To:
Mr. Jonathan Hill
Commissioner
Financial Stability,
Financial Services and
Capital Markets Union

Kraainem, 12 May 2015

Ref: EUF/MP/15-006

Ref.: Green Paper "Building a Capital Market Union"

Dear Mr. Hill,

The EU Federation for Factoring and Commercial Finance (EUF) is the representative body for the factoring and commercial finance industry in the EU. It is composed of national and international industry associations that are active in the EU and represent 97.5% of the industry turnover. The EUF seeks to engage with Government and legislators to enhance the availability of finance to business, with a particular emphasis on the SME community. The EUF wishes to act as a platform between the factoring and commercial finance industry, and key legislative decision makers across Europe. Therefore, the EUF offers itself as a source of reference and expertise on the factoring and commercial finance industry in order to assist with the direction of existing and future finance legislation with a view to ensuring the continued provision of prudent, well structured and reasonably priced finance to businesses, SMEs in particular, across the EU.

Factoring, a solution for financing the SMEs

The EUF agrees with the Commission's Green Paper "Building a Capital Markets Union" about the importance of improving access to capital, especially for SMEs, and that there are many barriers in this context that should be removed. The EUF also appreciates that the Commission, within its staff working document on Building a Capital Market Union, makes several references to factoring as another source of funding and an alternative to e.g. bank loans. Moreover, both the EU Commission and the ECB have identified factoring as a financing source for SMEs in their recently published reports on EU financial integration ("European Financial Stability and Integration Report (EFSIR)" and "Report on Financial Integration in Europe"). Against this background, the EUF would like to provide its views and expertise specifically concerning factoring.

EU Federation for the Factoring and Commercial Finance Industry
■ Avenue Reine Astrid, 452 ■ BE-1950 Kraainem ■ BELGIUM ■ c/o IFG secretariat
■ Tel: 32/2/772-6969 ■ Fax: 32/2/772-6419 ■ TVA: BE 420.306.542
■ KBC Bank: 733-0548074-54 ■ IBAN: BE42 7330 5480 7454 ■ SWIFT: KREDBEBB

As you know, factoring is a means of finance which is widely used especially by SMEs as it is a method of providing working capital finance to a supplier of goods and services. The factor will provide a range of services to its clients, including providing capital against the assignment of their receivables, accepting the risk of bad debts and collecting on past due accounts. Factoring has been considered a stable financing alternative by many companies, particularly during and since the financial crisis. Many SMEs that were unable to obtain traditional bank funding turned to factoring as an alternative means of financing. Hence, the factoring industry thrived during the financial crisis, helping especially SMEs throughout the EU. In 2014, the factoring turnover in the EU exceeded 1.36 trillion € (2008: 845 billion Euro), growing over 6.5% with respect to the previous year and representing more than 10% of the total EU GDP.

Factoring, a low-risk financing activity
It appears useful to spend some words in order to explain the features that make factoring a low risk financial product: factoring is a flexible form of finance which is secured by way of assignment or purchase of receivables. Consequently factoring is a self-liquidating exposure where the default risk of the client is mitigated and subordinated to the risk of dilution and/or default of the debtor of the assigned receivable. Moreover, in non-recourse factoring, the factor also provides credit protection on the debtor exposure, so that (depending on the agreement) the default risk of the debtor(s) may be actually and completely transferred from the client to the factoring company.

Factoring is widely used by SMEs, usually assigning or selling receivables against their larger and/or more creditworthy debtors/customers, in order to effectively reduce the risk of the operation for the financier.

The decision about the amount to advance to the client follows the assessment of the value of the sales ledger and takes into account the assessment of the level of debtor disputes that may cause dilution, as well as limits of the debtor balance in order to assure a proper diversification of the assigned portfolio of receivables.

