

To:
Basel Committee
Bank for International Settlements BIS
Centralbahnplatz 2
4051 Basel
Switzerland

Kraainem, 10 April 2014

Dear Madam or Sir,

We would like to thank you for giving us the opportunity to comment on the Net Stable Funding Ratio (NSFR) consultative document which you published in January 2014. We would like to draw your attention to some facts and suggestions related to the **factoring and commercial finance (FCF) industry** and elements of the Basel III and CRD IV/CRR regulatory framework on liquidity, including the NSFR:

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.

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 Basel III and 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.

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 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

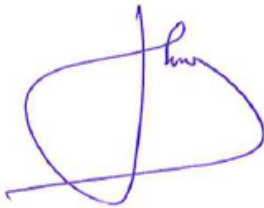
negative maturity transformation as factors would be compelled to fund short term lending with an average duration up to 90 days with a 50% funding maturing at more than 6 months. Even though the need to limit overreliance on short-term wholesale funding is understandable, the EUF believes that the detrimental 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 funding¹. 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 Basel Committee should adapt the Basel III framework to factoring, as it is already to trade finance, 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

¹

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