CONCEPT NOTE

Export Under Open Account Against Risk Coverage: Bangladesh Context

Dr. Shah Md Ahsan Habib
Professor & Director (Training) BIBM

Antara Zareen
Assistant Professor, BIBM

Tofayel Ahmed
Assistant Professor, BIBM

Pradip Paul
Joint Director, Bangladesh Bank

Mahmudur Rahman
Senior Executive Vice President, Islami Bank Bangladesh Limited

ATM Nesarul Hoque
Vice President, Mutual Trust Bank Limited

October 10, 2020

Centre for Trade Studies Bangladesh

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1. Introductory Note

'Open Account', shipping or delivering the goods before receiving payment, is the most commonly used payment technique in all trade transactions. Driven by the dominance of the buyers/importers, this payment method contains the highest risk options for the sellers/ exporters. In an environment of intense competition in the market, sellers/exporters face the challenge of accommodating the highly advantageous payment option of the buyers/importers i.e. 'open account'. Thus, opting for open account payment terms is a contributory factor to the sellers/exporters to be competitive in the market. However, in the context of international trade, things are not so straight forward.

International trade is highly regulated where government agencies, central banks, and commercial banks are among the key stakeholders alongside exporters and importers. These are much more formal, structured, and documented transactions as compared to that of the domestic trade. There are perceptions that additional concerns of international trade like 'country risk' and 'crime risk' can be handled effectively in a highly regulated and formal environment. Thus, in several global economies, especially in developing countries, there are restrictions on using relatively less formal open account payment terms in cross-border trade transactions. However, promoting export competitiveness and their economic and business implications cannot be ignored by any global economy. In the context of the Covid-19 crisis and trade interruption, there are newer efforts on the part of the policymakers to promote their export competitiveness further.

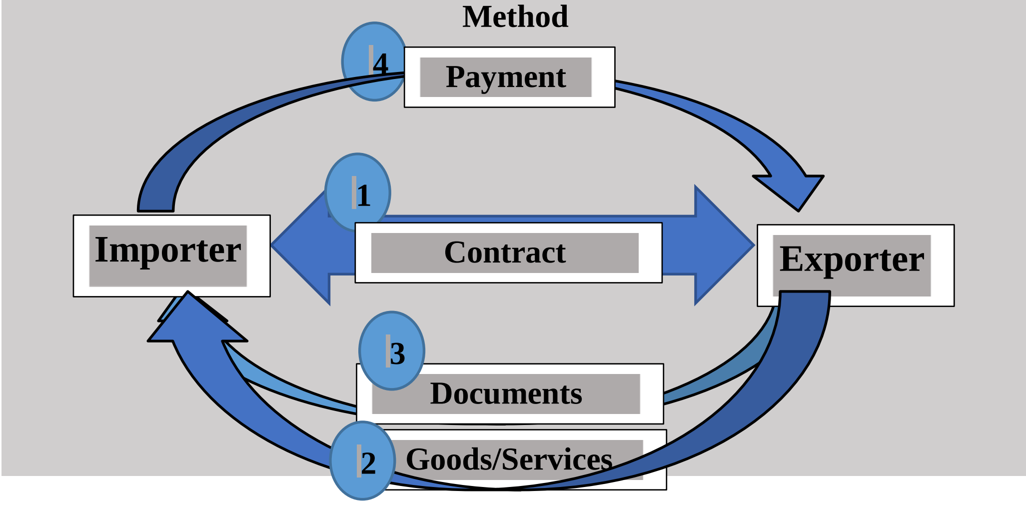
Traditionally, Bangladesh has several explicit and implicit restrictions on using open account payment terms in the cross-border trade facilitation. As part of the response strategy to the Covid-19 trade disruption, Bangladesh Bank (BB) changed its stand and allowed a modified and customized form of open account in the export transactions. The circular titled 'Export under open account credit terms against payment undertaking/payment risk coverage with the option of early payment arrangement on non-recourse basis'[1] issued in this regard appears to be a dynamic approach on the part of the central bank of Bangladesh. The concept note is an attempt to conceptualize the payment terms and financing options that are endorsed in the circular and to identify the associated concerns for optimizing benefits out of this reshaping effort of the trade finance product composition.

