EUFederation
Factoring & Commercial Finance

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EUF Position Paper
on a case study note on factoring

Dear Mr. Israël,
Dear Mr. Winkler,

The EUF once more wishes to thank you for inviting representatives of the EUF to the workshop on the AnaCredit Manual in Frankfurt a.M. on January 20, 2017 in order to discuss the most recent draft of the Case Study Factoring with you as well as other representatives of the ECB and National Central Banks. We appreciate the ECB lending an open ear to the concerns, arguments and suggestions of the factoring industry, even though we find it very unfortunate that **the factoring industry is only heard at this late stage in the process**, despite the EUF having issued several position papers on AnaCredit since its first letter to Mr. Schubert from the ECB on this matter, dated April 23, 2015, wherein the EUF clearly offers its expertise in the field of factoring and advocates an early involvement of the industries affected by AnaCredit in order to set up "realistic and workable new requirements".

In this context, the EUF also wishes to mention that it was only presented with the draft Case Study Factoring to be discussed during the workshop on January 20 a week before the event, hence leaving no time for a thorough analysis and consultation of this draft which contains substantial changes in comparison to the last draft Case Study Factoring known to the EUF, dated June 2016.

As you know, the EUF is the industry body and voice for the European factoring industry. The EUF's members consist of 14 national factoring and commercial finance associations (representing 15 EU-member states, namely [in alphabetic order] Austria, Belgium, the Czech Republic, Denmark, France, Germany, Greece, Ireland, Italy, the Netherlands, Poland, Portugal, Spain, Sweden and the UK) and the international factoring association FCI. In 2015, the factoring industry in the EU provided over €168 billion of working capital financing to over 171,000 businesses. According to the results published in the EUF White Paper "Factoring and Commercial Finance" (January 2016, cf. http://euf.eu.com/what-is-euf/whitepaper-factoring-and-commercial-finance.html), mostly SMEs and principally businesses in the manufacturing, services and distribution sectors used factoring, a financing solution with low Loss Given Default (LGD). The amount of working capital provided by the European

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factoring industry has to be seen in relation to the total factoring turnover, which in 2015 was over € 1.47 trillion. If you consider that the total GDP of Europe exceeded € 13 Trillion, this figure represents a significant portion of the real economy within the EU. Our members account for 97% of the total European factoring market, and comprise of both regulated and non-regulated factoring companies. Over half of the factored volume conducted within the EU is generated by factoring companies that are banks or part of consolidated banking groups.

As agreed upon during the workshop on January 20, with this letter, the EUF wishes to put forward its main concerns, arguments, but also outline possible solutions to certain issues. Given the short time frame, however, this statement is not to be considered a complete and final response. To clarify the EUF's point of views, we will first outline our general opinion on the AnaCredit requirements and in particular the Case Study Factoring as part of the AnaCredit-Manual and then go on to a more detailed analysis of the current draft Case Study Factoring, including examples for reporting requirements which seem feasible and realistic for especially credit institutions specialized in factoring.

1. General remarks

On the basis of Regulation EU n°680/April 2014 of the European Commission, to which the Anacredit regulation refers, the reporting is based on “loans and advances”, without any distinction between recourse and non-recourse factoring, and with reference to a proportionality principle.

According to Art. 1 (23) and Annex IV of the AnaCredit regulation of the European Central Bank, the types of instruments covered by the AnaCredit regulation also include "*trade receivables as defined in paragraph 5.41(c) of part 2 of Annex V to Implementing Regulation (EU) No 680/2014*" (FINREP), i.e. "*loans to other debtors granted on the basis of bills or other documents that give the right to receive the proceeds of transactions for the sale of goods or provision of services*", including "*all factoring transactions (both with and without recourse)*". It is clear that many concepts and definitions for the purpose of the AnaCredit Manual are not suitable for factoring, thereby raising the question of a sound legal basis for the details of reporting requirements regarding factoring as stated in the AnaCredit Manual, particularly in the draft Case Study Factoring.

However, factoring is not comparable to traditional loan structures, because of its triumvirate of a factor, a factoring client and the factoring client's customer (usually referred to as the debtor of the receivable).

To be more specific: Art. 1 (12) of the AnaCredit regulation defines the debtor which has to be reported under AnaCredit as „*the counterparty which has the unconditional obligation to make repayments arising under the instrument*“, while Art. 1 (10) defines the counterparty as "*an institutional unit that is a party to an instrument or has an affiliation with a party to an instrument*".

There is no contractual link between the debtor of the receivable and the factor. In the case of confidential factoring, the debtor doesn’t know the factor.

