EUF position letter on decision of Eurostat on government deficit and debt of 31st July 2012 to stakeholders and press

The list of names of the key stakeholders to whom the letter has been sent:

European Commission:

Mr Antonio Baigorri Matamala, Head of Unit

Ms Catherine Ahsbahs, European Central Bank

Mr Carsten Olsson, Statistical Officer

Mr Daniel Calleja Crespo, Director-General

Mr Gallo Gueye, Head of Unit

Mr Inigo Urresti, Policy officer

Mr Marco Buti, Director-General

Mr Vilmos Budavari, Policy officer

Mr Walter Radermacher, Director-General

Background and introduction

The EUF comprises the national and international associations for the factoring and commercial finance industry that are active in the EU. In 2012, the total turnover of the factoring and commercial finance industry in the EU exceeded 1,200 Billion €, representing 9.36 per cent of the total EU GDP. The EUF seeks to engage with governments and legislators to enhance the availability of finance to business and brings a particular expertise in supporting the SME community. The EUF acts as a platform between the factoring and commercial finance industry and key legislative decision makers across Europe, providing a source of reference and expertise on the industry, and also on access to finance and other issues affecting SMEs.

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Issue of concern

It is in the above role that the EUF has considered in detail the decision of Eurostat on government deficit and debt issued on July, 31st 2012, with regards to "The statistical recording of some operations related to trade credits incurred by government units". We note that a specific taskforce, chaired by Eurostat and drawing on external expertise, was established to examine issues in this area in advance of this decision; to our knowledge, the industry represented by the EUF was not consulted by the taskforce. Given the direct impact it will have on the industry we are surprised and disappointed that we were not given the opportunity to contribute in advance.

The EUF wishes to formally express its serious concern about the potential impacts of this decision on the factoring and commercial finance industry in Europe. These impacts will, in turn, have potentially detrimental consequences for businesses that the industry serves, which are predominantly SMEs.

The Eurostat decision refers directly to factoring services and, in effect, states that trade credits against Public Authority (PA) units of a Member State assigned without recourse to factoring companies will now be reclassified as loans. This means trade credits will be considered as part of the public debt of that State, even if the assignee is a non banking company (until now, trade credits assigned to non banking companies were not included in the sovereign debt calculation), and will henceforth be included in the stock of government debt in the excessive deficit procedure (EDP).

This decision represents far more than a minor technical change to public sector accounting practices; it could potentially lead to businesses no longer being able to use factoring as a means of financing with regard to receivables against the public sector. In particular, this would affect negatively the availability of financing to SMEs which are already affected by the current banking/credit crisis and which are using factoring as an alternative form of financing.

In fact, the internal regulations of some countries of the EU prevent public units taking on financial debt beyond certain limits. Depending on how the decision will be recognized/implemented by individual EU Members, non-recourse trade debts assignments may need to be reclassified as loans (thereby raising their financial debt).

<u>As a consequence of this, public units are likely to become reluctant to allow factoring and confirming operations, thereby severing a principal source of working capital financing for SMEs, in particular.</u>

This could have a dramatic impact in a number of EU markets where the industry plays an essential role in supporting SMEs supplying PA organisations. In addition to this impact, there are also other reasons why the EUF believes that this decision should be reconsidered: first, the potential effects are not consistent with the rationale of the exercise; second, it will affect competition between different products, and third, it will not achieve the aim of full comparability of government debt and deficit data across EU Member States.

With regard to the rationale of the decision, the EUF does not agree with the underlying premise that the assignment of an asset changes the nature of the asset itself – or, in other words, that the assignment of a trade credit turns the trade credit into a financial loan simply because of the (financial) nature of the assignee, especially not if the debtor does not enter into any new agreement with the assignee. It is also worth noting that in most countries, the debtor can raise the same disputes regarding the purchased good or service with the assignee as he could raise with the assignor - this demonstrates that a trade debt cannot be considered as a financial loan simply because of an assignment to a factoring company.

