EUFederation
Factoring & Commercial Finance

**To:**
Mr. Niall Bohan and Mr. Michael Thom
DG Internal Market and Services
Directorate H: Financial Institutions
SPA2 – Pavillon
Rue de Spa 2
1000 Brussels

**Kraainem, 28 March 2014**

Dear Mr. Bohan, dear Mr. Thom,

We would like to thank you for giving us and so many other stakeholders from different parts of the finance industry not only the opportunity to deliver questions and statements at the EU Commission's public hearing in Brussels on March 10, 2014, but also to elaborate on these viewpoints in written statements until March 31, 2014. In addition to the points we raised in our last position paper, dated December 16, 2013, and also to complement our statement delivered at the aforementioned public hearing, we would like to draw your attention to some more detailed facts and suggestions related to the **factoring and commercial finance (FCF) industry** and elements of the CRD IV/CRR regulatory framework on liquidity:

As we already stated in our position paper of December 2013, at the end of 2012, the **FCF industry provided € 170 billion of working capital to 160,000 businesses, mostly SMEs**. This amount of working capital has to be seen in relation to the total factoring turnover, which in 2012 added up to over € 1.2 trillion. Given that the primary source of liquidity for the factors is the payment made by its debtors for the receivables they have in their portfolio, the **duration of the exposure is directly connected with the duration of the assigned receivables**, which is normally below 90 days (the **estimated average collection period in the EU in 2012 amounted to 67 days**). In a dynamic view of the operations management of a FCF company, one can observe that the **financial outflows are substantially balanced by the inflows which originate from the debtors' payments on the assigned debts** coming to maturity at their respective due dates. Any temporary excess liquidity is generally used by the factor to either refund its own liabilities or, occasionally and with regard to the interest rates' dynamic, it is left on the FCF company's current account. From this, it is clear that **factoring companies can achieve a high degree of funding against a portfolio of factored (purchased) receivables against a relatively small pool of capital**, in large part **due to the self-liquidating nature of the accounts**.

This has **never created any major problems nor has it ever caused a crisis**, neither within the finance industry nor without, i.e. in the real economy. On the contrary: **factoring has been considered a stable financing alternative by many companies in particular during the financial crisis** or "credit crunch" over the last years. This is backed up e.g. by a study on the German factoring market conducted by the University of Cologne (Germany) in 2011: Approx. 57% of all the companies who were factoring clients and took part in the survey answered that a "stronger independence from banks" was one of their reasons for using factoring ("Wachsen mit Factoring – Nutzung und Erfahrungen in Deutschland", 2011, p. 21). **Spillover effects from liquidity problems affecting the FCF industry to the real economy are therefore not to be expected**: FCF companies do not simply provide financing against the invoice, but rather by acquiring receivables in return for payment. FCF companies are hence rather a direct mirror of the real economy and therefore show more similarities to trade finance than to traditional commercial banking.

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The EUF emphasizes the **need for proportionate regulatory measures**, which are suitable for all encompassed forms of financing, not only traditional commercial banking. The EUF maintains that the **framework for liquidity coverage is not consistent with the FCF activity and that corresponding exceptions or adapted rules are necessary**: Both LCR and NSFR were conceived for banks and banking groups with a wide range of activities and financial services on offer and whose need for refinancing is a direct mirror of these activities, thereby making them vulnerable to shortfalls in liquidity supply. Even though in many EU member states, there are either banks which have specialized in FCF activities or FCF companies which belong to a banking group or are regulated rather like banks, a significant number of FCF companies without bank status still exists in the EU. **This diversity of the FCF industry also ensures the flexibility of financing which is needed by especially SMEs**. Moreover, it should be taken into account that FCF companies' refinancing partners are often banks. Hence, the CRD IV/CRR regulatory framework on liquidity should grant relief to specialized business forms such as FCF in order **not to create disincentives for banks, but rather to foster low risk forms of financing such as FCF**, which generally seem to be welcomed and positively acknowledged by the EU institutions.

**The regular activities of factoring companies neither encompass the collection of deposits nor do they foresee the holding of sovereign bonds and other HQLA, as required by the LCR**. Factoring companies should not be required to carry out such speculative operations, which neither correspond to their license nor to their core business, thereby **unnecessarily increasing** (instead of reducing) **the risk situation for factoring companies**. Any possible liquidity risk in factoring is mainly due to the mismatch between the assets and the (short term) liabilities' duration. This mismatch, however, is notably lower in factoring than in commercial banking, due to the short duration of the receivables on the asset-side and also due to the absence of a demand or withdrawal of deposits on the liabilities' side. Therefore, **factoring companies could not meet the requirements of the NSFR without facing severe financial constraints**: The obligation to borrow at one year's maturity in order to be able to finance at three months' maturity or even less would lead to reverse transformation and furthermore make hedging mechanisms regarding interest rate risks necessary, thereby creating additional and unnecessary financial and administrative costs.

In particular, the **EUF advocates that the European Commission**, when drafting the delegated acts for the liquidity coverage requirements, **takes into account the following remarks** :

- **exemption from the 75% inflow cap for specialized factoring institutions or factoring business in diversified banks**, as suggested by the EBA:
  The EBA, in its report about the impact assessment of the LCR rule[1], recognized that the cap will negatively affect:
  - the business models that do not hold (many) HQLA;
  - the business models that predominantly manage their liquidity risks by reducing the maturity mismatch between assets and liabilities.

