GSCFF

GLOBAL SUPPLY CHAIN FINANCE FORUM

Dynamic Discounting

BAFT

ABE EBA EURO BANKING ASSOCIATION

FCI Facilitating Open Account – Receivables Finance

ICC INTERNATIONAL CHAMBER OF COMMERCE The world business organization

ITFA

Dynamic Discounting

Disclaimer
This document represents the collective views of both the BAFT Supply Chain Finance Committee and the Global Supply Chain Finance Forum. This document is intended to provide our members a set of common market practices for Receivables Discounting. Members are encouraged to consult their own internal and external subject matter, legal, accounting and professional advisors to establish internal policies and procedures.

Dynamic Discounting

Advanced Payment

This section addresses structures that fall into neither the Receivables Purchase nor loan-based category. All techniques described herein relate to payments that include distinctive features that justify a section of its own, aiming to clarify the relevant differences. This section covers Corporate Payment Undertaking, Bank Payment Undertaking & Dynamic Discounting.

Definition

Dynamic Discounting is a buyer led solution that allows sellers to receive early payment on a buyer's outstanding invoices at a discount to the invoice value. The discount applied is 'dynamically' calculated based on the number of days settlement occurs prior to the original invoice due date. That is, the earlier an invoice is paid the larger the early payment discount that is applied. A technology platform may be engaged to facilitate both the early payment requests from suppliers and the discount calculations. Upon early payment to the supplier, the buyer extinguishes the payables on its balance sheet.

The buyer funds the early payment to the sellers using their own funds, potentially generating higher yields on excess cash. This is unlike Payables Finance or Corporate Payment Undertaking, where sellers in the buyer's supply chain are able to access liquidity provided by Banks, Funds, or other alternative financiers by means of Receivables Purchase or other arrangements that cover the finance provider's right to receive the buyer payment. In these solutions, the payable continues to be due by the buyer until its due date.

Synonyms

Buyer funded early payment programme, Buyer funded program, self-funded early payment programme, Early Payment Program.

Parties

The parties to the dynamic discounting arrangement are the seller and the buyer.

- Buyer: the entity that sets up the Dynamic Discounting program and invites sellers to join the program
- Seller: the entity selling goods or services to the buyer and agrees to the arrangement for receiving optional early payments at a discount.

Distinctive features

The buyer sets up a Dynamic Discounting program, inviting their sellers to join the program.
It is at the Seller's sole discretion to accept an invitation to participate in the buyer's Dynamic discounting

program. In the event that they opt in, and they have been on boarded they may request early payments on approved invoices.
Sellers can select individual invoices for early payment, or set rules / parameters to be automatically applied to invoices uploaded to a technology platform. The seller then requests for an earlier date of payment, at any time between invoice approval and invoice due date, and the discount rate will be calculated and applied based on the actual payment date.
Buyer can define available liquidity and payment schedules and block calendar days when no early payment can be made.
The discount is dynamic as it is adjusted based on the number of days until the invoice due date. Either the buyer or sellers can specify the discount:

- Buyer specified: The buyer applies an agreed Annualised Discount Rate (ADR) for individual sellers or seller groups.
- Seller specified: Seller submits preferred annualised discount rate quotes to the buyer on a transactional basis for the buyer to accept or reject.

In Dynamic Discounting, a Bank/finance provider does not provide any financing, however is likely to have a role facilitating buyer payments to sellers and/or providing the technology platform.

Contractual relationships and documentation

- Commercial contract for the supply of goods and services entered into between the seller and buyer, which typically includes specific payment terms and may specify the methodology for calculating dynamic discounts.
- Terms of use agreement for access to and use of the Dynamic Discounting technology platform.

Security

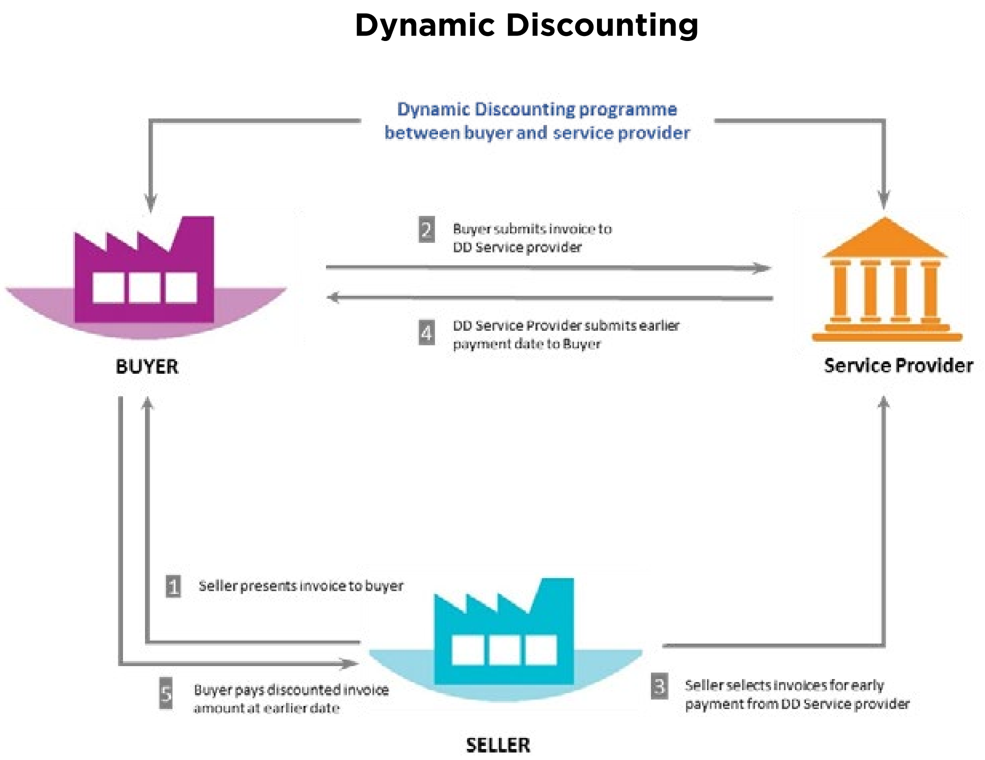
Dynamic Discounting utilises the buyer's available cash when making payment to sellers. As the program uses available cash there is no requirement for collateral, and therefore there are no security requirements.

