

Guidelines for the Trade Receivables Discounting System (TReDS)

(Updated as on July 2, 2018)

Micro, Small and Medium Enterprises (MSMEs), despite the important role played by them in the economic fabric of the country, continue to face constraints in obtaining adequate finance, particularly in terms of their ability to convert their trade receivables into liquid funds. In order to address this pan-India issue through setting up of an institutional mechanism for financing trade receivables, the Reserve Bank of India had published a concept paper on *“Micro, Small & Medium Enterprises (MSME) Factoring-Trade Receivables Exchange”* in March 2014.

2. Based on the public comments received on the concept paper and the subsequent draft guidelines issued for setting up and operating the system, and interactions held with relevant stakeholders, the following guidelines are being issued for setting up and operating the trade receivables system in the country. These Guidelines are issued by Reserve Bank of India under Section 10(2) read with Section 18 of Payment & Settlement Systems Act, 2007 (Act 51 of 2007).

Scheme

3. The scheme for setting up and operating the institutional mechanism for facilitating the financing of trade receivables of MSMEs from corporate and other buyers, including Government Departments and Public Sector Undertakings (PSUs), through multiple financiers will be known as Trade Receivables Discounting System (TReDS).

4. The TReDS will facilitate the discounting of both invoices as well as bills of exchange. Further, as the underlying entities are the same (MSMEs and corporate and other buyers, including Government Departments and PSUs), the TReDS could deal with both receivables factoring as well as reverse factoring so that higher transaction volumes come into the system and facilitate better pricing.

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

Definitions

6. For the purpose of the Scheme, notwithstanding any other definition used in any other context, scheme, law or document, the following definitions are used:

a) Factoring unit - a standard nomenclature used in the TReDS for an invoice or a bill on the system. Factoring Units may be created either by the MSME seller (in the case of factoring) or by corporate and other buyers, including Government Departments and PSUs, (in case of reverse factoring) as the case may be.

b) Financier – refers to banks, NBFC Factors and other financial institutions as permitted by the Reserve Bank of India participating in the TReDS and accepting the factoring unit for financing purpose.

Participants

7. MSME sellers, corporate and other buyers, including the Government Departments and PSUs, and financiers (banks, NBFC Factors and other financial institutions as permitted by the Reserve Bank of India) will be direct participants in the TReDS. The TReDS will provide the platform to bring these participants together for facilitating uploading, accepting, discounting, trading and settlement of the invoices / bills of MSMEs. The bankers of sellers and buyers may be provided access to the system, where necessary, for obtaining information on the portfolio of discounted invoices / bills of respective clients. The TReDS may tie up with necessary technology providers, system integrators and entities providing dematerialisation services for providing its services.

Process flow and procedure

8. The objective of the TReDS is to facilitate financing of invoices / bills of MSMEs drawn on corporate and other buyers, including the Government Departments and PSUs, by way of discounting by financiers. To enable this, the TReDS has to put in place suitable mechanism whereby the invoice / bill is converted into “factoring unit” as indicated in the [Annex](#).

9. In the first phase, the TReDS would facilitate the discounting of these factoring units by the financiers resulting in flow of funds to the MSME with final payment of the factoring unit being made by the buyer to the financier on due date. In the second phase, the TReDS would enable further discounting / re-discounting of the discounted factoring units by the financiers, thus resulting in its assignment in favour of other financiers.

10. The **process flow** of the TReDS has to enable at the minimum, the uploading of invoices/bills and creation of factoring units by the MSME sellers; its acceptance by the corporate and other buyers, including the Government Departments and PSUs, within a specified time limit; discounting, rating and re-discounting of factoring units; sending of notifications at each stage to the relevant parties to the transaction; reporting and MIS requirements; and finally, generation and submission of settlement of obligations. In case of reverse factoring, the buyer could also create factoring units based on the documents uploaded by the MSME seller. A brief illustrative outline of the minimum features required in the process flow is given in the [Annex](#).

11. The actual business, technical and operational processes and procedures to be followed in the system will be prepared by the entity operating the TReDS, and will be part of the Procedural Guidelines for the system.

12. The TReDS may also undertake some random **audits** to ensure that the factoring units uploaded on the exchange are authentic & based on genuine underlying transactions involving the sale of goods or services.