[1] BB FE Circular No-25, June 30, 2020: https://www.bb.org.bd/mediaroom/circulars/fepd/jun302020fepd25e.pdf

2. Open Account and the Risks in Exportation- Conceptual Thoughts

The dictionary meaning of the term 'open account' is characterized by the provision of suppliers' or sellers' credit and the existence of the payment risk: "An unpaid or unsettled account; an account with a balance that has not been ascertained, that is kept open in anticipation of future transactions; a type of credit extended by a seller to a buyer that permits the buyer to make purchases without a note or security and based on an evaluation of the buyer's credit."[2]

Figure 2.1: Operational Process of the Open Account Tarde Payment Method



Like all other forms of trade payment methods, the starting point of 'open account' trade transaction is the purchase/sale contract between an exporter and an importer (Figure 2.1). Based on the contact, the exporter then make shipment and generally send documents through courier service. And finally, in line with payment terms, payment is sent by the importer using the service of a regulated entity like a bank. It can be observed that the involvement of financial institutions or bank is relatively less in the open account as compared to that of the payment techniques like documentary credit and documentary collection, and thus regulatory control has also to be lower. From the traders' perspective, it is a less costly payment term as the cash in advance; and the open account is the most popular form of trade payment method throughout the globe. It is believed that the open account is used in the four-fifth of the total number of trade instances. However, it is to be noted that open account payment terms have not been enforced in its classical form in all economies, rather compliance requirements and involvements of banks vary across jurisdictions and thus cost as well.

The open account does not have any universally accepted regulatory or guiding frameworks like Uniform Customs and Practices for Documentary Credits

[2] https://legal-dictionary.thefreedictionary.com/Open+Account

(UCPDC) or Uniform Rules for Collection (URC). Purchase/sale contact is the only guiding document for smooth facilitation and protection of the parties involved in the open account transactions. Thus, a legally enforceable purchase/sale contract is very useful for this method. Though the benefits of open account trade terms and preferences are well recognized, traders and trade financing banks have very responsible roles to play in open account trade transactions and facilitation because the open account is prone to country risk and trade-based money laundering risk.[3]

Open account terms can be used with one or more of the appropriate trade finance techniques that mitigate the risk of non-payment. Even in a sense, the classical forms of trade payment methods like documentary collection and documentary credit are some forms of 'open account' transactions where goods are delivered before receiving payments by the exporters. In a simplified form, it may be stated that the documentary collection method adds the additional feature of sending documents through banks, and documentary credit adds an undertaking with that of the open account transaction attributes. Several other trade financing products under the broad banners of traditional trade finance or TFP (include letter of credit, documentary collection, standby LC and international bank guarantees) and supply chain trade finance products or SCF (mainly include, receivable finance, payable finance, factoring, forfaiting, etc.) may add protective features to the open account transactions.

Data on the exact volume of trade financing products lack accuracy; however, still, traditional trade financing products have comprehensive dominance in the trade finance market.[4] As per the most recent ICC survey (2020)[5], the majority of the respondents (52%) indicated that SCF constitutes only 0-5% of their trade finance made available today; however, there are evidences that the popularity of the supply chain finance is growing among the traders. Of the different supply chain products, currently, receivables discounting (71%) is seen as the most in-demand supply chain technique from a client perspective, followed by payables finance (54%), loans/ advances against receivables (46%), and factoring (45%). About 35% of respondents believe that the proportion of their SCF would be 0-15% in 2025; whereas 38% feel that it could be somewhere 15-30% of the total trade finance; and 10% have expectations that their SCF would cross 50% of the total by 2025; and (ICC, 2020). Despite the growing popularity of SCF, the projections indicate the possible dominance of TFPs even in the coming years.

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[3] 'Despite a significant proportion of international trade being conducted on 'open account' terms, firms' trade-based money laundering controls typically focus on transactions supported by traditional trade financing such as LC and this is disproportionate and leaves a gap in the industry's response to TBML.'[Global Banking and Finance Review (2017) Trade Based Money Laundering: Where the Risks Lie for Financial Services Firms: https://www.globalbankingandfinance.com]

[4] According to the ICC (2018) published report, TFPs constitute around 85% of the trade financing activities compared to that of 15% of SCF.

