GLOBAL SUPPLY CHAIN FINANCE FORUM

STANDARD DEFINITIONS FOR TECHNIQUES OF **SUPPLY CHAIN FINANCE**

Joint product of the industry sponsoring associations

BAFT

ABE EBA EURO BANKING ASSOCIATION

FCI + ifg For a strong future.

ICC INTERNATIONAL CHAMBER OF COMMERCE The world business organization

ITFA International Trade & Forfaiting Association

Contents

Table of Figures **5**

Executive Summary **7**

Part 1: Introduction **11**

1.1. The establishment and work of the Global SCF Forum 11

1.2. The audience for this document 12

1.3. A note on the legal implications of the standard market definitions 14

1.4. A note on the accounting and regulatory capital treatment of Supply Chain Finance 14

1.5. A note on Know Your Customer and Anti-Money Laundering requirements 15

1.6. Acknowledgments 15

Part 2: Context and background **17**

2.1. Physical and Financial Supply Chains 17

2.2. New patterns in trade flows 17

2.3. Examples of definitional frameworks for SCF 20

Part 3: The standard definitions of SCF techniques **22**

3.1. Approach and scope 22

3.2. Master definition of Supply Chain Finance 24

3.3. The SCF technique definitions developed by the Global SCF Forum 25

3.4. Receivables Purchase category 27

3.4.1. Receivables Discounting 28

3.4.2. Forfaiting 34

3.4.3. Factoring 39

3.4.4. Factoring Variations 43

3.4.5. Payables Finance 45

3.5. Loan or Advance-based SCF techniques 49

3.5.1. Loan or Advance against receivables 49

3.5.2. Distributor Finance 52

3.5.3. Loan or Advance against Inventory 56

3.5.4. Pre-shipment Finance 60

3.6. Bank Payment Obligation (BPO) 63
3.6. 1 BPO as an enabling framework for SCF 67
3.7. Synopsis of SCF techniques 71
3.8. Asset or risk distribution techniques used by finance providers 73
3.9. Supply Chain Finance: client centric view 73

Part 4: Glossary 74

Part 5: Appendices 92
Appendix A: Sources and Methodology 92
A.1. Capturing existing SCF definitions and initiatives as a starting point 92
A.2. Specific steps taken to define the SCF techniques 93
Appendix B: Physical and Financial Supply Chains 95
Appendix C: List of Reviewers 96

Notes

Table of Figures

Figure 1: Development foreign trade (exports) from 1978 until 2013 18
Figure 2: Supply Chain Finance portfolio 20
Figure 3: Open account processing and financing opportunities 21
Figure 4: SCF definitions: conceptual hierarchy 23
Figure 5: Receivables Discounting 33
Figure 6: Forfaiting 38
Figure 7: Factoring 42
Figure 8: Payables Finance 48
Figure 9: Loan or Advance against receivables 51
Figure 10: Distributor Finance 55
Figure 11: Loans or Advances against Inventory 59
Figure 12: Pre-shipment Finance 62
Figure 13: Establishing the baseline 65
Figure 14: Matching of trade data 66
Figure 15: Bank Payment Obligation as an enabling framework for Supply Chain Finance 67

Executive Summary

The "Standard Definitions for Techniques of Supply Chain Finance" set out in this document builds upon several excellent initiatives and documents aiming to develop terminology related to this fast-growing, high-value but still fairly nascent form of financing, which applies equally in support of domestic and international supply chains.

The Global Supply Chain Finance Forum[1] represents a number of industry associations with members around the world, and it has been a core principle of this initiative, that the activities of the team be collaborative, inclusive and consensus-based.

The drafting effort, executed by a team of senior practitioners, has benefitted from the guidance of an international and multi-industry Steering Group, and has actively sought a wide range of commentary and feedback from the market, including providers of supply chain finance solutions as well as end-users.

The intent of this initiative is to help create a consistent and common understanding about Supply Chain Finance (SCF) starting from the definition of terminology, to be followed by advocacy in support of global adoption of the standard definitions. It is recognised that SCF propositions have evolved at different rates and in varying directions by region and at the level of individual providers; however, the view is that there is agreement on the clear benefits to the financial industry, regulatory authorities, clients and other stakeholders, from the development and dissemination of standard definitions and terminology. Further work based on the definitional framework developed in this document is likely to follow, including further standardisation and other development activity.

After the introduction in Part 1, Part 2 provides context and background to the initiative. Part 3 articulates the rationale, methodology and process followed by the Drafting Group in the selection of the SCF techniques to define, and to determine the elements that ought to be included in each definition. The individual techniques are then defined. The Forum has opted to deliver a document that provides more than a list of techniques and a set of high level definitions. The scope and extensive detail are offered with a view to the larger objective of global adoption, and in recognition of the various audiences to which the document will be of interest. The definition of each technique (which includes an illustrative transaction flow) can stand on its own and the document includes a summary table for quick reference purposes.

Numerous variations of SCF techniques and programmes exist today, and more will evolve, so that this document must of necessity be a 'living document' that will require periodic updating. The growing range of SCF providers and the application of technology to SCF solutions will further drive a need to keep up with market developments.

Global adoption of the suggested terminology – and the corresponding benefits which such adoption would bring – rest on advocacy which this document is intended to progress and support. We believe that such efforts should begin with this publication and recommend these standard market definitions for adoption.

1 Global SCF Forum participating organisations: The International Chamber of Commerce (ICC) Banking Commission , BAFT, the Euro Banking Association (EBA), Factors Chain International (FCI), and the International Trade and Forfaiting Association (ITFA). The International Factors Group, one of the original sponsoring associations is now integrated with FCI.

This first edition of the “Standard Definitions for Techniques of Supply Chain Finance” articulates the following ‘master’ definition for Supply Chain Finance and includes definitions for the eight identified core techniques, as well as for the Bank Payment Obligation, which is to be understood as an enabling framework for SCF, rather than a technique.

The following definition of Supply Chain Finance is intended to be used for reference throughout this document and is recommended as the master definition for Supply Chain Finance.

Supply Chain Finance is defined as the use of financing and risk mitigation practices and techniques to optimise the management of the working capital and liquidity invested in supply chain processes and transactions. SCF is typically applied to open account trade and is triggered by supply chain events. Visibility of underlying trade flows by the finance provider(s) is a necessary component of such financing arrangements which can be enabled by a technology platform.

Portfolio: SCF is a portfolio of financing and risk mitigation techniques and practices that support the trade and financial flows along end-to-end business supply and distribution chains, domestically as well as internationally. This is emphatically a ‘holistic’ concept that includes a broad range of established and evolving techniques for the provision of finance and the management of risk.

Open account: SCF is usually, but not exclusively, applied to open account trade. Open account trade refers to trade transactions between a seller and a buyer where transactions are not supported by any banking or documentary trade instrument issued on behalf of the buyer or seller. The buyer is directly responsible for meeting the payment obligation in relation to the underlying transaction. Where trading parties supply and buy goods and services on the basis of open account terms an invoice is usually raised and the buyer pays within an agreed time frame. Open account terms can be contrasted with trading on the basis of cash in advance, or trading utilising instruments such as Documentary Credits, as a means of securing payment.

Parties: Parties to SCF transactions consist of buyers and sellers, which are trading and collaborating with each other along the supply chain. As required, these parties work with finance providers to raise finance using various SCF techniques and other forms of finance. The parties, and especially ‘anchor’ parties on account of their commercial and financial strength, often have objectives to improve supply chain stability, liquidity, financial performance, risk management, and balance sheet efficiency.

Event driven: Finance providers offer their services in the context of the financial requirements triggered by purchase orders, invoices, receivables, other claims, and related pre-shipment and post-shipment processes along the supply chain. Consequently, SCF is largely ‘event-driven’. Each intervention (finance, risk mitigation or payment) in the financial supply chain is driven by an event or ‘trigger’ in the physical supply chain. The development of advanced technologies and procedures to track and control events in the physical supply chain creates opportunities to automate the initiation of SCF interventions in the related financial supply chain.

Evolving and flexible: SCF is not a static concept but is an evolving set of practices using or combining a variety of techniques; some of these are mature and others are new or 'leading edge' techniques or variants of established techniques, and may also include the use of traditional trade finance. The techniques are often used in combination with each other and with other financial and physical supply chain services.

The definitions for the individual SCF techniques and the enabling framework are set out here as follows:

1. Receivables Purchase SCF category

Receivables Discounting is a form of Receivables Purchase, flexibly applied, in which sellers of goods and services sell individual or multiple receivables (represented by outstanding invoices) to a finance provider at a discount.

Forfaiting is a form of Receivables Purchase, consisting of the without recourse purchase of future payment obligations represented by financial instruments or payment obligations (normally in negotiable or transferable form), at a discount or at face value in return for a financing charge.

Factoring is a form of Receivables Purchase, in which sellers of goods and services sell their receivables (represented by outstanding invoices) at a discount to a finance provider (commonly known as the 'factor'). A key differentiator of Factoring is that typically the finance provider becomes responsible for managing the debtor portfolio and collecting the payment of the underlying receivables.

Payables Finance is provided through a buyer-led programme within which sellers in the buyer's supply chain are able to access finance by means of Receivables Purchase. The technique provides a seller of goods or services with the option of receiving the discounted value of receivables (represented by outstanding invoices) prior to their actual due date and typically at a financing cost aligned with the credit risk of the buyer. The payable continues to be due by the Buyer until its due date.

2. Loan or Advance-based SCF category

Loan or Advance against Receivables is financing made available to a party involved in a supply chain on the expectation of repayment from funds generated from current or future trade receivables and is usually made against the security of such receivables, but may be unsecured.

Distributor Finance is financing for a distributor of a large manufacturer to cover the holding of goods for re-sale and to bridge the liquidity gap until the receipt of funds from receivables following the sale of goods to a retailer or end-customer.

Loan or Advance against Inventory is financing provided to a buyer or seller involved in a supply chain for the holding or warehousing of goods (either pre-sold, un-sold, or hedged) and over which the finance provider usually takes a security interest or assignment of rights and exercises a measure of control.

Pre-shipment Finance is a loan provided by a finance provider to a seller of goods and/or services for the sourcing, manufacture or conversion of raw materials or semi-finished goods into finished goods and/or services, which are then delivered to a buyer. A purchase order from an acceptable buyer, or a documentary or standby letter of credit or a Bank Payment Obligation, issued on behalf of the buyer, in favour of the seller is often a key ingredient in motivating the finance, in addition to the ability of the seller to perform under the contract with the buyer.

3. Enabling framework

Please see Part 3.6 for a discussion of this framework

Bank Payment Obligation (BPO) is an inter-bank instrument to secure payments against the successful matching of trade data. As per the Uniform Rules for Bank Payment Obligations, the Bank Payment Obligation 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 resulting in a Data Match or an acceptance of a Data Mismatch' (URBPO, ICC Publ. No. 750E).

An illustrative summary table can be found at the end of Part 3.

A full glossary of terms and expressions used is provided herein and further detail on sources and methodology is included in Part 4.

Part 1: Introduction

1.1. The establishment and work of the Global SCF Forum

It has been recognised by a number of leading industry associations and practitioners globally, that there is a need to develop, gather and disseminate **standard market definitions** related to Supply Chain Finance – a nascent but increasingly important dimension of the financing of domestic and international commerce.

The expression "supply chain finance" (SCF) today covers a wide range of products, programmes and solutions in the financing of commerce, including international trade, and has been used to refer to a single product, or a comprehensive range of products and programme of solutions aimed at addressing the needs of buyers and sellers, especially when trading on open account terms, in the increasingly complex supply chains in which they are involved.

The current inconsistency in definitions, nomenclature and general language around the financing of trade linked to open account terms and to the support of global supply chains, is proving to be challenging for buyers, sellers, finance providers, service providers and other stakeholders alike[2]. This issue has immediate implications for the accounting and regulatory treatment of supply chain finance structures, and by extension, impacts market uptake and the engagement of traditional as well as emerging providers of SCF solutions.

The inconsistent– even contradictory- language currently in use is complicating advocacy efforts and diluting the effectiveness of communication aimed at fairly articulating the value proposition around supply chain finance, at a time when it is increasingly important to domestic commercial activity as well as to the facilitation of global trade. **The purpose of this document is to help to remove the uncertainty, ambiguity and lack of clarity when terminology is used in both technical industry discussions and in broader conversations.**

Whilst the techniques of traditional trade finance such as Documentary Credits, Documentary Collections and Guarantees may be used in conjunction with the SCF techniques described in this document, they are not extensively described or discussed because of the vast existing literature and established practices. The exclusion of traditional trade finance should not be taken as a value judgment or a reflection of relative importance, and has been done for practical reasons.

The Global Supply Chain Finance Forum (the Forum) was established in January 2014, as an initiative of a number of sponsoring industry associations facilitated by the International Chamber of Commerce (ICC) Banking Commission, to address what has been recognised as a need to develop, publish and champion a set of commonly agreed standard market definitions for Supply Chain Finance and for SCF-related techniques. Through this document the sponsoring associations of the Forum have confirmed their support for these standard market definitions which are now recommended to the wider stakeholder community for adoption.

The Forum is widely representative and inclusive, with bank and non-bank contributors, from five continents and from the four major industry associations forming the Forum membership[3]. The

2 Global SCF Forum Drafting Group Terms of Reference 2014

3 Global SCF Forum participating organisations: The International Chamber of Commerce (ICC) Banking Commission , BAFT, the Euro Banking Association (EBA), Factors Chain International (FCI), and the International Trade and Forfaiting Association (ITFA). The International Factors Group, one of the original sponsoring associations is now integrated with FCI.

Forum has adopted a wide-ranging consultative process to develop global alignment around Supply Chain Finance definitions and nomenclature.

It is the hope of the Forum and its constituent sponsoring associations that this document will evolve with industry practice, serving as a practical and current guide for practitioners and interested parties, including finance providers, their clients, regulators and investors. In that spirit, this document seeks to clarify and actively shape the evolution of SCF terminology, by identifying and recommending a set of common globally accepted standard market definitions. The document includes contextual discussion, as well as specific definitions and transaction flow illustrations related to each key element defined herein.

The definitions that follow in Part 3 of this document are described by a single headline name, which is proposed as the standard identifying name of the SCF technique to which it refers. Commonly encountered synonyms are listed separately. The Forum believes that use of the headline names is critical in ensuring consistency but understands that currently wide use is made of alternative expressions. This initiative offers the opportunity for market participants to align their products and services with the standard definitions, whilst retaining the freedom to differentiate and brand individual services in a fully competitive manner. Phrases such as ‘Our product X is a form of Payables Finance (ICC/GSCF definition ref. ABC)’ might become common as the terminology takes hold.

The Forum recognises that the achievement of these objectives and intentions will require ongoing advocacy and championing, and will evolve over time: certain expressions and definitions in use today have been in industry “vocabulary” for decades or longer, and are used in marketing collateral, finance provider information systems, various guides and professional publications, such that the adoption of the recommendations reflected in this document is likely to happen in at least two broad phases: adoption and agreement in principle, followed by adoption in practice. The Forum recognises that this process will require ongoing support, especially given many regional and jurisdictionally based variations. The process may in time lead to a demand for further work in areas such as proposals for further market standards, a practical user guide for the SCF techniques, more material on risk and policy issues, possible infrastructure proposals and other developments for SCF. Such areas do not form part of the present initiative.

It should be clearly stated that although this project involved many market competitors working together in a cooperative environment, the subject of discussion related purely to the standardisation process being pursued and not to any matters of a competitive or sensitive nature. Members of the Forum were conscious of the ‘competitive environment’ and took explicit care in their deliberations not to exceed the brief or mandate of the initiative, by making recommendations that could inappropriately extend into the competitive realm.

1.2. The audience for this document

The standard market definitions are intended to be of value to a variety of audiences and interested parties, including but not limited to the following:

Finance Providers

The definitions will support the development of the SCF market, the growth of individual provider businesses and effective communication with end-clients, by creating clarity and transparency as to products being offered by banks and non-banks alike. The use of standard market definitions will also facilitate dialogue between important internal stakeholders within institutions including business development, senior management, risk, compliance and product management.

Corporate, commercial and SME clients

The terminology will greatly enhance the ability of clients to understand, compare and select optimal solutions to their supply chain finance needs and consider the offerings as an attractive alternative to other financing models. Clients will be able to weigh alternatives, their advantages and disadvantages, and engage in a clearer and more relevant dialogue with finance providers and other supporting communities.

Investors

Secondary market investors are expressing increasing interest in SCF given the inherent attractiveness of these mainly short term, self-liquidating and trade-related assets and transactions. Investors need clarity related to the nature of the structures and portfolios in which they might invest, and reassurance as to the risk characteristics, safety and regulatory integrity of the transactions. This includes details on security and transfer of rights, and the source of repayment. The definitions will permit finance providers' asset distribution teams and their trade associations to deliver clear messages to investors.

It should be stressed that the provided definitions focus mainly on a description of the techniques, any security taken and the parties that become obligated towards a finance provider. Given the variety of transactional structures which may arise under the described techniques, finance providers and investors will need to undertake a further level of analysis in relation to an individual transaction to determine the overall level of riskiness, the primary source of repayment, the degree to which perfection of security has been completed and is effective, and the priority that any claim may have against other creditors. Exploration of these detailed issues may form another stage of work[4].

Regulators

The definitions will support the broader understanding by regulators and the public sector of the SCF asset class and should lead to the development of fit for purpose regulatory provisions, knowledge of risks and mitigation, and improve the dialogue between private sector practitioners and regulators on issues such as Know Your Customer and Anti-Money Laundering.

Legal practitioners

Over time it is expected that the standard market definitions will be recognised by legal practitioners and find their way into legal documentation as a reflection of domestic and international market practice and convention. This is well-recognised as one cornerstone of the success and effectiveness of classical or traditional trade finance products, and will prove equally important to the evolution of SCF.

4 The Forum is grateful to Fermat Capital Management LLC for this observation.

IT and infrastructure providers

SCF is increasingly a business deploying advanced technology and rapidly evolving IT support. Clearer business definitions and requirements will add value to the community of technology providers supporting market development by providing insights into processes, core definitions and product requirements, as well as improving time to market.

Other communities

Other communities of interest include professional bodies (especially in accountancy), export and import associations, chambers of commerce, academic institutions, maritime and customs organisations.

1.3. A note on the legal implications of the standard market definitions

The degree of stakeholder representation through participating banks, non-bank providers of SCF and industry associations and subsequent peer review, makes this document the product of a highly inclusive and collaborative, consensus-based effort, and positions the recommendations included here particularly well for dissemination, advocacy and adoption on a global basis.

The extent to which the proposed framework, and the specific definitions under that framework, attain or maintain legal standing and impact will be determined by courts and legislators based upon the continuing evolution of SCF and its increasing prominence in commercial activity. Internationally recognised standards will always be confronted by a plethora of jurisdictionally specific definitions and rulings. Whilst the result cannot be predicted with accuracy, the use of standard market definitions should assist in the establishment of legal precedents and of consistency from one geographic region to another. Given that the document incorporates many existing definitions and was explicitly developed following a review of existing market literature, the content can legitimately and immediately claim a degree of authority as a statement of market practice.

Some members of the Forum are either lawyers or possess legal training, and thus some consideration has been given, during the course of compilation editing and review, to the legal implications of the content of this document.

1.4. A note on the accounting and regulatory capital treatment of Supply Chain Finance

The accounting and capital treatment and reporting of SCF structures has been identified as potential impediments to the faster uptake of supply chain finance, partly due to the substance and optics of SCF transactions and to the potential legal and regulatory implications of using and reporting on such financing mechanisms. The issue is particularly acute in light of the current lack of alignment of accounting standards and practices across jurisdictions, including the main accounting disciplines (IFRS, IAS, USGAAP and others).

SCF transactions reflect many different risk profiles and economic impacts, which removes the potential for uniformity in the accounting and capital treatment of all the techniques described herein. Nevertheless, a consistent and widely accepted set of definitions related to SCF techniques should make a useful contribution to advancing the development over time of appropriate regulatory and accounting standards and to their consistent application across markets, jurisdictions and legal traditions.

1.5. A note on Know Your Customer and Anti-Money Laundering requirements

Know Your Customer (KYC) and Anti-Money Laundering (AML) rules and guidance may not always properly reflect the actual risk profiles of SCF structures, often leading to unfavourable and unwarranted mischaracterisation. This is especially acute in one technique described herein i.e. Payables Finance where the on-boarding of SMEs often becomes a major logistical and economic challenge limiting the size, or even feasibility, of many proposed programmes. It is hoped that adoption of the definitions herein will help to facilitate a common understanding of the characteristics of SCF programs and techniques, thereby enabling the dialogue necessary to the development of appropriate requirements linked to KYC, AML and financial crime compliance, while allowing the pursuit of legitimate, value-creating business through SCF.

1.6. Acknowledgments

The associations and organisations that have come together to collaborate in the conception, development and dissemination of this document wish to acknowledge the invaluable contributions of the project team, comprised of a Steering Group and a Drafting Group.

Sponsoring associations

- The International Chamber of Commerce (ICC) Banking Commission (project facilitator)
- BAFT
- Euro Banking Association (EBA)
- Factors Chain International (FCI)
- International Trade and Forfaiting Association (ITFA)

Steering Group members

The Forum Steering Group comprised a group of senior executives with deep knowledge of the SCF domain have exercised governance and oversight and provided advice to the Drafting Group at all stages of the project. The members of the Steering Group to whom we extend our appreciation are:

- Daniela Bonzanini, FCI
- Tod Burwell, BAFT (Steering Group Vice-Chair)
- Eugenio Cavenaghi, EBA
- Alexander R. Malaket, ICC
- Peter Mulroy, FCI
- Simon Peterman, FCI
- Paolo Provera, ITFA
- Daniel Schmand, Chair, ICC Banking Commission
- Kah Chye Tan, ICC (Steering Group Chair)
- Erik Timmermans, FCI
- Jose Vicente, EBA
- Markus Wohlgeschaffen, BAFT

Drafting Group members

The Forum Drafting Group comprised a team of practitioners and domain specialists from a range of organisations, located in major markets across the globe. The Group (and its sub-teams) has conducted work through a combination of regularly-scheduled conference calls, and in-person meetings in Dubai, Frankfurt, Toronto, Paris, Singapore and London.

The members of the Drafting Group are:

- Charles Bryant, EBA and ICC (Editor)
- Irfan Butt, Bank of America Merrill Lynch
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- Bertrand de Comminges, HSBC Bank
- Roque G. Damacela, Standard Chartered Bank
- Simon Davies, FCI
- Peter Deisenbeck, UniCredit
- Sean Edwards, ITFA and Sumitomo Mitsui Banking Corporation
- Stacey A. Facter, BAFT
- Vivek Gupta, ANZ
- Christian Hausherr, Deutsche Bank
- Xu (James) Jiang, Bank of China
- Angela Koll, Commerzbank
- Joaquin Jimenez Krijgsman, ING
- Vinod Madhavan, Standard Bank
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- Michael J. McDonough, JP Morgan (Drafting Group Vice-Chair)
- John Monahan, Citi
- Alejandro Romanos Serrano, Santander
- Anil K. Walia, Deutsche Bank
- Nicole Wong, DBS

ICC staff

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- Doina Buruiana
- Whitney Jolivet
- Emily O'Connor

Reviewers and commentators

In addition to the core team, this document has been significantly enhanced through a broad and inclusive review process involving the membership of each partner association, the ICC National Committees and corporate users of SCF, as well as industry specialists who volunteered their time to provide comments and feedback on an advanced draft of this document. The project team wishes to acknowledge and express appreciation these organisations and entities which are listed in Appendix C.

Part 2: Context and background

This Part 2 is designed to explain the background to the development of Supply Chain Finance and its support for open account trade.

2.1. Physical and Financial Supply Chains

It is important to understand the relationship between physical and financial supply chains, in order to provide context for the role of supply chain finance.

The **Physical Supply Chain (PSC)** is a system of organisations, people, activities, information, and resources involved in moving a product or service from seller to a buyer, either domestically or across borders. Physical supply chain activities transform natural resources, raw materials and components into semi-finished and finished products that are delivered to the end customer. It is the underlying basis of economic functions which give rise to financial requirements and must be supported by financial supply chain activities. Physical Supply Chain Management describes the management activities involved in managing the PSC.

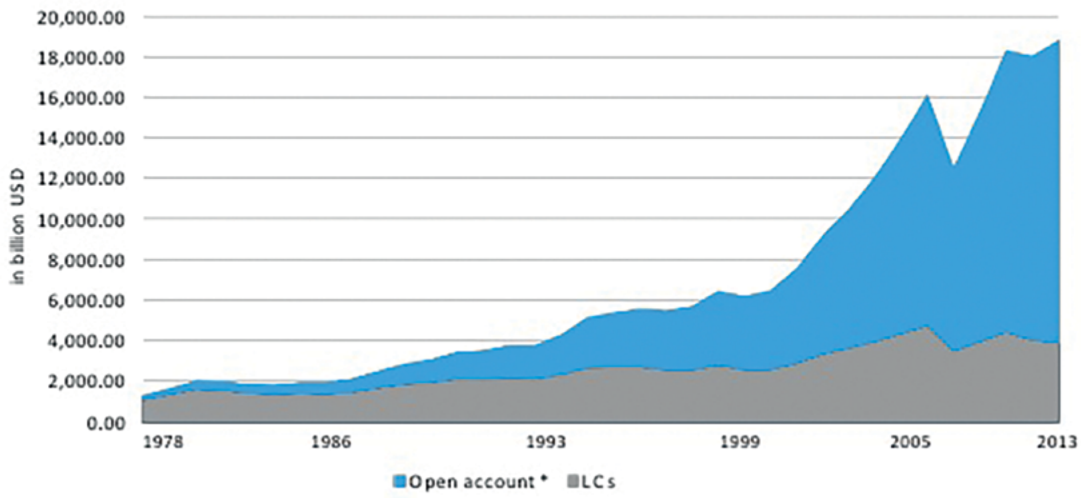
The **Financial Supply Chain (FSC)** is the chain of financial processes, events and activities that provide financial support to PSC participants. Financial Supply Chain Management refers to the range of corporate management practices and transactions that facilitate the purchase of, sale and payment for goods and services, such as the conclusion of contractual frameworks, the sending of purchase orders and invoices, the matching of goods sent and received to these, the control and monitoring of activities including cash collections, the deployment of supporting technology, the management of liquidity and working capital, the use of risk mitigation such as insurance and guarantees, and the management of payments and cash-flow. FSC management involves the orchestration of a range of contributors to meeting FSC needs such as internal corporate functions, trading parties, and service providers in the area of supply chain automation and in the whole range of financial services. Supply chain finance is one service cluster supporting the FSC.