13. TReDS would put in place a standardized mechanism / process for **on-boarding of buyers** and sellers on the TReDS. This one-time on-boarding process will require the entities to submit all KYC related documents to the TReDS, along with resolutions / documents specific to authorised personnel of the buyer, and the MSME seller. Such authorised personnel would be provided with IDs / Passwords for TReDS authorisations

(multi-level). Indemnity in favour of TReDS, if required, may also be given if it is made part of the standardized on-boarding process.

14. The **KYC documentation** and its process may be standardised and disclosed to all stakeholders by TReDS. As it requires confirmation of the banker of the MSME seller / buyer, as the case may be, the KYC documentation may be synchronous with the documentation / verification done by the banks in adherence to the extant regulatory requirements (Reserve Bank of India's "[Master Direction - Know Your Customer \(KYC\) Direction, 2016](#)" dated February 25, 2016 (as amended from time to time)).

15. There would be a **one-time agreement** drawn up amongst the participants in the TReDS:

- a) Master agreement between the financier and the TReDS, stating the terms and conditions of dealings between both the entities.
- b) Master agreement between the buyers and the TReDS, stating the terms and conditions of dealings between both the entities. This agreement should clearly capture the following aspects:
 - (i) The buyer's (corporates and other buyers including government departments and PSUs as the case may be) 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, stating the terms and conditions of dealings between both the entities. The agreement should also have a declaration / undertaking by the MSME seller that, in respect of goods and services underlying the factoring unit, no finance is extended by the working capital financing bank and such goods and services are not charged to the working capital financing bankers (i.e., finance availed through the TReDS would not be part of existing charge / hypothecation of its working capital bankers).
- d) In case of financing on the basis of invoices, an assignment agreement would need to be executed between the MSME seller and the financier. Alternatively, this aspect may be incorporated in the agreement between the MSME seller and the financier, to the effect that any financing transaction on TReDS will tantamount to an assignment of receivables in favour of whoever is the financier.
- e) The TReDS will be in custody of all the agreements.

16. Other procedural aspects of TReDS functioning and operations may be incorporated either in the Master Agreement, if so necessitated by the participants, or in the Procedural Guidelines where applicable. In all instances, such procedural aspects, even if incorporated in the Master Agreements, should be in adherence to regulatory norms issued from time to time. The Master Agreement may also clearly indicate that any legal proceedings to be initiated by one entity against another, if at all, will be outside the purview of TReDS.

17. TReDS will also review the need for CERSAI registration for the assignments as indicated above, and put in place a suitable mechanism for the same (preferably driven automatically through the TReDS), as soon as feasible after a factoring unit has been accepted for financing by a financier.

Settlement process

18. Critical to the operations of the TReDS is the mechanism that ensures timely settlement of funds between the member financiers and the MSME sellers (when the factoring unit is financed) and the subsequent settlement of funds between the member buyers and the respective financiers on due date of the factoring unit. In order to ensure a smooth process of such payments, the TReDS would be required to:

a) Trigger settlement between financier and MSME for accepted bids - In respect of all factoring units financed on a given day, the TReDS will generate the payment obligations of all financiers on T+2 basis and send the file for settlement in any of the existing payment system as agreed among the system participants. The TReDS would have to put in place a separate recourse mechanism to handle settlement failures in respective payment systems.

b) Trigger settlement between the buyer and the ultimate financier on due date - the TReDS would generate the payment obligations file and send the same for settlement on due date to the relevant payment system.

19. The TReDS will generate the settlement files and send the same to existing payment systems for actual payment of funds. This would ensure that the inter-bank settlement (between the bankers representing member MSMEs, buyers and the financiers) will take place and defaults, if any, by the 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. However, it would not entail a guaranteed settlement by the TReDS.

20. The TReDS would be required to put in place a mechanism for bankers to report defaults in payments by buyers. The TReDS would also need to ensure adequate arbitration and grievances redressal mechanism is in place.

