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SWIFT GPI - Transferring Money in a Racecar

Finance- and Treasury Management Switzerland

The timespan a web user is willing to wait until a website has loaded is mere seconds. We make payments using PayPal in real time. We use Twitter to learn about events halfway around the globe in seconds. We buy items online with a few clicks if we do not have time to go buy them in real life; depending on the mailing option, the item could already be in front of our door by the end of the day. If the item ships from abroad, we can track its whereabouts every step of the way. It is clear: our world moves in real time, satisfying our need for immediate gratification.

And yet, when it comes to payment operations we are willing to accept that cash being sent may take days (especially if it is sent to/from abroad), it is untraceable and sometimes carries ridiculously high fees.

It's a no-brainer that such a model cannot survive for much longer. But what will take its place? Maybe it is indeed already possible to make payments abroad in real time? So how will the way international payments are executed at banks and companies change and how can Treasury benefit from such changes?

We would like to show the current developments of what could await us in the future by taking a closer look at the "Global Payments Innovation" initiative.

SWIFT GPI – Overview

Since SWIFT (Society for Worldwide Interbank Financial Telecommunication) announced a new service to improve and accelerate international payments with its "Global Payments Innovation", banks and companies have been following this with great interest because this would significantly ameliorate the correspondent bank business and facilitate the settlement of cross-border payments.

Upon the launch of the service in February 2017, already 12 banks were connected to this system and 30 further banks had implementation projects in the pipeline. In the meantime, nearly 100 banks in 224 countries are participating, which amounts to about 75% of all cross-border payments. Just about half of all participants are located in the EMEA area, 20% in the Americas and just shy of 30% in Asia.

In order to be able to participate in the GPI initiative, companies and banks had to register for the service with SWIFT. The GPI concept foresees that participating banks, using an SLA framework, are given access to special products and are able to communicate with each other. The service levels

defined for this create new possibilities to make international payment operations faster and more transparent. The adherence to these SLAs is constantly and centrally overseen by so-called SLA observers.

Timeline and Phases

But let's back up a bit: In 2015, SWIFT first announced its GPI initiative. This was followed by marketing efforts, a presentation of the pilot version at SIBOS in Singapore, the subsequent pilot phase and the definition of strategic road maps by 2016. The service went live in its first phase in February 2017. It includes the intra-day availability of capital (as long as the GPI partner is in the same time zone), provides transparency on the fees, offers end-to-end tracking of payments and communicates important remittance information securely and unalterably.

A second phase will follow soon, the so-called digital transformation. Among other things, it should allow the cancellation of payments anywhere along the path of the correspondent banks. Moreover, the transfer of enhanced payment information will allow automatic compliance checks and reconciliations of related invoices. Furthermore, the communication with participants will be improved in the Cloud to lower the number of errors when generating payments in view of the many different local standards and/or regulatory requirements and duties.

In a third phase, SWIFT will look into the use of new technologies, unlocking the potential blockchain and others.

Taking a detailed look at SWIFT GPI: so where is all of this innovation?

The disadvantage of the current system of settling payments with correspondent banks is the delay between the time a sender releases a payment and the recipient is credited with it, not to speak of the absence of transparency when it comes to the fees. Add to this the fact that the long path often involving several correspondent banks makes it difficult to track the transfer without gaps until the confirmation has finally arrived at the sender.

The GPI initiative would like to change something and provide more transparency with unified standards and the possibility to permanently track the payment. Moreover, remittance information should be transmitted along the entire path in order to facilitate the reconciliation and booking of payments.

Using SWIFT and the underlying worldwide network guarantees security, robustness, global availability and compliance, among other things.

Due to the constant updating of the debits and credits as well as the end-of-day statements, the correspondent bank model currently used is very complicated and costly for both banks and their clients, which is why SWIFT initiated a feasibility study together with the leading transaction banks. This study is to find out whether the use of blockchain and banks' distributed-ledger technology (DLT) could assist in reconciling the nostro account securely and efficiently. By using their own blockchains and closed user groups as well as strictly regulated data access rules, costs and liquidity for reconciling nostro accounts will be improved and risks reduced.

Despite all of this, the initiative would like to remain open and flexible towards new technological market trends and standards. For instance, SWIFT is currently working out guidelines in a task force together with the Payments Market Practice Group (PMPG) to ensure compatibility with ISO20022.

In the future, payments using GPI should be faster, more transparent and trackable at all times without compromising security.

Implementing transparency and end-to-end tracking in real time looks like this:
A GUI will enable clients to see the current status of their payments. From the moment the order is placed to the moment it is credited to the recipient, every single step of the way is recorded by all of the correspondent banks and tracked in a cloud-based database; this information can be queried in real time.

This means that the institutions involved, the places, arrival and forwarding times, reference IDs and any individual fees are available in real time.

The summary also contains the current status, the full duration of the transfer, the sum of the fees and the general tracking ID.

The tracker can also be integrated into client systems through an API, thus allowing further processing. Like this, information on the payment status can be integrated into a treasury management system or payment operations system, where it can be mapped and analyzed.

A next small step to Treasury 4.0

The SWIFT GPI initiative shows once more that payment operations are developing into real-time processing as we speak. Parallel to the development regarding SEPA instant payments, cross-border payment operations are also evolving. The wish for more transparency, efficiency and speed as well as an increase in automation when it comes to matching and reconciling accounts does not end at country borders.

The positive impact is especially obvious for Treasury: improved localization of liquid funds and timely confirmations by counterparties, increased transparency concerning fees (and their future reduction) as well as efficiency gains due to faster available capital (i.e. on the same day). In addition, the risk of delayed payments is lower, resulting in lower contractual penalties.

