

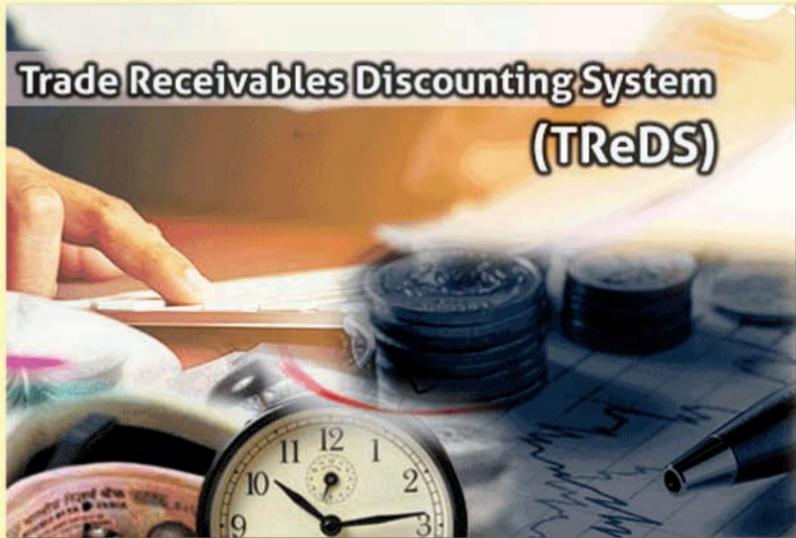


STUDENTS' ECONOMIC FORUM

A monthly publication from South Indian Bank

*To kindle interest in economic affairs...
To empower the student community...*

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APRIL 2018

Theme 317

“TRADE RECEIVABLE DISCOUNTING SYSTEM (TReDS)”

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Theme No: 317: “Trade Receivable Discounting System (TReDS)”

A well informed customer will make the policy makers as well as organizations which produce goods and render services more responsive to the customer needs. This will also result in healthy competition among organizations and improve the quality of its products.

The “SIB Students’ Economic forum” is designed to kindle interest in the minds of younger generation. We highlight one theme in every monthly meeting of the “Forum”. This month the topic for discussion is “Trade Receivable Discounting System (TReDS)”

1. What is TReDS (Trade Receivable Discounting System)?

The electronic platform that facilitates the financing of trade receivables of MSMEs from corporate buyers through multiple financiers is known as Trade Receivables Discounting System (TReDS). The TReDS facilitate the discounting of both invoices as well as bills of exchange.

The process is also commonly known as ‘bills discounting’, a financier (a bank and non-bank) buying a bill (trade receivable) from a seller of goods before it’s due or before the buyer credits the value of the bill. In other words, a seller gets finance against a bill which is due to him at a later date. The discount is the interest paid to the financier.

The transactions processed under TReDS will be “without recourse” to the MSMEs.

2. Who are the various stakeholders in the system?

MSME sellers, corporate buyers and financiers – both banks and non-bank (NBFC factors) are the participants in the TReDS. The TReDS provide the platform to bring these participants together to facilitate uploading, accepting, discounting, trading and settlement of the invoices / bills of MSMEs.

3. How does the TReD system work?

MSME supplies goods to corporate buyer. The corporate buyer takes months

to settle the payments after the delivery of goods. This holds up the working capital of MSME leading to liquidity crunch to the MSME seller. Efforts of MSME to convince corporate buyer to make payment earlier doesn't work as big corporates have market power to dictate terms to MSME and other suppliers. With the advent of TReDS, MSME can upload the digitally signed invoice on the TReDS platform. The upload is done after the supplies are made to corporate.

Corporate gets a time window to approve the invoice online, thus verifying the authenticity of the supply and the commitment that it would pay the sum against the invoice raised on due dates. The approved invoice can now be factored on the platform, through auction by the financial intermediaries like bank / NBFCs. For example Bank buys the invoice at a discount and pays the money to MSME, thus providing it with immediate liquidity. The actual payment would be realized by the Bank on due dates from the corporate.

