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Changing the Face of Trade Finance

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For too long, trade finance has centred on traditional product offerings and bespoke open account settlement solutions — but the sector is being challenged by the launch of the Bank Payment Obligation (BPO).

Corporates seeking trade finance solutions have, in recent years, been faced with a decision — whether to prioritise the efficiency and flexibility of open account trade settlement, or the security and payment assurance of more traditional instruments such as letters of credit (LCs) and import bills for collection.

But this is all set to change with the arrival of the BPO — an innovative form of trade settlement that not only combines the advantages of existing instruments, but also addresses the current and future needs of an evolving marketplace. Defined as "an irrevocable undertaking given by one bank to another that payment will be made on a specified date following successful electronic matching of data*," the BPO has been borne out of existing needs and designed with the future requirements of the market in mind.

Supply Chain Finance

The BPO is a recognition of, and reaction to, the preferences of market participants — and, in particular, the popularity of open account settlement. Despite the uncertainty of the current financial climate, and accompanying demand for increased risk mitigation, a high proportion of transactions settled using open account finance has continued.

However, open account has yet to benefit from the structure that regulation brings. Despite its size and importance, the settlement method constitutes the largest unregulated segment of the market — and one that is in need of additional risk mitigation and liquidity product offerings.

For this reason, the International Chamber of Commerce (ICC) Banking Commission has created the new area of supply chain finance. And as I take on the accompanying new role, the priority is undoubtedly to bring the marketplace into the digital age — and the BPO is integral to this endeavour.

A Market-led Design

Expected to gain formal approval by the Banking Commission in 2013, the BPO is designed around a number of objectives. First, a challenging economic climate — and continuing volatility in particular — means risk mitigation is foremost in mind for participants in international trade. This concern is addressed by the accuracy and payment assurance of the solution — accurate because a successful trade report (generated by SWIFT's Trade Services Utility or an equivalent application) relies on the matching of data via ISO 20022 messaging standards, and payment assured due to the bank-to-bank nature of the obligation.

Risk is further reduced by the objectivity of the payment process. Certainly, electronic matching consigns the potential for human error to the past.

Second, banks and corporates alike are looking to improve working capital management — meaning efficiency is key. With this in mind, the automation of the solution will prove a dramatic improvement on other forms of trade finance reliant on manual processing.

Furthermore, at a time when corporates are under considerable (and growing) pressure to reduce costs, the speed with which settlement can be reached will be particularly welcome — as will the provision of access to flexible financing. The BPO is, for example, equally suited to pre-export trade finance.

In addition, the BPO goes one step further. Not only does the solution unite the efficiency and freedom of open account settlement with the structure and security of traditional documentary business, it also addresses a current restriction to market trade — the limited number of banks with suitable platforms to execute receivables. Until now, trading corporates have been effectively tied down to a restricted number of global providers. This has, in turn, hindered interoperability in today's truly global market. But by using standardised messaging (in the form of ISO 20022), thereby enabling seamless end-to-end processing with corporate enterprise resource planning (ERP) systems, the BPO provides strong support for increased interoperability.

ICC/SWIFT Partnership

Previous attempts to provide e-commerce solutions for the open account space have failed to achieve the market-wide take-up needed to revolutionise global supply chain finance. But this is where the BPO has its greatest advantage of all — in the unprecedented partnership between ICC and SWIFT.

Certainly, the combined power of the leading rule-making body, known for its neutrality and expertise, and the well-trusted financial messaging provider of renowned technological strength, creates an incredibly strong foundation for the solution — and places the BPO in the best possible position to modernise global trade finance through market-wide implementation.

Indeed, at Deutsche Bank, our own confidence in the evolvement of the BPO (and the partnership behind it) is illustrated by our close involvement in its development. Deutsche Bank is represented on a number of ICC working groups including the drafting group.

Of course, for a solution specifically aimed at meeting market needs, it is vital that corporates are actively engaged to ensure commercial compatibility. Certainly, as banks and corporates alike look forward to the benefits the BPO will bring, the wider trade finance community should make the most of this opportunity to be involved in a solution that heralds a new chapter in trade finance.

**ICC document on BPO, http://www.iccwbo.org/About-ICC/Policy-Commissions/Banking/Task-forces/Bank-Payment-Obligation-(BPO)/*