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Discussion Paper



Bank Payment Obligation (BPO)

Frequently Asked Questions (FAQs) – Corporates

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Highlights

- The Bank Payment Obligation is an instrument designed to provide risk mitigation and the basis for financing of transactions between buyers and Seller who chose not to use documentary instruments but rely upon the exchange and validation of data to effect payment.
- With the adaption of the Bank Payment Obligation as URBPO 750 by the ICC Banking Commission this discussion paper has been developed to answer questions that result from Corporates becoming increasingly aware of the BPO. Though not viewed as a competing instrument to the traditional documentary instruments, the frame of reference of parties interested in the instrument leads to logical comparisons between the L/C and the BPO.
- This guide can be used in conjunction with the Bank Payment Obligation Product Quick Start Guide or on a standalone basis.

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I. About Bank Payment Obligation (BPO)

What types of risk mitigation may be available through the use of the BPO?

BPO provides a risk mitigation tool for:

- **Financial risk** of the parties in the supply chain such as the weak credit rating of the importer, the temporary need for working capital of the exporter, and the financial risk of the bank.
- **Payment risk:** Being an irrevocable and abstract payment undertaking by the Obligor Bank, the BPO ensures payment at due date upon successful data match.
- Like an L/C, the BPO can be transferred from the Obligor to the Recipient bank via a bilateral “confirmation” agreement between the Recipient bank and the exporter.
- **Commercial risk** related to the fact that the importer refuses to honour its obligation to pay or forgets to pay or pays late. BPO is always an irrevocable obligation.
- **Transport risk** related the shipment timing. As for the L/C, the BPO can be used to protect against shipment delays. Like the L/C, the BPO cannot; however, protect against loss, theft, deterioration as such.
- **Economic risk** related to fluctuations in currency rates, inflation rates and interest rates can be mitigated through the use of the home currency in the BPO or currency hedging (predictability of the cash flows).
- **Political risks** related to insurrections, terrorism and war are covered by the BPO in the same way as for the L/C.

What exactly is agreed in the establishment of the baseline?

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

Who decides the volume of data to be matched?

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

What is the difference between BPO and TSU?

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

What message types and data are supported in BPO?

A set of ISO 20022 messages has been developed for the BPO. The relevant ISO 20022 tsmt messaging standards and related documentation are available on the ISO20022 web site(www.iso20022.org), page "Catalogue of ISO 20022 messages" tsmt.001-052. The data elements, which are part of a Transaction Matching Application (TMA) transaction, represent extracts from the following document types: purchase order, commercial invoice, transport and insurance documents (optional), and certificates (optional).

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

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

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

The BPO offers a new instrument in support of trade settlement and offers a means for corporate customers to improve their efficiency by reducing paper handling in the commercial transactions. As a result, the implementation of BPO is a business paradigm shift from paper handling to electronic processing that impacts sales, legal, accounting, credit management, risk management and operations. It requires a change in the existing processes starting with the underlying commercial agreements between buyer and seller as they adapt new payment terms. In many cases, both buyers and Seller have the commercial information in data format as they communicate among themselves and third-party intermediaries. Under the BPO, they will include the banks in the electronic data exchange, repurposing their and/ or their third-party provider's data. ERP applications need to be connected to their banks and support the ISO 20022 XML standards and workflow for BPO. Fortunately, many corporates already deal with XML messaging in the context of payments and cash management so the changes may not be dramatic.

How is the BPO related to Supply Chain Finance?

According to the new Standard Definitions for Techniques of Supply Chain Finance, published on 9 March 2016, the BPO is not seen as a SCF technique itself, but as an enabling framework for Supply Chain Finance.

The BPO offers opportunities for the discounting of receivables due under a BPO based on the risk of the Obligor Bank:

- a) Post-shipment finance: Discounting of the deferred payment after successful matching of trade data and
- b) Pre-shipment Finance: Based on a BPO transaction after establishment of the Baseline.

Especially for open account trade flows, the BPO offers new possibilities for finance in addition to its role as payment instrument to secure payments.

II. BPO Governing Standards: The URBPO

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

The ICC has published rules governing the BPO, the Uniform Rules for the Bank Payment Obligation (URBPO) Publication 750 which are expected to have the same effect as UCP 600 has for L/Cs.

Unless otherwise specified in the BPO the governing law and jurisdiction will be that of the Obligor Bank.

What is meant by "ICC adoption of BPO"?

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

Is the BPO enforceable in all jurisdictions?

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

Why is the bank the beneficiary of the BPO?

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

Can the buyer reject to pay after the data match has been successfully carried out?

No, as soon as the matching of data sets has been successful, the BPO automatically comes into force. If the Buyer is aware of any changes regarding the shipment, he can instruct an amendment of the baseline, which needs to be agreed by the Seller.

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

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

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

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

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

No. The URBPO relates only to the obligation of the Obligor Bank (often but not always the Buyer Bank) to pay the BPO Recipient Bank (always the Seller Bank)—the Seller Bank is under no obligation to pay the Seller under the URBPO unless the Seller Bank offered an additional undertaking to pay under a separate contractual agreement between them and the Seller (analogous to a silent confirmation of an L/C).

If a bank goes bankrupt who is responsible for paying?

This depends entirely on the agreement the exporter has with the BPO Recipient Bank. If the seller has received an additional payment undertaking from the Recipient Bank (analogous to a silent confirmation of an L/C), then the latter would still have to pay in case the Obligor Bank goes bankrupt.