Regulatory framework for TReDS

21. The TReDS, which undertakes clearing and settlement activities, would be governed by the regulatory framework put in place by the Reserve Bank of India under the Payment and Settlement Systems Act 2007 (PSS Act). It will function as an authorised payment system under the PSS Act 2007. The activities of the TReDS as well as those of the participants in the TReDS would be governed by the relevant legal and regulatory provisions applicable to various stakeholders in the system. As such, the processes and procedures of the TReDS should be compliant with such legal and regulatory provisions which may be issued and amended from time to time by respective authorities.

Eligibility criteria to set up and operate the TReDS

22. Entities desirous of setting up and operating the TReDS should fulfil the following criteria.

(a) Financial Criteria

- (i) Since the TReDS will not be allowed to assume any credit risk, its minimum paid up equity capital shall be Rs. 25 crore.
- (ii) The foreign shareholding in the TReDS would be as per the extant foreign investment policy.
- (iii) 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.
- (iv) The overall financial strength of the promoters/entity seeking to set up TReDS would be an important criteria of assessment/selection.

(b) Due diligence of promoters

The entities and their promoters/promoter groups as defined in the SEBI (Issue of Capital & Disclosure Requirements) Regulations, 2009 should be 'fit and proper' in order to be eligible to operate as TReDS. RBI would assess the 'fit and proper' status of the applicants on the basis of their past record of sound credentials and integrity; financial soundness and track record of at least 5 years in running their businesses. RBI may, *inter alia*, seek feedback on the applicants on these or any other relevant aspects from other regulators, and enforcement and investigative agencies like Income Tax, CBI, Enforcement Directorate, SEBI, etc. as deemed appropriate.

(c) Technological capability

The TReDS should have sound technological basis to support its operations. As such, the TReDS should, at the minimum, fulfil the following technological requirements.

- TReDS shall be able to provide electronic platform for all the participants.
- Information about bills/ invoices, discounting and quotes shall be disseminated by the TReDS in real time basis, supported by a robust MIS system.
- The TReDS shall have a suitable Business Continuity Plan (BCP) including a disaster recovery site.
- The TReDS shall have an online surveillance capability which monitors positions, prices and volumes in real time so as to check system manipulation.

Application procedure for Authorisation

23. The general guidelines as well as the application format for any non-bank entity to seek authorisation under the PSS Act for operating a payment system are available at <https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/86707.pdf>

24. Entities meeting the eligibility criteria as outlined in the Guidelines and desirous of setting up the TReDS, may apply in the prescribed format to the Chief General Manager, Department of Payment and Settlement Systems, Reserve Bank of India, 14th Floor, Central Office Building, Shaheed Bhagat Singh Marg, Mumbai – 400001, as and when the window for receipt of applications for this purpose is opened.

Illustrative Outline of Process flow under TReDS

- a) Corporate and other buyers, including Government Departments and Public Sector Undertakings, send purchase order to MSME seller (outside the purview of the TReDS).
- b) MSME seller delivers the goods along with an invoice. There may or may not be an accepted bill of exchange depending on the trade practice between the buyer and the seller (outside the purview of the TReDS).
- c) Thereafter, on the basis of either an invoice or a bill of exchange, the MSME seller creates a **'factoring unit'** (which would be a standard nomenclature used in the TReDS for an invoice or a bill on the system) on TReDS. Subsequently, the buyer also logs on to TReDS and flags this factoring unit as 'accepted'. In case of reverse factoring, this process of creation of factoring unit could be initiated by the buyer.
- d) Supporting documents evidencing movement of goods etc. may also be hosted by the MSME seller on the TReDS in accordance with the standard list or check-list of acceptable documents indicated in the TReDS.
- e) The TReDS will standardise the time window available for buyers to 'accept' the factoring units, which may vary based on the underlying document – an invoice or bill of exchange.
- f) The TReDS may have either a single or two separate modules for transactions with invoices and transactions with Bills of Exchange, if so required. In either case, all transactions routed through TReDS will, in effect, deal with factoring units irrespective of whether they represent an invoice or a bill of exchange.
- g) Factoring units may be created in each module as required. Each such unit will have the same sanctity and enforceability as allowed for physical instruments under the "Factoring Regulation Act, 2011" or under the "Negotiable Instruments Act, 1881"
- h) The standard format / features of the 'factoring unit' will be decided by the TReDS – it could be the entire bill/invoice amount or an amount after adjustment of tax / interest etc. as per existing market practice and as adopted as part of the TReDS procedure. However, each factoring unit will represent a confirmed obligation of the corporate and other buyers, including Government Departments and PSUs, and will carry the following relevant details – details of the seller and the buyer, issue date (could be the date of acceptance), due date, tenor (due date – issue date), balance tenor (due date – current date), amount due, unique identification number generated by the TReDS, account details of seller for financier's reference (for credit at the time of financing), account details of buyer for financier's reference (for debit on the due date), the underlying commodity (or service if enabled).
- i) The TReDS should be able to facilitate filtering of factoring units (by financiers or respective sellers / buyers) on any of the above parameters. In view of the expected high volumes to be processed under TReDS, this would provide the necessary flexibility of operations to the stakeholders.

