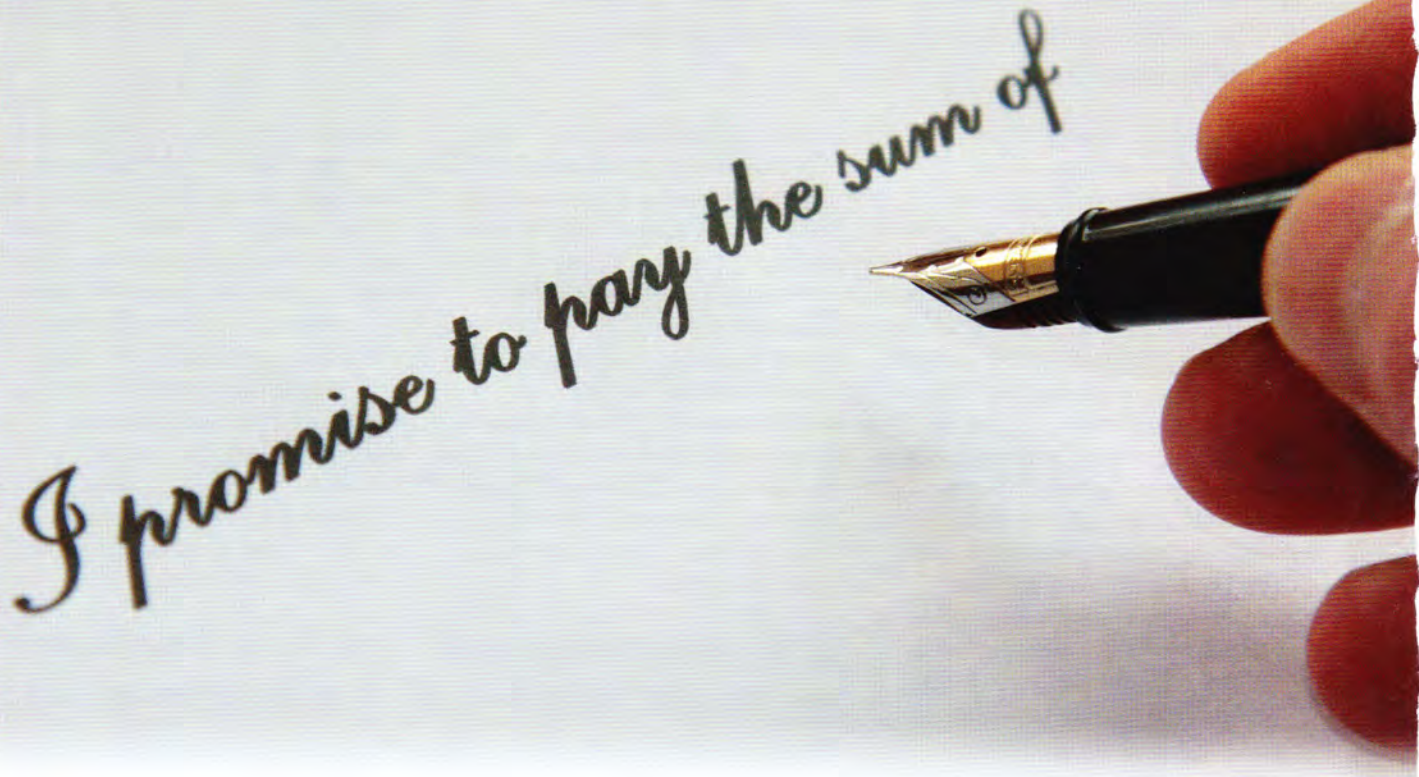


- ◆ Will BPO replace letters of credit?
- ◆ Credit: still sales prevention?
- ◆ Global credit trade body

Letters of credit may be on the way out, replaced by the new bank payment obligation, which offers more security to sellers of goods around the world

By Ron Wells



I promise to pay the sum of

**A**las poor letter of credit (LC), I knew him well, reader: a fellow of infinite costliness and complexity, but most excellent utility in enabling trade betwixt strangers.

How so the demise of the LC? He doth bestride the narrow world like a Colossus, and all petty alternatives walk under his huge legs and peep about.

There is a bank payment obligation (BPO) tide in the affairs of traders, buyers and sellers, which, taken at the flood, leads on to fortune. Omitted, by those who cling to the UCP 600-'07, fondly remembering the UCPs of old 500-'93, 400-'83, '74, '62, '51 and the first 1933, they are bound in shallows and miseries. (With humble apologies to Shakespeare – *Hamlet* and *Julius Caesar*)

The BPO process allows for all commonly used payment terms to be incorporated. It is an irrevocable undertaking given by one bank to

another bank that payment will be made on a specified date after a successful electronic matching of data according to an industry-wide set of rules, namely the Uniform Rules for Bank Payment Obligations (URBPO).

The scope of the URBPO lies solely in the bank-to-bank space. URBPO are designed to operate in what is known as the 'collaborative' space as will any transaction matching application (TMA) chosen by financial institutions (known in URBPO as 'involved banks') for a given transaction.