2.2. New patterns in trade flows

It is frequently noted that the vast majority of international trade is supported and enabled by some form of 'trade finance', be it purely the provision of financing and liquidity, or some form of risk mitigation, or simply a payment solution. Even on a narrower definition of trade finance, Bank for International Settlements (BIS) estimates suggest that one third of world trade utilises actual trade financing.

The transition to a situation where the vast majority of trade takes place on open account terms and where traditional trade finance has seen a relative decline requires trade financing to evolve. Supply chain finance is the pre-eminent example of this evolution, and a direct response to this near-global shift to open account terms.

Figure 1: Development foreign trade (exports) from 1978 until 2013



World trade volumes have seen a startling increase in open account transaction over the recent years. Already today more than 80 % of the total world trade volume (export) is settled by clean payment. This impressive ratio is expected to grow even further in the future. As a consequence banks are compelled to offer their corporate clients products that support fully automated processing as well as cost savings combined with payment assurance and financing options.

Source: Unicredit Group – 2015

The above graphic reflects the relative slow growth of traditional trade finance as against the exponential growth in open account trade activity, particularly in the last decade.

It is in part this very significant growth in open account trade, at which a good portion of supply chain finance is targeted, that provides an underlying urgency around achieving global clarity, transparency and common terminology relative to the financing of global supply chains. While the involvement of banks in SCF and open account trade flows has grown as a share of their trade financing portfolios year-over-year, the majority of open account flows are supported by the trading parties' own resources or by non-bank entities such as service providers offering logistics, B2B networks, e-invoicing and financial solutions. However, the value propositions around supply chain finance are evolving, and the degree of engagement of financial institutions is growing and accelerating, as is the continued interest and engagement of non-bank providers of SCF solutions.

Open account trade is no longer reserved for transactions involving established trading relationships, or trade in or with low-risk markets. The shift to open account trade is near-global in scope, and thus, so is the relevance of SCF techniques and structures.

The increasing engagement of developing and emerging markets in international trade, and the increasing policy focus on international trade as a mechanism to enable economic development and poverty-reduction in these markets contributes to urgency around the development of a common set of global definitions covering SCF techniques. Additionally, the fact that much economic and trade activity is driven by small and medium-sized enterprises (SMEs) underpins a search for trade financing solutions that can meet their needs, as opposed to only the narrower segment of large volume buyers and their suppliers. Emerging markets today account for 45-50 % of global output based on Purchasing Power Parity (source: European Central Bank), and it is estimated that SMEs produce 52% of global value added (source: Edinburgh Group/ACCA).

The potential positive impact of SCF on economies across the globe is beginning to be appreciated, though it is equally clear that there is an inconsistent, and at times contradictory view of what constitutes SCF, and how it relates to trade finance and to broader realms such as asset-based lending, working capital management and corporate finance in general.

In practical terms, the challenge of education and information that surrounds SCF has contributed in part to an ongoing difficulty in “on-boarding” new clients, particularly SMEs, onto supply chain finance programs. Finance providers have observed that the key to the successful on-boarding is in developing trust and relationships, in part by illustrating the benefits of SCF programmes to SMEs with typically limited expertise in sophisticated forms of finance, and they also refer to the need for flawless IT and operational infrastructure.

The value of a standard global terminology around SCF extends beyond pure financial transaction considerations, to the realm of automation, dematerialisation and technology. Supply chain automation based on dematerialisation, from e-procurement, to e-invoices and to e-logistics, coupled with data-driven decision-making, enhances efficiency and creates efficient ‘triggers’ on the basis of which financing can be provided across international and domestic supply chains. Finance providers will increasingly engage with B2B networks and also benefit from trends towards dematerialisation throughout the economy and in adjacent supply chain activities such as transport, customs and logistics, all encouraged by regulatory leadership.

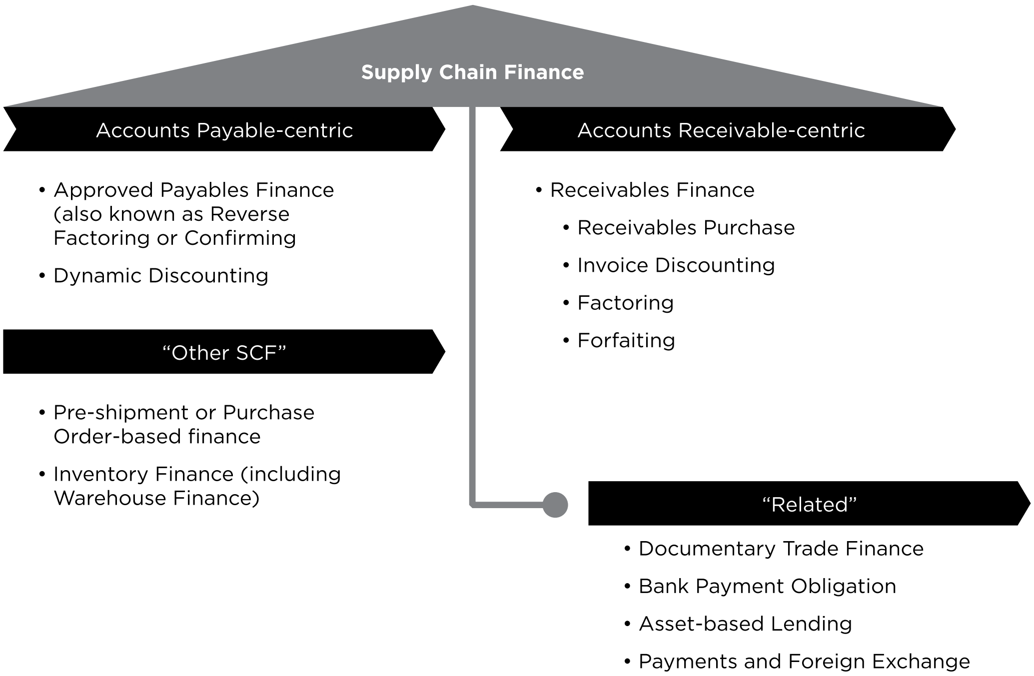
Whilst perfect consistency is unlikely given the diversity of SCF techniques, standard nomenclature will greatly facilitate the design, development and deployment of the supporting technology and web-based services for the SCF market. A lack of standards will impede these processes.

2.3. Examples of definitional frameworks for SCF

Supply Chain Finance techniques and their relationship to adjacent spaces such as classical trade finance have attracted attention and been presented in a variety of models and conceptual frameworks in pre-existing explanatory documents.

Two examples (there are numerous others) are set out below, as illustrations of recent thinking only:

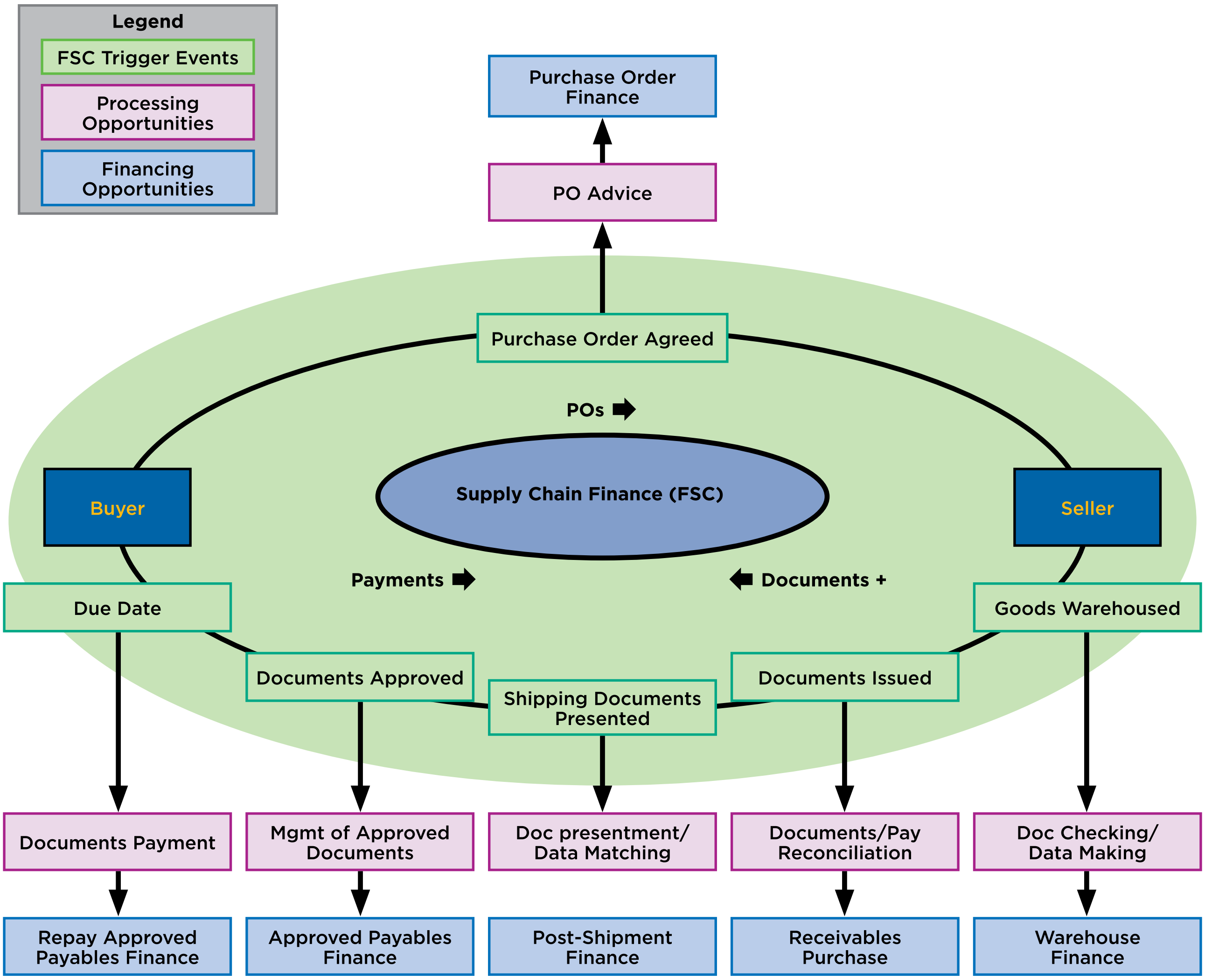
Figure 2: Supply Chain Finance portfolio



Source: The "Umbrella", EBA Market Guide to Supply Chain Finance – 2014

It must be noted that the umbrella view was created to illustrate logical linkages, nor to represent a hierarchy of techniques. Additionally, the "Related" category, while it is shown to be under the umbrella of SCF, encompasses techniques, categories of financing and an enabling framework (BPO) that can be included within but also extends beyond SCF.

Figure 3: Open account processing and financing opportunities



Source: BAFT-IFSA Product Definitions for Open Account Trade Processing and Open Account Trade Finance – 2010

SCF as an overarching concept, or as a category encompassing a series of financing techniques, can also be viewed or understood with reference to a transaction flow, or with reference to a financial supply chain between buyer and seller, as illustrated in the graphic developed by BAFT.

The representation of SCF and its place in the market, which underpins this document, gratefully takes elements from both the BAFT transactional view and the EBA 'umbrella' view, recognising that SCF techniques can be seen in the lifecycle of a commercial and trade transaction or supply chain, as well as in relation to traditional trade finance and other forms of financing.

The foregoing material in this Chapter does not constitute part of the standard market definitions proposed in this document but is provided for context and background only.

Part 3: The standard definitions of SCF techniques

3.1. **Approach and scope**

This Part 3 sets out the master definition of SCF and the definitions of the Supply Chain Finance (SCF) techniques selected by the Forum as currently representing the key techniques making up the SCF portfolio and best reflecting current market practice. Each technique has been allocated a headline title, which is recommended to be accepted as the standard market name for the technique. Synonyms and variations are also identified.

In the Glossary for this document the SCF techniques, their synonyms and an extensive range of related and other terms covering parties and components of SCF transactions, are defined.

While there is debate in the industry about the relationship and positioning of traditional trade finance and supply chain finance, the Forum has taken a broad and holistic view of SCF, and thus considers that traditional trade finance is included in the scope of SCF as a potential component in the structuring of an SCF solution**.** However, actual definitions of traditional trade finance techniques, products and mechanisms are **not** included here, as they are well-established and have long achieved a level of global adoption that is a cornerstone of their effectiveness and success. They are present in the Glossary.

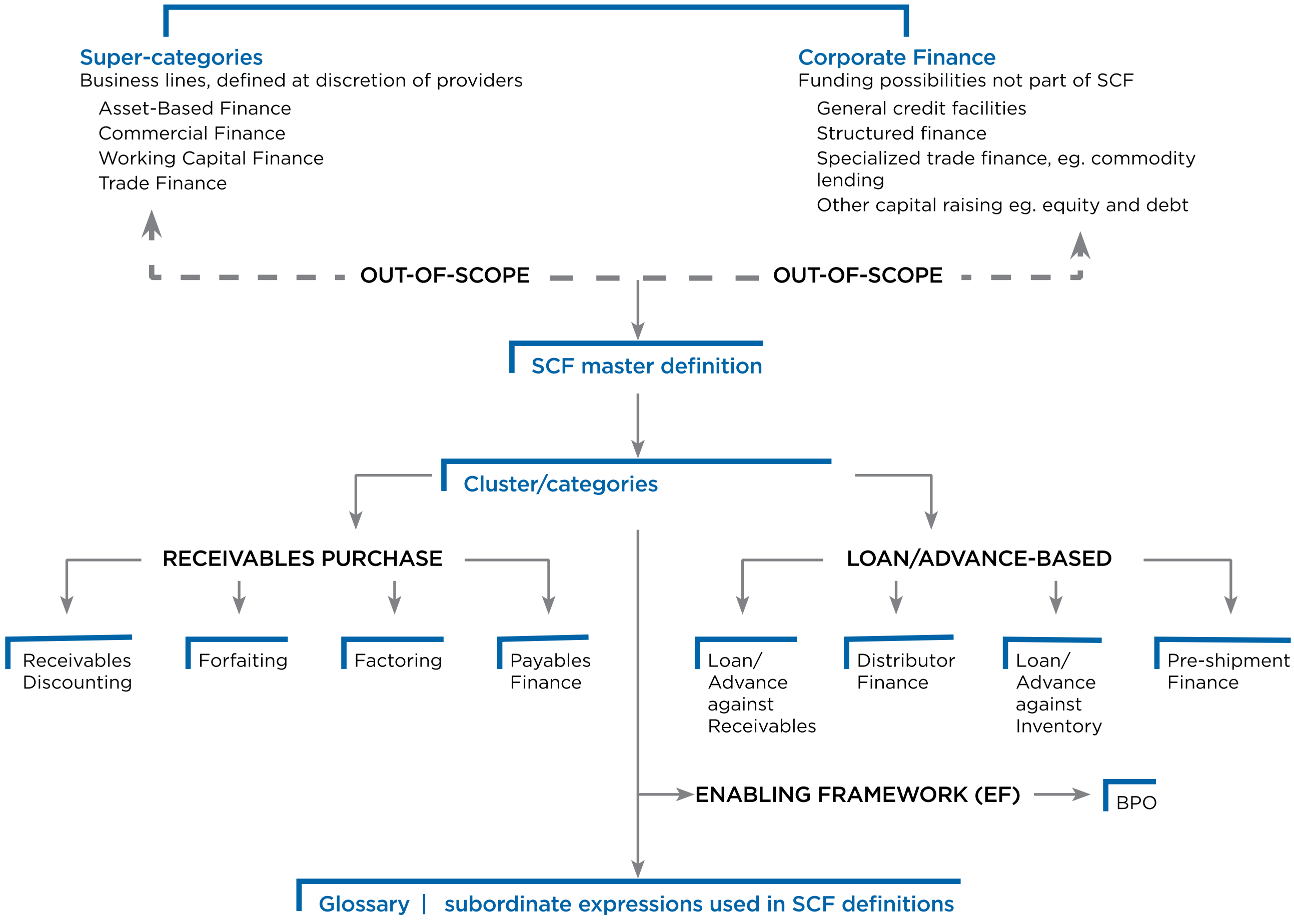
SCF defined herein also does **not** include specifically the range of corporate financing techniques such as overdrafts, general 'trade' and other loans, leasing and other forms of asset-based finance, although they may be employed in support of domestic and/or international commercial activity, as may other capital raisings such as bonds and equity. SCF may indeed include the deployment of many such financing techniques, but these have been deliberately omitted from this document, given its focus on the specific techniques of supply chain finance.

There are also a range of structured and specialised financing techniques such as in the commodity finance space and other individually-tailored corporate or special purpose transactions for the finance of trade. All of these may create funds for investment in supply chain activity, and for some practitioners they are viewed as important contributors to SCF in the widest sense. They have **not** been defined in this document as they are by definition individually tailored and proprietary in nature.

The Drafting Group has identified a number of expressions that have been defined as **'super-categories'.** These are typically used to describe business lines, organisational units and activities rather than representing actual SCF techniques. *Examples include: Commercial Finance, Asset Based Lending, Transaction Banking, Financial Supply Chain Services and Working Capital Services*. These expressions are also described in the Glossary, but are **not** the subject of standard market definitions related to SCF. It is left to competitive activity to use and shape these expressions.

The diagram below illustrates the hierarchy of terminology described in this document, commencing with those regarded as out of scope and then the clusters, techniques and subordinate expressions defined in this document. Further information about sources and the detailed methodology employed by the Drafting Group is set out in Appendix A.

Figure 4: SCF definitions: conceptual hierarchy



Source: Global SCF Forum

3.2. Master definition of Supply Chain Finance

The following definition of Supply Chain Finance is intended to be used for reference throughout this document and is recommended as the base or master definition for Supply Chain Finance.

Supply Chain Finance is defined as the use of financing and risk mitigation practices and techniques to optimise the management of the working capital and liquidity invested in supply chain processes and transactions. SCF is typically applied to open account trade and is triggered by supply chain events. Visibility of underlying trade flows by the finance provider(s) is a necessary component of such financing arrangements which can be enabled by a technology platform.

Portfolio: SCF is a portfolio of financing and risk mitigation techniques and practices that support the trade and financial flows along end-to-end business supply and distribution chains, domestically as well as internationally. This is emphatically a 'holistic' concept that includes a broad range of established and evolving techniques for the provision of finance and the management of risk.

Open account: SCF is usually, but not exclusively, applied to open account trade. Open account trade, refers to trade transactions between a seller and a buyer where transactions are not supported by any banking or documentary trade instrument issued on behalf of the buyer or seller. The buyer is directly responsible for meeting the payment obligation in relation to the underlying transaction. Where trading parties supply and buy goods and services on the basis of open account terms, an invoice is usually raised and the buyer pays within an agreed time frame. Open account terms can be contrasted with trading on the basis of cash in advance, or trading utilising instruments such as Documentary Credits, as a means of securing payment.

Parties: Parties to SCF transactions consist of buyers and sellers, which are trading and collaborating with each other along the supply chain. As required, these parties work with finance providers to raise finance using various SCF techniques and other forms of finance. The parties, and especially 'anchor' parties on account of their commercial and financial strength, often have objectives to improve supply chain stability, liquidity, financial performance, risk management, and balance sheet efficiency.

Event driven: Finance providers offer their services in the context of the financial requirements triggered by purchase orders, invoices, receivables, other claims, and related pre-shipment and post-shipment processes along the supply chain. Consequently, SCF is largely 'event-driven'. Each intervention (finance, risk mitigation or payment) in the financial supply chain is driven by an event or 'trigger' in the physical supply chain. The development of advanced technologies and procedures to track and control events in the physical supply chain creates opportunities to automate the initiation of SCF interventions in the related financial supply chain.

Evolving and flexible: SCF is not a static concept but is an evolving set of practices using or combining a variety of techniques; some of these are mature and others are new or 'leading edge' techniques or variants of established techniques, and may also include the use of traditional trade finance. The techniques are often used in combination with each other and with other financial and physical supply chain services.

3.3. The SCF technique definitions developed by the Global SCF Forum

The following pages set out the SCF techniques selected for the development of a cogent and convincing standard market definition. This definitional framework makes a key distinction between a cluster of techniques based on Receivables Purchase, and a range of other techniques clustered on the basis of loans or advances. As a third category an Enabling Framework, the BPO, is defined.

Consequently, the definitions are divided into three categories below:

1. **Receivables Purchase SCF category**

Receivables Discounting
Forfaiting
Factoring and its variations
Payables Finance

2. **Loan or Advance-based SCF category**

Loan or Advance against Receivables
Distributor Finance
Loan or Advance against Inventory
Pre-shipment Finance

3. **Enabling framework**

Bank Payment Obligation (BPO)

SCF techniques properties

For each of the SCF techniques described below, the following structure of properties is followed:

- Definition
- Synonyms
- Distinctive Features
- Parties
- Contractual relationships and documentation
- Security
- Risk and risk mitigation techniques
- Transaction illustration
- Benefits
- Asset distribution (as applicable)
- Variations (as applicable)

Please note that within the heading ‘Synonyms’ are a variety of expressions used in the industry to connote an exact or close replication of the same technique. The recommended standard market definition for the technique is the headline expression used in the definition box. The Forum proposes the general discouragement of the use of any other expression as the standard market definition for the relevant SCF technique. The Forum neither endorses nor rejects the synonyms provided.

The transaction illustrations provided are intended to provide an example of a possible flow or structure and should not be taken to be definitive or comprehensive, since SCF techniques can incorporate many variations and exhibit a range of nuances to meet client needs. Variations are described, when recognised as generally occurring variations of the core technique. The same expression may appear as both a synonym and a variation reflecting usage.

3.4. **Receivables Purchase category**

Receivables Purchase is a description and convenient intermediate category for a variety of techniques in which sellers of goods and services obtain financing by selling all or a part of their receivables to a finance provider. The receivables will be transferred into the ownership of the finance provider by means of the assignment of title rights appropriate to the jurisdiction in question. Upon such a change of ownership, the seller will receive an advance payment for the receivables, which may include a margin or deduction reflecting the quality of the receivables, and a finance charge based on the pricing agreed between the finance provider and the client. Receivables Purchase is offered through the four distinctive techniques described in detail below, together with a number of variations.

The four techniques share some overlapping characteristics, since their provenance lies in different historical developments in the market for financial services. The standard market definitions are intended to express the current market reality, and it is recognised that they may evolve further. There is no attempt here to artificially segment them into watertight categories, as this would not be useful.

Throughout the four techniques defined under the category Receivables Purchase, and also in relation to Loans or Advances against Receivables, the following considerations will always apply when a finance provider is considering making finance available:

- The Receivable exists, i.e. it can be clearly identified and validated
- The Receivable is assignable
- The Receivable is enforceable against its debtor in the debtor's jurisdiction

3.4.1. Receivables Discounting

Definition

Receivables Discounting is a form of Receivables Purchase, flexibly applied, in which sellers of goods and services sell individual or multiple receivables (represented by outstanding invoices) to a finance provider at a discount.

Synonyms

Receivables Finance, Receivables Purchase, Invoice Discounting, Early Payment (of Receivables).

Distinctive features

Discounted receivables range from a single receivable through to the majority of the receivables within the sales ledger of a seller. The funds available to the seller are based on the outstanding value of the invoices related to the relevant buyers.

Receivables Discounting is usually offered by finance providers to larger corporate clients selling to multiple buyers. The buyer coverage will depend on the number of buyers for which the finance provider is willing to take credit risk.

The finance provider offers finance based on a security margin applied to the open account receivables being assigned by the seller and as pre-agreed between the seller and the finance provider.

