PAYABLES FINANCE PRINCIPLES

DRAFTED BY:

BAFT GLOBAL TRADE INDUSTRY COUNCIL (GTIC)
PAYABLES FINANCE WORKING GROUP

BAFT

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• INTRODUCTION

In 2016, the Global Supply Chain Finance Forum (GSCFF)[1] published the *Standard Definitions for Techniques of Supply Chain Finance* (SDTSCF)[2] to provide details of the various supply chain finance techniques used in the marketplace. The GSCFF defined Supply Chain Finance (SCF) as :

"the use of financing and risk mitigation practices and techniques to optimize 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."

The SDTSCF separated SCF into three categories: *Receivables Purchase, Loan or Advance-based and Enabling Framework*. Within the Receivables Purchase category, four techniques were identified:

- Receivables Discounting
- Payables Finance
- Forfaiting
- Factoring

While we recognize that there are multiple techniques in this category, Payables Finance is the technique focused on herein. In the SDTSCF Payables Finance is defined as follows:

"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."

The current accounting treatment of Payables Finance is aligned with the guidance outlined by the SEC in 2003/2004. This document concentrates solely on key features of Payables Finance as defined by SDTSCF, and considerations relating to other techniques is out of scope.

1 GSCFF participating organizations: BAFT, The International Chamber of Commerce (ICC) Banking Commission, the Euro Banking Association (EBA), FCI, and the International Trade and Forfaiting Association (ITFA).

2 *Standard Definitions for Techniques of Supply Chain Finance* Source: https://cdn.iccwbo.org/content/uploads/sites/3/2017/01/ICC-Standard-Definitions-for-Techniques-of-Supply-Chain-Finance-Global-SCF-Forum-2016.pdf

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PROGRAM STRUCTURE

- Program structure includes an irrevocable payment undertaking by the Buyer to make payment at maturity date[3] for a specific approved amount.
- Buyer selects Paying/Payment Agent to create a Payables Finance program, which is designed to allow Suppliers to elect to receive payment prior to invoice maturity date.
- Paying/Payment Agent has an arrangement with Finance Providers (note Paying/Payment Agent and Finance Provider may be the same entity) to provide payments to Suppliers.
- Buyer issues an irrevocable payment undertaking to make payment for approved invoices at maturity date for the specified approved amount.
- Once Paying/Payment Agent receives payment instruction for approved invoices from the Buyer, Supplier may elect to receive early payment for the approved amount.
- Any early payment to the Supplier is based on Supplier's agreement to sell receivables to the Finance Provider at a discounted rate, and the Finance Provider is paid the full invoice amount by the Paying/Payment Agent on behalf of the Buyer at original maturity date.
- Participation in a program is optional for Suppliers:
  - Suppliers who participate can elect to be paid for invoice(s) prior to the maturity date at a discounted rate
  - Suppliers who chose not to participate will be paid total invoice value on the maturity date
- Program typically requires two legal agreements to be executed details of which are outlined below:
  - Buyer Agreement a.k.a. Payables Agreement/Payment Service Agreement (PSA)
  - Supplier Agreement, a.k.a. Receivables Purchase Agreement (RPA)
- Buyer is not a party to the RPA, and the Supplier is not a party to the PSA; there are no tri-party agreements.
- No economic value is transferred from the Paying/Payment Agent or Finance Provider to the Buyer.
- Buyer is responsible for consulting with their internal and external auditors about the program details structure.
- Finance Provider/Payment Agent communicates directly with Suppliers regarding on-boarding including but not limited to the execution of an RPA, discount rate for payment prior to due date and documentation required for on-boarding.
- Tenor is short term, generally under one (1) year.
- Commercial disputes for credit notes, offsets, warranties, etc. are managed outside of the program before the Buyer approves invoices for payment and gives instructions to the Paying/Payment Agent.

3 Payables Finance Programs may or may not be structured to include a Paying Agent or Payment Agent and may simply include only the concept of an Irrevocable Payment Undertaking. Programs may use different nomenclature to describe the same entity or concept according to program structure and jurisdiction.

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- ## BUYER AGREEMENT

- Paying/Payment Service Agreement (PSA) executed between Buyer and Paying Agent. PSA requires Buyer to give an unconditional, irrevocable commitment to pay approved invoices at maturity date. Supplier is not a party to this agreement.
- Paying/Payment Agent is instructed to make payment for Buyer approved invoices to designated supplier or assignees on the defined invoice maturity due date. Paying/Payment Agent obligation to pay invoices at maturity date is subject to there being sufficient funds in Buyers designated account. Paying/Payment Agent is not obligated to make pay-ments involving sanctioned entities.

- ## SUPPLIER AGREEMENT

- Receivables Purchase Agreement (RPA), or similar, is executed between a Supplier and Finance Provider.[4] RPA legally assigns title of Supplier's receivable to the Finance Provider. Buyer is not a party to this agreement.
- Receivable is purchased by the Finance Provider at a discount to the invoice amount.
- Supplier provides representations & warranties that the receivable is unencumbered before discounting invoices
- Sale of the receivable to the Finance Provider is established with limited recourse (limited to issues such as fraud and misrepresentation of representations & warranties) to the Supplier.
- There is no recourse to the Supplier for non-payment by the Buyer for already discounted invoices. For invoices not discounted, Supplier retains the risk of Buyer non-payment.
- Finance provider has the option to choose not to discount Supplier's receivables. Receivables not discounted will be paid at total invoice value on original maturity date.

- ## BUYER AND SUPPLIER COMMERCIAL/CONTRACTUAL TERMS

- Finance Provider is not involved in negotiating commercial terms.
- Payment terms are aligned with the commercial terms for specific products/services and agreed between the Buyer and Supplier, within industry norms.

4 Paying/Payment Agent may act on behalf of the Finance Provider or may assign their rights to a Finance Provider or Service Provider may act on its own.

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