[5] ICC (2020) ICC Global Survey 2020-Securing Future Growth: https://iccwbo.org/publication/global-survey/

3. Open Account against Risk Coverage in Exportation- Product Options

The BB's circular (FE No-25), issued on June 30, 2020, permitted exporters to ship goods on sales contracts under open account credit terms- a remarkable initiative towards reshaping the overall trade finance environment. It is a conditional open account arrangement against payment undertaking or payment risk coverage by the international factoring companies/ foreign banks/foreign financial institutions/trade financiers/insurance entities arranged in association with importers and/or exporters. Besides, several other conditionality and supportive provisions are added in the circular (Box 3.1).

Box 3.1: Some Key Conditionality/Provision of the Export under Open Account

- Both physical and electronic presentation of export invoices, bills, or documents are allowed for presentation; and export price declared in EXP Form shall be competitive.
- Payment undertaking or payment risk coverage from designated institutions abroad may contain an option for early payment arrangement before maturity.
- Early payment shall be arranged on non-recourse basis.
- Interest with relevant charges for early payment shall not exceed 6-month USD LIBOR plus 3.50 percent annually.
- Export documents can be sent abroad through banking channel/electronic platform/suitable arrangements directly to designated institutions/importers/other relevant parties.
- ADs may extend early payment facilities to exporters on non-recourse basis out of their own funds against payment undertaking/payment risk coverage from designated institutions abroad.

Note: based on BB FE Circular no-25, June 30, 2020.

The circular appears to have extensive coverage with remarkable implications in the export facilitation of the country. Multiple product options are believed to be offered as part of the circular that includes the use of standby letter of credit, international bank guarantees, receivable discounting, international factoring, avalized bill discounting, or co-guarantees, trade credit insurance, and undertaking offered from global trade financers or entities. These undertakings have been tagged with the open account arrangement to minimize non-payment related risks and to facilitate financing options.

The structures of the process flow of the combination products (payment and finance) may be sketched in different forms in the context of Bangladesh. However, for shaping these derivatives, the basic products (international factoring, standby LC, international bank guarantees, co-guarantees, export credit insurance) have to be introduced before the stakeholders.

International factoring is a supply chain product variation. Export factoring is an arrangement of the purchase of account receivable which is offered under an agreement between the factor and the exporter, in which the factor purchases the exporter's short-term foreign accounts receivable with or without recourse basis. The factor also assumes the risk on the ability of the foreign buyer to pay, and handles collections on the receivables and allows exporter to offer open account terms and improves liquidity position. There might also be reverse factoring which is a solution where the importer assists his exporters by financing their receivables. There could be one or two-factor in the arrangement process. Export factoring is a good option for small and medium-sized exporters, however, is generally a more expensive option especially the non-recourse option that may erode a significant amount of an exporter's margin. Efforts on creating a uniform and sound legal framework for factoring is on. Factor Chain International (FCI) developed a draft Model Law on Factoring (FML), which has been used in certain countries.[6] In addition, international good practices in factoring are scripted in the FCI General Rules of International Factoring (GRIF) that are constantly updated by FCI.

In the context of the new open account circular, the arrangement might be categorized as 'Factoring within FCI' and 'Factoring outside FCI framework'. Variations of the process-flow are shown in figures 3.1, 3.2, and 3.3.

Forfaiting is another similar form that allows exporters to obtain cash by selling their medium and long-term foreign accounts receivable at a discount on a "without recourse" basis and eliminates the risk of non-payment, once the goods have been delivered to the foreign buyer in accordance with the terms of sale. However, forfaiters typically work with exporters who sell capital goods and commodities, or engage in large projects and therefore need to offer extended credit periods from 180 days and above. But small and medium-size companies are slowly embracing forfaiting. In most cases, the foreign buyers must provide a bank guarantee in the form of an aval, letter of guarantee or letter of credit. The existing rules of export proceed realization within 120 days kept this product out of the open account circular issued by the BB.

[6] https://www.linkedin.com/pulse/factoring-laws-impact-receivables-finance-industry-peter-mulroy

Figure 3.1: Operational Procedure of Open Account Backed by International Factoring [FCI Framework]	
Step-1:	Purchase/Sale (Open Account) Agreement between Exporter and Importer
Step-2:	Requesting Export Factor for Credit Approval Based on Importer Creditworthiness
Step-3:	Inter-factor Agreement Between Export Factor and Import Factor
Step-4:	Credit Approval Decision from Import Factor
Step-5:	Delivery of the Goods and Export Documents to the Importer
Step-6:	Assignment of the Proceeds and Notifying the Buyer about the payment clause
Step-7:	Purchase of the Receivable as per Factoring Agreement between Exporter and Export Factor
Step-8:	Payment Collection by Import Factor from Importer and Remitting Fund to Export Factor
Step-9:	Payment from Import Factor to Export Factor in case of non-payment from importer