Typically, the finance provider will limit such offering to a client base, whose receivables comply with certain criteria, such as a minimum credit rating and will offer various typical features as follows:

- The financing can be provided on a 'without recourse' basis to the seller, although there are many situations where recourse or limited recourse is maintained. The act of discounting does not by itself connote whether a transaction is 'with' or 'without' recourse
- In general, if Receivable Discounting is executed without recourse to the seller, the expectation of the seller is that the receivable is removed from its balance sheet, subject to a confirmation of the relevant auditor
- The financing transaction may be disclosed or undisclosed to the buyer (i.e. confidential)
- The finance provider may discount up to 100% of the receivables up front or apply a security margin or advance ratio to account for potential dilutions or cover for possible credit deterioration
- The finance provider may charge the discount in advance when paying out the discounted amount or in arrears within periods and terms pre-agreed with the seller
- Receivables Discounting may be provided on a one-off, seasonal or continuous programme basis
- The facility may be provided on an uncommitted or committed basis to the seller, the latter giving the seller a higher level of comfort in terms of access to liquidity within the buyer credit limits set by the finance provider. The likely offer of committed or uncommitted facilities may vary from one geographic market to another

- In the event that the transaction is disclosed to the buyer, the process of the collection of the receivables may be undertaken by either the seller (acting as agent for the finance provider which has purchased the receivable) or by the finance provider. In the event that the transaction is disclosed to the buyer, the buyer may be asked to acknowledge the sale of the receivables. The exact form of such acknowledgement will depend on the local jurisdiction, the size or structure of the transaction or the commercial preferences of the buyer and the finance provider
- A buyer may be asked to validate the existence of a receivable and indicate at a moment in time whether it is approved or accepted for payment
- The finance provider may act at its own risk or insure or share the credit risk with a third party (trade credit insurance or risk participations by other financial institutions), thus limiting its own risk exposure.

Parties

The parties to the financing are the seller and the finance provider. Whilst the buyer is not a party to the agreement, it is relied on for payment of the underlying receivables or invoices and may also be required to validate that specific invoices are genuine and in certain circumstances may confirm that invoices are approved for payment within a specified timeframe.

Contractual relationships and documentation

A Receivables Purchase Agreement (RPA) is executed between the seller and the finance provider. A certified copy of the invoice(s) or the invoice data set is made available to the finance provider. Under the agreement, the seller provides the finance provider with an assignment of rights to the receivables(s) being financed, according to the jurisdiction in question. Depending on the terms of the underlying Receivables Purchase Agreement, a notice of assignment may be provided to the buyer. Any additional required procedure according to the respective jurisdiction is suitably documented.

Security

Generally speaking, Receivables Discounting is structured as a ‘true sale’ and the rights and title to the receivables are transferred to the finance provider by means of an assignment of rights (or transfer of title), or by filing or registering a security interest granting the same rights as an assignment, all executed according to the relevant jurisdictional requirements.

Risks and risk mitigation

- Default or insolvency of the buyer, mitigated by credit and risk assessment, monitoring and potentially credit insurance
- Existence of valid and eligible receivables being discounted, mitigated by a regime of sampling or individual verification
- Country or political risk, mitigated by due diligence and political risk insurance. Special circumstances relating to sovereign risk may apply to receivables due from governments or government agencies

- Risks arising from the removal of recourse to the seller in the event of non-recourse or limited recourse transactions, mitigated by the buyer's ability to pay
- Receivables dilutions (e.g. credit notes, offsets against invoices due for payment), mitigated by the security margin and advance ratio
- Pre-existing security arrangements or bans on assignments, mitigated by waivers given by other secured parties or their removal or by taking additional security and completing the required perfection requirements
- Certain types of receivables, which could be said to be 'non-fungible' or not comparable with typical receivables, are often avoided, for example: where long warranties have been given, or where specific warranties or recourse arrangements have been provided by the seller, or for receivables arising in contracting businesses (e.g. construction), or situations involving stage payments; alternatively such receivables could be converted into 'fungible units' that meet the quality requirements of a Receivables Discounting transaction. In general, the finance provider will exclude prohibited and restrictive categories of goods. Restrictions may also be applied in the case of intercompany receivables
- KYC/AML to be handled during the on-boarding procedures and subsequently in periodic reviews
- Lack of legal authority, mitigated by legal due diligence on the respective jurisdiction and the involved contractual parties
- Set off and risks arising from counter-trading mitigated by regular verification for disclosed transactions that the balance outstanding with the finance provider matches that on the buyer's records
- Risks arising in the event of insolvency such as 'claw-back', where a finance provider is aware of distress at the time of a receivable purchase, or in the case of co-mingling of funds in a general bank account. For the latter, there is mitigation through the use of a collection account in the name of the finance provider
- Fraud by the seller, for example by inflating the value of invoices or offering invoices without an underlying commercial transaction, mitigated by verification of the transaction and deploying adequate credit controls
- Double financing, mitigated by obtaining a security interest in the receivables, applying appropriate KYC procedures and perfecting the assignment of rights to the receivable, including notification to the buyer
- Fraud by collusion between seller and one or more of its buyers leading to diversion of funds from meeting maturing obligations, mitigated by monitoring the financial health and management integrity of the client through maintaining contact and receiving regular management information to look for signs of a deterioration of the business and suspicious circumstances, and also mitigated, where necessary, by direct collections on the part of the finance provider
- Fraud by collusion between the seller and an employee of the finance provider, mitigated by internal controls and segregation of duties
- General operational risks resulting from multiple operational requirements to perfect title to the receivables and undertake ongoing administration, mitigated by sound procedures, appropriate levels of automation and process controls

- Potential issues with the assignment of receivables due to various underlying governing laws in place and the resultant enforceability of the transaction, in both domestic and cross-border situations mitigated by legal due diligence.

All the above risks are also mitigated by a robust audit process regarding transactions, systems, and controls.

Transaction illustration

The finance provider undertakes assessment of all aspects of the underlying transaction and agrees to provide financing to the seller. A credit facility on a committed or uncommitted basis is established for the seller, which may be further allocated to sub-components by buyer, geography and other agreed parameters, set out in the Receivables Purchase Agreement (RPA). If the transaction is structured without recourse, the credit limits would usually be marked against the buyer(s). Depending on how the transaction is structured, the credit limits may alternatively or additionally be marked against the seller, a guarantor or a portfolio of obligors.

The seller retains control of the sales ledger management and therefore must have established and adhere to credit control procedures that meet the finance provider's requirements.

For individual transactions, the seller raises an invoice upon delivery of the goods or services rendered and sends a copy of the invoice or the invoice dataset to the finance provider.

After verification of the invoice copy or dataset, the finance provider makes a payment for the discounted value of the receivable (invoice) to the seller. The amount of such payment may be reduced according to the contractual details of the RPA.

At maturity, the buyer pays the proceeds of invoices due into a bank account in the name of the seller, but only the finance provider may withdraw available funds from that account, to meet maturing obligations, as the client has limited access rights to the account. Alternatively, the collection account can also be pledged to mitigate the transfer risk to the bank. However, it is also common for buyer payments to be made directly to the finance provider's bank account, under an arrangement where the finance provider acts as the seller's collection agent.

Sometimes sellers do not agree with the above mentioned process for collection of proceeds and funds continue to be paid directly into the seller's bank account in the normal way. The seller then transfers the proceeds of collections to the finance provider under the terms of the RPA. This process for the collection of proceeds creates an additional element of risk for the finance provider.

If not deducted at the time of the initiation of the transaction, interest and other charges will be payable upon receipt of the proceeds from the buyer and any or the remaining, unfinanced portion of the invoice proceeds will be payable according to the terms of the RPA.

Operational procedures are appropriately modified in the event of individual receivables finance transactions or in the event of a breach of the RPA.

Benefits

For sellers:

- Potentially allows the seller to provide extended credit terms to its buyer
- Working capital optimisation
- Growth in business on 'open account' terms
- Finance and liquidity availability with limited credit availability from traditional banking sources
- Potential for balance sheet management via 'true sale' of the receivables under the relevant legal structures
- Credit risk coverage in non-recourse Receivables Discounting as the finance provider will be responsible for normally 100% of any losses arising from the credit covered receivables if the buyer defaults
- Reduction of the concentration risk by distributing risk to a finance provider
- Better utilisation of the seller's financial and operational resources if the sale of the receivable is disclosed and collection is handled by the finance provider
- Confidentiality of the source of finance from the buyer in the case of an un-disclosed contractual relationship between the seller and the finance provider
- Possible improved balance sheet management as the sale of receivables generates off balance sheet liquidity without creating additional leverage or use of credit facilities (as would be the case with a traditional loan facility).

For buyers, potentially extended payment terms and improved stability of its supply chain.

For finance providers, credit exposure with a lower risk profile due to the supply chain-related nature of the financed transaction.

Asset distribution

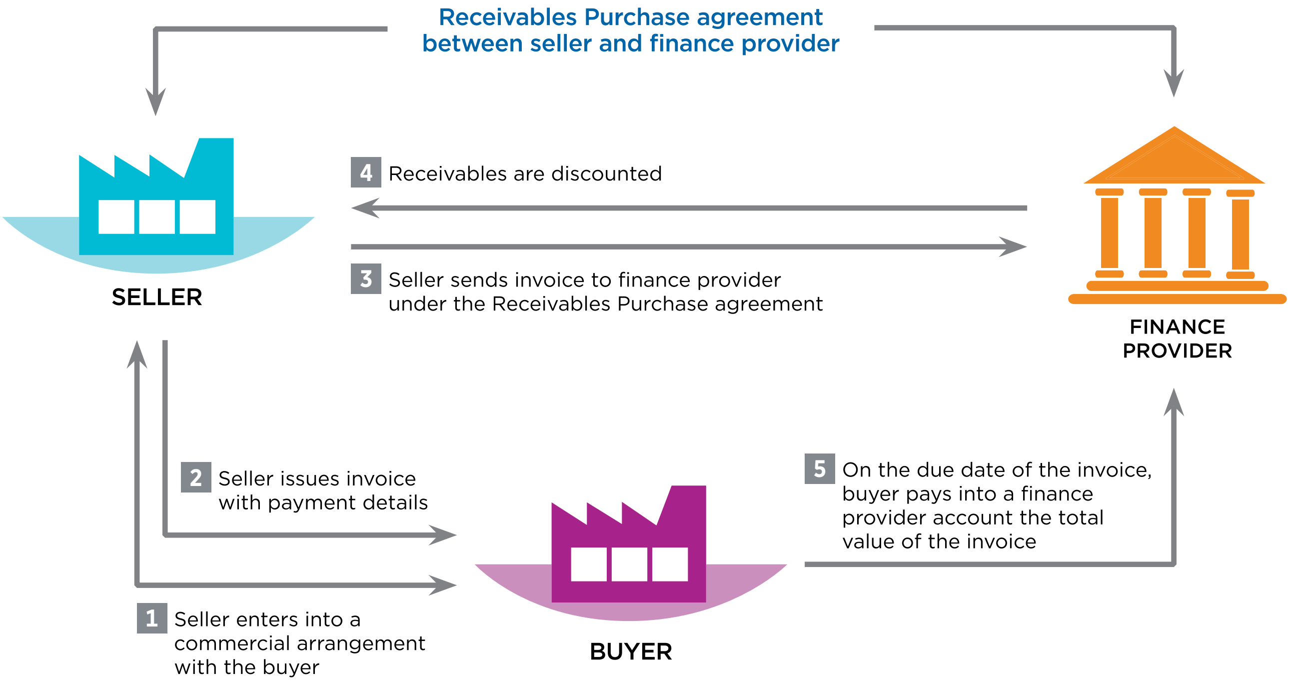
Such financings are typically offered by one finance provider to a client although in the event of very large volumes, distribution techniques may be used, such as risk participations or syndications.

Variations

It should also be stated that a variation of Receivables Discounting involves the discount of negotiable instruments such as drafts, bills of exchange and promissory notes. This is akin to Forfaiting, but in this variation the transaction is less likely to be sold or traded in the forfaiting secondary market but rather provided as finance direct to the client.

Transaction flow: illustrative only

Figure 5: Receivables Discounting



Source: Global SCF Forum

3.4.2. Forfaiting

Definition

Forfaiting is a form of Receivables Purchase, consisting of the without recourse purchase of future payment obligations represented by financial instruments or payment obligations (normally in negotiable or transferable form), at a discount or at face value in return for a financing charge.

Synonyms

Without recourse financing or discounting of promissory notes/bills of exchange.

Distinctive features

Forfaiting requires the existence of an underlying payment obligation usually embodied in some form of legal instrument distinct from the commercial transaction that gave rise to it. Such commercial transactions could be exports, imports or domestic trade. Typical payment instruments include negotiable instruments such as bills of exchange and promissory notes but obligations arising from letters of credit are also widely forfaited. All of these are ideal for forfaiting because they are, by law or agreement, independent from the underlying trade, benefit from a robust legal regime, and are easily transmissible to third parties through endorsement or assignment. This legal autonomy, founded on well-established law and precedent, giving rise to receivables which may be easily sold is a hallmark of forfaiting.

Such obligations may or may not be guaranteed by third parties such as banks, for example, by adding an aval or guarantee to a negotiable instrument. The range of payment obligations capable of being forfaited is not, however limited to these instruments but is very wide. Suitably worded and assignable contractual undertakings e.g. open account receivables can also be forfaited, but will normally need to include an unconditional obligation to pay.

There is a primary and secondary forfaiting market.

In the primary market, transactions are originated and obligations can be purchased from sellers of goods and services or their buyers, often in the latter case involving a bank in the buyer's country. Pure working capital can also be raised through forfaiting by purchasing a promissory note or an unconditional payment undertaking from the finance provider.

The secondary market is conducted between finance providers such as banks, forfaiting houses or other investors.

Tenors can vary from one month to several years. Transaction sizes are generally at the higher end of the supply chain spectrum and large volumes of low value instruments are more commonly confined to domestic forfaiting. The advance ratio is normally 100% of the face value of the payment obligation less finance charges. There may be one or more such instruments in any given transaction although the number is usually small.

Forfaiting is undertaken without recourse to the seller of goods and services or, in the secondary market, the seller of the forfaited asset (see below in 'Risks and risk mitigation').

Parties

In the primary market there is normally a seller of goods and services (e.g. exporter) or buyer (e.g. importer) as seller of the instrument or payment obligation to the initial finance provider (commonly known as the primary forfaiter). In the secondary market, there will be sellers and buyers (forfaiting), usually composed of finance providers and investors.

Contractual relationships and documentation

In the primary market there will be either a master agreement with a confirmation for each individual transaction or a one-off agreement limited to a single transaction.

In the secondary market, a sale is legally concluded either by telephone and then confirmed in writing or there is a written confirmation only following earlier non-binding discussions.

The payment instrument containing the obligor's undertaking to pay will be obtained either directly from the obligor or through transfer of such instrument.

In a forfaiting transaction the documentation relating to the underlying commercial documentation will be examined by each purchaser of the forfaited asset to the extent required by its policies and legal obligations.

The extent to which the documentation is examined will vary according to which market is involved (there being generally less documentation produced in the secondary market), the risk appetite of the parties and the nature of the transaction. There is likely to be less documentation in the case of a 'buyer credit' than in the case of a 'supplier credit'.

Forfaiting transactions can be documented using the Uniform Rules for Forfaiting ICC Publication no. 800 (URF) which is a joint publication of the International Chamber of Commerce and the International Trade and Forfaiting Association. The URF took effect on 1st January 2013 and contains a set of rules for the conduct of the primary and secondary markets including provisions covering the examination of documents and the liability of parties. A set of model agreements for both markets is included.

Security

Generally, Forfaiting results in a "true sale" whereby the buyer owns all the rights in the forfaited payment obligation. Security in respect of the forfaited asset can be given in the form of an aval or guarantee from a third party.

Risks and risk mitigation

- Default by, or insolvency of the Buyer, mitigated by security, credit insurance and due diligence
- Country or political risk, mitigated by due diligence and political risk insurance. Special circumstances relating to sovereign risk may apply to receivables due from governments or government agencies
- Dilutions and disputes arising out of the underlying commercial transaction, mitigated by use of unconditional payment instruments and limited recourse to the seller

- The risk arising from removing recourse to the seller of goods and services or, in the secondary market, a seller of the forfaited asset, mitigated by the credit rating of the buyer and limited recourse in certain circumstances (see Article 13 URF)
- KYC/AML handled during the on-boarding procedures and subsequently in periodic reviews
- Risks arising in the event of insolvency of the seller of goods and services, such as 'claw-back', especially where a finance provider is aware of distress at the time of financing mitigated by due diligence
- Fraud by the seller, for example by inflating the value of payment instruments or offering payment instruments without an underlying commercial transaction, mitigated by verification of the transaction and deploying adequate credit controls
- Double financing, mitigated by obtaining ownership of the forfaited receivable, applying appropriate KYC procedures and perfecting the assignment of rights to the forfaited receivable
- Fraud by collusion between the seller and one or more of its buyers leading to diversion of funds from meeting maturing obligations, mitigated by monitoring the financial health and management integrity of the seller through maintaining contact and receiving regular management information to look for signs of a deterioration of the business and suspicious circumstances, and also mitigated where necessary, by direct collections on the part of the finance provider
- Fraud by collusion between the seller of goods and services and an employee of the finance provider, mitigated by internal controls and segregation of duties
- General operational risks resulting from multiple operational requirements to perfect ownership of receivables and undertake ongoing administration, mitigated by sound procedures, appropriate levels of automation and process controls
- Legal risks such as lack of authority to sign documentation, payment instruments being in unenforceable form, and failure to perfect an assignment of rights, mitigated by legal due diligence
- In general, the finance provider will exclude prohibited and restrictive categories of goods
- Currency and interest rate risks, mitigated by hedging

All the above risks are also mitigated by a robust monitoring, reporting and audit process regarding transactions, systems, and controls.

Transaction illustration

Generally, forfaiting is a manual or semi-manual process. Sale and purchase documentation is negotiated and signed between parties in both primary and secondary markets in hard copy. Individual transaction confirmations can be sent by email or SWIFT.

Due diligence and credit analysis will need to be carried out on the obligors and on the legal nature of the instruments being used with a view to ensuring that, so far as possible, these are valid and enforceable even where problems may arise in the related sale of goods. The need for any local registrations and permissions will also be investigated.

Ownership to the payment instrument being used must pass to the purchaser and the appropriate legal method of doing this must therefore be ascertained. These can include assignment, novation or endorsement. There may be a need to hold and/or present originals of the payment instruments for payment to the obligor. The precise situation will depend on the nature of the instrument.

Confirmations from obligors to pay the new holder of the payment instrument are often sought especially in relation to letters of credit where the forfaiter is not a nominated bank under the letter of credit and is thus not a party to that transaction.

KYC/AML must be carried out on all relevant parties including the seller and the obligors in accordance with applicable local requirements.

Documentation relating to the export or import of goods must be examined manually with a view to satisfying not only KYC/AML requirements but ensuring the transaction is capable of being financed and that all documentation is authentic and legally valid and enforceable. URF 800 sets out rules for examination of such documents.

Benefits

- Working capital optimisation for buyer and seller
- Potential finance raised against a strong credit rating (either of buyer or financial institution providing security for the payment obligation) with lower implied cost of funding for the seller
- Assists sellers in selling to buyers or countries where they have little local knowledge and open-account sales would not otherwise be possible
- Potentially improved payment and commercial terms for the seller and buyer
- Finance and liquidity availability for sellers with limited credit availability from traditional banking sources
- Supply chain stability
- Relieves sellers of goods and services of administration and collection costs

Asset distribution

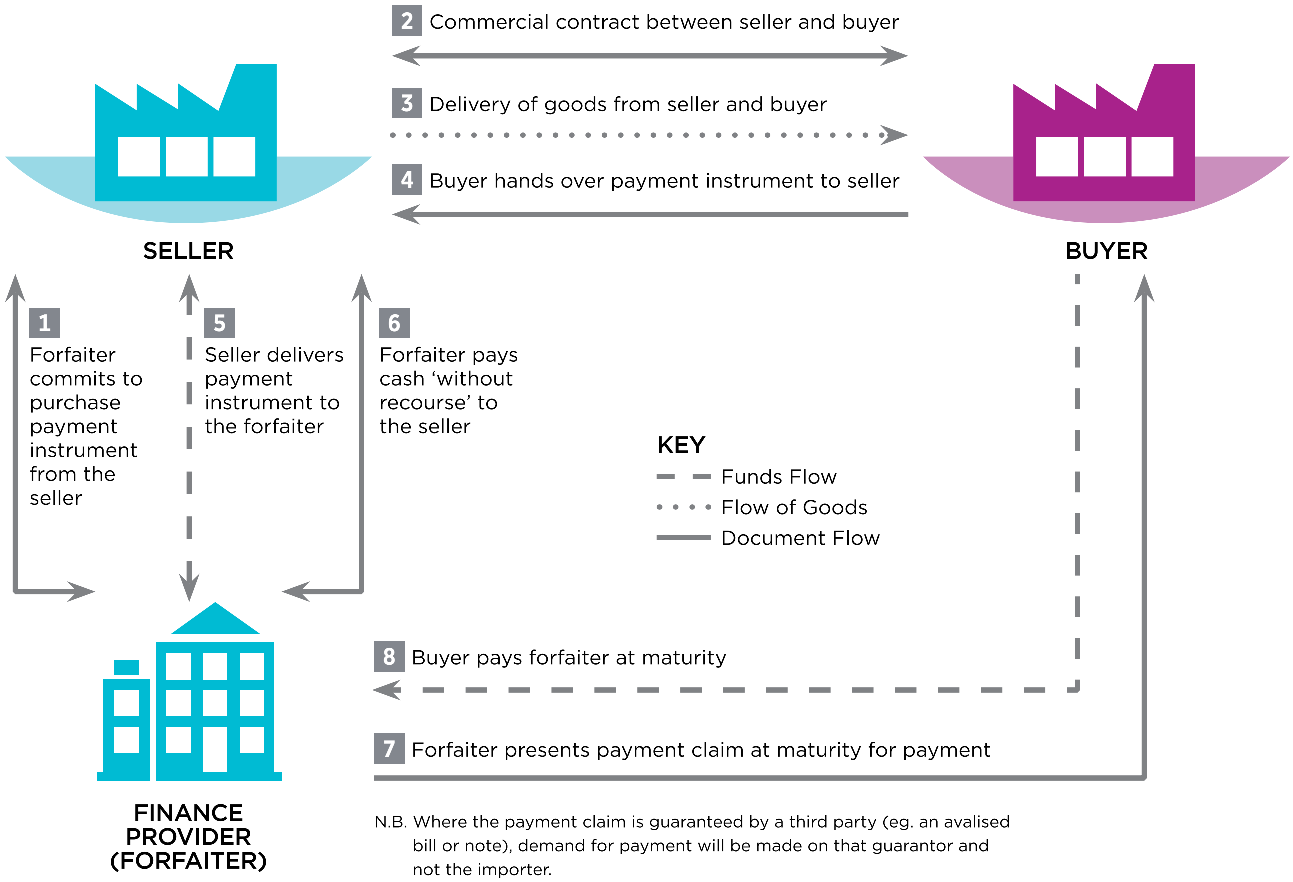
By outright or “true” sale and through funded or unfunded (risk) participation agreements.

Variations

See “Distinctive Features” above.

Transaction flow: illustrative only

Figure 6: Forfaiting



Source: Global SCF Forum

3.4.3. Factoring

Definition

Factoring is a form of Receivables Purchase, in which sellers of goods and services sell their receivables (represented by outstanding invoices) at a discount to a finance provider (commonly known as the 'factor'). A key differentiator of Factoring is that typically the finance provider becomes responsible for managing the debtor portfolio and collecting the payment of the underlying receivables.

Synonyms

Receivables Finance, Receivables Services, Invoice Discounting, Debtor Finance.

Distinctive features

A key differentiator of Factoring is that the finance provider advances funds and is then usually responsible for managing the debtor portfolio and collecting the underlying receivables, often also offering protection against the insolvency of the buyer, which may be protected by credit insurance. Indeed, by international convention, known as UNIDROIT (1988), Factoring is traditionally associated with functions beyond pure financing to include collection of receivables, debtor management, and protection against default by debtors.

In Factoring, ownership of the receivable lies with the finance provider and the buyer settles the invoice with the finance provider, not with the seller. Factoring is normally disclosed to the buyer. Factoring is provided with or without recourse depending on aspects such as credit insurance, jurisdiction and market practice. There are multiple variations of Factoring which are separately described, below.

Factoring is usually offered by specialised finance providers operating as factors, explicitly targeting the receivables financing market and serving a wide array of supplier companies including small and medium sized enterprises (SMEs). Factoring has also been extended to large value transactions. Factors may also offer Receivables Discounting services.

Parties

The parties to the factoring transaction are the seller and the finance provider. While the buyer is not a party to the factoring agreement, it is both normally aware of the transaction and relied on for payment of the underlying receivables or invoices directly to the finance provider, except for cases where confidential factoring is provided.

Contractual relationships and documentation

A factoring agreement is entered into between the seller (as client), and the finance provider under which the seller provides the finance provider with an assignment of rights (or transfer of title or the equivalent) to the asset(s) being financed, according to the jurisdiction in question. Notice of assignment is usually provided to the buyer; a certified copy of the invoice or the invoice data set is provided to the finance provider. Any additional security is suitably documented.

Security

An assignment of rights (or transfer of title or the equivalent) to the asset(s) being financed, according to the jurisdiction in question. Additional security interests may be taken by the finance provider. Credit insurance is commonly applied.