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

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

III. Bank Payment Obligation (BPO) vs. Letters of Credit (LCs) and Open Account Trade

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

An L/C requires physical presentation of documents through the banking system. Under a BPO those physical documents will be sent directly from seller to buyer, as in an open account transaction. However, selected elements of data which have been extracted from the documents will be routed

through the banking system for the purposes of automated matching to mitigate risk and to support the value proposition for a financial service e.g. pre-or post-shipment financing.

Another difference between an L/C and a BPO is the beneficiary of the payment undertaking. Under a BPO, the Obligor Bank (Buyer Bank) provides an irrevocable payment undertaking to the Recipient Bank (Seller Bank). Under an L/C, the beneficiary is the Seller.

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

The BPO is an inter-bank instrument used to mitigate the payment risk of a trade transaction. Similar to an L/C, a BPO is an irrevocable payment undertaking provided by the Buyer Bank (Obligor Bank) to the Seller Bank (Recipient Bank) to pay a specified amount on maturity. As an interbank instrument, any risk mitigation by the Recipient Bank in favour of the Seller is separate from the BPO and can be forwarded on the basis of a separate legal contract.

The BPO thus enables a bank (Obligor Bank or Recipient Bank) to provide risk mitigation in the context of an open account and supply chain financing solution. Both the L/C and the BPO can; therefore: a) act as a means of mitigating risk; b) provide the exporter assurance of payment; c) act as a form of collateral for financing.

Unlike an L/C, the BPO does not require trade documents to be presented and routed through the banks, it is based on the electronic submission and matching of data; trade documents are sent directly sent by the Seller to the Buyer without the involvement of the banks. As an enabling framework for supply chain finance (see Global Definition of SCF), the BPO offers numerous financing opportunities along the physical supply chain.

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

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

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

Commercial pricing of competitive offerings is a matter for the banks to decide. It will vary from bank-to-bank. If you are a seller, the BPO discussion with your customers is likely to revolve around processing efficiency. For example, physical documents will not be required to pass through the banking system as they do today under an L/C.

Data matching is performed electronically reducing the related risks of discrepancies, disputes, delays, demurrage charges etc. By handling data instead of paper, the transaction processing costs may be reduced due to less manual work and faster processing times. Buyers and Seller will only have to focus on a limited subset of data or elements which will be digitized, electronically exchanged and matched. Electronic matching of elements of information will improve the quality and objectivity of the information, reduce the number of discrepancies, and accelerate the process. This will significantly reduce the processing costs related to the trade data compliance verification. Nonetheless, trade documents are still required to be issued, but are directly sent by the Seller to the Buyer instead of being routed through banks.

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

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

The BPO is a bank-to-bank obligation. As such a BPO Recipient Bank may be taking on the risk that the BPO Obligor Bank does not pay. Since the BPO is bank-to-bank only the BPO cannot be “confirmed” in the same way as an L/C can be confirmed; however, the Seller may separately agree with his bank for an additional undertaking (“silent confirmation”).

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

No. BPOs are meant to be paid at maturity upon successful matching of data related to an underlying trade transaction between a buyer and a seller. In this respect, BPOs are similar in nature to commercial letters of credit—not standby L/Cs.

Why should a Buyer move from Open Account to BPO when the former is much cheaper?

There are various benefits for a Buyer moving to BPO from open account settlement:

- Financing opportunities: In case the Seller has liquidity problems, the Buyer can offer financing for the deferred payment period of the invoice. In the event that the Buyer wants to optimise his working capital by extending his payment terms, he can also offer financing to the Seller to prevent liquidity problems on the Seller’s side.
- Increased supply chain transparency: With the near-term provision of data regarding the purchase order, invoice, shipment, and other data, the buyer benefits from an increased transparency in his supply chain.
- Faster processing: The exchange and matching of data on SWIFT TSM enables faster processing of the trade transaction.

IV. Data vs. Documents, Goods, Services, or Performance

How would a BPO prevent a fraudulent shipment?

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

Within a BPO transaction, the physical documents (referencing those that evidence shipment, authenticity and quality of goods and documents of title) as required in an L/C transaction are not routed through banking channels. How do we ascertain if the seller is submitting correct data/information during dataset submission?

The risk of fraud exists no matter what the method of payment may be. As with an L/C there is no way of checking beyond all doubt that the goods shipped are in line with what is described in the documents. BPO is not meant to replace existing LCs or open account payment terms as these methods of payment are dependent on the comfort level within counterparties. If an established trading history within the counterparties exist and both are comfortable with the risk to move away from letters of credit, BPO would be an ideal method of payment instead of moving to open account terms directly.

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

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

How are ‘discrepancies’ handled in BPO? How does this contrast with how discrepancies are handled in the LC?

A discrepancy in an L/C process is handled as a ‘mismatch’ in a BPO process. In both cases, the information presented is inconsistent with what is expected. In the case of the trade service utility (TSU)/BPO data is matched automatically. The result is instant and clear – either the data matches or it does not. If there is a mismatch, the involved banks are given the opportunity to accept or reject the mismatch. If the mismatch is accepted, the transaction can continue unabated. If the mismatch is rejected, the data must be re-submitted up to obtain an acceptable match. The automated matching process removes the subjectivity commonly associated with manual processing, hence reducing the risk of delays, disputes etc.

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

No. Although the data for matching can be extracted from a bill of lading, it does not replace the bill of lading.

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

Does BPO allow use of software from third party providers?

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

The International Chamber of Commerce (ICC)

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

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

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

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

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

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Policy and Business Practices

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