Clarifications are necessary.

From the workshop on January 20, we gathered that the AnaCredit regulation is for the time being to remain unchanged. The ECB has decided to put clarifications into the AnaCredit Manual of which the Case Study Factoring will be a part. With this in mind, the EUF stresses that any new reporting requirements need to comply with the current European regulation, including the principle of proportionality, both with a view to factoring being a low risk form of financing as well as to maintaining a level playing field.

Despite our aforementioned remarks about legal definitions and the doubts resulting therefrom, the EUF acknowledges that all factoring transactions are by the ECB considered as instruments covered by the AnaCredit regulation and this leaves the question as to what is to be reported under AnaCredit by credit institutions specialized in factoring. The EUF is also acutely aware that legal clarity and certainty (particularly

concerning basic issues and content of reports) is needed as soon as possible due to the implementation phase drawing near and affected credit institutions requiring time to implement changes, particularly in IT-systems.

2. Analysis of draft Case Study Factoring of the ECB

a) *Preliminary comments*

Although the EUF believes that the need for clarifications is first, foremost and best met by an implementation of the Anacredit regulation and Regulation EU n°680/2014 to which the Anacredit regulation refers as the sole legal basis not only for the new reporting requirements, but also for the AnaCredit Manual, we nevertheless wish to comment on the current draft Case Study Factoring, including some examples on what data factoring companies could or could not provide and report under AnaCredit.

Firstly, we appreciate that the current draft Case Study Factoring no longer sees any reporting duties on the single invoice/receivable level. The single invoice/receivable, resulting from transactions for the sale of goods or provision of services, does not represent the core financing aspect of factoring (rather, this lies in the payment of the purchase price for the receivable), and last but not least, reporting duties on the single invoice level would create a huge amount of data, the manageability and suitability of which for e.g. the ECB's research on risks and financial stability is doubtful. Factoring is well known as a low level of risk activity, with no systemic risk, and any reporting on factoring should comply with a proportionality principle (recital 3 of Regulation EU n°680/2014) and recital 14 of the Anacredit regulation.

In order to put up a system of feasible and fulfillable reporting rules, AnaCredit should orientate itself e.g. on the reporting frameworks for credit risks which already exist in different EU member states leaving room for manoeuvre for National Central Banks in charge of collecting the data.

For reporting under AnaCredit, the current draft Case Study Factoring distinguishes between factoring with and without recourse. Although this may appear to be a clear distinction at first sight, the EUF wishes to point out that factoring transactions take on various forms other than/on top of this distinction (e.g. non-notification factoring, maturity factoring, reverse factoring) ; this can make such a clear distinction more difficult or in some cases even impossible.

Moreover, it needs to be emphasised that factoring without recourse does not exclude all possibilities of recourse on the factoring client: In cases of dispute, non-delivery, etc. (mostly referred to as dilution), the factor can resort to the factoring client ; factoring without recourse rather refers to the factor protecting the factoring client from certain risks.

Last but not least, there are factoring contracts which can combine with and without recourse features, depending on the course of business.

In the interest of AnaCredit reporting requirements being simple and yet a true reflection of the reality of factoring transactions and in order to have homogeneous reporting from all European factors, focus could primarily be on the contractual relation of the factor to the factoring client and on the advances provided to the factoring client in the form of the payment of the purchase price for the receivables. Supposing, however, that it was ultimately required that the debtor of the receivable were to remain in certain cases as the debtor to be reported under AnaCredit, we wish to point out the following.

b) *On the level of granularity*

We understand, as suggested by the case study, that the level of granularity should now lie at individual facility level for exposures to the factoring client and at the level of the total balance by debtor and by the factoring client, i.e. one instrument for the pool of receivables to the same debtor of the receivables assigned under the same factoring contract.

As discussed during the meeting in Frankfurt, we would suggest to allow to aggregate receivables even more than that, reporting one instrument for the whole outstanding receivables on the debtor.

We also suggest to clarify further the words "*In particular, in accordance with the set out granularity level, the reporting threshold at a reporting reference date is to be checked against the sum of trade receivables pending collection from the debtor (i.e. the account debtor for non-recourse factoring and the factoring client for recourse factoring) purchased on the basis of the contract with the factoring client*." in §1.3.1 to clarify that the reporting threshold must be checked against the value of the total outstanding amount (i.e. total exposure to a single account debtor).

c) ***On the Settlement date and the Legal final maturity date***

The EUF commends the clarification in the context of explanations on the settlement date that "*any undrawn purchase commitments for purchased trade are not subject to AnaCredit reporting*", but there remain certain ambiguities with regard to the explanations on different dates relevant to the reporting duties in the draft Case Study Factoring. In factoring transactions, a distinction has to be made between the initial factoring framework agreement/contract and subsequent purchase agreements for single receivables, based on the framework agreement. In the EUF's view, it should be clarified that the inception date to be reported means the execution date of the initial factoring framework agreement.