4. Briefly explain the Settlement Process in TReDS.

The settlement process happens in two ways, one between the financier and MSME for accepted bids and the another one between the corporate buyer and ultimate financier on due date.

- a) Settlement between the financier and MSME for accepted bids - In respect of all bills discounted on a given day, the TReDS will generate the payment obligation to all financiers on T+2 basis and send it for settlement in any of the existing payment system as agreed among the system participants. The TReDS would have a separate recourse mechanism to handle settlement failures in respective payment systems.
- b) Settlement between the corporate buyer and ultimate financier on due date - The TReDS would generate the payment obligations and send it for settlement on due date to the relevant payment system.

The TReDS will generate the settlement obligation and send the same to existing payment system for actual payment of funds. This would ensure that the inter-bank settlement (between the bankers representing MSMEs, corporate buyers and the financiers) will take place and defaults, if any, by the corporate buyers will be handled by the buyer's bank and will not be the responsibility of the TReDS. Hence, the settlement process ensures payments to relevant recipients on due date thus, facilitating the smooth operations on the TReDS, it would not entail a guaranteed settlement by the TReDS.

5. What is the discounting rate?

The financiers / Bank can't bid below marginal cost of funds-based lending rate (MCLR) rate. The buyer with good credit rating has an advantage of getting the finance at very competitive rate. The spread widens depending upon the buyers' credit rating.

6. Briefly explain the process of on boarding the customer in the TReDS platform.

TReDS has a standardized mechanism / process for on-boarding of buyers and sellers. The one-time on boarding process require the entities to submit KYC related documents to the TReDS, along with resolutions / documents specific to authorised personnel of the buyer corporate and the MSME seller who would be provided IDs / Passwords for TReDS authorisations.

A random audit is introduced to ensure that there is no window dressing and that factoring units uploaded on the exchange are authentic & based on genuine transactions.

7. Briefly point out the mechanism established in TReDS platform for charge creation.

- a) There would be a one-time agreement drawn up among the participants of the TReDS:
- b) The Master agreement between the buyer corporate and the TReDS, includes the following aspects:
 - (i) The buyer's obligation to pay on the due date once the factoring unit is accepted online.
 - (ii) No recourse to disputes with respect to quality of goods or otherwise.
 - (iii) No set offs to be allowed.
- c) Master agreement between the MSME sellers and the TReDS, is drafted with a declaration / undertaking by the MSME seller that any finance availed through the TReDS would not be part of existing charge / hypothecation to its Working Capital bankers. An NOC is to be obtained from the working capital bankers to avoid possibility of double financing.
- d) Financing on the basis of invoices requires an assignment agreement which has to be executed between the MSME seller and the financier. The agreement between the MSME seller and the financier, should include that any financing transaction on TReDS will amount to an assignment of receivables in favour of the financier / Financing bank.

- e) The TReDS will be in custody of all the agreements.
- f) A suitable mechanism for CERSAI registration to be developed by the TReDS.

8. Briefly explain the financial criteria of TReDS.

- i) The minimum paid up equity capital to be Rs 100 crore and the TReDS should have a net worth of Rs100 crore at all times.
- ii) The promoter's minimum initial contribution to the paid up equity capital of TReDS shall be at least 40 per cent which shall be locked in for a period of five years from the date of commencement of business of the TReDS. Shareholding by promoters in TReDS in excess of 40 per cent shall be brought down to 40 per cent within three years from the date of commencement of business. Further, the promoter's stake should be brought down to 30 per cent of the paid-up equity capital of TReDS within a period of 10 years, and to 26 per cent within 12 years from the date of commencement of business.
- iii) The foreign shareholding in the TReDS is as per the extant FDI policy.
- iv) Entities other than the promoters will not be permitted to have shareholding in excess of 10 per cent of the equity capital of the TReDS.

9. Name the players who have been issued license for operating as TReDS?

RBI has given license to three entities and they are governed by the Payment And Settlement Systems Act. The Receivables Exchange of India (RXIL), which is a joint-venture between National Stock Exchange and SIDBI; "A TReDS" a joint-venture between Axis Bank and Mjunction Services and third one is Mynd Solution.





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