Risks and risk mitigation

- Default or insolvency of the buyers, including relevant country risk, mitigated by credit and risk assessment, monitoring and potentially credit insurance
- Existence of valid and eligible invoices being factored, mitigated by a regime of sampling and in some cases individual verification
- Concentration risk mitigated by setting concentration limit thus spreading the risk over the sales ledger
- Factorability of the receivables – transaction characteristics, contract or financing terms that adversely impact the ability to factor, such as long warranties that the seller has to provide, contractual businesses (such as construction), the sale of perishable goods or the presence of stage payments. In general, the finance provider will exclude prohibited and restrictive categories of goods
- Receivables dilutions (for example, credit notes, offsets against invoices due for payment), mitigated by the security margin and advance ratio, through the establishment of a reserve (or margin) against the eligible discounted receivables
- Pre-existing security arrangements or bans on assignments, mitigated by waivers given by other secured parties or their removal or by taking additional security and completing the required perfection requirements
- Party-related risk mitigated by KYC/AML handled during the on-boarding procedures and subsequently in periodic reviews
- Lack of legal authority, mitigated by legal due diligence on the respective jurisdictions and the involved contractual parties
- Counter-trading mitigated by regular verification that the balance outstanding with the finance provider matches that on the buyer's records
- Risks arising in the event of insolvency of the seller, such as 'claw-back', where a finance provider is aware of distress at the time of a receivable purchase, or in the case of co-mingling of funds in a general bank account. For the latter, there is mitigation through the use of a collection account in the name of the finance provider
- Fraud by the seller, for example by inflating the value of invoices or offering invoices without an underlying commercial transaction, mitigated by verification of the transaction and strong credit controls
- Double financing, mitigated by obtaining a security interest in the receivables, applying appropriate KYC procedures and perfecting the assignment of rights to the receivable

- Fraud by collusion between seller and one or more of its buyers leading to diversion of funds from meeting maturing obligations, mitigated by monitoring the financial health and management integrity of the client through maintaining contact and receiving regular management information to look for signs of a deterioration of the business and suspicious circumstances, and also mitigated, where necessary, by direct collections on the part of the finance provider
- Fraud by collusion between the seller and an employee of the finance provider, mitigated by internal controls and segregation of duties
- General operational risks resulting from multiple operational requirements to perfect ownership of receivables and undertake ongoing administration, mitigated by sound procedures, appropriate levels of automation and process controls
- Risks arising from incomplete or faulty perfection of jurisdictional requirements for assignments of title, particularly in a cross-border context, mitigated by appropriate due diligence.

All the above risks are also mitigated by a robust audit process of transactions, systems and controls and by regular reporting and monitoring, based on due diligence.

Transaction illustration

The finance provider undertakes assessment of various aspects of the underlying transaction and agrees to provide the factoring service to the seller of goods and services (usually a credit limit is established for each buyer). The seller raises an invoice upon delivery of the goods/services rendered and sends a copy of the invoice or the invoice data set to the finance provider. After verification of the invoice copy or data set (or a suitable sampling regime), the finance provider advances a percentage (usually around 80%) of the value of the invoice to the seller. On due date, the buyer pays the outstanding invoice to the finance provider who in turn pays the remaining value of the invoice to the seller, less agreed fees and discount as applicable. The finance provider is responsible for reminder and collection procedures. The discount and other fees are payable according to the terms of the factoring agreement.

Benefits

- Growth of business for the seller on open account terms
- Credit risk coverage in non-recourse factoring as the finance provider will pay normally 100% of the credit covered receivables if the buyer defaults in its payment
- Working capital optimisation for the seller without increasing balance sheet leverage (subject to accounting treatment in the relevant jurisdiction)
- Improved payment terms for the seller
- Finance and liquidity availability for sellers with limited credit availability from traditional banking sources
- Sales ledger management and collection of receivables as part of the service frees up the seller's resources, and may offer improved debtor management
- Improved stability of the supply chain and reduced risk of supply chain disruption.

Asset distribution

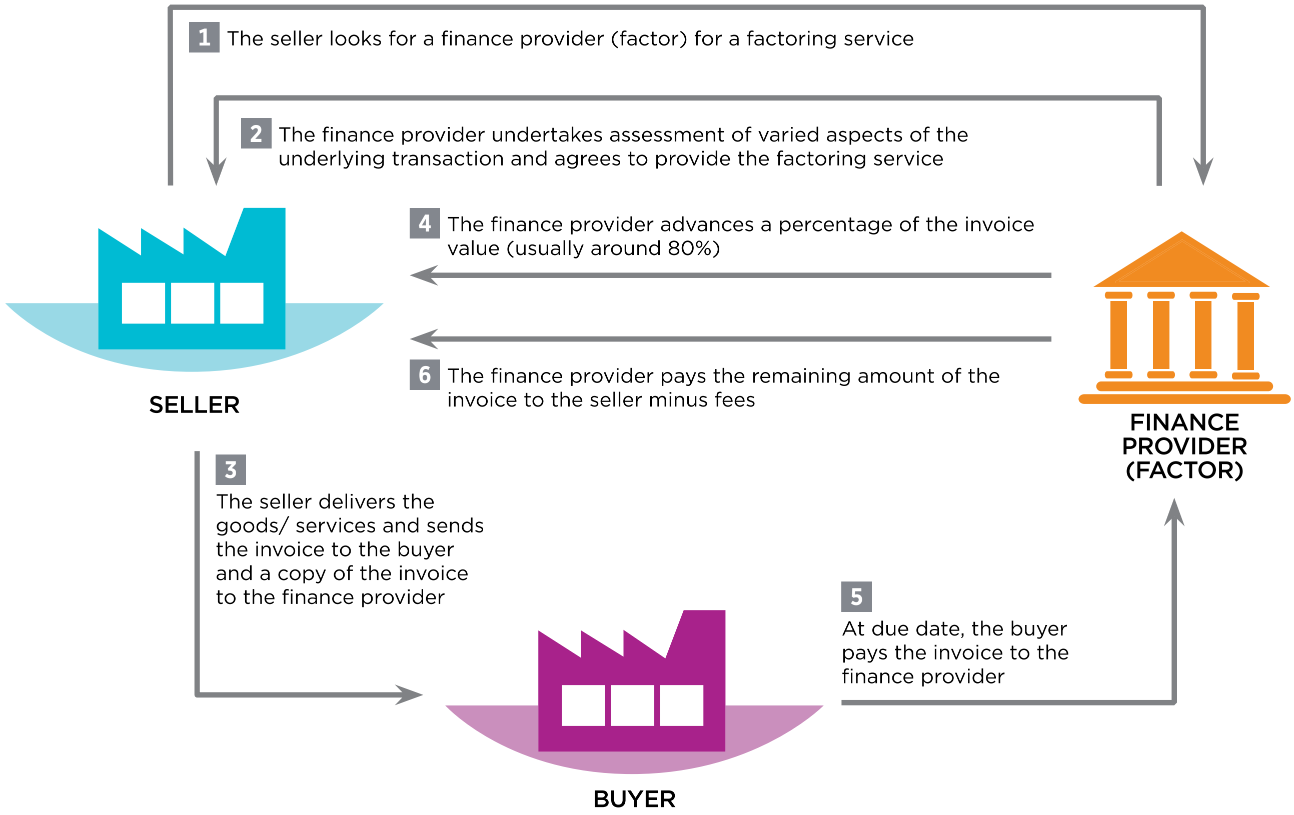
Such financings are typically offered by one finance provider, although in the event of very large amounts distribution techniques may be used.

Variations

Confidential or Non-Notification/Disclosed; Domestic/International; Recourse/Non-recourse; Whole Turnover/Selective.

Transaction flow: illustrative only

Figure 7: Factoring



Source: Global SCF Forum

3.4.4. Factoring Variations

The variations described below do not represent a separately defined technique but are common variations of the factoring technique defined above:

Domestic Factoring

The buyer is situated in the same country as the seller. Country-specific rules or regulations may apply due to the domestic character of the transaction which would affect the relationship between the finance provider, the buyer and the seller.

International Factoring

- The buyer is situated in a different country from the seller. Country-specific rules or regulations may apply due to the international character of the debt which could affect the relationship between the finance provider, the buyer and the seller.
- For this reason, often two factors are involved, one in the buyer's country (known as the 'Import Factor') and one in the seller's country (known as the 'Export Factor'). The two factors establish a contractual or correspondent relationship to service the buyer and the seller respectively (called the 'Two-Factor-system').

Typically, the two factors use an established framework such as the General Rules for International Factoring (GRIF), provided by Factors Chain International (FCI) and by International Factors Group. Since 2 January 2016, FCI and IFG have been integrated into one organisation.

Recourse Factoring

The finance provider has recourse to the seller in the case of buyer default.

Non-Recourse Factoring

The Finance Provider does not have recourse back to the seller in the case of buyer default within established credit lines. Country-specific rules or regulations may affect the nature of the relationship between the finance provider, the buyer and the seller.

Limited recourse may be maintained however, to ensure that the seller delivers against specific warranties that are a condition of payment. Country-specific rules or regulations may affect the nature of the relationship between the finance provider, the buyer and the seller.

Confidential or Non-Notification Factoring

The invoice bears no notice of assignment and the buyer is not aware of the factoring agreement between the seller and the finance provider.

The debt verification is carried out by the finance provider in the name of the seller so that the buyer is not aware of the factoring agreement. The buyer typically pays the outstanding invoice into a 'trust' or 'escrow' account. In some cases, the buyer may pay funds into a normal current account in the name of the seller, who acts as a collecting agent on behalf of the finance provider and undertakes to forward the funds immediately after collection to the same finance provider.

Disclosed or Notification Factoring

The invoice bears a notice of assignment and the buyer is notified of the assignment of the receivables. The buyer pays the outstanding invoice to the finance provider to discharge the obligation.

Whole-Turnover Factoring

The seller assigns all invoices or allowable invoices to the finance provider.

Selective or Spot Factoring

In Selective Factoring, the seller or finance provider selects a range of invoices to be assigned to the finance provider, identifiable by a common feature, such as buyer name, governing law of the receivables, and production segment among others. Spot factoring involves the factoring of an individual invoice.

Invoice Discounting

The seller communicates the outstanding balance of its receivables ledger to the finance provider, which finances a percentage of the amount available to the seller by selecting invoices from specifically identified buyers. The funds available to the seller are adjusted based on the outstanding value of the sales ledger and further adjusted for a security margin. This use of the expression of Invoice Discounting is akin but not identical to Receivables Discounting, which also has a synonym Invoice Discounting. The usage of the term Invoice Discounting consequently varies as a matter of detail.

3.4.5. **Payables Finance**

Definition

Payables Finance is provided through a buyer-led programme within which sellers in the buyer's supply chain are able to access finance by means of Receivables Purchase. The technique provides a seller of goods or services with the option of receiving the discounted value of receivables (represented by outstanding invoices) prior to their actual due date and typically at a financing cost aligned with the credit risk of the buyer. The payable continues to be due by the buyer until its due date.

[Please note that this SCF technique is subject to a number of naming conventions, as is clear from the number of synonyms recorded. The Forum decided that the term Payables Finance is a generic and neutral expression that captures the essence of the technique].

Synonyms

Approved Payables Finance, Reverse Factoring, Confirming, Confirmed Payables, Supplier Payments, Vendor Pre-Pay, Trade Payables Management, Buyer-Led Supply Chain Finance, Supplier Finance, or just Supply Chain Finance (the latter two when inappropriately applied as an individual 'technique' rather than a holistic category).

Distinctive features

The buyer identifies an invoice(s) or account(s) payable (on its books) for which it has given an unconditional, irrevocable commitment to pay, and the seller has the option to sell the receivable(s) (i.e. the counterpart of the buyer's payable on its own books) and receive an early, discounted payment from the finance provider. The technique is 'buyer-centric' in that the buyer will typically arrange a payables finance programme with one or more finance providers in favour of its suppliers. The buyer encourages its suppliers to consider the use of this Payables Finance programme; the suppliers make an independent decision to utilise the programme.

The finance provider relies on the creditworthiness of the buyer and typically grants the financing 'without recourse' to the seller. Such 'without recourse' relates to the credit risk or risk of non-payment by the buyer of the invoice or account payable. It is common that certain elements of recourse are retained against the seller, such as relates to breaches of representations and warranties.

The buyer will pay the principal amount owed at the invoice maturity/due date or at another agreed upon due date directly to the finance provider. If there are any dilutions between the buyer and seller, it would be resolved outside of this Payables Finance structure.

The buyer acting as the 'anchor party' or programme arranger will have previously established a Payables Finance programme with a single or multiple finance provider(s) for the benefit of its (designated) suppliers. Whilst Payables Finance is often arranged by large corporate buyers and their finance provider, it can also be applied to non-investment grade and medium-sized buyers.

Parties

The parties to the financing are the seller and the finance provider. The buyer, although it may be referred to as the 'anchor party' and facilitates/ helps to make available the financing for the benefit of its supply chain, is *not* a party to the financing. The buyer unconditionally approves the payment of the invoices or accounts payable at a maturity/due date that has been agreed upon with its seller. This approval will take the form of an undertaking to make payment of the invoice or accounts payable included in the programme.

Contractual relationships and documentation

- A service agreement is entered into between the finance provider and buyer
- This will contain an undertaking issued by the buyer agreeing to pay 'approved for payment' invoices and accounts payable
- Receivables Purchase Agreement (RPA) between the seller and the finance provider under which the seller provides the finance provider with an assignment of rights (or transfer of title or the equivalent) to the asset(s) being financed, according to the jurisdiction in question.

Security

A Receivables Purchase is effected by means of an assignment of rights to the accounts payable (i.e. of the receivables held on the books of the seller).in accordance with the procedures of the finance provider and subject to the applicable jurisdictionally specific rules.

Risks and risk mitigation

- Default by the buyer, mitigated by careful risk assessment and monitoring
- Seller dilutions handled by credit notes and offsets against invoices due for payment, mitigated by the 'approved for payment' undertaking given by the buyer
- Operational risks resulting from multiple operational requirements to perfect ownership etc., mitigated by automation or ensuring possession of a negotiable instrument for the proceeds of the receivable
- Appropriate KYC/AML on the buyer and the seller, handled during the on-boarding procedures and subsequent post-transaction reviews
- Risk of double financing, mitigated by KYC and perfection of ownership of the receivable or ensuring possession of a negotiable instrument as per the relevant jurisdictional requirements
- Pre-existing security arrangements, mitigated by waivers or their removal and completing perfection requirements or ensuring possession of a negotiable instrument
- Lack of corporate or signing officer authority, mitigated by legal due diligence

All the above risks are also mitigated by a robust monitoring, reporting and audit process regarding transactions, systems and controls.

Transaction illustration

- The buyer will usually have established a Payables Finance programme with the finance provider(s) for the benefit of all or a sub-set of its suppliers acting as sellers to it
- The seller(s) and finance provider(s) interact in relation to the provision of finance and on-boarding procedures including KYC/AML
- The key 'trigger' for the provision of finance is the unconditional approval of the invoice or account payable for payment by the buyer; this may be initiated through the creation of an approved payment instruction, which is unconditional and irrevocable, from the buyer to the finance provider, or evidence of approval of the invoice
- '100%' financing is the norm less a financing discount. The process may be manual, semi-manual or automated and a technology platform is often a central feature
- Electronic invoicing may play a vital role since it will usually accelerate invoice approval and the ability for the supplier to promptly discount the invoice/receivable
- The seller has the option to hold the receivable and receive full payment at maturity or offer the receivable for sale for early payment at a discount.

Benefits

- For the buyer improved payment and commercial terms and liquidity optimisation
- Greater supply chain stability from the point of view of the buyer
- Benefit of improved operating processes through automation
- For the seller, finance raised against a strong credit rating with lower implied cost of funding than would have been obtained on its own
- Also for the seller, working capital optimisation and improved cash flow forecasting and flexibility, including the option to not finance and hold the receivable until maturity
- Provides alternative sources of funding with reduced use of credit availability from traditional banking sources
- For sellers, the ability to manage potentially significantly longer payment terms imposed by financially strong buyers
- For the finance provider offers high quality transaction-based short term finance based on the credit of a prime buyer and supporting the business objectives of both trading parties.

Asset distribution

May be a feature of such transactions or programmes and achieved through funded or unfunded risk participations, trade receivable securitization, syndications, or by means of credit insurance.

Variations

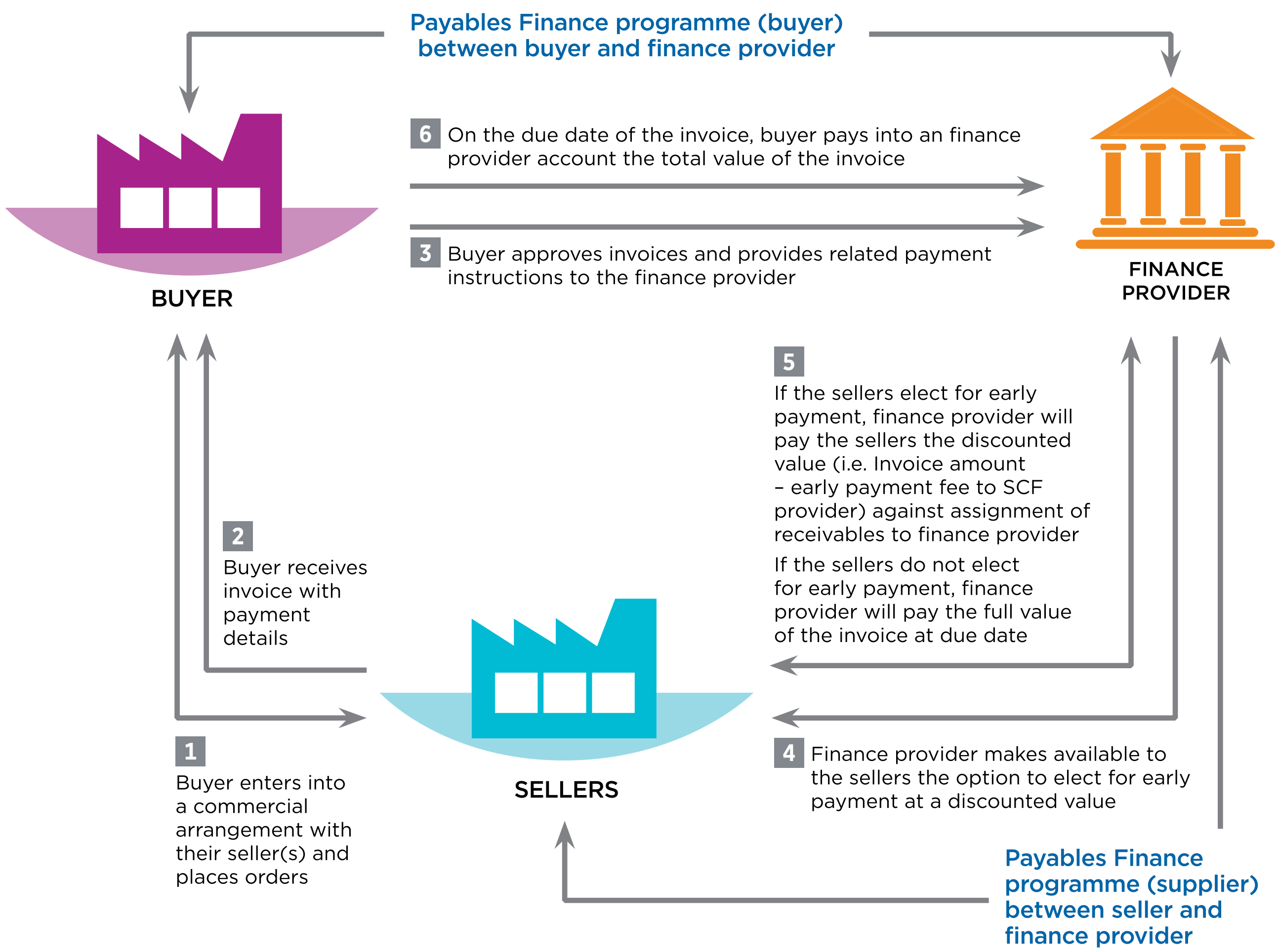
'Confirming' as applied in the Iberian context may be considered as a variation with differing distinctive features, contractual relationships and operational procedures. Such facilities usually contain a binding commitment as to availability and inclusion of recourse to the seller.

An additional variant is 'dynamic' discounting whereby the buyer may utilise its own funds to pay an invoice or account payable prior to the original due date (see Glossary).

Reverse Factoring, which is also a synonym, is also used to refer to a 'softer' variant of Payables Finance, whereby the buyer does not formalise its commitment to the finance provider to pay the invoices at maturity, but does provide information on which invoices it considers valid and correct. In this variant, the buyer may introduce its suppliers to the finance provider. The scheme is then managed as a series of factoring or receivables purchase agreements between the finance provider and each of the sellers and thus lacks the element of an unconditional and irrevocable payment undertaking that is given to finance provider in a standard Payables Finance setup. This is also referred to as import or post-shipment finance.

Transaction flow: illustrative only

Figure 8: Payables Finance



Source: Global SCF Forum

3.5. Loan or Advance-based SCF techniques

The second intermediate category of techniques are Loan or Advance-based. These include loans and advances made against receivables, rather than by means of purchase, as in the previous cluster of techniques. Other techniques that are also based on loans and advances are: Distributor Finance, Loans or Advances against Inventory and Pre-shipment Finance.

3.5.1. Loan or Advance against receivables

Definition

Loan or Advance against receivables is financing made available to a party involved in a supply chain on the expectation of repayment from funds generated from current or future trade receivables and is usually made against the security of such receivables, but may be unsecured.

Synonyms

Receivables Lending, Receivables Finance, Invoice Financing, Trade Receivable Loans, Trade Loans.

Distinctive features

In this case the loans or advances may be legally secured on a stream of future receivables or may be unsecured and simply take comfort that such receivables will be converted to cash at a future date to repay the financing. Such loans are only made where the seller (the borrower) has, or will acquire through use of the loan monies, receivables arising from its business activities as a seller of goods or services. Where the relevant receivables exist at the time the loan is made, such a loan may be considered as a type of secured loan collateralised by the receivables. Where the loan is advanced on a promise or expectation of such receivables arising at a future date, the loan is akin to working capital finance with the comfort of potential future collateral.

Varying degrees of security are possible. In some case, the finance provider may not take security at all but use the existence of the receivables as either informal comfort or as notionally satisfying financial covenants or tests imposed on the seller. It is a technique of supply chain finance, where it contributes to the operation and integration of supply chain activity. In other situations, it may be viewed as a type of corporate lending.

Parties

The finance provider and the client, a seller of goods and services.

Contractual relationships and documentation

A loan agreement (or credit facility) with applicable terms and conditions agreed between the finance provider and the client. This may contain financial covenants or tests which are capable of being satisfied by the existence of the receivables.

Where security has been agreed, a suitable security agreement will also exist under which the receivables are appropriately charged, assigned or pledged. The precise nature of this security agreement will depend on a number of factors such as the nature of the receivables, the jurisdiction involved and the commercial arrangement between the parties.

Security

A security agreement with appropriate terms and conditions.

Risks and risk mitigation

- Creditworthiness of the client especially where no formal security is taken over the receivables, mitigated by due diligence
- Performance risk on the seller (client) which may lead to failure to create receivables, mitigated by due diligence
- Bans on Assignment, mitigated by due diligence and representations and warranties.
- Dilutions, mitigated by due diligence and presentations and warranties from the seller (client)
- Timeliness of creation of the receivables, mitigated by due diligence
- Failure to create or perfect effective security, mitigated by legal due diligence
- All the above risks are also mitigated by a robust monitoring, reporting and audit process regarding transactions, systems and controls
- All the above risks are also mitigated by a robust monitoring, reporting and audit process regarding transactions, systems and controls.

Transaction illustration

The loan agreement will be issued in accordance with the finance provider's usual procedures and the appropriate security as applicable perfected in the usual manner.

Monitoring of the receivables may or may not be undertaken.

In some instances, the finance provider may establish a borrowing base to regulate the amount of funding advanced (see Glossary).

Benefits

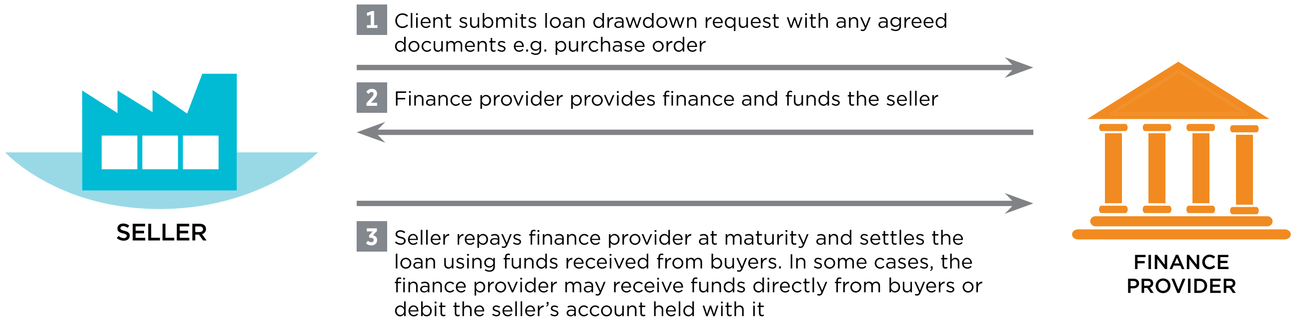
- Enables access to financing on potentially better terms than without the use of receivables
- For the finance provider, security of the receivables, where taken.

Asset distribution

Syndication, Sub-Participation.

Transaction flow: illustrative only

Figure 9: Loan or Advance against Receivables



Source: Global SCF Forum

3.5.2. Distributor Finance

Definition

Distributor Finance is the provision of financing for a distributor of a large manufacturer to cover the holding of goods for re-sale and to bridge the liquidity gap until the receipt of funds from receivables following the sale of goods to a retailer or end-customer.

Synonyms

Buyer Finance, Dealer Finance, Channel Finance, Floor Plan Finance (latter not always stricly comparable).