In this context, the EUF feels that it does not make sense to report the settlement date and the final maturity date neither for each receivable nor the pool of receivables as the pool of receivables in factoring has a revolving nature and new receivables come in as old ones go out (this is sometimes referred to as "silo principle", cf. also p. 10 and 14 of the draft Case Study Factoring where this is mentioned in a confusing/unclear way). This means that the factor purchases pools of receivables on a daily basis and hence pays the purchase price on a daily basis.

Given the fact that the factor has a pool of receivables in his books at reporting date, resulting from multiple purchase dates, it is unclear (i) which dates to report (for settlement and final maturity date) and (ii) whether these dates provide an added value for ECB purposes. As for the explanations on settlement date in the draft Case Study Factoring, it remains unclear whether the full payment of the purchase price (incl. reserve) is meant or not, which would definitely increase complexity and distort AnaCredit data as the full purchase price is paid after the debtor pays. Therefore, the settlement date and legal final maturity date should be reported as N/A (non applicable).

d) ***On the Outstanding nominal amount***

Outstanding nominal amount should be clarified as being equal to:

- Advanced funds in case of exposure to the client,
- Outstanding amount of approved receivables in case of exposure to the account debtor.

e) ***On Interest rate and Accrued interest***

The factoring fee is charged on the face value of the receivable, whether it is purchased or not purchased, with or without recourse. It is debited to the factoring client's account on the date when the advance amount is available to the client, while interest is charged at least on a monthly basis on the amount actually drawn.
This leads to the EUF's comments on how interest in factoring transactions is regarded in the draft Case Study Factoring. Again, the EUF is under the impression that the ECB has misconceptions on this issue: Interest is not calculated on the outstanding amount, but it is rather the cost for the amount drawn by the factoring client during a certain period of time. Interest is calculated as a rate consisting of the interest base rate (e.g. EURIBOR) plus a margin on the overall amount drawn by the client. In reality, a factoring company buys receivables on a daily basis against multiple debtors (in Germany alone, factoring companies in 2015 purchased receivables against nearly 7 million debtors), the period and amount of advanced financing is determined by the factoring client's

decision and depends on his account balance. This implies that a factor is unable to link an interest charge to (or calculate it for) a single factoring client-debtor transaction as it is only determined by the factoring client's decision and account balance. Hence, (accrued) interest should not have to be reported on this apportioned level.

While the information on interest might have a sense in case of the exposure to a factoring client, we stress that on the account/receivables' debtor level, the information does not make sense at all as it would include costs that are borne by another subject, on a different amount, and only partially. Therefore, interests should not be part of the reporting obligations.

f) ***On Trade receivables in arrears and past due***

§ 1.3.2.9 of the Manual reads as follows : "*Please note also that if payments are conditional on the elaboration of final expenditure document by the debtor (for example in the case of public health debtors where the law provides that the payments over the planned amount are suspended until the final expenditure is settled), the purchased trade receivable should not be considered past due*".
We want to underline that there are a lot of other cases where a trade receivable cannot be considered as past due. In particular, we wish to stress that one of the main causes for delayed payments by the debtor of receivables in factoring transactions is dilution/disputes, e.g. due to the debtor of the receivable asserting the delivery of faulty goods and therefore making use of his legal right to refuse payment (in part or full). It needs to be considered that usual procedures to clarify possible dilutions/disputes take some time and that during this period of time, the receivable cannot be considered as "in arrears" or "past due".

A (non exhaustive) list of cases where delayed payments should not be considered as past due would include, for example:

- disputes, as well as discounts, deductions, netting or in general credit notes issued by the seller ;
- laws preventing payments over the planned amount by PA (Public Administration) debtors or allowing the PA debtors to delay the payment by way of a hindrance to the enforcement or other mechanism ;
- agreement between the factor and the factoring client that allows the latter to transfer the collected amount, under a non-notification factoring agreement or when the factoring client acts as agent for the collection, at certain agreed dates rather than one by one ;
- other case of flexibility in the payment terms provided in the contract between the seller/factoring client and the buyer/debtor of the receivables.