Risks and risk mitigation

The seller assumes buyer default risk, and the buyer assumes non- or mal-performance risk of the seller through their commercial dealings with each other, and which exists with or without a Dynamic Discounting solution. As the buyer is paying, using its own funds to its seller there is no significant additional risk in a Dynamic Discounting financing solution.

Transaction illustration

The seller assumes buyer default risk, and the buyer assumes non- or mal-performance risk of the seller through their commercial dealings with each other, and which exists with or without a Dynamic Discounting solution. As the buyer is paying, using its own funds to its seller there is no significant additional risk in a Dynamic Discounting financing solution.



- Dynamic Discounting is typically facilitated via a technology platform, which can be integrated into the buyer's ERP systems.
- The seller prepares and ships goods and issues invoices to the buyer under existing supply chain arrangements
- The buyer receives and approves invoices which are then uploaded to the Dynamic Discounting technology platform
- Sellers have platform access to view approved invoices and to select any invoices for immediate early payment or at a target payment date in the future
- If an invoice is selected for early payment and the buyer has available funds to make an early payment the invoice is paid to the seller at a discount.
- Discount rates are agreed between the buyers and sellers and fully transparent to the seller.
- The buyer exclusively determines liquidity availability and seller limit management (if any).
- The buyer manages its own program without bank funding

Benefits

Benefits to buyers:

- Investing available cash in their own supply chain to capture discounts can potentially provide a favourable and widely risk free return on funds
- Injecting liquidity into the supply chain can strengthen seller relationships and contribute to the viability and stability of the supply chain
- Ability to take advantage of early payment discounts at any time up to the invoice due date, maximising savings and leading to improved operating profit.

Benefits to sellers:

- Access to working capital that may be at a lower cost of funds than other financing options
- Allows the seller to free up internal credit limits on the buyer that can lead to potentially more business with that buyer
- Using automated on boarding procedures through Dynamic Discounting technology providers, allows the on boarding of small suppliers which under Payable Finance Programs may not be economically viable
- Reduce Days Sales Outstanding through faster conversion of receivables to cash that may then be deployed for other needs
- Ability to request automatic early payment on all invoices upon full approval to pay, or on an individual invoice basis as and when cash flow needs dictate

Asset distribution

Not applicable, as there are no assets to distribute.

Variations

Static discounting programs traditionally applied to commercial terms where a buyer has the option to a percentage discount for goods and/or services if paid before a fixed date. Once the fixed date lapses full invoice value is payable on the due date. For example, “2/10 net 30 terms” provides the buyer an opportunity to benefit from a 2% discount if the invoice is paid within 10 days, or if not 100% of the invoice amount remains due in the original 30 days.

Depending on a buyer’s liquidity, they may be able to switch between self-funded dynamic discounting and an implemented third party payables finance program (including Corporate Payment Undertaking). The third party payables finance program must be an already established program with corresponding executed documentation (i.e. buyer service agreement, seller receivables purchase agreement, or other relevant seller terms). Switching between services will depend on the functionality of the technology platform, but could include allocating the invoice to the applicable service bucket within the same interface, or uploading the invoice to a separate interface. The service election will always be at the buyer’s discretion.

About the Global Supply Chain Finance Forum

The Global Supply Chain Finance Forum was established in 2014 to develop, publish and champion a set of commonly agreed standard market definitions for Supply Chain Finance (SCF). Comprised of trade bodies BAFT (Bankers Association for Finance and Trade), FCI (previously known as Factors Chain International), the International Chamber of Commerce (ICC), the International Trade and Forfaiting Association (ITFA) and the Euro Banking Association (EBA), the industry consortium leverages its collective footprint to aid the target audience of SCF in gaining clarity and consistency on the various terms and techniques used. The main objective of the GSCFF is to support the sustainable growth of supply chain finance by establishing consistency and a standardized understanding of SCF across the industry. Subsequently, the GSCFF strives towards acknowledgement of its definitions and their benefits by its target audience, especially on the regulatory side. The GSCFF monitors and reacts to major market developments in all relevant matters for SCF. It is open to financial institutions, non-FI finance providers, accounting firms, investors, rating agencies, regulators and corporates who have a stake in SCF.

http://supplychainfinanceforum.org/