EUFederation
Factoring & Commercial Finance

To:

European Commission

Directorate-General for Financial Stability, Financial Services and Capital Markets Union

Kraainem, 24 June 2016

Object: DG FISMA Consultation paper on further considerations for the implementation of the NSFR in the EU

Dear Madam or Sir,

the EU Federation for the Factoring and Commercial Finance Industry (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 chain FCI+IFG. In 2015, the Receivables Finance industry in the EU provided over €168 billion of working capital financing to over 171,000 businesses, about 85% of which are SMEs. This amount of working capital 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, which fall under the umbrella of regulatory oversight.

Factoring is a means of finance which is widely used, especially by SMEs, as a method of providing working capital finance to a supplier of goods and services. This is achieved by the supplier assigning and selling its accounts receivable to a factoring company. The factor will provide a range of services to its clients, including providing working capital against the assignment of their receivables, accepting the risk of bad debts and collecting on past due accounts. The factor will usually charge an administration fee for these services and a discount charge for the advancement of funds against eligible assigned invoices. Factoring has been accepted as a stable financing alternative by many companies, particularly during the financial crisis over the last five

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years. Many SMEs that were unable to obtain traditional bank funding were able to obtain funding under factoring facilities, offered by bank owned and independent factoring companies. Hence, the factoring industry thrived during the financial crisis, helping hundreds of thousands of SMEs throughout the EU to obtain working capital. You could say that factoring companies are a direct mirror of the real economy.

The EUF would like to thank the Commission for giving the opportunity to the stakeholders to express their views on this important initiative: as you may remember from our previous communications about this item, NSFR is actually a crucial issue for the factoring industry, as its requirements would have extremely detrimental effect on the whole economy, and in the particular in the availability of alternative sources of finance for the European SMEs, if applied without the adjustments that are necessary to consider the specificities of factoring.

Therefore, it is with great pleasure that the EUF acknowledge (and fully support) the will of the Commission for more “proportionality” in the implementation of the EU regulation, in order to avoid weakening low-risk financing activities that finance the real economy, as already shown in concrete by the amendment to the LCR rules introducing specific waivers for factoring and as recently confirmed by Commissioner Jonathan Hill in his speech of May, 17th.

Following the suggestion enclosed in the Consultation paper, the EUF is glad to describe more specifically the factoring business model and how it could be affected by the NSFR rule[1]: commercial finance and factoring are generic terms for a range of asset based finance services which include factoring, invoice discounting, international factoring, supplier finance/reverse factoring and asset based lending. There are many variations on each of these product sets and the precise nomenclature varies from market to market, but all exist to provide working capital funding and financing solutions to businesses, particularly SMEs. The exact content of the services provided by the commercial financier will vary according to the clients' particular requirements, but all of these solutions have in common the idea that funding is offered based upon the accounts receivables created by the client company: With a factoring solution, the factor agrees to pay an agreed percentage of approved debts as soon as the receivables are assigned or (in some jurisdictions) pledged to him. If credit protection is part of the factoring agreement, it is referred to as “non-recourse” factoring, while a factoring agreement where the credit risk on the debtor remains with the seller is called “with-recourse” factoring. The factor will often also undertake all credit management and collections work. There will normally be a charge for the collections service and, if it is required, for bad debt protection as well as a discount charge for finance provided in advance of collections.

Factoring is simply a unique blend of services designed to ease the traditional problems of selling on open account terms, mainly aimed towards SMEs. Typical services include investigating the creditworthiness of the seller’s buyers/debtors, assuming credit risk on those debtors, and providing credit protection against the debtor’s default and/or bankruptcy, prompt collection of accounts receivable, management of the receivables ledger, and provision of finance through immediate cash advances against outstanding

[1] Please also refer to the attached White paper on Factoring and Commercial Finance.

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receivables. The factoring industry has enjoyed a long and rich history with a low record of credit losses as a percentage of revenue. Factoring is one of the very few sectors within financial services whereby a financial institution purchases the asset from the client, in this case the account receivables (intangible assets which have a very tangible source of liquidity) and all underlying rights, including the right of payment by the debtor. This strengthens the scenario that the factor will be paid (as the seller's receivable is the source of liquidity of the advance made to the seller by the factor). And in the case where the seller files for bankruptcy protection, the factor generally will have redress in the courts due to its ownership stake in the receivables from the seller. Traditionally, the receivables assigned to the factor are generally well diversified, are of short term duration, and are normally under a 90 day period. Also, the financing provided to the seller is contracted on a flexible basis, often providing leeway for the factor to exit quickly in a deteriorating financial condition scenario, which in part explains the low loss record for the industry.