Considering the differences between national markets as stated above, the recognition of this accounting rule in the National regulations may entail significant changes in the attitude of the PA debtors regarding the assignment of their debts. As noted, these debts represent a significant share of the credit outstanding of the factoring companies in many European Countries. It is possible that this situation will in fact advantage some types of commercial finance operations (e.g. invoice discounting) to the detriment of others (e.g. non-recourse factoring), particularly in countries where PA trade debts are more often assigned to factoring companies. This would be in direct contradiction to the aim of creating a "level playing field" among EU markets.

From a technical and practical point of view, the EUF wishes to draw attention to the fact that this decision will be particularly difficult to apply in a uniform fashion across member states: indeed, the parties of a factoring contract need not always disclose the assignment to the debtor and, even if disclosed, it would not necessarily include any information about the assignment being with or without recourse. This means that it is impossible for any PA to know the exact amount of the debts assigned without recourse to the factoring companies, not speaking of invoices whose statuses (with/without recourse) change in the course of the agreement. Member States will therefore have to make estimates. Such estimates may be produced differently from country to country, with accuracy depending on the sources available and on the regulation applicable to the factoring companies. Therefore, the decision will fail its core objective of creating a reliable and authoritative basis for assessing the government debt.

Request and summary

Although the EUF understands and agrees with the need for a better quantification of government debt, the EUF underlines that this decision can only offer a partial (and biased) view of public trade debt. This will be far outweighed by the damage not only to the factoring and commercial finance industry, but more importantly to the wider economy and especially SME businesses relying on factoring as a source of liquidity.

Given the current situation, a homogeneous and unbiased treatment of the trade debt outstanding towards government units across the Member States of the EU, both consistent with the European and national regulations, and the need to assure the continued provision of working capital support to PA unit suppliers, appears to be necessary and crucial.

The aforementioned criticism of the measurement of levels of public debt is based on two main aspects of this decision: the reclassification of the trade debt of the PA unit into financial debt and the restriction of this reclassification to debts assigned without recourse to banks and financial companies.

Therefore, the EUF believes that in the interests of the EU in general, Eurostat should reconsider this decision in order to provide a homogeneous and more effective statistical representation of the public trade debt issue. The EUF suggests evaluation of the inclusion of the whole amount of the trade credits payable by government units (AF.71) in the stock of government debt in the EDP procedure regardless of the nature of any assignee and/or of any assignment.

Indeed, although the EUF is aware that the inclusion of all trade credits payable toward government units will probably entail several issues concerning the identification and the measurement of the debt for each government unit, this would be the only way to accurately measure and effectively control the amount of such debts in the future. Moreover, it seems inconsistent that a part of the trade debt would be included in the EDP government debt while the rest would not be, provided that no changes have been made to the nature of the obligation in connection with the assignment. For these reasons, should the inclusion in the stock of government debt of all trade credit payable by government units not be feasible, a total exclusion of all trade credit payable by government units would be a better alternative than only a partial inclusion based on the assignment of the credits.

This, added to the fact that a government unit is highly unlikely to be aware whether the assignment is with or without recourse, means that the decision to include only trade credits assigned to banks and financial companies is more likely to increase differences in the data recorded by EU Member States rather than reduce them.

In any case, any kind of reclassification of the trade debts (AF.71) into loans (AF.4) should be avoided, except for cases where the debtor enters a new agreement with the assignee as a consequence of the assignment (novation).

The EUF considers this to be the only way to assure the full comparability of government debt and deficit data across all EU Member States without introducing unintended negative consequences that are likely to harm SMEs and the real economy.

In brief summary, we believe that this decision will not in practice achieve the stated objectives and will bring with it significant unintended consequences for SMEs in particular.

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Our concerns are significant and we would welcome the opportunity to discuss them with you in greater detail. Should you require more information or any clarification, please feel free to contact us through info@euf.eu.com. For further information on the factoring industry in the EU, please visit our website www.euf.eu.com.

With kind regards

John Gielen
Chairman – EUF

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