  The EBA's report[2] therefore maintained that *"diversified business models tend to be more adapted to the LCR than specialized banks"* and suggested *"derogations from the cap (Article 425 of the CRR) or exemption from the cap or a higher cap than 75%"*, proposing two hypothesis: *"i) only institutions specialized in the above mentioned business models can apply a higher than 75% cap. Specialization could be measured by a certain percentage of inflows stemming from specific activities"*, including factoring;

[1] EBA, "Report on impact assessment for liquidity measures under Article 509(1) of the CRR", December, 20th 2013, page 158.

[2] EBA, "Report on impact assessment for liquidity measures under Article 509(1) of the CRR", December, 20th 2013, page 10.

*"ii) all institutions may apply a higher than 75% cap for such derogation, but only for particular business lines which perform the above activities"*. EBA *"has a preference for option (i), due to its less complex implementation and the potential impact on the LCR of the whole institution"*. **Regardless of which hypothesis is chosen, it is essential to grant the possibility that *"if … the specialized institution under consideration for a derogation is part of a (diversified) banking group, this would not prevent* [them from] *applying for a derogation"*, and the effects of such a derogation should hold also on a consolidated level.** Factoring institutions, as stated above, definitely present the aforementioned conditions and therefore will be strongly and negatively impacted by the LCR rule, unless an adaption or exemption is introduced.

- to **take into account in full as inflows the repayments measured over the next 30 days on the basis of the receivable due dates**:

  Article 425, second subparagraph, point b) provides that *"monies due from trade financing transactions [...] with a residual maturity up to 30 days, shall be taken into account in full as inflows"*. In its previous position paper of December 2013, the EUF already insisted[3] that there are very close similarities between factoring and trade finance as factoring
  - is clearly a form of financing;
  - is connected to the exchange of goods and services, as it works on receivables arising from the business of the factoring clients;
  - works of fixed short term maturity, as the receivables' duration is usually less than 90 days;
  - is a flexible form of financing for SMEs, providing the factoring company means to terminate or reduce its exposure quickly when the financial conditions of the seller or its customers deteriorate.

  From this point of view, also a Study Group established by the Committee on the Global Financial System[4] affirms that factoring supports the firms' ability to extend trade credit to their customers, recognizing that it is as important as trade finance.

  **Factoring should therefore be treated similar to trade finance and not to commercial banks, which show much less similarities and parallels to factoring**. Moreover, the fact that, in case of liquidity stress, factors can terminate or reduce their exposure by simply refusing the purchase of new receivables excludes any automatic roll-over in factoring, thus naturally suggesting the exemption for factoring inflows from the roll over assumption.

With regard to the **NSFR** rule, the EUF believes that the **current rule is not appropriate for and should not apply to FCF.**

**At least, it needs to be better balanced in order to avoid disruptive effects on specialized business models like factoring** and commercial finance and **strongly advocates the following amendments**:

- to **reduce the 50% Required Stable Funding (RSF) factor required for factoring exposures**:

  The current run-off rate of 50% provided for loans with residual maturity of less than one year is not consistent with the liquidity risk profile of factoring, as the average duration of the lending provided by

[3] EUF, "EUF position Summary on Basel III/CRD IV re LCR & NSFR", December 2013.

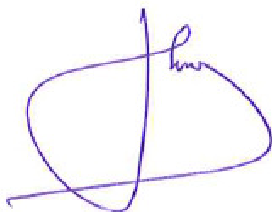
[4] Committee on the Global Financial System, "Trade finance: developments and issues", CGFS Papers N. 50

factors is actually a short term one, linked to the maturity of the purchased receivables, usually up to 90 days.

- to **increase**, at least for specialized business models, and in particular for factoring institutions or factoring business lines in banking groups, the **Available Stable Funding (ASF) factor for wholesale funding from central banks and financial institutions with a residual maturity of less than six months**:
  Factoring companies which are not banks do not hold deposits; their funding is therefore based on the wholesale market or, for factors owned by a banking group, on the liquidity granted by the parent company. With the current rule, almost all the funding of the advancing of short term receivables would be weighted with a 0% factor. Provided that specialized institutions, as stated above, tend to manage liquidity risk by reducing the maturity mismatch between assets and liabilities, such a situation would be extremely negative for the FCF industry. From another point of view, it is also worth noting that combination of the 0% ASF factor provided for liabilities with a residual maturity of less than 6 months with the 50% RSF factor required for loans with a residual maturity of less than one year would lead to a negative maturity transformation as factors would be compelled to fund short term lending with an average duration up to 90 days with a 50% funding maturing at more than 6 months. Even though the need to limit overreliance on short-term wholesale funding is understandable, the EUF believes that the detrimental effect on the institutions specialized in factoring clearly outweighs the benefits.
- to **provide a specific and favorable treatment for short term funding granted by the parent company**, where the specialized business is carried out in a banking group:
  In addition to an increase of the ASF factor for short term liabilities, a more favorable treatment for short term funding granted by the parent company is desirable and consistent with the nature of the liability as within a stress scenario, the EBA recognizes intragroup liquidity to be more stable than third party funding[5]. Specialization in a short term business models, as well as the low credit and liquidity risk related to the factoring industry, can counterbalance any increase in complexity and interconnection within the banking system, thus ensuring that the overall systemic risk is not increased.

Accordingly, the EUF advises that the EU institutions should urgently adapt the CRD IV and CRR rules to factoring, as it is already to trade finance, as well as the pertaining delegated acts and put in place proportionate regulation to foster FCF in order to protect the financing of SMEs as wealth creators of the real economy, and the European growth.

With kind regards,



John Gielen
Chairman - EUF

[5] EBA, "Report on impact assessment for liquidity measures under Article 509(1) of the CRR", December, 20th 2013, page 13.

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