

Trade Receivables e-Discounting System (TReDS)

TReDS is an electronic platform facilitating the financing/discounting the Trade receivables of the Micro, Small and Medium Enterprises (MSMEs) through multiple financiers. This scheme was introduced by RBI to meet the liquidity crisis of the MSMEs by providing a mechanism for financing their trade receivables. According to RBI, the TReDS would 'facilitate the discounting of both invoices as well as bills of exchange.' This way, MSME sellers, corporate buyers, and financiers (banks and NBFCs) would be linked on a common platform. After approval from both the seller and the buyer, the financiers would bid on invoices and make the payment to the seller. The process to join any of the TReDS platforms is short and quick.

Background

Micro, Small and Medium Enterprises (MSMEs) are the back bone of Indian Economy and 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.

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).

The TReDS Scheme

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).

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. The transactions processed under TReDS will be "without recourse" to the MSMEs meaning that MSME vendors need not be responsible for non-payment of the trade receivables amount (from buyers)

Executive Summary

The major concerns regarding the scheme are discussed below. This has reference to the FAQ (frequently asked questions) released by the Reserve Bank of India on 01st January 2020 for information and general guidance purposes.

SI No	Issues/ Questions	Answers
1	Who are the participants in TReDS?	Sellers, buyers and financiers are the participants on a TReDS platform.
2	Who can participate as a seller in TReDS?	Only MSMEs as per the definition of the Micro, Small and Medium Enterprises Development Act, 2006 (MSMED Act) can participate as sellers in TReDS.
3	Who can participate as a buyer in TReDS?	Corporates, Government Departments, PSUs and any other entity can participate as buyers in TReDS.
4	Who can participate as a financier in TReDS?	Banks, NBFC - Factors and other financial institutions as permitted by the Reserve Bank of India (RBI), can participate as financiers in TReDS.
5	Who are required to register themselves?	Mandatory for all companies with a turnover more than Rs.500 crores and all Central Public Sector Enterprises vide Notification dated November 02, 2018. Registration is optional for sellers and financiers in the scheme.
6	What are the eligibility criteria for the MSMEs to join the TReDS Platform?	The basis of classifying MSMEs are Investment & annual turnover. The new definition of MSME announced recently as a relief measure to MSMEs in COVID time is as below: <ul style="list-style-type: none"> • Micro Enterprises - investment less than Rs 1 crore and turnover less than Rs 5 crore • Small Enterprises - Investment less than Rs 10 crore and turnover of less than Rs 50 crore • Medium Enterprises - Investment less than Rs 20 crore and turnover less than Rs 100 crore
7	How does TReDS work?	Broadly, following steps take place during financing / discounting through TReDS: <ol style="list-style-type: none"> i. Creation of a Factoring Unit (FU) - standard nomenclature used in TReDS for invoice(s) or bill(s) of exchange – containing details of invoices / bills of exchange (evidencing sale of goods / services by the MSME sellers to the buyers) on TReDS platform by the MSME seller (in case of factoring) or the buyer (in case of reverse factoring);

		<ul style="list-style-type: none"> ii. Acceptance of the FU by the counterparty - buyer or the seller, as the case may be; iii. Bidding by financiers; iv. Selection of best bid by the seller or the buyer, as the case may be; v. Payment made by the financier (of the selected bid) to the MSME seller at the agreed rate of financing / discounting; vi. Payment by the buyer to the financier on the due date.
8	What is a Factoring Unit (FU)?	A Factoring Unit (FU) is a standard nomenclature used in TReDS for invoice(s) or bill(s) of exchange. Each FU represents a confirmed obligation of the corporates or other buyers, including Government Departments and PSUs.
9	Who can create an FU?	In TReDS, FU can be created either by the MSME seller or the buyer. If MSME seller creates it, the process is called factoring; if the same is created by corporates or other buyers, it is called as reverse factoring.
10	Whether TReDS could deal with reverse factoring?	Yes. The TReDS could deal with both receivables factoring as well as reverse factoring.
11	Can the financier resell the factoring unit?	The factoring unit is a tradeable unit and therefore, it can be sold in the secondary market
12	Whether the MSME seller would have to pay to the financier in case the buyer defaults in repayment?	No. The transactions processed under TReDS are "without recourse" to the MSMEs.
13	Whether any authorisation is required to set up and operate a TReDS platform?	Yes, authorisation is required to be obtained from RBI under the Payment and Settlement Systems (PSS) Act, 2007.
13	What is the eligibility criteria for setting up and operating TReDS?	Eligibility criteria for the purpose of setting up and operating a TReDS platform is provided in the guidelines (as amended from time to time) for TReDS issued by RBI.
15	Where can I find the details of TReDS entities authorised by RBI?	List of all authorised Payment System Operators (PSOs), including TReDS, is available at the following path: www.rbi.org.in → "Payment and Settlement Systems" dropdown → "Information Useful to Customer" → "List of Authorised Entities – Payment System Operators".
16	Whether TReDS entities undertake KYC (Know Your Customer) of participants?	Yes. The KYC process adopted by the TReDS entities shall adhere to the "Master Direction – Know Your Customer (KYC) Direction, 2016" dated February 25, 2016 (as amended from time to time) issued by RBI.