We understand all those cases are not to be considered as past due receivables also in Anacredit and suggest to adapt the Manual according to this interpretation. Those cases are common and occur daily in practice.

g) ***On Carrying amount***

The carrying amount will follow the recognition of the receivables in the balance sheets according to the applicable accounting standards. Nevertheless, usually purchased trade receivables that are not recognized also generate an exposure for the factor, being the funds advanced to the client. We suggest to change the words "*If the purchased trade receivables are not recognised on the balance sheet, the carrying amount is reported as "Non-applicable". Otherwise, a non-negative value is reported*" into "*If the purchased trade receivables are not recognised on the balance sheet, the carrying amount is reported as the balance sheet exposure to the client. In any case, a non-negative value is reported".*

h) ***On Reserve as a protection***

The EUF also wishes to point out another misconception, this time regarding the reserve in factoring: The reserve's purpose is to inter alia cover the dilution risk with the factoring client. The reserve is not a "deposit" – such terminology could lead to confusion and misunderstandings with regard to regulatory requirements, particularly if this classification were to be used out of context. The same applies to the reference made in the

Case Study Factoring to the factor “primarily servicing the collection of the invoices“ (cf. p. 6 of the Draft Case Study Factoring) which could lead to misunderstandings with regard to the definition of payment services. We do not agree with the classification of the reserve as type of protection “Currency and deposits” and suggest to change it into “Other”.

i) On Counterparty reference data

If the reporting were to be due on the account debtor under AnaCredit, the minimum standard dataset for such debtors in factoring should only include the name, address and (at the most) the legal form of the debtor of the receivable, but not the following: Legal Entity Identifier (LEI), National identifier, Head office undertaking identifier, Immediate parent undertaking identifier, Ultimate parent undertaking identifier. As there generally is no contractual relationship between factor and the debtor of a receivable, (the debtor’s responsibilities are simply tied to the rights of the factor transferred at the time of purchase of the receivables which were created through the purely commercial transaction between the factoring client and the debtor of the receivables), the factor has no legal basis or other possibility to gather and report reliable information on these data points.
Especially in the case of non-notification factoring, the obligation to gather such data would be impossible or result in having to notify the debtor of the receivables of the sale of the receivables – this would make this accepted form of factoring as foreseen by the private law of several European jurisdictions practically unfeasible. Moreover, in other areas of law such as Anti-Money Laundering (AML), it is generally recognised and accepted that KYC-like information on debtors of receivables in factoring transactions need not be obtained other than in special cases where reasonable doubts pointing to criminal activities have arisen, the reason being that the contractual relationship is with the factoring client, who receives liquidity from the factor, not with the debtors of the receivable. It seems irrelevant to draw the debtor of the receivable in a financial operation.

j) On the reporting of protections

As for the reporting on protection in factoring transactions, it has to be noted that the suitable allocation of a protection such as a credit insurance to one instrument is not feasible: One or more factoring transactions (including the receivables purchased thereunder) may be protected by several credit insurance policies, e.g. client credit insurance policies assigned to the factor, top-up policies and the factor’s own credit insurance policies. Furthermore, the credit insurance policies vary greatly in content and coverage (excess or deductible, coverage only from or up to a certain amount, etc.), making apportioning or allocation even more difficult, if not even impossible. As for other means of protection, there can in certain cases also be protection which are legally enforceable in theory, but which in practice have more “moral“ value – this also complicates the matter of valuation of such protection. In general, such insurance policies make difficult the distinction between factoring with and without recourse.

3. Concluding remarks

The EUF also wants to point out that certain special cases and forms of factoring may require consideration and ultimately clarification in the Case Study Factoring, e.g. :

- “inhouse factoring“ (often in the form of non-notification factoring, where the factoring client manages the sales ledger for the factoring company, thereby probably becoming the „servicer“ in the meaning of AnaCredit, and which can include the factoring client receiving payments from debtors and forwarding these to the factoring company so that there is a change of receivables and corresponding debtors) ;
- cases of outsourcing (e.g. of collection process) from non-CRR institutions to CRR-institutions or vice versa.

Bringing this all together, we advocate a system of reporting to Anacredit :

-with a sound legal basis,
-not creating distortion of competition,
-respecting the proportionality principle,
-simple and feasible, in order to avoid huge costs,
- and not one that is detrimental for the financing of the “real” European economy and particularly SMEs.

We hope that these remarks and suggestions will prove helpful in finding a way forward with regard to the treatment of factoring transactions under AnaCredit. Please do not hesitate to contact us should you require further information or clarifications.

With kind regards,

Erik Timmermans
Chairman,
EUF

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