In general (and in contrast to the banking sector), factoring margins are reflective of the risk being taken in the SME space and are therefore quite adequate. Again, this in part stems from the strong credit metrics factors use, the benefit of management of the receivables by the factor, enhanced credit underwriting analysis on both seller and buyer, a robust technology platform to manage the risk, along with a strategy of receivables diversification, keeping credit losses to a minimum.

With regard to the NSFR, the EUF would stress the fact that the regular activities of factoring companies does not encompass the collection of deposits and therefore 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. Moreover, such rule could be penalizing when the factoring companies are part of banking group: in this cases, the liquidity is granted by their parent bank, so that the funding is, by definition, very stable for the single entity.

Hence, we strongly believe there is a need for proportionality about the application of the NSFR rules to the factoring industry and that such proportionality would perfectly fit with the above-mentioned general position and with the purposes of the Commission. It is useful to underline that also the EBA, in its report on Net Stable Funding Requirements under Article 510 of the CRR (dated 15 December 2015), actually recommended a differentiated treatment for factoring: "*A distinct treatment may also be necessary for factoring and forfaiting for the same reasons. Given that factoring transactions have maturities reflecting the underlying trade of goods and services, a greater differentiation of RSF could be considered. This may be warranted given the short-term nature of these transactions, which are typically well below six months and are potentially not adequately captured by the broader maturity buckets of the NSFR. For specialised factoring*

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institutions, the NSFR requirements may thus be difficult to meet, particularly when they have a limited deposit base and largely rely on short-term wholesale markets for their funding. At the same time, it should be noted that export factors typically have contracts with exporters, implying automatic rollover of exposures related to factoring, i.e. a longer term commitment to acquiring the receivables from the exporter. Moreover, factoring institutions also engage in maturity transformation in their activities, thus also warranting limits on their funding mismatch. The following options could be envisaged:

- *a lower RSF factor for exposures with a residual maturity below six months, e.g. similar to loans for exports and imports;*
- *a lower NSFR requirement reflecting the insufficient granularity of the NSFR buckets; and*
- *waiving the NSFR requirement on a solo basis, reflecting that most factoring firms are subsidiaries of banks.*"

Table 23: Proposed RSF factors for trade finance products

Trade finance product	< 6 months	Between 6 months & 1 year	More than 1 year
Letter of credit	5%	10%	15%
Bank guarantees	5%	10%	15%
Loans for export/import	*(10-25%)*	50%	85%
Factoring or forfaiting	Exposures to non-financial firms: *(10%-25%)* For exposures to financial institutions: 15%	50%	100%

According to that position by the EBA, the EUF would like to stress once again the need for a for a better balance of the NSFR rule for factoring institutions, in order to avoid disruptive effects on specialized business models like factoring and commercial finance and would suggest the Commission to actually follow the advise of the EBA and to consider the possibility to go even beyond the suggestions of the Authority (that we find appropriate in concept but still conservative in measure), according to the requests of the industry, that we remind you to be the following:

- to set the Required Stable Funding (RSF) factor required for factoring exposures in the range of [0-10%] for factoring lending with residual maturity below 6 months and between [15-25%] for factoring transactions between 6-12 months in duration;
- 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, and

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- 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, assuming intragroup liquidity to be more stable than third party funding.

Finally, we would like to draw the Commission's attention on a really important issue: should any exemption or adaptation of parameters be provided on the entity level, it would be of the utmost importance that it also shows its effects on the consolidated level, when the entity is part of a banking group. Otherwise, the positive impact of any waiver or preferential treatment allowed to the factoring company could vanish due to the need to fulfill the (not adjusted) requirements at consolidated level, thus incentivizing internal arbitrage within the group.

These amendments, along with the EBA proposals, are aimed to set up a better balanced rule and to prevent the risk that the NSFR rule ends up, eventually, in a significant and unjustified increase in the cost of such crucial working capital financing source for the SMEs.

Thank you in advance for your attention. We look forward to hearing back from you. In the meantime, if you have any questions or want additional information and details about the above mentioned position of the EUF, please do not hesitate to contact Diego Tavecchia, Chairman of the Prudential Risk Committee of the EUF (contact details below).

With kind regards,

Erik Timmermans

Chairman, EUF

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