In particular, notification to the debtor of the factor's interest on its debts is the key to assure a lower risk for factoring, as it allows the factor to directly manage the sales ledger of the client and channel the payments by the debtor on its own accounts. Additionally, through the collection services offered, the factor is able to intercept promptly non-recoverable invoices and to adjust accordingly the level of finance made available to the client, usually up to 80% of the approved debts. Moreover, it is useful to notice that the value of receivables, as security, is not linked to the market value of the asset, and is always equal to 100% of the nominal value except in case of dilution or debtor default (which the factor has already taken into consideration by establishing an appropriate buffer/reserve based on the companies past dilution history), thus allowing the factor to grant higher levels of advances than for example other asset-based lending solutions and, in particular, to recover most of the defaulted exposures by having the possibility to revert to the assets of the assigned debtors or, in recourse operations, of the client.

Harmonization and legal certainty (cf. in particular questions 16, 23 of Green Paper)
As effectiveness of the assignment against third party rights is crucial to the factoring industry, the EUF fully agrees with the CMU Green Paper which stresses the importance of legal certainty in cases of cross-border transfer of claims and with the Staff Working Paper where it says that "differences between the national conflict-of-law rules in respect of the third party effects of assignment and the

order of priority between an assignment over the rights of other persons, as well as between certain substantive rules such as the conditions for the effectiveness of an assignment hamper the development of cross-border financing instruments", as well as where it says that "As long as insolvency law remains national in character, it will be difficult for investors to assess the risks they assume when investing in securities issued in other jurisdictions." Indeed, financing has retreated to more national borders after the crisis. This is why the EUF generally supports harmonization and standardization, a common set of market rules. Harmonization in those fields would actually improve the benefits of such operations. Seeking funding from one member state to another is fraught with different regulations, tax structures, policies towards factoring, constraining the free flow of capital and making it much harder to operate a pan European factoring operation. Improving the effectiveness of markets is also imperative. Also, the heavy reliance on bank financing in the EU as pointed out in the CMU Green Paper results in a lack of transparency relating to SMEs, a more conservative financing landscape and fluctuation of capital during an economic crisis, making SMEs' access to capital more difficult. That is why factoring is needed as an alternative and additional source of financing, to keep a balance in the financing market when banks reduce exposures and/or risk.

Rome I-regulation and insolvency legislation (cf. in particular questions 16,23 of Green Paper)
In particular, the EUF has already addressed the issue of legal certainty when dealing with the assignment of receivables by pointing out the regulatory gap in the Rome I-regulation (Regulation (EC) No 593/2008 on the law applicable to contractual obligations). Unfortunately, the Rome I-regulation currently lacks provisions on the law applicable to the priority of several assignments of the same receivable and to the effectiveness of assignments against third parties. The EUF advocates that applying the law of the place where the assignor has its centre of main interest is the most predictable and fair solution to this issue. With regard to insolvency legislation, one can easily note that since factors take both trade credit risk on the debtors and financial/performance risk on the seller, it is important that the laws are not only uniform or harmonized throughout the EU but it is also important that the creditor's ability to recover any losses is practically achievable, by creating transparency, increasing the timeliness on the process, and supporting the continuation of business when it is a restructuring. These issues would also hinder, in the same ways, any initiative aimed at improving securitization of receivables by SMEs.

Other legal uncertainties as impediments (cf. in particular questions 5, 16, 32 of Green Paper)
Moreover, there are still issues of civil or contractual law which cause legal uncertainty or are a hindrance for all factoring clients, SMEs in particular, impeding their use of factoring and commercial finance. Contractual bans and/or limitations on assignments represent such a hindrance - especially to factoring and commercial finance in some EU member states: SMEs and other companies are contractually prevented from using their assets, i.e. the receivables, in order to obtain financing by inclusion of contractual clauses which generally prohibit the assignment of these receivables or which only allow assignments under certain conditions. Such contractual clauses are often imposed on SMEs through the terms and conditions of large corporate purchasers with more power in the supply chain, even though there are no tenable reasons for such clauses and both SMEs' clients and purchasers would ultimately benefit from the receivables' assignments to factoring companies, e.g. through trade discounts granted to the SMEs' clients. In some EU member states, this legal issue has been resolved, at least in part, but this is unfortunately not the case for all the EU member states. An EU-wide harmonized solution would enable all companies, including SMEs, to use their receivables as assets on which to base their financing.