URBPO do not cover the interaction between a bank and their corporate client. It is for each bank, in what can be described as the 'competitive' space, to offer its clients financing or other services and products based on the strength of agreeing to incur a BPO or through the receiving of one. URBPO indicate the separateness and independent nature of the BPO from

the underlying sale or other contract.

The BPO-Plus (BPO and friends) will gradually, but inexorably, replace transaction-related documentary LCs over the next five years. The considerable rewards intrinsic to using BPO and electronic documents in combination are available to every trading partnership today; you should be benefiting.

In 2000 I made a presentation subtitled "Are LCs past their 'sell-by date'?" based on the premise that technologies were being developed that would make the LC obsolete.

Why the passionate plea to consign LCs to the history books, considering they have been the backbone of international trade for centuries? The answers to this question remain that LCs are:

- ◆ Too labour and expertise intensive.
- ◆ Too expensive in terms of bank charges plus internal administration cost.
- ◆ Too unpredictable in terms of outcome.



## CCR

# IS IT THE END FOR LETTERS OF CREDIT?

◆ Too difficult to process correctly, as 70% of documents presented are rejected.

◆ Require too many intermediaries.  
◆ Do not meet all the needs of real businesses.

In 2001 I followed up with a presentation titled "Will Bankruptcy Swaps Kill Letters of Credit?", in the course of which I posited that bankruptcy swaps (then recently invented by Enron) provided a plausible and better alternative to LCs; suggesting that progress was being made towards the goal of making LCs redundant.

Sadly the Enron bankruptcy swap product turned out to be a sham built on misleading information, which only came to light when the group imploded and was declared bankrupt in December 2001.

All was not lost, however, since the quest was continued by honest and dedicated people. TradeCard – founded by Kurt Cavano in 1999 and now part of GT Nexus – for example created a process that proved to be the genesis of the BPO-Plus process that will oust LCs.

In a blog in 2012 I wrote: "The BPO promises to replace open account and simple standby letters of credit (under UCP 600 or ISP98) payment terms, for domestic and international trade transactions relatively soon."

The subsequent approval by the International Chamber of Commerce and SWIFT of BPO rules for banks – the URBPO 750 – and the associated ISO 20022 message standards that cover trade document-related data sets have made my prediction a reality.

Every business that accepts standby LCs as collateral cover (security) for its sales transactions should switch to requiring BPOs.

The reason to restrict the use of unenhanced BPOs to the replacement of standby LCs is that BPOs on their own do not protect the buyer from supplier risks; risks such as the supply of incorrect goods, quality or volume, mass,

or number deficiencies, or outright fraud.

The stand-alone BPO process is only suitable for well-established relationships; that is cases where the buyer does not consider it necessary to 'insure' the risk that the expected goods will be paid for but not delivered. This exactly mirrors the situation when a buyer agrees to provide a standby LC, rather than a documentary LC, to cover its purchase of goods.

Either by using the SWIFT TSU (Trade Services Utility) link for delivery of SWIFT messages received by a bank straight into a company's accounting and banking systems or a bank's proprietary bank-to-client trade system, companies are able to capture a number of benefits from the BPO system; for example:

## The BPO promises to replace open account and simple standby letters of credit payment terms, for domestic and international trade transactions relatively soon

◆ Improved cashflow management based on certainty as to when invoice payments will be credited.

◆ Reduced document handling – whether paper or electronic – since purchase orders and invoices are keyed into the system and communicated automatically; via one or two banks in nanoseconds. The SWIFT system is exceptionally secure and reliable, and covers more than 10,000 financial institutions and corporations in 210 countries.

◆ Reduced information discrepancies and reduced time involved in identifying and correcting mismatched data. The BPO system automatically matches buyer and seller data against the purchase order or contract and provides various reports.

◆ Better payment protection (for the seller) compared to a standby LC; with reduced costs and handling required on both sides of a transaction.

◆ Access to financing options is improved for both buyer and seller.

Banks offering BPO solutions will be able to reduce their costs vis-a-vis handling LCs, by avoiding the need to employ expert document checkers and virtually eliminating the documentary risks they would otherwise carry.

According to SWIFT, as at 18 August 2014: "13 banking groups are live on BPO/TSU, including four of the top 10 trade banks – based on Cat 7 traffic. In addition 45 other banks are in the process of adopting BPO." The point is that, if your house bank does not offer BPO services, you should be able to find a suitable alternative bank, so there is no need to wait for a laggard.

In conclusion, it is now possible for sellers and buyers of goods and

services to enjoy all the amazing utility offered by the LC for past eons, without bearing the associated risks and costs. The dedicated efforts of bankers and academics to reform the LC, stretching back to 1933, are gratefully acknowledged, unfortunately however 'the patient could not be saved'.

The first 'four corner' BPO live transaction (one involving a seller, the seller's bank, the buyer, and the buyer's bank) completed in 2010. Therefore there is no reason for you to 'wait and see' if the process works – it does! **CCR**



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