Distinctive features

The funding facility is typically offered to the distributor (or buyer) of a large manufacturer/exporter in the form of direct financing by means of loans or advances, subject to annual review. These facilities are, typically, used for funding inventory and receivables on a short term basis The underlying need that is being fulfilled, is to permit smaller/local distributors to obtain financing, especially if they have limited access to other sources of funding, and where there is a material timing gap between the credit terms of the large manufacturer selling to them, and the date by which the goods can be sold and receivables converted to cash. Typically, the distributor is a third-party owned company, but it could be owned or part-owned by the large manufacturer.

The risk is mitigated by ensuring that the large manufacturer, often called the 'anchor party', is closely engaged and has a certain degree of exposure to motivate successful conduct of the distributor's contractual arrangements. There may be a specific agreement between the anchor party and the finance provider. Additional engagement by the anchor party could take the form of various types of risk-sharing arrangements. The distributor could benefit from better loan pricing than would have been the case had the distributor sourced financing solely on the strength of its own balance sheet. The distributor is usually expected to meet the characteristics of being a well-established business with stability and a record of success in acting as a distributor.

Parties

The parties to distributor finance are large manufacturers acting as sellers (often called 'anchor parties') their distributors acting as buyers, and finance providers.

Contractual relationships and documentation

A financing agreement or facility letter is typically established directly between the distributor and the finance provider. In addition, there is often a master Distributor Finance agreement between the anchor party and the finance provider that would contain the terms of engagement for the finance provider to provide facilities for multiple distributors in a number of global territories, any agreed risk-sharing arrangements, and the operating model applying to the three parties – i.e., the anchor party, the distributor, and the finance provider.

Security

Since this is a direct financing in favour of the distributor, the security is usually an assignment of rights over inventory and receivables and/or other forms of security, as agreed between the distributor and finance provider. Given that the borrower is likely to be an SME, considerations of risk in relation to the adequacy of security will be required in the usual way. Additional risk mitigation is provided by the engagement of the large manufacturer. This could take the form of a master Distributor Finance agreement, a stop-supply letter, a buy-back guarantee, a comfort letter, or a risk sharing arrangement. Care is required in assessing the value of the latter undertakings, as practitioners vary in the evaluation of their value and the feasibility of obtaining them.

Risks and risk mitigation

In addition to generic financing-related risks, there are a series of risks specific to Distributor Finance. They are:

- Default by the distributor, including credit and political risk, mitigated by careful credit risk assessment and continuous monitoring. The importance of the particular distribution contract to the borrower's business survival is an important factor to be evaluated
- Diversion of funds, such as a situation, where the distributor uses borrowed funds for other reasons (such as financing the growth of the business in other directions) rather than repaying the financing mitigated by the large manufacturer supporting the distributor finance programme by providing information about the performance of the distributor, and/or any agreement for risk sharing
- Operational risks especially the requirement to coordinate many commercial and financial components, mitigated by automation, management quality and business controls
- Pre-existing security arrangements, mitigated by waivers or their removal, or by taking additional security
- Fraud by the distributor or by collusion, mitigated by monitoring and verification
- Lack of authority, mitigated by legal due diligence

All of the above risk mitigation would be augmented by a robust audit process (or field-surveys and visits to the distributor's business).

Transaction illustration

The operational process model may be manual, semi-manual or automated by a technology platform provided by the finance provider. Global finance providers often offer Distributor Finance programmes via web-based platform solutions tailored for their multinational clients. These platforms are accessed by the seller and distributors for purchase order approvals, invoice confirmations, and the handling and tracking of payments and drawdowns.

Benefits

For the distributor (or buyers) of a large exporter/manufacturer it provides:

- Working capital optimisation permitting the distributor to bridge the liquidity gap between the purchase of inventory and payments received from its customers
- Increased credit for distributors (esp., distributors with limited credit availability from the traditional banking sources) based on the existence of actual financial or commercial support from the large manufacturer
- Credit for distributors at a lower cost than what would be available from traditional banking sources.

For the large manufacturer, potentially allows for generating sales growth (by providing additional finance to increase product availability through distributors, the finance of inventory and support for the prompt delivery of products, especially in emerging and frontier markets). Potentially allows the large manufacturer to provide extended credit terms to the distributor or to ensure that additional funding can be raised with its support.

Variations

A variation of Distributor Finance arises where a large manufacturer acting as seller provides extended or longer than usual credit terms to the distributor, and a finance provider agrees to enter into a Receivables Purchase facility with the large manufacturer. The distributor is thereby provided with liquidity to finance its order to cash cycle as a result of the extension of credit. In turn the finance provider is able to provide the large manufacturer with the means of financing the longer credit terms on a basis agreed between them.

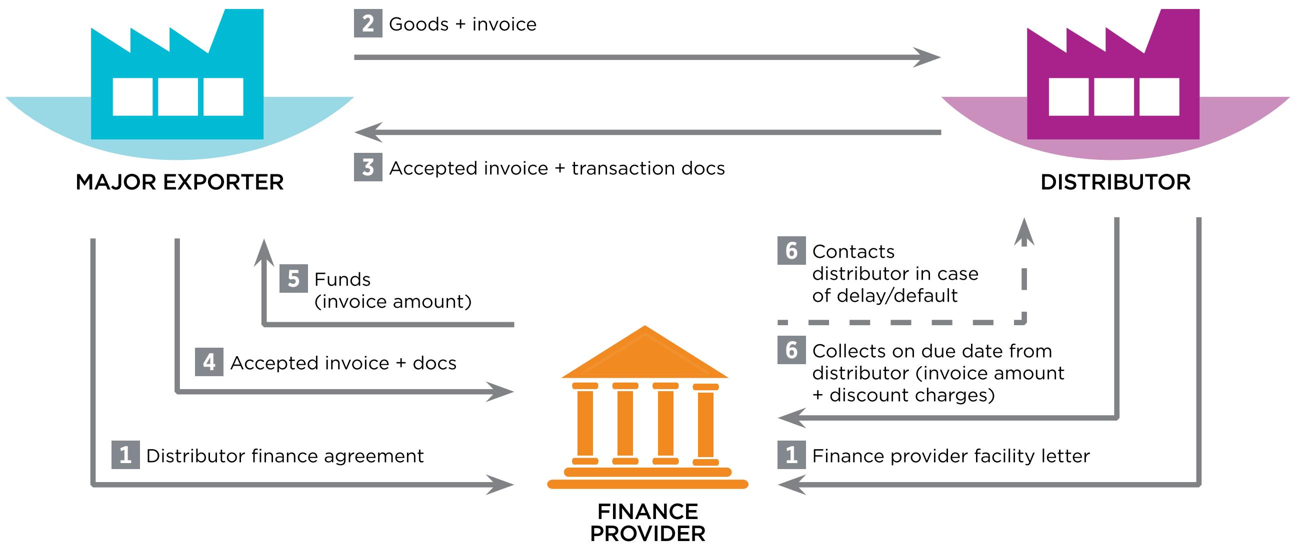
There are a variety of other financing arrangements, which could be offered to a distributor, such as factoring, leasing, invoice discounting and regular working capital finance not covered herein.

Asset distribution

Not usually applicable but for larger facilities, syndication may be utilised.

Transaction flow: illustrative only

Figure 10: Distributor Finance



Source: Global SCF Forum

3.5.3. Loan or Advance against Inventory

Definition

Loan or Advance against Inventory is financing provided to a buyer or seller involved in a supply chain for the holding or warehousing of goods (either pre-sold, un-sold, or hedged) and over which the finance provider usually takes a security interest or assignment of rights and exercises a measure of control.

Synonyms

Inventory Finance, Warehouse Finance, Financing against Warehouse Receipts, Floor Plan Finance.

Distinctive features

Loans or Advances against Inventory may be used at any stage and by any party in a supply chain acting as seller and/or a buyer. The incidence of the financing need will depend on the structure and timing of the manufacturing and delivery cycles deployed along a particular supply chain. Inventory financing is typically confined to qualifying marketable commodities (e.g. raw materials such as minerals, metals and agricultural products) for which a value can be readily ascertained, and to finished goods or work in progress where a potential buyer may have already been identified and for which a contract to purchase or a purchase order may have already been issued; the requirement to identify a buyer or have a contract or purchase order in place recognises the potential lack of marketability of finished goods or work in progress.

The financing is usually arranged as a loan or advance against the inventory, although variations described below provide alternatives. The tenor of transactions will be short term and advances are usually made under a committed or uncommitted facility with an annual review.

For the financing of finished goods and work in progress, reference is made to the definition of Pre-shipment Finance (see separate SCF technique definition). The finance of goods in transit such as on-board a vessel or by air may also be included.

For some market participants, loans against inventory in the setting of SCF necessarily involve a seller and a buyer in a structured relationship as part of a particular supply chain. For the purposes of this standard market definition a wider view has been taken to include all types of inventory finance.

Parties

A typical Loan or Advance against Inventory transaction involves two main parties: the client or borrower (which could be a seller or buyer, as noted earlier) and the finance provider. A third party warehouse may also be involved, which could be certified or recognised by governmental or trade bodies, and in which the existence and condition of stored inventory is continuously monitored by a reputable third party and/or by the finance provider itself. The goods may also be stored in a location under the direct control of the finance provider or on the borrower's own premises.

Contractual relationships and documentation

The borrower and finance provider enter into a financing agreement and a security agreement covering title to the underlying inventory and covering warehouse receipts (evidencing storage of the goods in the warehouse) where used. Ancillary agreements with a warehouse operator and third party collateral management or inspection agents may also be required.

Security

The finance provider obtains title over the goods for the duration of the transaction and only releases title when the loan is repaid. Security will be obtained by means of delivery of negotiable warehouse receipts or warrants or an assignment of rights (or assignment of title such as a pledge) relevant to the location of the inventory and the specific jurisdiction concerned. Legal advice and opinions are an essential precaution in relation to any specific situation. In the case of goods in transit this may take the form of bills of lading, often consigned or endorsed to the finance provider. Other security perfection techniques may be employed depending on the relevant jurisdiction.

Risks and risk mitigation

- Difficulties experienced by the customer in disposing of the inventory in a timely fashion under a third party sale in order to generate repayment or an inability to refinance the inventory
- Quality or damage to the inventory mitigated by inspections and property and casualty insurance
- Ongoing business risks impacting the ability to repay
- An ability to re-possess and dispose of the relevant inventory in the event of the borrower becoming illiquid or insolvent. Having and retaining the necessary industry and product experience is a key risk for the finance provider
- The location of the inventory, for example, stored within an independent warehouse, or if on the borrower’s premises stored in a way that the goods can be easily identified and carefully controlled
- The intrinsic value and saleability of the inventory remains a continuing risk factor during the life of the transaction and this is influenced by the condition of the inventory, its importance to a critical manufacturing or sales process, market conditions, and logistics aspects in the event of the need to exercise the right to repossess and sell
- It is common to advance only a percentage of the value of the inventory so as to establish a margin of protection. For a situation where a number of lines of inventory are financed, a ‘borrowing base’ may be established whereby an ongoing collateral pool is established against which a maximum advance is computed
- Credit analytics is applied to the borrower in the normal way to ensure on-going viability and cash generation ability especially by means of a firm take-out by means of sale to a reputable buyer, and to establish that dependence on realising security is minimised
- There is a risk of the borrower double-pledging the same inventory. This can only be mitigated by the financing provider’s due diligence and, where relevant, a good choice of warehouse provider with adequate controls

- All the above risks are also mitigated by a robust monitoring, reporting and audit process regarding transactions, systems and controls.

Transaction illustration

Procedures are required for the disbursement and repayment of the financing; the perfection of the security interest through the assignment of rights; the possession and control over the inventory being financed; the continuous monitoring of the condition and value of the inventory; and the calculation of margin and borrowing base as applicable. If the value of the inventory has been hedged in the futures market this also requires continuous monitoring.

Benefits

The main benefit of this form of SCF is the ability of the client to obtain funding based on the security of easily realisable assets and bridging the working capital gap between the point of procurement and the achievement of sales.

For the finance provider it provides a short term business opportunity based on an expected source of repayment and readily realisable security.

Asset distribution

Such financings are typically offered by one finance provider although in the event of very large amounts distribution techniques might be used.

Variations

Pre-shipment Finance is the subject of a separately defined SCF technique. Inventory finance for goods in transit may be provided under classical trade finance mechanisms such as letters of credit or by another means of structuring the financing and taking a security interest.

A variation of inventory finance is based on ‘tolling’, whereby finance is provided to allow raw materials or components to be submitted to a third party refining or manufacturing process prior to onward sale.

A variation of inventory finance is based on a borrowing base, whereby a maximum level of finance is made available against a calculated market value of goods (which could be of more than one type) being financed less a margin which will vary according to the quantity or quality of the goods.

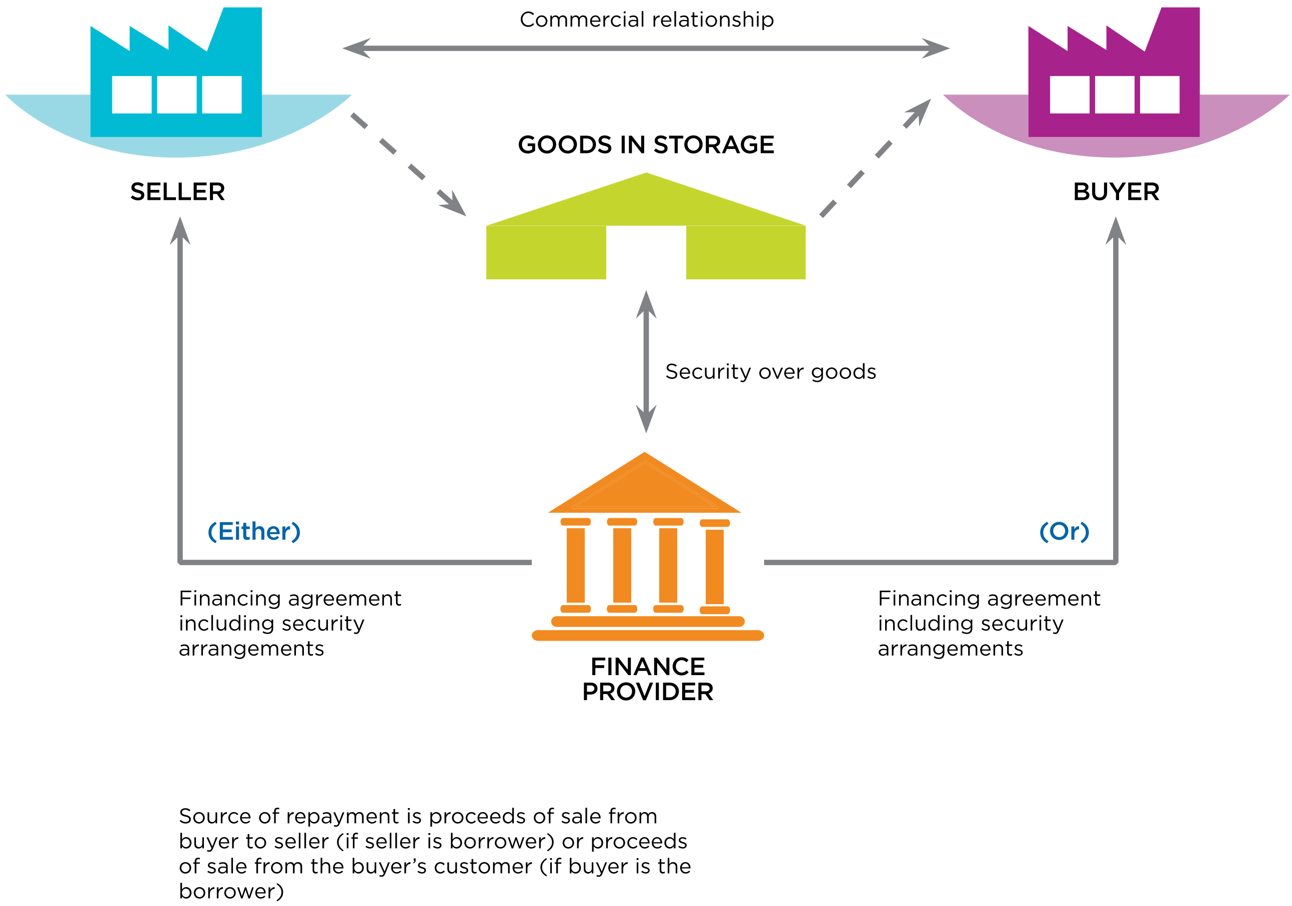
Although inventory finance is normally provided as a Loan or Advance against assets remaining on the client’s balance sheet and with recourse, in selected cases a ‘true-sale’ may occur and the inventory may be removed from the (original) inventory owner’s balance sheet. Under such an arrangement the finance provider enters into a ‘sale and repurchase’ (repo) agreement for the goods being financed. In less common cases involving a true-sale, there may not be a repo, but a more general obligation to retire the funding.

A further model for inventory finance may be offered by means of Floor Plan Finance whereby finished stock is placed in the hands of a distributor by a manufacturer and financed by a finance provider

Trading parties may enter into a variety of inventory finance transactions for the management of inventory or work in progress, whereby the latter may be physically on the premises of one party but under the ownership of and financed by the other party. Such models are referred to as Vendor Managed Inventory (VMI) or more traditionally consignment stock.

Transaction flow: illustrative only

Figure 11: Loans or Advances against Inventory



Source: Global SCF Forum

3.5.4. Pre-shipment Finance

Definition

Pre-shipment Finance is a loan provided by a finance provider to a seller of goods and/or services for the sourcing, manufacture or conversion of raw materials or semi-finished goods into finished goods and/or services, which are then delivered to a buyer. A purchase order from an acceptable buyer, or a documentary or standby letter of credit or Bank Payment Obligation, issued on behalf of the buyer, in favour of the seller is often a key ingredient in motivating the finance in addition to the ability of the seller to perform under the contract with the buyer.

Synonyms

Purchase Order finance, Packing credit/finance, Contract monetization financing.

Distinctive features

Pre-Shipment Financing covers the working-capital needs of the seller, including procurement of raw materials, labour, packing costs, and other pre-shipment expenses in order to allow the seller to fulfil delivery to its buyer(s). Pre-shipment Finance can be provided in any number of structural variations. Financing can be provided against purchase orders (confirmed by buyer or unconfirmed), demand forecasts or underlying commercial contracts.

Although Pre-shipment Financing is most commonly provided in an open account situation, other sources of repayment from the buyer may also be the proceeds of a Documentary Credit or standby letter of credit or a Bank Payment Obligation. Pre-shipment Finance can be provided on a programmatic basis, covering a series of transactions (typically for smaller sellers) or on a transactional basis (typically for larger sellers).

The finance provider is likely to advance a certain percentage of the value of the order, potentially disbursed in stages as the order is fulfilled. Maturity dates for the financing are established between the seller and finance provider and are often tied to the ultimate date on which the buyer will make payment.

Upon shipment, the finance provider may offer post-shipment financing using techniques such as Receivables Discounting, or Payables Finance to cover the period from shipment and the raising of the invoice until the final payment by the buyer.

Parties

A typical Pre-shipment financing transaction involves two main parties: the seller and the finance provider. The buyer is not a party to the financing transaction but depending on the contractual arrangement with the finance provider, the source of the repayment is usually the flow of sales proceeds from the buyer. The history of the commercial relationship is a factor in determining the probability of repayment. Bank and non-bank finance providers are active in this type of financing particularly in Asia.

Contractual relationships and documentation

The seller and finance provider enter into a financing agreement detailing terms of the financing structure. This may but will not always include a security agreement covering assignment of rights (transfer of title or a pledge) to the underlying work in progress and finished goods prior to shipment. The finance provider may require a security interest in the receivables following shipment. The seller may grant inspection rights to the finance provider or its nominated agent for the period of manufacture or conversion.

Security

As described in the previous section, a security agreement will be executed covering assignment of rights (transfer of title or a pledge) to the underlying work in progress and finished goods prior to shipment and to the receivables following shipment.

Risks and risk mitigation

The primary risk is the performance risk of the seller as repayment is dependent on the seller's performance ability and reputation. Specifically, the seller's ability to perform against the purchase contract, and the buyer's ability and willingness to pay on delivery of the goods are the key risks. Mitigation of risk is provided by the credentials of a creditworthy and reliable buyer and the proven performance of the seller in a repeatable and predictable fashion. Security over assets prior to shipment is an important control mechanism, but is not the primary source of risk mitigation.

Transaction illustration

The finance provider will work with the seller to establish a transaction structure, and will undertake credit assessment of both the seller and of the buyer in order to assess its credentials to meet its purchasing obligations. It will monitor the issuance of purchase orders by the buyer and provide finance to the seller in stages against materials purchases, work-in-progress and invoiced amounts. All subsequent actions and events taken by the seller once the order is received will be closely controlled and monitored in relation to fulfilment of the order. Sequential financing may occur in any chosen form as agreed by the parties.

Benefits

The benefit to the seller of this form of finance is the ability of the seller to obtain finance for the fulfilment of an order from a buyer, in circumstances where it is possible that other forms of finance are financially less attractive or not available.

The benefit for the finance provider is that rather that there is greater control and reassurance based on the trading relationship between the seller and its buyer(s).

Asset distribution

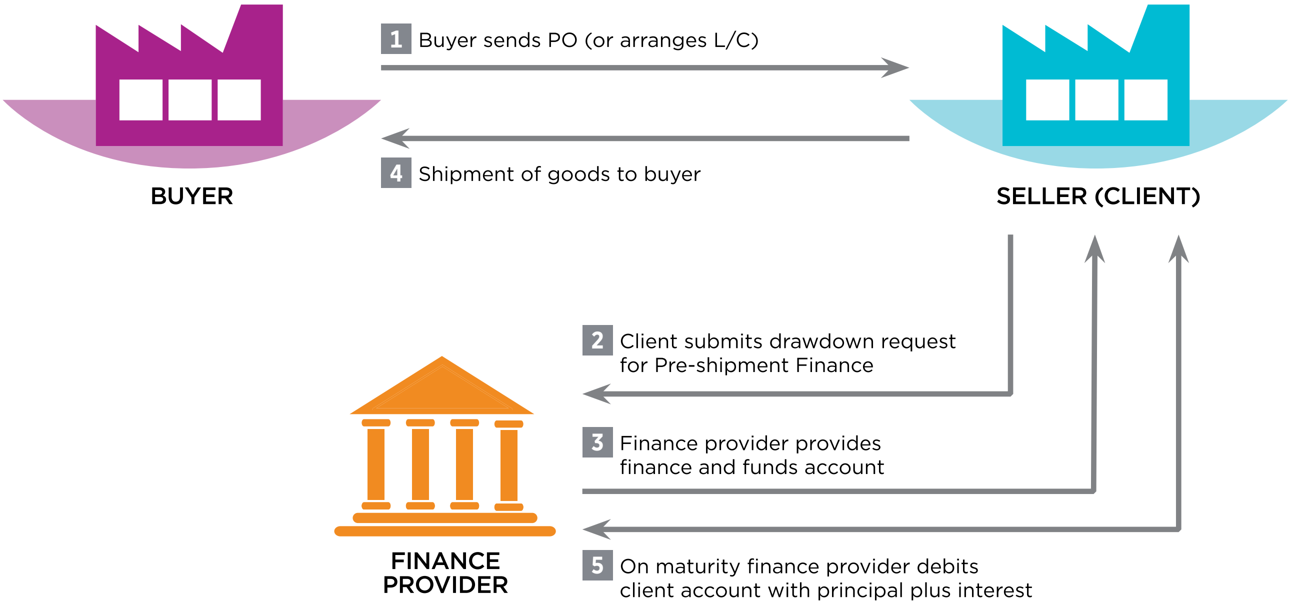
Such financings are typically offered by one provider although in the event of very large amounts distribution techniques might be used.

Variations

There are many variations on the technique of Pre-shipment Finance, such as finance undertaken against a general contractual framework established by a buyer with a seller, and finance extended against a letter of credit established by the buyer in favour of the seller (so-called red and green clause letters of credit- see Glossary).

Transaction flow: illustrative only

Figure 12: Pre-shipment Finance



Source: Global SCF Forum

3.6. Bank Payment Obligation (BPO)

Note: The BPO, as described below, is not strictly an SCF technique, but is an 'enabling framework' for the provision of trade and supply chain finance, risk mitigation and payment services.

The BPO is included in these definitions because it is a technology and data-driven enabling framework that has significant potential for facilitating SCF solutions based on open account trade flows, in addition to its role as a payment mechanism. As a cooperatively developed instrument, with a common set of rules developed by ICC, the BPO deserves its treatment herein.

It is recognised that there are other proprietary enabling and operational frameworks for the deployment of SCF techniques offered by individual or groups of finance providers. Traditional trade finance instruments, such as Documentary Credits, also act as enabling frameworks for trade finance and are extensively documented elsewhere.

In describing the parties to a BPO, the definition refers to 'banks' instead of finance providers as used in other SCF technique definitions, due to the fact that the Uniform Rules for Bank Payment Obligations (URBPO) applies only to banks and the required Transaction Matching Application (TMA) is only accessible by banks at this time.

Given the characteristics of the BPO the headings under which the BPO is described below differ slightly from those used earlier in the definition of the other SCF techniques.

Definition

The BPO is an inter-bank instrument to secure payments against the successful matching of trade data. As per the Uniform Rules for Bank Payment Obligations, the 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 resulting in a Data Match or an acceptance of a Data Mismatch' (URBPO, ICC Publ. No. 750E).

Synonyms

There are no current synonyms for BPO.