17	What is a settlement file and who generates it in TReDS?	A settlement file provides information as to how much amount has to be debited from and credited to the accounts of participants (sellers, buyers and financiers), due on a particular date / time. In other words, it indicates how much a financier has to pay to an MSME seller, and how much a buyer owes to the financier on a particular date / time. The TReDS entities generate the settlement file and send the same to existing payment systems (for instance, National Automated Clearing House) for actual payment of funds.
18	Whether defaults on TReDS platform are the responsibility of TReDS entities?	No. Default handling is outside the purview of TReDS platforms.

Features:

Following are the Salient Features of TReDS.

- Unified platform for Sellers, Buyers and Financiers
- Eliminates Paper
- Easy Access to Funds
- Transact Online
- Competitive Discount Rates
- Seamless Data Flow
- Standardised Practices

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.

TReDS platforms operating currently

Currently, the following three platforms are registered with RBI for operating as a TReDS platform.

- Receivables Exchange of India Ltd (RXIL)
- A.TREDS Ltd (Known as Invoicemart)
- Mynd Solutions (Known as M1 exchange)

Registration process on TReDS Platform

1. Fill the application form on the website.
2. The TReDS Platform shall call the buyer and send their agents for further discussions on the registration process.
3. The buyer is required to register/ synchronise their bank account with the TReDS platform so that the amount can be auto-debited at the end of each transaction.
4. The TReDS Platform mails the checklist and other application forms which are required to be submitted for initiating the registration process. Documents required for registration are the KYC Documents of the Applicant Entity and the promoters/ administrators/ authorised signatories etc.
5. The buyer is required to arrange the necessary documents and mail the same to concerned TReDS Platform.
6. The TReDS Platform charges an upfront registration fees, usually depending on the size of the buyer. This will be a one-time non-refundable fee at the time of registration.

Process Flow

Once registered on one of the three TReDS platforms, here's how the process flow works, supported by RBI data:

1. The corporate buyer, including Government Departments and Public Sector Undertakings, indicates the intention to buy by sending a purchase order to the MSME seller
2. The MSME delivers the goods and generates an invoice. At this stage, there may or may not be an accepted bill of exchange between the buyer and the seller.
3. 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.
4. Based on the invoice or bill of exchange, the TReDS will standardise the time window available for corporate buyers to 'accept' the factoring units.
5. The MSME seller may decide to go on the TReDS platform and upload documents supporting evidence of the movement of goods.
6. 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.
7. 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'.

8. The standard format and features of the 'factoring unit' will be decided by the TReDS platform. But each unit will represent a confirmed obligation from the buyer to pay. The unit will have all details such as information of the seller and the buyer, issue date, due date, amount due, etc.
9. The TReDS platforms should be able to filter these factoring units by any of the above parameters. This provides flexibility of operations to the stakeholders.
10. A notice or advice is created and automatically sent to the buyer's bank once the factoring unit and all the details have been generated.
11. These factoring units can be financed or bid for by any of the financiers registered on the TReDS platform. The final amount quoted by the financier can be viewed only by the MSME seller and not other financiers.
12. There will be a window period provided for financiers to quote these bids against factoring units. Further, financiers are free to choose how long their bids are valid.
13. The MSME then chooses and accepts any bid. The financier then gets the notification that their bid has been accepted.
14. Once a bid is accepted by the MSME seller, financiers cannot revise or change their bid.
15. The factoring unit will then get tagged as 'financed' and the funds will be deposited in the MSME seller's account by the financier on T+2 basis (two business days after the date of acceptance). However, TReDS platforms can choose to speed up the time taken for payment. For instance, MSMEs on the M1xchange platform receive payment in T+1 days (one business day after the acceptance).
16. Simultaneously, financing by a financier generates another notice to the buyer's bank which enables a direct debit from the buyer's account to the financier's account on the due date. These are based on the settlement obligations generated by the TReDS platform.
17. On the due date, the corporate buyer transfers the due amount to the financier. All the while, the TReDS platform sends due notifications to corporate buyers and their banks reminding them of the amount due.
18. If the buyer doesn't pay on the due date, it will attract penal provisions and enable the banker to proceed against the corporate buyer.
19. Any action in this regard will be strictly non-recourse with respect to the MSME sellers.
20. After financing, these instruments are rated by the TReDS platform and may be further transacted or discounted among financiers in the secondary segment.
21. 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.
22. In case any factoring unit is unfinanced, the buyer corporate will pay the MSME seller outside of the TReDS platform.

Conclusion

There is an increase in the government pressure for promoting and pushing the MSME sector for the industrial development. The recent developments in this field emphasises this motive of the government. The revised definition of MSMEs with an aim to give more benefits based on investment and turnover criteria and elimination of distinction between manufacturing and service sector in the MSME sector are a welcome move from the government in recent times. The MSMEs can further utilise the other measures taken by the government for a better financial environment for the MSMEs. TReDS is one among such existing measure.