j) The buyer's bank and account details form an integral feature of the factoring unit. The creation of a factoring unit on TReDS shall result in automatic generation of a notice / advice to the buyer's bank informing them of such units.

k) These factoring units will be available for financing by any of the financiers registered on the system. The all-in-cost quoted by the financier will be available on the TReDS. This price can only be viewed by the MSME seller and not available for other financiers.

l) There will be a window period provided for financiers to quote their bids against factoring units. Financiers will be free to determine the time-validity of their bid price. Once accepted by the MSME seller, there will be no option for financiers to revise their bids quoted online.

m) The MSME seller is free to accept any of the bids and the financier will receive the necessary intimation. Financiers will finance the balance tenor on the factoring unit.

n) Once a bid is accepted, the factoring unit will get tagged as "financed" and the funds will be credited to the seller's account by the financier on T+2 basis (T being the date of bid acceptance). The actual settlement of such funds will be as outlined under the Settlement section.

o) Once an accepted factoring unit has been financed by a financier, notice would be sent to buyer's bank as well as seller's bank. While the buyer's bank would use this information to ensure availability of funds and also handle the direct debit to the buyer's account on the due date in favour of the financier (based on the settlement obligations generated by the TReDS), the seller's bank will use this input to adjust against the working capital of the MSME seller, as necessary (the TReDS procedures may, if necessary, also indicate that the proceeds of the accepted and financed factoring units will be remitted to the existing working capital / cash credit account of the MSME seller). If agreed by members, the TReDS may also provide the option to members, whereby the financiers would take direct exposure against the buyers rather than through their bankers.

p) On the due date, the financier will have to receive funds from the buyer. The TReDS will send due notifications to the buyers and their banks advising them of payments due. The actual settlement of such funds will be as outlined under the Settlement section.

q) Non-payment by the buyer on the due date to their banker should tantamount to a default by the buyer (and be reported as such as per regulatory procedures prescribed from time to time) and enable the banker to proceed against the buyer. Any action initiated in this regard, will be strictly non-recourse with respect to the MSME sellers and outside the purview of the TReDS.

r) These instruments may be rated by the TReDS on the basis of external rating of the buyer, its credit history, the nature of the underlying instrument (invoice or bill of exchange), previous instances of delays or defaults by the buyer with respect to transactions on TReDS, etc.

s) The rated instruments may then be further transacted / discounted amongst the financiers in the secondary segment.

t) Similar to the primary segment, any successful trade in the secondary segment will also automatically result in a direct debit authority being enabled by the buyer's bank in favour of the financier (based on the settlement obligations generated by the TReDS). In parallel, it will also generate a 'notice of assignment' intimating the buyer to make the payment to the new financier.

u) In the event that a factoring unit remains unfinanced, the buyer will pay the MSME seller outside of the TReDS.

In order to meet the requirements of various stakeholders, the TReDS should ensure to provide various types of MIS reports including intimation of total receivables position, financed and unfinanced (to sellers); intimation of outstanding position, financed and unfinanced with details of beneficiaries and beneficiary accounts to be credited (for buyers); total financed position for financiers; etc. Similarly, data on unfinanced factoring units in the market should also be made available by the TReDS. The system should also generate due date reminders to relevant parties, notifications to be issued to bankers when a factoring unit is financed, notifications to be issued to buyers once a factoring unit related to their transaction is traded in the secondary segment, etc.