Distinctive features

BPO combines some of the features of a Documentary Credit but with the intention to meet the needs of open account trade transactions. As a conditional payment mechanism, it may be issued to make immediate (sight) payments or deferred payments, based on the irrevocable undertaking of the obligor bank towards the recipient bank. The matching of trade data on an electronic matching platform triggers this irrevocable undertaking.

The BPO, especially those with deferred payment periods, provides opportunities for the provision of SCF to the buyer and the seller, together with various business opportunities for participating banks in financing trade transactions. The BPO should therefore be seen as an enabler for partner bank-based SCF solutions, in addition to its role as a payment mechanism. The BPO creates SCF opportunities both before and after shipment.

The BPO uses the 4-corner model, involving the buyer, buyer's bank (obligor bank), seller and seller's bank (recipient bank). The role of banks in providing the BPO and cooperating with each other as partner or correspondent banks at each end of the transaction, offers a number of benefits. Each bank is fully versed in the circumstances of their respective clients (and will have completed KYC procedures and compliance checks) and typically have a willingness to apply appropriate credit facilities for their customers to support the specific obligations created by the BPO. Their presence in different geographic territories, market knowledge, and mutual agreements provide a framework for the execution of trade transactions and related financings on a global basis in both developed and emerging markets.

Parties

The parties to the BPO are the buyer, obligor bank (buyer's bank), seller (supplier) and recipient bank (seller's bank). The role taken by the parties will vary.

BPO transaction flow

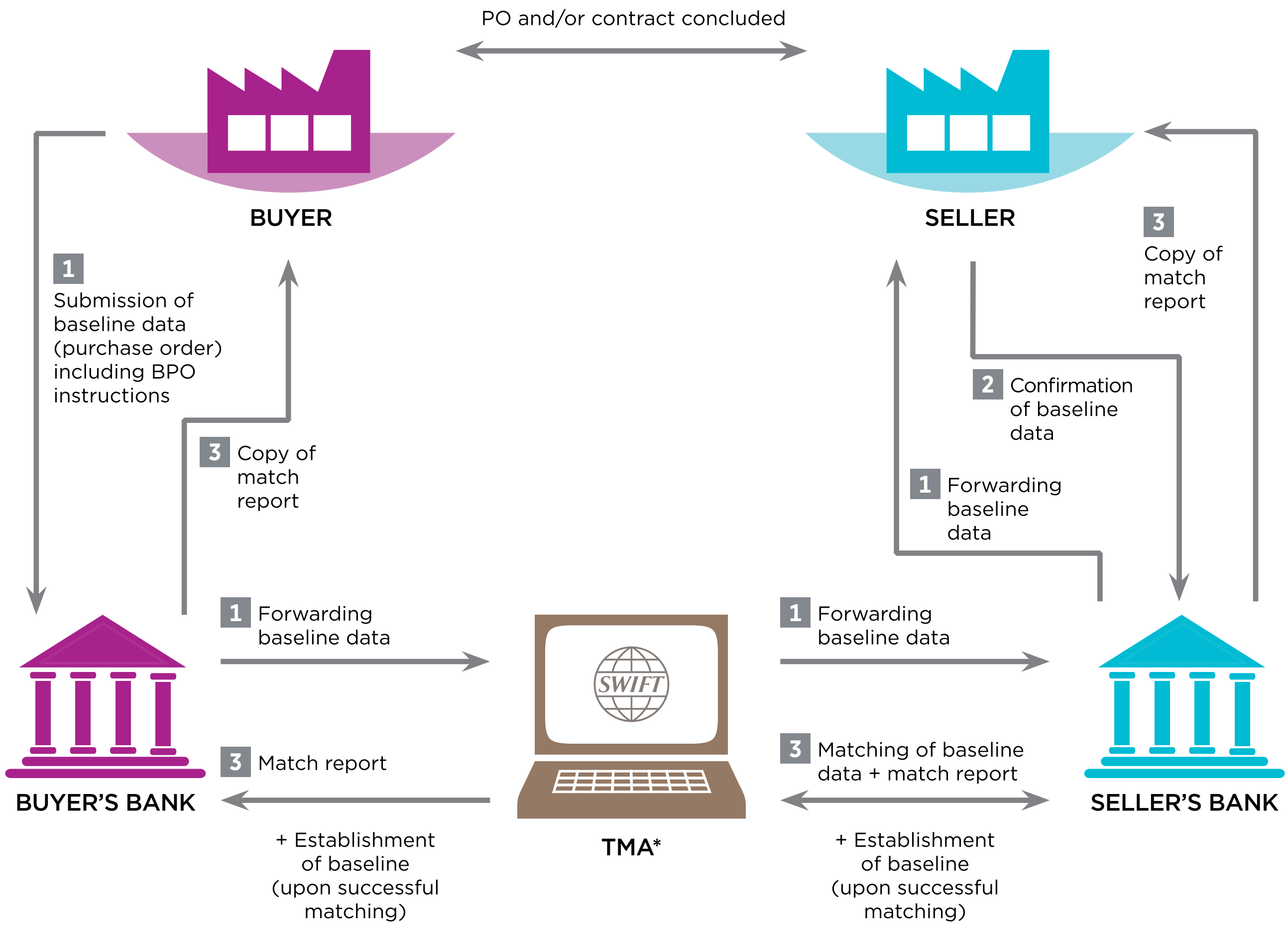
Instead of physical documents being presented to banks as is the case with Documentary Credits, trade data is electronically submitted by the buyer and the seller to their banks and automatically matched on a special purpose platform called a Transaction Matching Application (TMA) using the standard format ISO20022 TSMT (Trade Services Management) This is an XML standard designed exclusively for exchanging data between involved banks and the TMA. The matching takes place via the TMA, against an established 'baseline'. Only regulated banks have access to TMA to undertake these transactions.

The establishment of the baseline is the first step and identifies the data elements agreed between the buyer and the seller as the basis for triggering the payment obligation and any subsequent financing. The established baseline forms the basis for the matching of the data set and can only be amended with the agreement of all BPO parties involved. It would be usual for the required data elements to constitute the baseline to be drawn from the purchase order, although a requirement for other data elements may be included.

After shipment, as a second step, the seller submits the trade data (data set) for automatic matching against the established baseline on the TMA. Upon successful matching (with zero mismatches), the BPO becomes due and the obligor bank is automatically obliged to pay the BPO amount at maturity to the recipient bank. In the event of mismatches, the buyer is contacted for acceptance of the mismatch and the BPO becomes due if and when the approval is received.

The payment of the BPO at maturity is effected outside the TMA through normal payment channels. The two figures below illustrate the establishment of the baseline and the matching of the trade data.

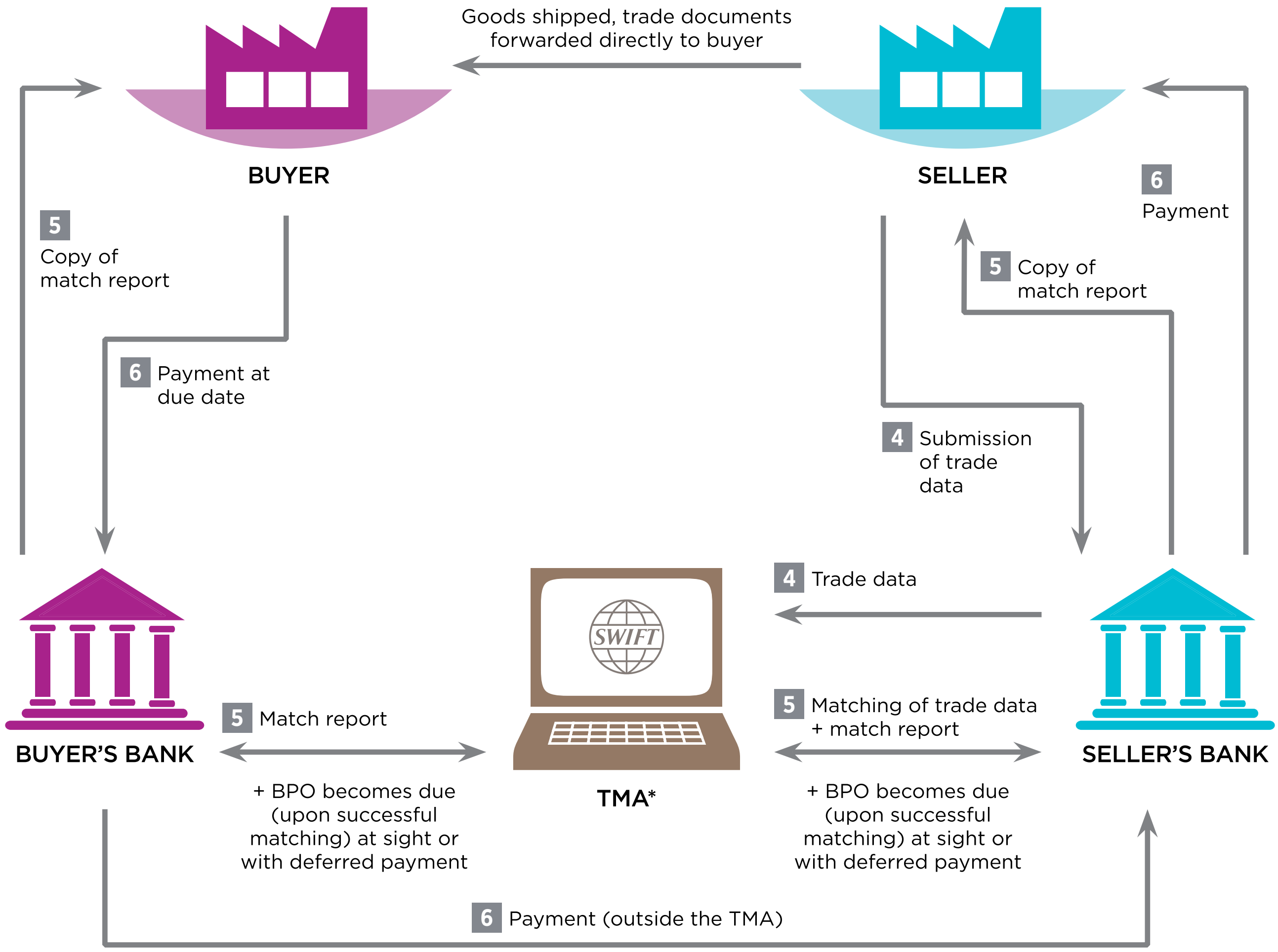
Figure 13: Establishing the baseline



* Trade Matching Application, e.g. SWIFT TSU

Source: Global SCF Forum

Figure 14: Matching of trade data



* Trade Matching Application, e.g. SWIFT TSU

Source: Global SCF Forum

3.6.1 BPO as an enabling framework for SCF

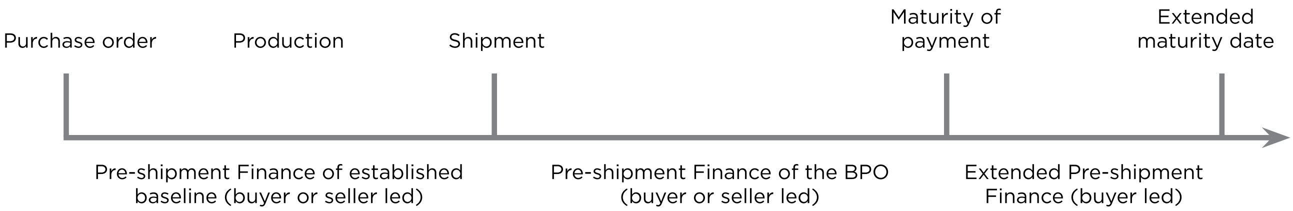
Depending on the existence of relevant partner bank relationships, the 4-corner model provides the opportunity to offer SCF in various countries and markets.

Most obviously, there are opportunities for the discounting of receivables due under a BPO based on the risk of the obligor bank. Further finance opportunities are also available, such as Pre-shipment Finance, the early settlement of the undertaking of an obligor bank to a recipient bank, or an extension of the timeframe for payment by the obligor bank in favour of the buyer.

For example, upon the successful matching of data sets (extracted from invoice and perhaps transport and other documents) against the established baseline (usually based on the purchase order), the BPO becomes due and the irrevocable undertaking of the obligor bank can offer the basis of a financing within the '4-corner model'.

The Figure 15 illustrates a number of spaces: pre-shipment, post-shipment and extended post-shipment, which offer SCF opportunities.

Figure 15: Bank Payment Obligation as an enabling framework for Supply Chain Finance



Source: Global SCF Forum

Variations of SCF to be contemplated under the BPO as an enabling framework

1. **Post-shipment finance BPO – discounting of the deferred payments after successful matching of trade data**

- Financing requested by the seller and effected by the recipient bank

The seller instructs its bank (recipient bank) to discount the deferred payment outstanding for the period of the BPO after the matching of trade data. The financing is provided without using the seller's credit line, but is earmarked under the obligor bank's credit line at the recipient bank. The seller receives early payment of the BPO amount less discount charges. A finance agreement between the seller and recipient bank is the contractual basis for this financing (including the components of recourse).

- Financing requested by the obligor bank and effected by the recipient bank

The obligor bank (on behalf of the buyer) instructs the recipient bank to advance the BPO amount to the seller after the matching of trade data. The financing is booked under the obligor bank's credit line at the recipient bank. The seller receives early payment of the full BPO amount, the obligor bank is charged with the BPO amount plus financing costs. A financing agreement between the recipient bank and obligor bank is the contractual basis for this financing.

- Advance of payment requested by the buyer and effected by the obligor bank

The buyer instructs its bank (obligor bank) to advance deferred payment obligation created after the matching of trade data due under the BPO to the seller. The obligor bank finances the deferred payment period and pays the BPO amount to the recipient bank in advance. The seller receives early payment and the buyer is charged in addition to the BPO amount with the financing costs. A financing agreement between the buyer and the obligor bank is the contractual basis for this financing.

- Financing requested by the buyer after maturity date of the BPO (refinancing of the obligation of the buyer to meet a maturing BPO which can be characterised as extended post-shipment finance)

At maturity date of the BPO, the buyer requests its bank (obligor bank) to extend credit to it for an additional period, so as to meet the maturing BPO. This financing does not affect the handling of the BPO as between obligor and recipient bank, i.e. the BPO amount is fully paid by the obligor bank at maturity. But based on a financing agreement between the buyer and the obligor bank, the obligor bank recovers the funds due under the BPO together with the financing charges from the buyer's account at a later date agreed between them.

2. **Pre-shipment Finance based on a BPO transaction**

An established baseline containing reference to the issuance of the BPO (and often data present in a purchase order) offers a first level of security for the transaction, as it provides the basis of the source of repayment, provided that the seller performs its contractual obligations. The established baseline enables the seller to prepare and ship goods and therefore provide the trade data for a successful data set matching and payment by the obligor bank at maturity date. In this way the BPO is facilitating Pre-shipment Finance based on the purchase order (see chapter 3.4.4). A financing agreement between the seller and the recipient bank would be the contractual basis for this financing.

Contractual relationships and documentation

For the BPO transaction flow

Obligor and recipient banks rely on the ICC Uniform Rules for Bank Payment Obligations (URBPO), which came into force on 1st July 2013, and the contractual agreement of the Transaction Matching Application, such as SWIFT's Trade Services Utility.

The contractual relationships of the buyer and seller for the handling of the BPO transaction with their respective banks (obligor and recipient bank) need to be agreed bilaterally. To support the issuance of these agreements, ICC has published 'Guidelines for the Creation of BPO Customer Agreements' in August 2015, with reference to clauses which should be part of such contracts in the corporate-to-bank space. The use of a Bank Payment Obligation needs to be agreed as a defined payment term between buyer and seller in their underlying commercial contract.

For financings under a BPO

Due to the fact, that such financings are not included in the BPO transaction itself, financing agreements (quite separate to the BPO itself) involving the relevant parties i.e. seller & recipient bank, buyer & obligor bank or between the recipient and obligor bank, need to be established. The terms of such financing agreements will depend on the type of finance. (see above 'Variations of SCF to be contemplated under the BPO as an enabling framework')

Security

The irrevocable payment undertaking of the obligor bank to effect payment at maturity is based on the buyer's credit worthiness. It does not only secure the payment itself, but also provides security for financing by the recipient bank or the obligor bank, depending on the type of finance. In the 4-corner model, the reliability of the bank-to-bank relationship provides additional security for the financing.

The existence and authenticity of the trade transaction is secured by two matching processes of the BPO transaction: 1) matching of baseline data between buyer and seller and 2) matching of trade data against the established baseline. According to their contractual agreements, the buyer and seller are obliged to provide correct data for the matching, and the banks concerned are not expected to verify the authenticity of data; therefore, a trusted trading relationship between the trade partners is essential.

Risks and risk mitigation

Post- shipment Finance under a BPO

The risk for the obligor bank is that the buyer does not make payment of the BPO amount at maturity. This risk is mitigated by buyer's credit worthiness and the establishment of an appropriate credit facility.

The risk for the recipient bank engaged in any financing under the BPO is the failure of the obligor bank to meet its obligations for whatever reason. The recipient bank needs to establish the necessary credit line for the obligor bank.

Pre-shipment Finance under a BPO

The primary risk of re-shipment finance on the basis of the established BPO baseline is the performance and credit risk of the seller, as repayment is dependent on the seller's performance ability and its provision of trade data for a successful matching against the baseline. Mitigation of risk is provided by proven performance of the seller in a repeatable and predictable fashion. Other risks and their mitigation are analogous to those under post-shipment finance above.

Benefits of the BPO and financing

For buyer:

- Reassurance that the goods will be delivered in accordance with expectations
- Controlled payment under the BPO
- Harnessing the ability of the partner banks to carry out the transaction in all its aspects
- Improved operating processes through automation
- Fast and flexible digital matching processes based on the Transaction Matching Application
- Opportunities to raised finance flexibly at various points during the transaction cycle.
- Working capital optimisation by extension of payment terms combined with financing possibilities for the seller
- Improvement of supply chain stability

For seller:

- Reassurance that payment for the goods will be made on the assumption that a successful matching of trade data against the established baseline takes place.
- The ability to raise finance against a deferred BPO, subject to the recipient bank having the required credit line for the obligor bank
- Further possibilities to raise Pre-shipment Finance
- Finance is raised against the payment undertaking of the obligor bank and the buyer's strong credit rating with the possibility of a lower implied cost of funding than would have been obtained under other financing structures
- Harnessing the ability of the partner banks to carry out the transaction in all its aspects
- Improved operating processes through automation
- Fast and flexible digital matching processes based on the Transaction Matching Application
- Improvement of supply chain stability

The BPO handling and financing offers benefits not only to large corporates, but also to small and medium-sized enterprises (SMEs), subject to status and credit availability.

Asset distribution

Financings of the BPO are typically offered by the recipient or obligor bank. In the case of very large amounts distribution techniques might be used.

3.7. Synopsis of SCF techniques

The following table is provided as a simplified summary of the SCF techniques to provide a quick and convenient overview. It categorises all techniques described in this document against characteristics the reader may find useful when judging which technique may be most appropriate for the respective individual need.

Being an enabling framework for various financing forms rather than a financing technique in itself, the BPO is not listed in this overview.

Within the characteristics offered, the techniques are classified along a scale ranging from 'never' to 'always', including the option of not being applicable:

Rating	N.A.	Never	Sometimes	Often	Usually	Always
Probability	0%	0%	25%	50%	75%	100%

Percentages may vary by financial provider and market practice. The categorisation of the techniques in the table is based on best estimates at the time of publication.

The underlying reason for such classification may result from commercial, legal, operational, technical or any other circumstances that are not further elaborated in this section, as its primary intention is to condense the detailed information provided in the preceding section.

The table should hence be used as a primary indicator, providing a first orientation and direction to the reader. In order to validate whether a specific SCF technique applies to a respective need, it is recommended to read the detailed technique description or further material quoted in this document and thereafter to seek expert advice as appropriate.

		Receivables Purchase-based				Loan/Advance-based			
Aspects		**Receivables Discounting**	**Forfaiting**	**Factoring**	**Payables Finance**	**Loans against receivables**	**Distributor Finance**	**Inventory Finance**	**Pre-Shipment Finance**
Commercial	**Large Volume**	Usually	Sometimes	Usually	Usually	Often	Often	Often	Often
	Large Value	Usually	Usually	Sometimes	Sometimes	Often	Often	Often	Often
	Low Volume	Often	Usually	Never	Often	Usually	Often	Often	Often
	Low Value	Often	Sometimes	Usually	Sometimes	Usually	Often	Often	Often
	Large Corporate Obligor	Usually	Sometimes	Often	Always	N.A.	Sometimes	Sometimes	Sometimes
	Large Corporate Creditor	Usually	Usually	Sometimes	Sometimes	Sometimes	Always	N.A.	N.A.
	SME Obligor	Sometimes	Sometimes	Sometimes	Never	N.A.	Often	Often	Usually
	SME Creditor	Sometimes	Sometimes	Usually	Often	Usually	Never	N.A.	N.A.
	Buyer-centric	Never	Sometimes	Never	Always	Never	Never	Often	N.A.
	Seller-centric	Always	Usually	Always	Never	Always	Always	Often	Always
Finance	**100% Financing**	Often	Usually	Sometimes	Usually	Sometimes	Sometimes	Sometimes	Sometimes
	Committed Facility	Sometimes	Sometimes	Sometimes	Sometimes	Sometimes	Sometimes	Sometimes	Sometimes
	3rd Party Distribution	Often	Often	Sometimes	Sometimes	Sometimes	Sometimes	Sometimes	Sometimes
	Off-Balance Sheet	Usually	Always	Usually	Usually	Never	Sometimes	Sometimes	Never
	Credit-enhanced / insured	Sometimes	Often	Often	Sometimes	Sometimes	Sometimes	Usually	Sometimes
Legal	**Loan-based**	Never	Sometimes	Never	Never	Always	Usually	Usually	Always
	Purchase-based	Always	Usually	Always	Always	Never	Sometimes	Sometimes	Never
	Disclosed	Often	Usually	Usually	Always	Often	Always	N.A.	N.A.
	Undisclosed	Often	Sometimes	Sometimes	Never	Often	Never	N.A.	N.A.
	With full recourse	Often	Sometimes	Usually	Never	Always	Never	Usually	Usually
	Without / with limited recourse	Often	Usually	Often	Usually	Never	Always	Sometimes	Never

3.8. Asset or risk distribution techniques used by finance providers

Finance providers use a number of techniques to distribute or share risk or to distribute assets to other finance providers or investors. These are listed for convenience only. See Glossary for definitions of these terms.

- Credit Insurance
- International Factoring
- Funded or Unfunded Sub-Participation
- Securitization
- Syndication
- Multilateral Institution or Export Credit Agency finance or insurance
- SCF intermediation platforms and services

3.9. Supply Chain Finance: client centric view

Following the presentation of individual definitions for the SCF techniques in Section 3.5 and 3.6, the table below offers a categorisation of SCF techniques from a client-centric perspective with the objective of further assisting readers in selecting appropriate SCF techniques to meet specific requirements.

The categorisation of SCF techniques below, still within the master definition of SCF is based on a high level view of client's supply chain. The approach is illustrated primarily because it is reflective of the solutions required by clients in their activities and comprises the procurement, conversion/ inventory and sales/distribution cycles.

1. **Procurement cycle- usually buyer-centric**
   - Payables Finance and its variations
   - Dynamic Discounting (not the subject of an SCF technique definition: see Glossary)
2. **Conversion cycle (inventory and production)- seller and buyer-centric**
   - Pre-shipment Finance and its variations
   - Loan or Advance against Inventory and its variations
3. **Sales/distribution cycle – usually seller- centric**
   - Receivables Discounting
   - Factoring and its variations
   - Forfaiting
   - Loan or Advance against Receivables
   - Distributor Finance

Part 4: Glossary

This alphabetic Glossary includes three sets of definitions covering the main terms and expressions used in the document:

- ■ **SCF techniques and related expressions and categories**
- ○ **Parties engaged in SCF transactions**
- ◆ **Components and subordinate expressions**

The definitions used are drawn from a variety of sources, including definitions already used in official publications, from other sources defining terms commonly experienced in business, and expressions defined by the authors of this document as a guide to understanding.

