Bank Payment Obligations are yet to take off, but here's why they will

UniCredit
Corporate & Investment Banking

Bank Payment Obligations have the potential to save corporates time and money, yet take-up has been slow since they were created in 2007. Oliver Spitz, senior trade finance manager at UniCredit, explains why more corporates are waking up to the benefits of BPOs

In recent decades trade finance has become a market used to innovation. Yet certain methods of settlement have yet to catch up with the speed of a newly globalised marketplace. Referring to Letters of Credit (LC), one credit manager of an oil major said recently that his firm can process 150,000 cubic metres of liquefied natural gas faster than 500 grams of paper.

This is a harsh indictment, even if true. Yet help is at hand for credit managers in the form of the Bank Payment Obligation (BPO). Designed to provide all the benefits of bank intermediation without the time necessary to post and process paper, BPOs take a maximum of seven days to handle while LCs take, on average, 21 (according to our research).

Certainly, in the modern era of increasingly efficient logistics, many companies report that physical deliveries now overtake the LCs intended to pay for them, often by significant margins. Here, BPOs can play a valuable role in the market by providing fast transaction settlement alongside financing and risk mitigation.

But since their launch in 2007, the take-up of BPOs remains slow. Unfortunately, a large number of corporates are unaware of the benefits BPOs provide and remain concerned that the instrument will not fit neatly into their workflows.

Finance and risk mitigation

That said, corporates should be aware that BPOs are not designed to supersede open account or LC methods of trade settlement entirely. Indeed, there will always be a place for straightforward open account payments, while LCs remain relevant for projects where there are many milestones to be achieved – like structured finance deals, or bespoke manufacturing projects. But there are many cases where the time and cost of transacting using a LC is deemed too great, so corporates take on the risk against their better judgment and transact through an open account system – simply hoping their counterparty will come good.

Indeed, it is the speed with which BPOs can provide all the benefits of bank intermediation – such as financing and risk mitigation – while processing payments that make it such a compelling instrument. BPOs allow banks to take risk from both exporters and importers by financing the deal: increasing days payable outstanding for the importer by fronting the money and paying the exporter, which builds a bridge between the needs of both parties.

Without doubt, UniCredit is a first mover in this area and has innovated further by leveraging its extensive network of correspondent banks. In the past, the bank may have been unable to process transactions because it was unable to calculate the risk of its client's counterparty. By combining its network of regional affiliates with the BPO model, UniCredit can partner with a regional bank – usually better placed to calculate the risk of the local counterparty – to finance that side of the deal. This allows UniCredit to take only its clients risk and that of its banking affiliate.

Of course, UniCredit's large number of longstanding relationships with regional banks means that both banks are comfortable dealing with each other. Crucially, the requisite documentation – such as Know Your Customer certificates – is already in place. Shifting the counterparty risk to regional correspondent banks in this way allows UniCredit to finance a much larger number of deals for its clients than otherwise, and is essential for the bank's supply chain finance offering.

Measures to increase take up

Despite the obvious advantages of BPOs, however, it's apparent to all that widespread adoption will not happen overnight. Indeed, the instrument was launched in 2007 and take up is expected to continue as it has begun: slowly.

Understandably, the largest concern many corporates have is that BPOs might upset their workflows: hence UniCredit's work to develop an IT framework which allows Straight Through Processing. Of course, each client's set-up is different and any solution will have to include a large level of adaptability, so the aim is to allow corporates to use BPOs with few changes to their organisational set up and IT infrastructure. This measure is currently undergoing a successful pilot phase, and the bank is confident that it will boost adoption of BPOs.

Also key to increasing take up is a rulebook published by the International Chamber of Commerce in July last year, which is publicly available and written in language familiar to trade finance specialists. The aim is to reassure corporates about how they can fit the product into their workflows and, crucially, help corporate treasurers win support for BPO adoption with their colleagues.

It is this wider education campaign that will be crucial in expanding the use of the instrument. Changes in trade finance settlement will always be driven on treasury departments needing certainty regarding the liquidity at their disposal. For them, the timing of payments is vital and the speed of a BPO is incredibly compelling. But work is still necessary to help them convince their colleagues in the sales force – as well as the sales force's clients – about the benefits.

Here, the publicly available ICC rulebook will be helpful. Indeed, prior to its release all that was available was the service description manual for Swift's Trade Service Utility – itself only available to Swift clients. But UniCredit believes that further steps in educating the market are necessary to improve adoption, which is why the bank has created a series of client workshops to explain the advantages of BPOs to treasury departments and sales forces. The aim is to engender conversations and provide expertise.

In fact, the bank can also be present when its clients are talking to their counterparties – again, with the objective of raising awareness and understanding of BPOs. Indeed, in UniCredit's opinion, this is where the battle for trade finance settlement efficiency will be won.

Oliver Spitz is senior trade finance manager at UniCredit