Another compelling case for such systems is the fight against cyber criminality: the improved transparency and faster payment confirmations as well as security concepts based on the latest technologies will improve things significantly.

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Factoring

Smack in between risk management and accounting

Finance- and Treasury Management Switzerland

Many companies have been using factoring to manage liquidity and credit risk already for a long time. And yet, questions about how to present sold receivables under international accounting standards arise time and again, especially concerning their classification and valuation.

The introduction of IFRS 9, the new financial instruments accounting standard, has made it harder to recognize such instruments in the balance sheet since this year, meaning companies have to rethink their existing processes and methods.

We would like to present a number of questions straight from the practice and explain why a centralized monitoring of transactions involving the sale of receivables makes sense.

Credit risk and financing in tandem:
To begin with, a general classification and definition of the sale of receivables in credit risk management is a good idea. Usually, it distinguishes four different approaches:

1. **Acceptance:** The credit default risk is accepted, i.e. no management measures are taken to mitigate, hedge or transfer it.
2. **Mitigation:** The credit default scenario is hedged or at least mitigated either with a traditional credit insurance or with a trade finance instrument (guarantees, letters of credit).
3. **Exclusion:** By implementing specific means, (additional) credit default risk is excluded from the get-go with advances, order blocks, credit limits, etc.
4. **Transfer:** The credit default risk is transferred to a third party (factoring [also known as receivable financing], non-recourse financing, ABS).

How factoring and similar models work is known in broad strokes, and therefore also their advantages, whereas it should be said that in practice, there are many ways to design such agreements. The basic idea is to transfer a company's trade accounts receivables to a purchaser of such receivables. In return, the purchasing institution is remunerated for supplying the immediate liquidity and assuming the risk that is transferred to it by receiving an invoice discount. Generally, the selling company benefits from a reduced credit risk and quicker cash inflow because it is no longer bound to the payment terms granted to the customer. In practice, next to the sale of individual receivables and entire portfolios of receivables (e.g. by using factoring) securitization transactions have also become popular (e.g. through Asset-Backed-Securities, a.k.a. ABS), where an entire pool of receivables is transferred to a special purpose vehicle, which finances itself by issuing securities.

Balance-sheet aspects that arise with factoring:
The following aspects should be focused on when presenting such receivables in a balance sheet under IFRS:

Accounting situation / timing	IFRS 9 requirements
Initial recognition and subsequent measurement of client receivable (prior to sale)	Review of the terms of payment and the definition of the business model (new)
Derecognition of client receivables (at sale or settlement)	Assessment of transfer of opportunities and risks arising from the sale (unchanged)

How the sales transaction is presented in the balance sheet under IFRS 9 (i.e. the criteria used to assess the opportunities and risks, which remain with the company) is based on IAS 39, and we will therefore not elaborate on it. However, it is important to understand that once the material opportunities and risks are transferred to the buyer of the receivable, it may have to be derecognized. Often, factoring is done to improve working capital in the balance sheet. If material opportunities and risks remain with the company (if for instance, it retains the default risk to a large extent), the receivable will also remain in its books, if not in full then at least in part. In the case of securitization transactions, any consolidation of the special purpose vehicle in accordance with IFRS 10 needs to be examined.

What is completely new under IFRS 9 is the way a company has to determine the classification and measurement of receivables, which we will look at in more detail further down. This is also relevant for the disposal of receivables, because in practice a disposal usually does not take place immediately.

What is decisive for the classification according to IFRS 9 is not only the characteristics of the contractual payment flows but also the business model the company uses to manage the receivables. Trade accounts receivables are held by companies primarily with the objective to collect the contractual payment flows and thus should be allocated to the business model "Hold". This allows the measurement at historical costs (in the assumption that payment flow terms will be observed, which in practice, usually is the case for simple trade accounts receivables).

However, if receivables are sold in the framework of factoring or ABS transactions and there is a (subsequent) derecognition, the business model is no longer (only) the collection of the contractual payment flows at the receivables' maturity as the transfer or sale is of substance for their management. The reason for the sale of receivables in a factoring program therefore is the intention to manage liquidity, which is why classifying the transaction in the category "Hold" no longer makes sense. Therefore, the measurement is made at fair value.

If different business models are used, it may also be necessary to split the receivables portfolio into different sub-portfolios. For instance, this is the case if the factoring program selects receivables based on certain criteria, i.e. currencies or ratings. The receivables not included in the program will remain assigned to the category "Hold" and will continue to be recognized in the balance sheet at historical cost.

Should a factoring program not be set up centrally but only by a subsidiary, for the purpose of the consolidated financial statements 'key management personnel', as defined in IAS 24, still has to define the business model.

In trade relationships with China, the export financing using a letter of credit (L/C), forfaiting or similar is very popular because it guarantees the exporter an up-front payment (albeit with a certain discount). Even in such cases, which may affect significant receivable portfolios in international groups, it must be assessed precisely which business model is present in order to appropriately classify the financial instruments in the financial statements.

Conclusion

IFRS 9 has not made the accounting of factoring and the underlying receivables any easier. The relevant requirements as well as the determination of the business models should be defined and coordinated centrally in order to guarantee a proper presentation in the consolidated financial statements under IFRS.

In a first step, this means obtaining transparency across all groups on these types of programs and sales activities, even if the local companies act mostly independently. In a second step, headquarters should define consistent standards, processes and documentation for the accounting.

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