3.2: Figure : International Factoring Other than FCI Framework	
Step-1:	Purchase/Sale (Open Account) Agreement between Exporter and Importer
Step-2:	Bank has agreements with the factor company
Step-3:	Factor sets credit limits for each buyer against the seller.
Step-4:	Seller sends the invoice, transport documents and others to the Bank
Step-5:	Bank uploads it in the factor system.
Step-6:	Factor makes early payment (95%)
Step-7:	Factor pays residual 5% (after deducting his charges and interest) upon receipt of payment from the buyer

Figure 3.3: Operational Procedure of International FCI Reverse Factoring	
Step-1:	Purchase/Sale (Open Account) Agreement between Exporter and Importer
Step-2:	Supplier Sends goods and invoice to buyer
Step-3:	Buyer checks the invoice and accepts it
Step-4:	Buyer sends the details of the invoice to be paid to the FI-IF
Step-5:	FI sends a proposal of non-recourse advance payment to the supplier
Step-6:	Supplier accepts the invoice and assigns it to the FI
Step-7:	FI pays the Supplier (irrevocably) in advance or at Maturity
Step 8:	At Maturity, Buyer will pay FI-IF

Standby LC or SBLC and international bank guarantees are conceptually same though these two popular trade finance products are structured under two different legal and guiding set up. SBLC helps facilitate international trade between companies that do not have long standing relationship. Although the buyer is certain to receive the goods and the seller certain to receive payment, a SBLC or international payment guarantees does not guarantee that buyer will be happy with the goods. SBLC is guided by the International Standby Practice 1998 (ISP 98) and international guarantees are guided by the Uniform Rules for Demand Guarantee (URDG 758) by ICC. The SBLC/international guarantee backed open account in Bangladesh context may take the following form (Figure 3.4):

Figure 3.4 : Exports under Open Account Backed by International Guarantee/ Standby LC	
Step-1:	Purchase/Sale(Open Account) Agreement between Exporter and Importer
Step-2:	Financing Arrangement between Exporter and Bank [Authorized Dealer]
Step-3:	Obtaining Payment Guarantee/Standby LC from Abroad in favor of Local Financing Bank or Exporter
Step-4:	Issuance of EXP Form and Delivery of Goods

Step-5:	Processing Export Documents as per arrangement and Certificate of Authorized Dealer To Carrier Company
Step-6:	Purchase of the Receivable by Bank without Recourse
Step-7:	Payment Settlement from Importer as per Arrangement
Step-8:	Claiming payment from Undertaker in case of non-payment from importer

Payment commitment on the part of a correspondent bank/entity may ensure secured payment by the foreign buyer and help proving finance to the local exporter in an open account arrangement between an exporter and an importer (Figure 3.5).

Figure 3.5 : Export under Open Account Backed by Payment Commitment and Integrated Receivable Discounting

Step-1:	Purchase/Sale (Open Account) Agreement between Exporter and Importer
Step-2:	Receivable Purchase Agreement between Seller and Finance Provider
Step-3:	Agreement between finance provider and payment undertaker
Step-4:	Delivery of Goods and Shipping Documents to Importer
Step-5:	Sending Invoice to Finance Provider under Receivable Purchase Agreement
Step-6:	Discounting of Receivables (With or Without Recourse)
Step-7:	Payment from Importer to Finance Providers’ Account

Documentary collection is a popular form of traditional trade payment product guided by the contract and the Uniform Rules for Collection (URC 522) of the ICC. Avalization and co-guarantees are special arrangement that might help minimizing the risks of non-payment by the foreign buyer and facilitating finance to the exporter under documentary collection or open account arrangements. In the context of Bangladesh, these might take the following forms (Figure 3.6 and 3.7):

Figure 3.6 : Operational Procedure of Avalized Bill Discounting/against Co-guarantees [Documentary Collection]