A

- ◆ **Account receivable:** a legally enforceable claim for payment held by a business entity against its customer for goods supplied or services rendered in execution of the customer's order, and recorded on the balance sheet. Such claims generally take the form of invoices raised by a business and delivered to the customer for payment within an agreed timeframe
- ◆ **Account payable:** a legally enforceable liability to a creditor recorded in the balance sheet, usually arising from purchases of goods and services on an open account basis and evidenced by a received invoice due to be paid within an agreed timeframe
- ◆ **Advance:** an extension of credit by means of a loan. Advance is a synonym for a loan herein.
- ◆ **Advance payment:** a payment made in advance of a prescribed event such as a due date or a contact commencement
- ◆ **Advance ratio:** the maximum percentage of the value of an asset or assets by reference to which a finance provider is prepared to make a loan or make available credit. The value of the asset or assets is reduced in the calculation by a **Security margin**, which is the inverse of the advance ratio. Where the advance ratio is 100%, the underlying finance may be termed 100% financing and may arise from a Commitment to Pay
- ○ **Anchor party**: a party usually a large buyer who facilitates a buyer-led supply chain finance programme for its suppliers and whose credit risk is the economic basis of the finance provided. It is also used to describe a large seller, which orchestrates a programme of Receivables Purchase financings in relation to its customers
- ◆ **Anti-Money Laundering (AML):** anti-money laundering regulations are a set of procedures, laws and regulations designed to stop the practice of generating income through illegal actions. In most cases money launderers hide their actions through a series of steps that make it look like money coming from illegal or unethical sources was earned legitimately
- ◆ **Approved Payables Finance**: a synonym for Payables Finance, a defined SCF technique herein
- ■ **Asset-based lending or finance**: *not* treated herein as an SCF technique but as a 'super-category' or umbrella term used by finance providers to describe their business lines, organisational units and activities. Asset-based lending or finance usually refers to a range of finance products secured by receivables, inventories and fixed assets

- **Assignee**: a person, company or entity that receives the transfer of property, title or rights under a legal arrangement
- **Assignment and assignment of rights:** a transfer of rights to an asset by means of an outright purchase for the purpose of either becoming the absolute owner, or in order to take a security interest in the asset. Assignments and their equivalent are jurisdictionally specific and therefore vary widely in terms of legal basis and form
- **Assignor**: a person, company or entity that transfers property, title or rights to the assignee under a legal arrangement
- **Audit:** the process by which financial records, business processes, and information systems are independently verified by an internal or external auditor
- **Availability:** the unutilised amount of funding or credit under a financing arrangement that could be potentially drawn or used following satisfaction of conditions precedent, transaction criteria, or requirements relating to permissible security
- **Aval:** a guarantee added to a debt obligation evidenced by a financial instrument by a third party who is not the payee or the holder, but who ensures payment should the issuing party default. The debt obligation could be a promissory note, bill of exchange, draft, note, or bond. The third party providing the aval is usually a bank or other financial institution

B

- **Bad debt:** a debt that is not collectible and needs to be written off
- **Ban on assignment:** a clause within a debtor's conditions of business, which specifically bans the assignment of the benefits or proceeds of a sale by a supplier, thereby refusing to accept the assignment of the invoice. Such bans are increasingly being challenged by legislators and the financial industry as an impediment to the raising of receivables related finance
- **Bank:** a regulated financial institution licensed to receive deposits and undertake a range of activities such as commercial, retail and investment banking
- **Bank Payment Obligation (BPO)**: an inter-bank instrument to secure payments against the successful matching of trade data. As per the Uniform Rules for Bank Payment Obligations, the 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 resulting in a Data Match or an acceptance of a Data Mismatch' (URBPO, ICC Publ. No. 750E).The BPO is not strictly an SCF Technique, but is an 'enabling framework' for the provision of various forms of SCF and other services
- **Baseline:** a term within the BPO rules defining the criteria (e.g. a dataset including a Purchase Order) required for a successful data match in a Transaction Matching Application (TMA)
- **Bill Discounting**: can be used as a synonym for Forfaiting, a defined SCF technique herein, as well as for the discounting of any bill of exchange for example arising under a letter of credit and can also be a variation of Receivables Discounting

- ◆ **Bill of exchange:** an unconditional order in writing, addressed by one person (the drawer) to another (the drawee), signed by the drawer, requiring the drawee to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money to or to the order of a specified person, or to bearer. A bill of exchange must be accepted by the drawee to be binding on it. Additional legal requirements may exist depending on the relevant jurisdiction
- ◆ **Bill of Lading**: a document which evidences a contract of carriage by sea and the taking over or loading of the goods by the carrier, and by which the carrier undertakes to deliver the goods against surrender of the documents. A provision in the document that the goods are to be delivered to the order of a named person, or to order, or to bearer, constitutes such an undertaking (source: The Hamburg Rules 1978)
- ○ **Borrower**: an entity that is lent money by a Finance Provider and who pays it back over time on an agreed basis
- ◆ **Borrowing base:** the amount of money a lender will loan to a borrower based on the value of the collateral or security that the borrower pledges. The borrowing base is usually determined by margining, where the lender determines a discount factor that is multiplied by the value of the collateral; the result is the amount that will be loaned to the company. See **Advance ratio**
- ◆ **Buy-back agreement or guarantee:** an agreement between a purchaser and a seller in which the seller agrees to repurchase goods or property from the purchaser if a certain event occurs within a specified period of time. The buy-back price is usually set out in the agreement. It is specifically used in the context of Distributor Finance, a defined term herein
- ○ **Buyer:** in the context of supply chain finance, a buyer is a corporate entity procuring goods and services, issuing orders and making payments to the suppliers, which form its supply chain
- ■ **Buyer credit:** financing that is put in place by a buyer to purchase goods or services or provided for its benefit by a third party such as an ECA. Contrast with a **Supplier credit.** Buyer credits may be incorporated into SCF transactions
- ○ **Buyer (Forfaiting)**: in a forfaiting transaction, a buyer refers, in the primary market, to the primary forfaiter who initially purchases a financial instrument or claim from an issuer or obligor and, in the secondary market, refers to a purchaser of the financial instrument or claim from the primary forfaiter or any subsequent buyer
- ○ **Buyer-centric**: a description of an SCF transaction where the origination usually takes place through a relationship with a buyer, sometimes referred to as the anchor party
- ○ **Buyer-centric SCF**: a synonym for Payables Finance, a defined SCF technique herein

C

- ■ **Channel Finance**: a synonym for Distributor Finance, a defined SCF technique herein
- ○ **Client:** a client or customer of a finance provider. In the context of the latter usage, the word client is used for the client of a finance provider. It is also used extensively to describe the user of a service offered by a professional, or generally as a synonym for customer
- ◆ **Collateral:** property or other assets that a borrower or a third party offers a lender to secure a loan or extension of credit. If the borrower stops making the promised repayments and/or interest and finance charges, the lender can take possession of the collateral to recoup its losses by means of sale. The legal perfection of collateral is jurisdictionally specific and takes

many forms. Collateral is often subject to Collateral Management procedures, e.g. collateral in a warehouse. Collateral has synonyms in the form of **Security or a security interest**

- ◆ **Collection:** refers to the general (cash) collection function of a business operating to collect funds for all outstanding invoices before they become overdue, by means of electronic payments, cheques, cash, documentary credits and collections and other means of payment
- ■ **Commercial Finance**: *not* treated herein as an SCF technique but as a 'super-category' or umbrella term used by Finance Providers to describe their business lines, organisational units and activities. Commercial Finance is usually used as a generic term for a range of asset-based finance services
- ◆ **Commitment to pay:** an obligation made by a party such as a finance provider to make a payment to meet a specified obligation at a future date
- ◆ **Committed facility:** a credit facility that is committed to be available for a stated period under specific conditions and is formally recorded as an obligation of a finance provider. The committed nature of the facility requires a more stringent credit assessment than is the case with an Uncommitted facility
- ■ **Commodity Finance**: *not* treated herein as an SCF technique but as a 'super-category' or umbrella term used by Finance Providers to describe their business lines, organisational units and activities. Commodity Finance is oriented towards the specialised market segment of commodity traders and processors and combines the use of SCF and a variety of other, often customised, financial services to meet their needs
- ◆ **Commodity:** a commodity is a raw material, e.g. foodstuff, metal ore or refined product, crude oil or oil product, for which there are normally liquid markets and which represent attractive collateral for the provision of finance
- ■ **Confidential Factoring**: a variation of factoring defined herein, in which the factored invoice or receivable is not subject to a notice of assignment and the buyer, is not aware of the factoring agreement between the seller and the finance provider. The term Confidential may also be applied to Receivables Discounting and Invoice Discounting
- ◆ **Confirmed or Confirmation**: confirmation by one party to another that an obligation or contract has been accepted and will be discharged. In the case of a Letter of Credit, upon request by the issuing bank, the advising bank adds its confirmation to the Letter of Credit, meaning that it commits itself to honour the payment in case the issuing bank fails to fulfil its obligation. A confirmation is a separate irrevocable and abstract undertaking to honour or negotiate complying document under the Letter of Credit ruled by UCP 600
- ■ **Confirmed Payables**: a synonym for Payables Finance, a defined SCF technique herein. Confirming is also used in Iberia to describe a variation of Payables Finance based on local practices
- ■ **Confirming:** a variation of Payables Finance, typically provided in Spain under a local structure
- ■ **Contract Monetization:** a synonym for Pre-shipment Finance, a defined SCF technique herein. Contract monetization is used more widely as a financial technique, outside the SCF and trade environment
- ○ **Corporate client**: a customer of a Financial Institution, which is an incorporated business entity of all kinds and ranging in size from a multinational, large domestic corporation, to a small and medium-sized business

- **Correspondent bank**: a financial institution that provides services on behalf of another financial institution. A correspondent bank can conduct business transactions, accept deposits and gather the proceeds of trade transactions on behalf of the other financial institution. Correspondent banks are more likely to be used to conduct business in foreign countries, and act as a domestic bank's agent abroad
- **Correspondent factor**: a finance provider that acts as an Import Factor or Export Factor under the Two-Factor system
- **Counter-trading:** a situation where two trading parties are buying and selling goods and/or services to each other, thus creating mutual obligations to settle invoices in both directions, or settle differences only
- **Country risk:** a collection of risks associated with investing in or creating exposure to a particular country. These risks include political risk, exchange rate risk, economic risk, sovereign risk and transfer risk, which is the risk of funds being frozen for external transfer by government action. Country risk varies from one country to the next
- **Credit control:** the system and procedures used by a business to manage its sales ledger, make certain that it extends credit only to customers who are able to pay, and that customers pay on time
- **Credit enhancement:** methods by which a finance provider is provided with additional rights, such as collateral, insurance, or a third party guarantee, to secure payment by a borrower or obligor
- **Credit Insurance**: insurance purchased by businesses to insure payment of sums due in relation to credit extended to trade debtors. It may be used as is a form of credit enhancement to protect finance provider providing receivables finance
- **Credit note:** a document issued by the seller of goods or services to the buyer, reducing the amount that the buyer owes to the seller under the terms of an earlier invoice. This may be due to a failure to deliver invoiced goods, a return of goods, or as the result of a dispute
- **Credit rating:** an evaluation of the credit worthiness of a debtor, a business or a government, but not individual consumers. The evaluation is made by a credit rating agency of the debtor's ability to pay back the debt (both short term and long term) and the likelihood of default. A rating is usually reflected in a grading range such as AAA to C
- **Credit risk:** the risk that a borrower or obligor will default on any type of debt or contractual obligation by failing to make required payments
- **Credit risk insurer**: an entity which offers to insure credit and, usually, political risk in relation to one obligor or transaction or a portfolio or continuing line of specified trade transaction or obligors. Such entities may be either private companies or public or semi-public institutions such as ECAs
- **Creditor**: an entity that is owed money, often being the supplier or seller of goods and services
- **Customer**: a person or entity which buys goods and services, ranging from a buyer in a supply chain to the user of financial services offered by a finance provider. For the sake of clarity, the latter is described herein as a **Client**

D

- ◆ **Data match or matching:** compares submitted data or datasets with a baseline or criteria and declares a match or non-match in a chosen environment e.g. a matching engine or a TSU (trade services utility)
- ◆ **Dataset:** a collection of data usually from a common source and assembled for a particular business or other purpose. The term is used generally to define data that could historically have been brought together in a document, but in an automated process is transmitted as a dataset. Under the rules of the BPO, datasets must be matched prior to a payment obligation becoming due.
- ○ **Debtor**: an entity which owes money under a commercial or financial transaction
- ◆ **Days Payables Outstanding (DPO)**: an efficiency ratio that measures the average number of days a business takes to pay its suppliers
- ◆ **Days Sales Outstanding (DSO)**: an efficiency ratio that measures the average number of days a business takes to collect the proceeds of invoices due from its customers, i.e. its average collection period
- ◆ **Dilution(s):** every situation that may reduce the value of an outstanding invoice except default by the debtor. Typical causes are returns, credit notes, commercial dispute, etc.
- ◆ **Disclosed or undisclosed:** when a finance provider undertakes a transaction such as a Receivables Purchase it may or may not be advised to or disclosed to the underlying debtor. Undisclosed might be described as Confidential or Non-Notification as in Confidential or Non-Notification Factoring
- ◆ **Discount rate or charge:** when a purchaser purchases a bill of exchange or an account receivable from a seller, the rate at which it is paid (discounted relative to its face value) prior to its maturity date
- ■ **Discounting of Promissory Notes**: a synonym for Forfaiting, a defined SCF technique herein
- ◆ **Distribution or third party distribution:** a general term for the various methods of selling or sharing financial risk (both funded and unfunded) in an underlying financial transaction with investors such as another financial provider, insurer or other. Typical examples are Syndication and Sub-Participation
- ○ **Distributor**: a person or entity that supplies goods on a wholesale basis to retail outlets or companies. It may be a manufacturing entity, an arm of a manufacturing entity or an independent entity
- ■ **Distributor Finance**: a *defined SCF technique* herein where a finance provider provides financing for a distributor of a large manufacturer to cover the holding of goods for re-sale and to bridge the liquidity gap until the receipt of funds from receivables following the sale of goods to a retailer or end-customer
- ◆ **Documentary collection**: the handling by banks of documents in accordance with instructions received in order to obtain payment and/or acceptance, or deliver documents against payment and/or against acceptance, or deliver documents on other terms and conditions, if subject to internationally recognised rules of practice issued by the International Chamber of Commerce (ICC). ICC's current publication is called Uniform Rules for Collections (URC 522). This publication also defines the documents handled thereunder

- **Documentary Letter of Credit:** an irrevocable undertaking by an institution (the issuing bank) to the beneficiary of the Documentary Letter of Credit on behalf of their client to pay the stated amount at sight or at a determinable future date or to accept a draft and effect payment at maturity subject to the presentation of compliant documents as stated in the terms and conditions of the Letter of Credit. They are usually subject to internationally recognised rules of practice issued by the International Chamber of Commerce (ICC). ICC's current publication is called Uniform Customs and Practice for Documentary Credits (UCP) 600
- **Documentary Trade Finance**: a term that covers a large element of the traditional trade finance market relating to instruments such as Documentary Credits, Documentary Collections and Guarantees, which are usually governed by rules published by the ICC (e.g. UCP 600 for Letters of Credit (or later version) or URC 522 for Collections or URDG 758 for Guarantees). Although not SCF techniques in their own right, these instruments can be incorporated into SCF transactions or used alongside SCF techniques
- **Domestic Factoring**: a variation of Factoring defined herein, in which the buyer is situated in the same country as the seller. Country-specific rules or regulations may apply due to the domestic character of the transaction
- **Double-financing or Double-pledging:** the fraudulent practice of raising funds more than once on the same receivable or other asset
- **Draft:** an alternative term for a bill of exchange or check/cheque
- **Due diligence:** an investigation or audit of a potential investment or transaction. Due diligence serves to confirm all material facts in regards to a transaction. Generally, due diligence refers to the care a reasonable person should take before entering into an agreement or a transaction with another party
- **Dynamic discounting**: describes a number of methods through which early payment discounts on invoices awaiting payment are offered to sellers and funded by the buyer. The service is dynamic in the sense that the earlier the payment the higher the discount

E

- **Early payment:** in receivables purchase, early payment is often used to portray the transaction as early payment of an invoice and is sometimes used as a synonym for receivables discounting
- **Electronic invoicing:** e-Invoicing is the exchange of the invoice document between a seller and a buyer wholly in an integrated electronic format or dataset. Traditionally, invoicing, like any heavily paper-based process, is manually intensive and is prone to human error resulting in increased costs and processing lifecycles for companies
- **Endorsement:** a legal term that refers to the signing of a document which allows for the legal transfer of a negotiable instrument from one party to another
- **Export Credit Agency (ECA)**: a financial institution or agency that provides trade financing to exporters. Export credit agencies usually provide guarantees, loans and credit insurance in order to promote exports by removing the risk and uncertainty of payments. Typically, ECA's provide credit support and less commonly actual financing ECAs may also underwrite the commercial and political risks of investments in overseas markets. ECA insurance may be used in an SCF transaction to provide credit risk enhancement for the Finance Provider
- **Export Credit Agency (ECA) Finance**: a form of trade finance provided by ECAs, which provide guarantees, loans and credit insurance in order to promote exports by removing the risk and

uncertainty of payments. Typically, ECA's provide credit support and less commonly actual financing. ECA Finance maybe combined with SCF to enhance the risk profile of a transaction

- ○ **Export Factor**: factor involved in the seller's country or elsewhere in the context of international factoring
- ■ **Export Factoring**: a variation of factoring defined herein, in which the assignor, based in the country of the factor, assigns or sells receivables due by debtors based in another country. It is also included in the definition of International Factoring

F

- ◆ **Face value:** the principal or redemption value of a financial instrument or claim
- ○ **Factor**: a financial institution providing factoring facilities
- ■ **Factoring**: a *defined SCF technique* herein as a form of Receivables Purchase, in which sellers of goods and services sell their receivables (represented by outstanding invoices) at a discount to a finance provider (commonly known as the 'factor'). A key differentiator of Factoring is that usually the finance provider becomes responsible for managing the debtor portfolio and collecting the payment of the underlying receivables
- ◆ **Factoring agreement:** the agreement between the finance provider (factor) and a client setting out the terms on which a factoring arrangement is made available, including scope, charge, operational procedures and security to be taken
- ○ **Finance provider**: a bank, financial institution, or other regulated or non-regulated provider of finance and related services, specifically herein in the context of supply chain finance
- ○ **Financial institution**: a provider of financial services in the broad sense, usually referring to banks and other regulated entities such as insurance companies, investment dealers and trust companies. It includes, by definition, a range of non-bank financial institutions
- ◆ **Financial instrument:** a tradable asset of any kind; either cash, evidence of an ownership interest in an entity, or a contractual right to receive or deliver cash or another financial instrument. In Forfaiting, rights under the financial instrument are normally independent of the underlying transaction which gave rise to the financial instrument, since they rely on the legal obligations created by the legal status of the financial instrument itself
- ◆ **Financial Supply Chain**: the chain of financial processes, risk and liquidity management decisions, events and activities that provide financial support to the physical supply chain
- ■ **Financial Supply Chain Services**: *not* treated herein as an SCF technique but as a 'super-category' or umbrella term used by Finance Providers to describe their business lines, organisational units and activities. Financial Supply Chain Services include a range of services such as purchase order management and electronic invoicing, payments and cash management and supply chain finance
- ○ **Financier**: a general expression for any person or entity that provides finance in various forms.
- ◆ **Financing margin:** a margin built in to an interest rate or discount rate charged to a client to cover risk and a level of profit for the finance provider
- ■ **Floor Plan Finance:** is a synonym for Distributor Finance, a defined SCF technique herein, specifically relating to finance of vehicles and machinery placed for sale on the sales floor of a dealer

- **Forfaiter**: a provider of forfaiting services, either being a bank or a non-bank financial institution.
- **Forfaiting agreement**: under the Uniform Rules for Forfaiting, the agreement between the initial seller and the primary forfaiter
- **Forfaiting**: a *defined SCF technique* herein and is a form of Receivables Purchase, consisting of the without recourse purchase of future payment obligations represented by financial instruments or payment obligations (normally in negotiable or transferable form), at a discount or at face value in return for a financing charge
- **Four-corner model**: a situation where two trading parties are using the services of separate financial institutions or service providers and use their services acting on an interoperable basis to carry out intermediation functions of various kinds

G

- **GRIF:** General Rules for International Factoring, which the members of FCI (now including IFG) agree to adopt when transacting two factor cross border factoring
- **Guarantee:** any signed undertaking however named or described, provided for payment (by the guarantor) on presentation of a complying demand. Guarantees may by also subject to internationally recognised rules of practice issued by the International Chamber of Commerce (ICC) URDG 758**.** Guarantees, both financial and performance-related, issued by finance providers, form an important category of traditional trade finance techniques. More generally, a Guarantee is a promise to take responsibility for another party's financial obligations, if that party cannot meets its obligations. The party assuming this responsibility is called the Guarantor

H

- **Hedging:** a hedge is an investment position intended to offset potential losses/gains that may be incurred by a physical position in or exposure to commodities or financial assets. In simple language, a hedge is used to reduce the potential for any substantial unexpected losses or gains suffered by an individual or an organisation. Hedges are typically taken out in the form of exchange-traded futures contracts and options, or similar transactions in the over-the-counter market. Where an entity has an offsetting position within its own operations, this can be said to create a 'natural' hedge

I

- **Import Factor**: factor involved in the buyer's country or elsewhere in the context of international factoring
- **Import Factoring**: a variation of factoring defined herein, in which an export receivable is managed and collected by an import factor based in the same country as the debtor. It is also included in the definition of International Factoring and sometimes referred to as Correspondent Factoring
- **Initial seller (Forfaiting):** the person who first sells a payment claim or receivable to a primary forfaiter or creates a receivable or payment claim and transfers it to the primary forfaiter

- **Insolvency:** this will occur when an entity can no longer meet its financial obligations with its creditors as debts become due. Insolvency can lead to insolvency proceedings, in which legal action will be taken against the insolvent entity, and assets may be liquidated to pay off outstanding debts
- **Inter-Factor agreement:** an agreement between correspondent factors whereby they mutually agree to act as import and export factors under a code of practice
- **International Factoring**: a variation of factoring defined herein, in which the buyer (debtor) is situated in a different country from the seller. Country-specific rules or regulations may apply due to the international character of the debt which could affect the relationship between the finance provider, the buyer and the seller. For these reasons, often two Factors are involved, one in the buyer's country (known as the 'Import Factor') and one in the seller's country (known as the 'Export Factor'). The two Factors establish a contractual relationship to service the buyer and the seller respectively (called the **'Two Factor System'**). Typically, the two factors use the established frameworks provided by either Factor Chain International (FCI) or International Factors Group (IFG)
- **International Factoring organisations**: organisations that act as trade associations for factoring companies and which usually manage international rules for the conduct of international factoring transactions
- **Inventory Finance-borrowing base:** a variation of loans and advances against inventory defined herein, whereby the amount of finance is made available against a calculated market value of the goods (which could be of more than one type) being financed less a margin which will vary according to the quantity or quality of the goods
- **Inventory Finance-repo:** a variation of Inventory Finance defined herein, whereby the finance provider enters into a sale and repurchase agreement for the goods being financed
- **Invoice discounter**: a provider of invoice discounting facilities
- **Inventory Finance-tolling:** a variation of Loans and advances against inventory defined herein, whereby the finance is provided to allow raw materials or components to be submitted to a third party refining or manufacturing process prior to onward sale
- **Invoice:** is a document, or electronic version of the document, addressed by a supplier of goods and services to a buyer recording and describing a transaction for the supply of goods and services, requesting payment by a specified due date, and setting out any applicable taxes to be collected and remitted to a tax authority
- **Invoice Discounting:** a synonym for Receivables Purchase, a defined SCF technique herein and is also used as a variation of factoring. The term is therefore subject to varying usage
- **Islamic Trade Finance:** trade finance which complies with Islamic (Shari'ah) law. Interest cannot be charged. Instead the finance is structured using discounts, sale/lease, profit participation or repurchase agreements. It may be integrated into SCF transactions.

