in the market place. The new nomenclatures to come will have no specific ownership. However, specific rules, standards and agreements under tier 3 may be developed and owned by the respective competent organisations.

H / Timetable

The full timetable has to be agreed. An initial meeting was planned for January 2014 and the drafting of the terminology is envisaged to take place in 2014. The drafting process is planned to take place in several steps:

- 1.**
Collection of all existing definitions
- 2.**
Review, grouping and harmonisation of existing definitions
- 3.**
Distribution to a larger review group
- 4.**
Consolidation of the feed-backs
- 5.**
Finalisation/publication.

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Contributors

The authors would like to thank all the contributors for their excellent work and commitment in putting together this valuable market guide, particularly the members of the EBA Supply Chain Working Group (SCWG).

An aerial photograph of a ship's wake in the ocean. The wake is a series of white, frothy lines trailing behind the ship, which is visible in the lower right corner. The ocean is a deep blue, and the horizon is visible in the distance under a pale, overcast sky. The text is overlaid in the bottom left corner.

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