Step-1:	Purchase/Sale (Documentary Collection) Agreement between Principal (Exporter) and Drawee (Importer)
Step-2:	Delivery of Goods to Importer and Presentation of Documents to Remitting Bank
Step-3:	Forwarding Document to Collecting Bank with D/A Instruction and Request for Aval
Step-4:	Acceptance of Bill of Exchange by Drawee
Step-5:	Release of Documents against Acceptance and Advice of Aval by Collecting Bank to Remitting Bank
Step-6:	Purchase of the Receivable by Remitting Bank without Recourse
Step-7:	Payment at Maturity by Drawee(Importer)
Step-8:	Payment from Collecting Bank in case of non-payment from Drawee(Importer)

Figure 3.7 : Operational Procedure of Avalized Bill Discounting/against Co-guarantees [Open Account]

Step-1:	Purchase/Sale Agreement between Exporter and Importer
Step-2:	Delivery of Goods to Importer and Presentation of Documents to the Exporter's Bank
Step-3:	Forwarding Document to the Drawee Bank for Aval/co-guarantees
Step-4:	Acceptance of Bill of Exchange by the Drawee Bank and Importer and Release of the Documents
Step-5:	Purchase of the Receivable by the Exporter's Bank without Recourse
Step-6:	Payment at Maturity by the Importer to the Drawee Bank/Exporters Bank
Step-8:	Payment from the Drawee Bank in case of non-payment from the Importer

Export credit insurance offers open account terms safely in the global trade finance market, and exporters and the exporting country may seek/require credit insurance for protection while using open account terms. Export credit insurance is an arrangement to protect the exporters of good and services against the risk of non-payment by the foreign buyers, and thus may help reducing payment risk significantly. The arrangement commonly covers commercial risks (like insolvency of the buyer, bankruptcy, default/slow payment) and certain political risks (like war, terrorism, riot) that might result in non-payment, however, does not cover the physical loss or damage to the goods shipped. These insurance policies are offered by many commercial insurance companies. Premiums are determined based on the risk factors, and costs are generically much lower than the LC.[7] The insurance backed open account payment terms in the context of Bangladesh may take the following form (Figure 3.8).

Figure 3.8: Operational Procedure of Open Account Backed by Credit Insurance

Step-1:	Purchase/Sale Agreement between Exporter and Importer
Step-2:	Seller's Request to Insurer (abroad) for Trade Credit Insurance
Step-3:	Analyzing Creditworthiness and Financial Stability of the policyholder's Insurable customers(Importers)
Step-4:	Setting a Specific Credit Limit for Importers to Indemnify Seller/seller's bank(Policy Holder)
Step-5	Issuance of the EXP by the Bank
Step-6:	Delivery of Goods and Shipping Documents to Importer
Step-7:	Payment from Importer against Each Consignment
Step-8:	Indemnifying Seller in case of Non-payment from Importer

Other than the above mentioned product options, globally recognized sovereign entities, and even corporates might be acceptable as the trade financiers to support open account transactions. The circular also rightly incorporated the potential digitization and electronic presentation of documents.

All the above mentioned products have differences in terms of advantages, challenges, risks, and costs. Factoring is a good option for the SMEs and non-recourse factoring offers payment protection and financing facilities to the enterprises. But non-recourse factoring is not very common and cost might be a great concern from both the exporters' and bankers' perspective. Moreover, the existing operational regulation on export proceeds realization timeline may

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[7] International Tarde Administration of the USA (undated), Trade Finance Guide for the Exporters: www.trade.gov

not always be suitable to ensure optimum use of factoring. Also, import factors may not be willing to provide payment commitment before the acceptance of the invoice from the buyer's end. The interest rate ceiling may not always be sufficient to cover the interest cost, and factoring may confront shadow banking challenges.

Standby LCs and international bank guarantees have potentials as trade financing products, however, are not widely popular and familiar products in the trade finance arena of Bangladesh. Repeated issuance of LCs or arrangement of financing facility for each specific import-export deal can easily be avoided by introducing SBLC and as such repeated payment of charges like issuing charge, advising charge, etc. can be substantially reduced. However, it needs supportive domestic regulation and capable human resources. Besides, sometimes, arranging risk coverage for full amount might be difficult under SBLC and guarantees. These might be less costly options as compared to that of the commercial LC in certain instances.

The provision of avalization is hardly used in providing trade financing facility in Bangladesh though documentary collection is widely in use. This facility is less costly and simple than factoring as banks can manage this within their own capacity. In addition, ADs can finance against a secured bank avalised draft. However, the rating of the bank, which is avalising, might be a point of concern. Besides, some countries' local law have restrictions on issuing avalization. Moreover, unwillingness of the traders and lack of awareness are the key barriers in the use of this product.