K

- **Know Your Customer (KYC)**: the process of a business verifying the identity and standing of its clients and the character of the business or transactions they generate. The term is also used to refer to the legal regulations which govern these activities

L

- **Large value**: a high monetary value of the items to be financed. Such large value may result from either a large or low volume of items and specifically triggers considerations related to credit and concentration risk
- **Large volume**: a high number of individual items or transactions that usually calls for automated ('straight-through') processing and a technical and operational infrastructure capable of handling such volume
- **Lender:** an entity that provides loans under an agreed credit facility or another form of credit akin to a loan
- **Loan:** making available money to another party in exchange for future repayment of the principal amount with interest or other finance charges. A loan may be for a specific, one-time amount or can be available as a variable credit line or overdraft up to a specified ceiling amount. It is also possible to make loans of actual real and financial assets
- **Loan or Advance against Inventory:** a *defined SCF technique* herein and is financing provided to a buyer or seller for the holding or warehousing of goods (either pre-sold, un-sold, or hedged) and over which the finance provider usually takes a security interest or assignment of rights and exercises a measure of control
- **Loan or Advance against Receivables**: a *defined SCF technique* herein and is financing made available to a party involved in a supply chain on the expectation of repayment from funds generated from current or future trade receivables and is usually made against the security of such receivables, but may be unsecured
- **Long warranties:** warranties in respect of goods and services that are long lasting and may over time affect the value of receivables purchased or discounted
- **Low value**: a lower monetary value relating to the individual items to be financed. For economic reasons, low-value items are likely to be processed as a large volume business
- **Low volume**: a lower number of individual items or transactions that allows for manual and individual processing on an item-by-item basis

M

- **Margin (2):** the percentage margin added to the cost of funds or a base rate to establish the interest rate to be applied to a loan or credit facility
- **Margin or Security margin (1):** a calculated deduction from the stated or market value of an asset being financed to allow for diminution of the value of the asset, while the finance provider is exposed to a borrower or obligor. See **Advance ratio**
- **Maturity date:** the date on which the principal amount of a loan, bill of exchange, note, draft, acceptance, bond or other debt instrument becomes due and is due to be paid or repaid to the creditor
- **Multilateral Institution**: a financial institution that provides advice and financing for national or regional development projects or programmes. The institution is usually owned by governments, and provides a framework of cooperation in which borrowers and suppliers of finance are represented

N

- **Negotiability and transferability:** in the case of goods, commodities, property and many financial assets, which are transferable from party to party, the general rule of law is that the transferor cannot transfer to the transferee title better than the transferor possesses. A negotiable instrument is an exception to this rule of law. The holder of a negotiable instrument in the position of being a transferee is not compromised by a fault in the title of the transferor or any other party
- **Negotiable instrument:** a written order or unconditional promise to pay a fixed sum of money on demand or at a future date. A negotiable instrument can be transferred from one party to another by Endorsement. Once the instrument is transferred, the holder obtains full legal title to the instrument. Examples also include bills of exchange, promissory notes, checks/cheques, drafts, certificates of deposit, and negotiable bills of lading
- **Non- Notification (or Confidential) Factoring:** a variation of Factoring defined herein, where the receivables to be financed are not subject to a notice of assignment and the buyer is not aware of the factoring agreement between the seller and the finance provider. The debt verification is done by the finance provider in the name of the seller. The buyer pays the outstanding invoice into a 'trust' or 'escrow' account. Factoring is usually conducted on a **notification** basis
- **Non-recourse:** see **with and without recourse**
- **Non-recourse Factoring:** a variation of Factoring defined herein, in which the receivables to be financed are subject to a 'true sale', and the Finance Provider does not have recourse to the seller in the case of buyer default. Factoring is usually conducted on a **recourse** basis
- **Notice of acknowledgement:** a notice issued by a debtor to a finance provider in which the debtor acknowledges and recognises that the debt (account payable) has been assigned to or purchased by the finance provider
- **Notice of assignment:** a notice which can be issued by a finance provider or by the assignor to a debtor, and which informs the debtor that a debt or debts (accounts payable) have been assigned or purchased by the finance provider. Also known as a Notification
- **Notification:** see Notice of Assignment
- **Novation:** the act of replacing one party to a contract with another, which may include the exchange of new debts or obligations for older existing ones with consent of all the affected parties. Unlike an assignment, obligations as well as rights may be assumed exchanged, depending on the jurisdiction

O

- **Obligor:** a synonym for any Debtor or Creditor under a financial obligation but also more specifically employed as term for a party which is obligated under payment instrument such as a Negotiable Instrument. In Forfaiting such a party is also known as the Primary Obligor. The underlying obligation may be supported by guarantees and similar arrangements provided by other parties, which create other (secondary) obligors
- **Obligor bank**: in a Bank Payment Obligation (BPO) transaction the Obligor Bank is the issuer of a BPO and is obligated to settle it at maturity, when the BPO conditions have been fulfilled through a Data Match

- **Off-Balance Sheet**: a term used to describe an asset, debt or financial transaction that is not reflected as such in the balance sheet of the obligor. Off-Balance Sheet transactions are subject to accounting rules (IFRS, IAS, USGAAP and others)
- **Open Account:** refers to trade transactions between a seller and a buyer where transactions are not supported by any banking or documentary trade instrument issued on behalf of the buyer or seller. The buyer is directly responsible for meeting the payment obligation in relation to the underlying transaction. Where trading parties supply and buy goods and services on the basis of open account terms an invoice is usually raised and the buyer pays within an agreed time frame
- **Order to cash cycle:** represents the process steps and the time interval between receipt of an order, the manufacturing or fulfilment process, delivery and the receipt of cash from the customer

P

- **Packing Credit or Packing Finance:** a synonym for Pre-shipment Finance, a defined SCF technique herein. It owes its origin to traditional trade finance practices whereby a supplier is able to draw down funds under a letter of credit to prepare goods for shipment
- **Party:** a party is any entity that becomes engaged in a financial or commercial transaction, whether a natural or legal person such as a company, corporation, financial institution, unincorporated business or government organisation or not-for-profit entity
- **Payables Finance:** a defined SCF technique herein, and is provided through a buyer-led programme within which sellers in the buyer's supply chain are able to access finance by means of Receivables Purchase. The technique provides a seller of goods or services with the option of receiving the discounted value of receivables (represented by outstanding invoices) prior to their actual due date and typically at a financing cost aligned with the credit risk of the buyer. The payable continues to be due by the buyer until its due date
- **Payment:** a means of settlement for a commercial or other obligation, such as an electronic credit transfer, direct debit, credit or debit card payment, wire transfer, automated clearing house payment (ACH), check or cash. The payment is completed when good funds are received by the creditor
- **Performance risk:** the risk associated with a party's ability to meet its obligations under a contract, in particular to procure, manufacture and ship goods, or provide services in a timely fashion according to quality standards
- **Physical Supply Chain**: a term used to describe the totality of the organisations, systems, people, activities, information, and resources involved in moving a product or service from supplier to a buyer
- **Platform:** a business processing capability embedded in an information technology system and its surrounding management
- **Pledge:** a process for taking possession of or, in some jurisdictions, non-possessory security over an asset for the purpose of securing a debt or other financial obligation. The key feature of a pledge is the fact that the creditor maintains possession of the pledged asset, but does not have ownership unless default occurs
- **Post-shipment finance:** a generic expression denoting all the SCF techniques that are employed once shipment has occurred. It will typically include all forms of receivables finance and also include the use of inventory finance

- **Pre-Export Finance:** a synonym for Pre-shipment Finance a defined SCF technique herein, where the goods or services are destined for a buyer in an export market
- **Prepayment:** repaying a loan or financial obligation before its maturity date, or paying in advance for goods **o**r other contractual liability
- **Pre-shipment Finance:** a *defined SCF technique* herein and is a loan provided by a finance provider to a seller of goods and/or services for the sourcing, manufacture or conversion of raw materials or semi-finished goods into finished goods and/or services, which are then delivered to a buyer. A purchase order from an acceptable buyer, or a documentary or standby letter of credit or a Bank Payment Obligation, issued on behalf of the buyer, in favour of the seller is often a key ingredient in motivating the finance, in addition to the ability of the seller to perform under the contract with the buyer
- **Primary Forfaiter**: the forfaiter which first purchases a financial instrument or claim from an initial seller
- **Primary market:** the marketplace where issuers of debt or other financial obligations deal directly with finance providers to raise funds. This can be described as origination and is contrasted with the secondary market where financial assets are traded and purchased by other finance providers or investors. This is a defined term in the Uniform Rules for Forfaiting
- **Procure to pay cycle:** represents the process steps and time interval between procurement, the issue of a purchase order, delivery of goods and services, receipt of invoice and payment to the supplier
- **Promissory note:** a financial instrument whereby one party (the *maker* or *issuer*) promises in writing to pay a determinate sum of money to the other (the *payee*), either at a fixed or determinable future time or on demand of the payee Typically Promissory Notes are negotiable instruments
- **Purchase order commitment to pay:** a commitment issued by a bank in favour of a seller that once goods relating to a specific purchase order have been received by the buyer, the seller will be paid. It is a form of payment guarantee
- **Purchase Order:** a buyer-generated document or dataset that authorises a purchase or procurement transaction sets out descriptions, quantities, prices, discounts, payment terms, date of performance or shipment, other associated terms and conditions, and identifies a specific seller. It is used to control the purchasing of products and services from external suppliers. When accepted by the seller, it forms the basis of a contract binding on both parties. It is also called an order
- **Purchase Order Finance:** a synonym for Pre-shipment Finance, a defined SCF technique herein, where reliance is placed on a Purchase Order issued by a reputable buyer
- **Purchaser (Forfaiting)**: see Buyer (Forfaiting)

R

- **Reassignment:** the process of reassigning an asset to the original assignor or to another assignee
- **Receivable:** the amount due from a Debtor or Obligor to a Creditor. This includes, but is more extensive than trade-related Account Receivables and for instance covers the amount due under a Negotiable Instrument

- **Receivables Discounting:** a *defined SCF technique* herein and is a form of Receivables Purchase, flexibly applied, in which sellers of goods and services sell individual or multiple receivables (represented by outstanding invoices) to a finance provider at a discount
- **Receivables Finance:** a collective expression for the various techniques of Receivables Purchase and Loan or Advance against Receivables, and may also be used as a synonym for such individual techniques
- **Receivables Purchase:** a convenient *intermediate category* of SCF techniques, which is defined herein and includes SCF techniques such as Receivables Discounting, Forfaiting, Factoring, and Payables Finance and includes a range of synonyms and variations
- **Receivables Purchase agreement:** an agreement between a finance provider and a client (supplier) to cover the purchase of individual or a portfolio of receivables
- **Recipient bank (BPO)**: the bank which receives a Bank Payment Obligation (BPO) in its favour and which on meeting the conditions specified in the BPO is entitled to receive money from the Obligor Bank on behalf of a client
- **Recourse:** see with and without recourse
- **Reserve/Retention**: the part of a receivable(s) retained by a factor to cover specific risks such as dilutions
- **Reverse Factoring:** a synonym for Payables Finance, a defined SCF technique herein
- **Risk Participation:** an unfunded Sub-Participation

S

- **Sale and Repurchase (Repo):** an alternative to a loan whereby a finance provider enters into a sale and repurchase agreement for the goods or financial assets being financed. The finance provider acquires title to the goods or financial assets concerned at the commencement of the transaction and reverses the process at a future date. The parties may include a margin to protect against the diminution in value during the life of the transaction. **See Advance ratio**
- **Sales Ledger Management:** the process of management of a portfolio of accounts receivable including **Credit** Control defined herein. Under a factoring agreement it is common for the factor to take responsibility for sales ledger management
- **SCF Intermediation Platform:** a technology and business platform, which brings sellers and purchases of SCF financial assets together for the trading and settlement of transactions
- **Secondary market**: the counterpart of the Primary market. In a secondary market financial assets are traded and purchased by other finance providers or investors, not involved in the primary origination of the transaction
- **Securitization:** the process of taking an illiquid asset, or group of assets, such as a portfolio of receivables, and through financial intermediation, transforming them into a security or tradable financial obligation
- **Security interest:** an interest created by agreement or by operation of law over assets to secure the performance of an obligation, usually the payment of a debt. It gives the beneficiary of the security interest certain preferential rights in the disposition of secured assets
- **Seller**: a supplier of goods and services

- **Seller (Forfaiting)**: an Initial Seller and any subsequent seller of the payment claim in the secondary market
- **Seller-centric**: a description of an SCF transaction, where the origination takes place through a relationship with a seller of goods and services
- **Silent:** means undisclosed. See **Disclosed or undisclosed**. Often used in connection with a Silent Guarantee or Silent Confirmation of a Letter of Credit
- **SME**: a small or medium-sized business
- **Stop-supply letter:** a letter from a seller to a distributor informing it that supply of goods will cease, as a method of protecting the seller's interests in the event of a distributor being unable to meet its obligations
- **Structured Trade Finance:** a general expression for the provision of finance for trade, where a variety of structures and techniques, which may include SCF techniques, are incorporated into a bespoke transaction or a specific financing solution. Such solutions often involve security being taken over assets, commodities or commercial off-take contracts
- **Sub-Participation**: an agreement between a finance provider who has incurred or is to incur a financial exposure on, or lend funds to, a debtor or obligor and another finance provider under which the second finance provider either provides funds to the first finance provider to fund that exposure or loan (in the case of a funded Sub-Participation) or provides a commitment to cover any losses of the first finance provider (in the case of an unfunded Sub-Participation). Repayment of the second finance provider in the case of a funded Sub-Participation is normally dependant on receipt of corresponding amounts by the first finance provider from the debtor or obligor. This may be, but is not always, the case in the case of an unfunded Sub-Participation. The existence of the second finance provider is normally undisclosed to the debtor or obligor. The second finance provider may, depending on the law of the Sub-Participation agreement, receive a derivative interest in the exposure or loan or may simply acquire rights against the first finance provider rather than the debtor or obligor
- **Supplier credit:** financing arranged by a supplier with or without a finance provider to enable it to provide credit terms to a buyer of its goods or services. Contrast with a **Buyer credit**
- **Supplier Finance:** a synonym for Payables Finance, a defined SCF technique herein
- **Supplier Payments:** a synonym for Payables Finance, a defined SCF technique herein, and denotes the idea that Payables Finance can be described as offering early payment of an invoice to a seller
- **Supplier**: a party that supplies goods and services to a buyer
- **Supplier-centric**: see **Seller centric**
- **Supply Chain Finance**: the *master definition* of SCF, which is discussed extensively herein and is defined as the use of financing and risk mitigation practices and techniques to optimise the management of the working capital and liquidity invested in supply chain processes and transactions. SCF is typically applied to open account trade and is triggered by supply chain events. Visibility of underlying trade flows by the finance provider(s) is a necessary component of such financing arrangements, which can be enabled by a technology platform
- **SWIFT:** the Society for Worldwide Interbank Financial Telecommunication, a member-owned cooperative through which the financial world conducts its business operations using SWIFT's secure messaging services based on standards. More than 10,800 banking organisations, securities institutions and corporate clients in over 200 countries are connected to SWIFT

- **Syndication**: the process of selling legal or economic interests in loans or other payment obligations to an investor or group of investors by the original arranger of such financing. Syndication may be built into the arrangement of the financing or take place subsequently, but usually promptly, thereafter. The investors may all be parties to a single agreement including the borrower or may be parties to a separate agreement not involving the borrower. The arranger of the financing is usually agent for the investors

T

- **Tenor:** the amount of time left until the maturity date for the repayment of a loan or financial obligation, or the initial term length of same. Tenor can be expressed in years, months or days
- **Three-corner model**: a situation where two trading parties are using the services of the same financial institution or service provider and use its services to carry out intermediation functions of various kinds
- **Tolling:** a process by which raw materials or components are submitted to a third party refining or manufacturing process prior to onward sale
- **Trade and Export Loans:** a general expression for loans made in the context of trade-related financing. They are not defined as a specific SCF technique herein, given the generality of circumstances in which they are granted
- **Trade Finance:** T*not* treated herein as an SCF technique but as a 'super-category' or umbrella term used by finance providers to describe their business lines, organisational units and activities. Trade Finance is usually used as a generic term for a range of traditional trade finance techniques and evolving SCF techniques
- **Transaction Matching Application (TMA**): in a BPO transaction the TMA is the matching engine which compares submitted datasets with the baseline and declares a match or non-match. SWIFT's Trade Services Utility (TSU) is an example of a TMA
- **Transfer of title**: a wide expression often used in relation to the transfer of real property as well as goods and financial assets. In SCF transfer of title is achieved principally by assignment, assignment of rights or endorsement
- **True sale:** an accounting and legal expression connoting that a financial asset or negotiable instrument has been sold by one party to another in the sense of no longer being recorded in the balance sheet of the seller and instead being recorded on the balance sheet of the purchaser. Where this occurs effectively, the purchaser will not be affected by any insolvency proceedings subsequently initiated against the seller and will have unfettered or absolute title to the asset in question. In this sense it is different from secured or collateralised lending. True sale is an important concept which underlies many securitization and financial transactions. Some SCF techniques, such as Forfaiting and Factoring, aim to achieve true sale
- **Two-Factor System:** see International Factoring definition

U

- **Uncommitted facility:** a credit or loan facility, which is uncommitted as to availability or time period

- **Uniform Rules for Forfaiting (URF800):** a set of standard rules for the primary and secondary Forfaiting markets published by the ICC in collaboration with ITFA in effect since 1 January 2013. URF 800 deals with issues such as examination of satisfactory documentation and recourse to sellers of Forfaiting assets. URF 800 includes a set of model agreements

V

- **Vendor-managed inventory (VMI):** a family of business models in which the buyer of a product (business) provides certain information to a vendor (supply chain) supplier of that product and the supplier takes full responsibility for maintaining an agreed inventory of the material, usually at the buyer's consumption location (such as a store). It is analogous to the holding of consignment stock

W

- **Warehouse Finance:** a synonym for Inventory Finance, a defined SCF technique herein and reflects the point that inventory being financed is usually located in a warehouse or in similar conditions
- **Warehouse receipt:** a document that provides proof of ownership of commodities or goods that are stored in a warehouse, vault, or depository for safekeeping. Warehouse receipts may be negotiable or non-negotiable. Negotiable warehouse receipts allow transfer of ownership of that commodity without having to deliver the physical commodity or goods. The status of and then nature and scope of the obligations arising under, a Warehouse Receipt or its equivalent will vary according to jurisdiction
- **Warranty:** this generally means a guarantee or promise which provides assurance by one party to another party that specific facts or conditions are true or will happen in relation to goods and services or an obligation to perform
- **Whole turnover:** a provision in factoring, where all the receivables generated by a business are assigned to the factor
- **With and without recourse:** in the case of **'with recourse'**, the finance provider relies on the seller (of a receivable or claim) for any shortfall in the event of non-payment. In a '**without recourse'** facility or agreement the finance provider relieves the seller of any further liability for the debt and accepts the entire credit risk of non-payment itself. Even where without recourse facilities are provided in respect of the credit risk, it is likely that **limited recourse** to the supplier is maintained for warranties given in respect of, or disputes arising out of, quality of goods, fraud, and the veracity of the transaction. URF 800 contains a detailed set of rules for recourse for the Forfaiting market
- **Without recourse finance or discounting:** a synonym for Forfaiting, a defined SCF technique herein
- **Working capital:** the financial resources invested by a business in financing its current trading operations usually expressed as the difference between Current Assets (receivables, inventory and operating cash balances) and Current Liabilities (payables and short term debt)
- **Working Capital Services:** *not* treated herein as an SCF technique but as a 'super-category' or umbrella term used by finance providers to describe their business lines, organisational units and activities. Working Capital services typically include short term working capital related financing such as many SCF techniques and related transaction banking services.

Part 5: Appendices

Appendix A: Sources and Methodology

This appendix sets out for reference purposes the sources and methodological steps taken to develop the definitional material in this document.

A.1. Capturing existing SCF definitions and initiatives as a starting point

The following materials, among others, have informed the development of this document:

- EUF Glossary on Factoring and Commercial Finance 2012
- Factors Chain International Glossary 2014
- BAFT IFSA Open Account Trade Definitions 2011
- BAFT IFSA Product Definitions for Open Account 2010
- BAFT IFSA Other TF Definitions for Distribution V1
- EBA Market Guide to SCF V2
- ICC Uniform Rules for Forfaiting ICC Publication No.800
- ICC Discussion Paper, BPO Capital and Accounting Treatment
- BAFT IFSA Traditional Trade Finance Definitions 2012
- BAFT IFSA Traditional Trade Finance Risk Clusters
- SWIFT White Paper SCF 2013
- ICC Uniform Rules for Bank Payment Obligations URBPO): ICC Publication No. 750

The Forum has benefitted directly from the existence of these foregoing materials, both in structuring this document by building on previously articulated definitions, and in identifying nomenclature that appear to be duplicative, or that otherwise create confusion or opacity about the nature of supply chain finance. These terms, when identified, and as agreed on a consensus basis within the Form, have been collected, and will be identified as terms that ought to fall into disuse. Similarly, and in line with recognised methodology in the development of terminology, the foregoing resources were leveraged to assist in creating and organising definitional context around specific category terms in supply chain finance, recommending, for example, the recognition of "umbrella terms" such as Receivables Finance, that refer to concepts and techniques with similar transactional attributes.

A.2. Specific steps taken to define the SCF techniques

The following steps were taken to progress the definitional work:

STEP 1: the Drafting Group first assembled from the existing materials a range of expressions used in SCF discourse. The major expressions in these lists are set out and defined in the Glossary in this document.

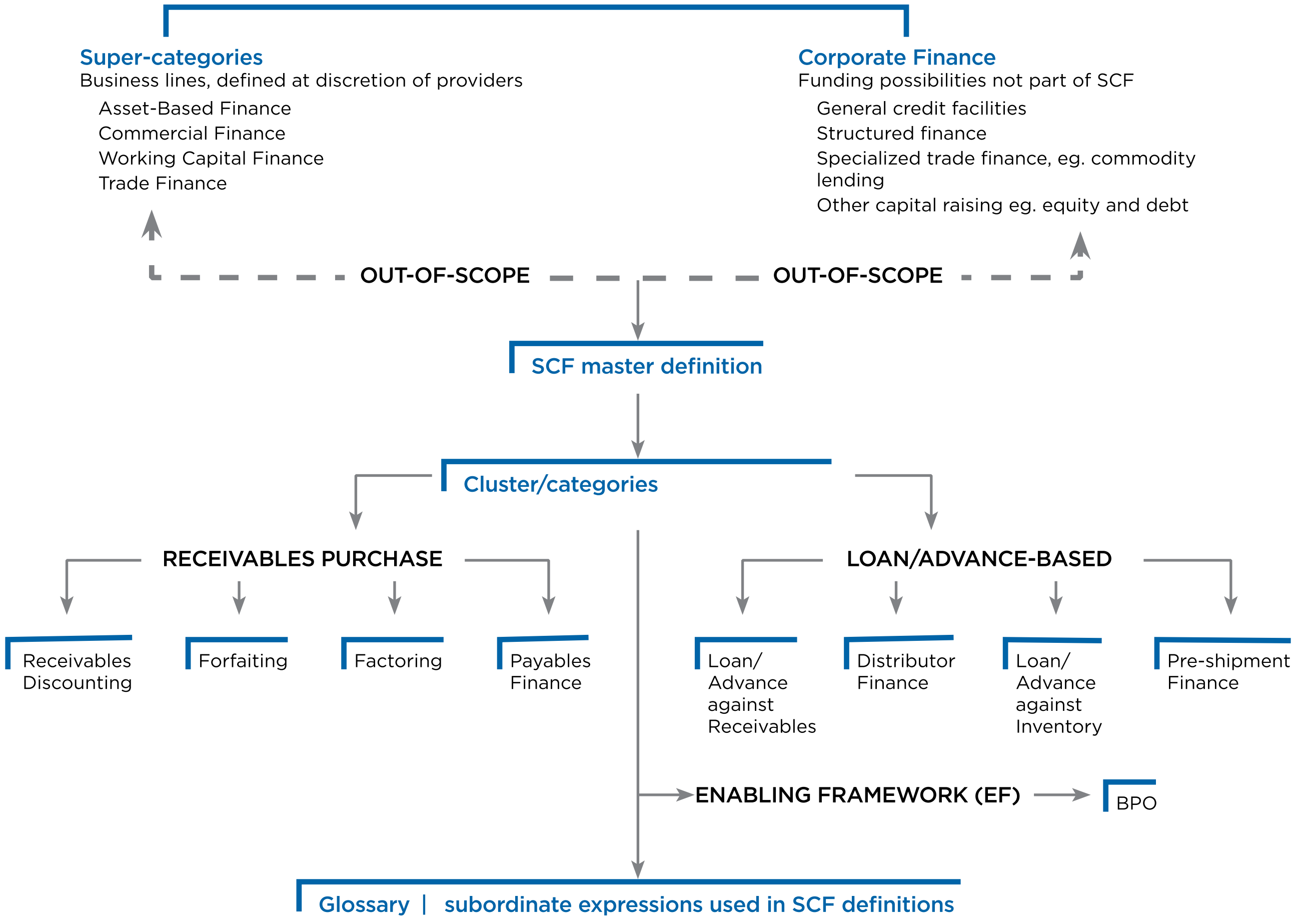
STEP 2: the Drafting Group then developed the following conceptual framework which resulted in the creation of four lists of expressions that would be identified and potentially defined:

- Expressions that appeared to be 'super-categories' used in the industry to describe business lines, organisational units and activities rather than representing actual SCF techniques. *Examples include: Commercial Finance, Asset Based Lending, Transaction Banking, Financial Supply Chain Services and Working Capital Services*. These categories are described in the Glossary, but are not the subject of standard market definitions related to SCF. It is left to competitive activity to use and shape these expressions.
- Expressions that are relevant to SCF as important 'categories' to which the SCF techniques belong. The most important of these is *Supply Chain Finance* itself, as set out in the master definition. The definitions are consequently grouped into 'Receivables Purchase-based' and 'Loan or Advance-based' Techniques.
- The core of the work is the provision of standard market definitions for the selected individual SCF techniques. These are defined and form the main output of the project. Many expressions, which are not recorded as SCF techniques, have been categorised as synonyms for the selected techniques.
- The components and other useful contextual and miscellaneous expressions that are used in creating the above definitions and have been defined in the Glossary.

STEP 3: the Drafting Group set about compiling the master definition of SCF and of selected techniques.

The hierarchy of definitions described above is illustrated in the following diagram, which also captures the core focus of the work of the Global Supply Chain Forum:

Figure 4: SCF definitions: conceptual hierarchy



Source: Global SCF Forum

Appendix B: Physical and Financial Supply Chains

The following document available on EBA website https://www.abe-eba.eu/ gives an overview and summary of the physical and financial supply chain: An Introduction to the Financial Supply Chain: Mapping the processes and finding the opportunities.

Appendix C: List of Reviewers

This document has been significantly enhanced through a broad and inclusive review process involving organisations, entities and industry specialists hereinafter listed, constituting the membership of each partner association, the ICC National Committees, and corporate users of who volunteered their time to provide comments and feedback on an advanced draft of this document:

BAFT members
ANZ, Bank of America Merrill Lynch, Bank of Montreal, BBVA, BNP Paribas, CGI, Comerica, Deutsche Bank, Ernst and Young, Fifth Third, Frost Bank, HSBC, JPMorgan, RBC, Scotiabank, Standard Chartered, US Bank, Wells Fargo, Westpac

EBA Members
Bank of Ireland, KBC Bank, Raiffeisen Bank International

FCI-IFG Members
Banco BPI, Bancomext, BB&T Intl, BNP Paribas, China Development Bank, Finans Faktoring Turkey, National Bank of Canada, UniCredit Romania, Wells Fargo

ICC National Committees and their numerous members
ICC Costa Rica, ICC Czech Republic, ICC France, ICC Germany, ICC Italy, ICC Portugal, ICC South Africa

Fermat Capital Management LLC

Shailesh Gothal (Gemini Corporation NV)

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