Striking a fair balance (cf. in particular questions 16, 23, 32 of Green Paper)

With regard to securitization, one may note that many companies take advantage of receivables securitizations in the US; yet, there are vast structural differences between the US and Europe: the Commission's Consultation Document regarding "An EU framework for simple, transparent and standardised securitization" acknowledges the fact that there have already been initiatives in the EU to foster securitization. However, such initiatives have not managed to achieve satisfying volumes of funding for SMEs, in particular due to the complexity of the operation raising from the lack of disclosure/information and form complex and non-standardized legal frameworks that make such operations expensive both for the issuer and the investors. For many SMEs, factoring presents a more effective solution, both in terms of costs and time/workload. Nevertheless, in the interest of a balanced supply of different forms of financing that can contribute to a financing mix especially for SMEs, the EUF believes that improvements in credit information would actually help the SMEs increase their access to finance, both from banks and other financiers as well as capital markets. Initiatives in this direction have already been implemented in some EU Countries and are used also within the national factoring markets: In Germany, private credit agencies provide information on credit and payment history, and the Italian "DAP" (Database delle Abitudini di Pagamento) provides the Italian factoring companies with collated information about payment behaviour by the debtor in trade relationships, that are particularly crucial in factoring. These national solutions could be used as examples for a European solution. Against this background and in the context of the current discussions regarding the General Data Protection Regulation, it is also important that a fair balance is struck between data protection laws and legitimate interests of e.g. credit institutions, factoring companies and other financiers, also considering that especially micro-sized enterprises can hardly be distinguished from the natural persons running them who in turn are data subjects.

In conclusion, the EUF and the factoring industry support wholeheartedly the aim of improving access to finance, and agrees that many SMEs are not aware of alternative financing solutions, like factoring, or have not a proper knowledge of their features and benefits.

Further information about factoring (cf. in particular questions 5, 16, 32 of Green Paper)

In this view, the EUF would like to stress that there is a mismatching between the focus on Capital Markets (oriented to long term financing) and the reference to factoring as an alternative to them. Indeed, factoring is a short term, self-liquidating, revolving kind of funding and cannot serve as an alternative to e.g. debt issuing: in particular, the Commission Staff Working Document recognizes that "these [...] alternative financing sources are [...] closely related to SMEs' business activity", but states also that "the potential for substitution is constrained if there is a decline in turnover levels". The EUF believes that the fact that the business' debt declines according to the actual need to finance its working capital should not be considered as a problem, but actually as one of the benefits of factoring. Hence why it is considered the closest to financing the "real economy" as funding is predicated on true sales. Factoring is by no means a substitute to other medium-long term financial instruments and should not be described as such, but in order to improve SMEs' access to finance, it is important to accurately portray a wide number of means of financing suitable for SMEs – and factoring definitely plays a major part in this mix.

Moreover, the EUF noted that, on page 13, the Document states that bank finance, including factoring, is difficult to access for growing companies that have significant percentage of intangible assets on their balance sheet. The EUF wishes to point out that factoring is a form of financing which focuses exactly on intangible assets, i.e. receivables. Therefore, factoring, due to the above-mentioned features, is very well suited "for smaller but rapidly growing firms" as it unlocks the hidden potentials by providing liquidity against the SME's intangible assets.

Please do not hesitate to contact us should you have any queries regarding the aforementioned viewpoints or require more information on the factoring industry in Europe.

With kind regards,

John Gielen
Chairman - EUF

EU Federation for the Factoring and Commercial Finance Industry
■ Avenue Reine Astrid, 452 ■ BE-1950 Kraainem ■ BELGIUM ■ c/o IFG secretariat
■ Tel: 32/2/772-6969 ■ Fax: 32/2/772-6419 ■ TVA: BE 420.306.542
■ KBC Bank: 733-0548074-54 ■ IBAN: BE42 7330 5480 7454 ■ SWIFT: KREDBEBB