Export backed by Credit Insurance Scheme is a good trade finance option in some global economies. The insurance premium is low considering other available options, and thus might be affordable to the traders. Though it covers different dimensions of risks, such as payment risk, political risk, etc., with low cost, assessment of credible trade credit insurer is a big challenge.

Familiarity with the traditional financing products and the effectiveness of the documentary credit in handling country risk and trade-based money laundering risks are challenging for the newer products in the country's trade finance market. Moreover, the newly introduced open account variations should be supported by the legally enforceable purchase/sale contracts that are hardly the case in Bangladesh. Though most of the Bangladesh trading partners are the signatories of the United Nations Convention on Contracts for the International Sale of Goods (CISG)[8] and the International Institute for the Unification of Private Law (UNIDROIT) Principles[9], the country is yet to ratify these as the cornerstones for developing practices of the legally enforceable contracts.

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[8] As of September 2020, 93 countries ratified the convention including China, USA, EU countries, Japan, Korea etc. (https://iicl.law.pace.edu/cisg/page/cisg-list-contracting-states).

[9] As of September 2020, there are 63 member countries that include major trading partners of Bangladesh- USA, EU countries, UK, China, India, Japan, Korea etc. (https://www.unidroit.org/about-unidroit/membership).

4. Way Forward

In the context of the new circular on the open account, there is expected change in the trade finance product basket in Bangladesh in the upcoming period. It is important to draw benefits out of this product composition by minimizing risks. The concept note puts forward a few observations and the associated propositions for sustaining and optimizing the product composition.

Observation and Proposition 1: Bangladesh Bank's circular on 'conditional open account transactions' is a good initiative, which means the products may be used. However, it is the traders who should consider cost, necessity, and risks before choosing one. Bankers must also calculate and disclose all the relevant information related to cost, legal obligations, and compliance issues to their clients to ensure the suitability of a product for a particular client. Especially, country and compliance risk issues should get the utmost priority to the 'authorized dealers banking institutions' of the country in facilitating a particular type of trade services. Not marketing, rather initiatives are required for familiarizing the newly introduced open-account linked trade financing products amongst traders and bankers for market fairness. A technical note has been introduced for international factoring as part of the circular. For effective enforcement, technical notes and supportive information/guidelines would be needed for standby LC/ international bank guarantee, export credit insurance, and avalization. The shadow banking component (if any) of these product variations should be under monitoring of the regulatory authority for avoiding any unexpected development and malpractices.

Observation and Proposition 2: The country's trade finance product basket has been dominated by the LC, documentary collection, and the associated financing. There are also instances of cash in advance and some forms for open account transactions. The exporters/enterprises who/that are availing LC to export have every reason to stick on that. The use of the commercial letter of credit in the context of Bangladesh and the Asia-pacific regions should not be considered only from the perspective of facilitating payment and financing. The product has unique features of handling country and crime risks, and a balanced approach of risk-sharing between exporters and importers. The classic and universal acceptance of its guiding framework i.e. UCPDC and proven credibility in handling trade-based money laundering is its huge strength. Thus, despite the limitations of its lengthy, cumbersome, and costly processes, it has been dominating as the most widely used trade financing product in international trade transactions for long. 'Pool of LC Specialist Bankers' is an added strength of using LC in the country. These invaluable benefits of LC must always be considered in designing the future landscape of the trade financing market in the context of Bangladesh.

Observation and Proposition 3: Legally enforceable purchase/sale contract is the immediate need. For sound purchase/sale agreement, it is essential to have coverage of a regulatory framework. Alongside ratifying the CISG, there should be clear instructions regarding transactions with the other non-ratifying countries. This is particularly important in the context of Bangladesh as in several instances back-to-back LCs are opened against contact; and it is a very important guiding document for the open account transactions. Moreover, UNIDROIT principles should be ratified as the soft law to handle contract-related disputes.

Finally, probably the most critical force that is going to contribute to reshaping the trade financing industry is the ‘technology’. Several stakeholders are already engaged or are getting ready to modernize to enable more digitized trade in the coming days. The time has come when documentation should no longer be mandated to be paper-based in the context of trade financing. The digitization is expected to change the process, transaction patterns, and costs of both traditional and supply chain products. The circular on open account rightly included the potential option of using a technology platform for handling documents.