NEWSLETTER / APRIL 2017 / ISSUE 13

EUFederation

Connecting and Supporting the Commercial Finance Industry Worldwide

Contents:

Welcome from Erik Timmermans

Chairman EUF

A warm welcome to our Spring Newsletter.

Dear Reader,

Based on the preliminary data gathered by our Economics & Statistics Committee, **the 28 EU countries realized in 2016 a total factoring turnover of 1.503 billion EUR which represents an impressive share of 64% of the total world factoring volume. With an annual growth percentage of 6,2 % in 2016 and a penetration ratio of 10,1%, the EU performed much better than the total world of factoring**. The most important markets in the EU are UK (327 billion EUR), France (268 billion EUR), Germany (217 billion EUR), Italy (209 billion EUR) and Spain (131 billion EUR).

These figures show that Factoring and Receivables Finance is playing an increasingly important role in supporting SME's in the EU, even during difficult economic times. And this support does not lead to increased risks for the financial system, quite on the contrary as illustrated by the findings of our White Paper that demonstrated a LGD in factoring that is four times lower than the LGD in non-secured bank lending. This message is heard more and more by policy makers in the EU and in the member states and gives full relevance to the important work that is done by the technical committees of the EUF. But there is still a lot to do to have our voice heard even more.

I am therefore pleased to see that we have taken some important new initiatives in the EUF. The comparative Study on the different Legal environments for Factoring in the EU is being updated and should be available in the summer. In the second part of this year we will also start updating the **White Paper** with more recent data. A new document "**Introduction to Factoring and Receivables Finance**" is being prepared and will support all our advocacy activities. **One of the biggest challenges indeed is the general lack of understanding and knowledge of our industry with policy makers**. Too often factoring is being reduced to some form of trade finance instrument and the real risks involved in Factoring are often completely misjudged.

Furthermore **we will increase our pro-active advocacy activities in cooperation with our external advisors of Euralia**. A workshop in the EU Parliament is planned for the second half of this year and a new "Regulatory and Lobbying Dashboard" will permanently keep our members informed about the key issues the EUF is dealing with.

Last but not least **we will of course organize our 4th EU Summit in the first half of 2018, based on the very positive feedback received from participants at the 3rd Summit in Madrid in January this year**.

Finally I want to thank everyone who gives his or her time and efforts to support the EUF: our organization is very lean and could not deliver without the support from members of Executive Committee and Technical Committees. A special thanks to the Chairpersons of Legal, Prudential and Statistics Committee who are the backbone of the EUF.

Kind regards,

Erik Timmermans

Chairman EUF

The success of the past is the challenge ahead

SEBASTIAN ERICH
INTERMARKET BANK AG
CEO
Austria

Opinion Paper on EU factoring regulatory framework

Factoring is one of the oldest financing instruments in the world – in Europe the first real Factoring entities appeared in the 17th century – and the principle of trading receivables was already discovered by the Babylonians. Despite this – Factoring has until recently played a minor role in the financing structure of corporate clients. As we all know, this has dramatically changed in the last 10 years – and the first "EUF White Paper" shows not only impressive growth rates but even more impressively low risk ratios – **World Factoring volumes as of 2016 are at 2,355 bln EUR – with 1,503 bln EUR done only within Europe. This is a real SUCCESS STORY in the world of finance.**

We know as well, that the financial crisis in 2007-2008 has created a lot of damage in most economies – and what has been "state of the art financial engineering" back in the 90's and early 2000's (i.e structured derivatives etc…) has backfired and created global instability in the financial industry. Loan books of banks have turned sour – and politicians and regulators have rightly discovered, that a lot of transactions were not helping but threatening financial markets and economies.

Since then, regulators understandably try to define and constantly refine rules and regulations with the aim of avoiding such dangerous accidents in the future. The name of the game is "transparency & simplicity" in financial products. Even though "proportionality" is one of the key principles of regulators – our experience (and this is quite human) shows, that fear can lead to overreaction – i.e. overregulation…

Indeed – one can see, that sometimes neither supervisors (ECB or local ones) nor the banking industry have a clear view in all details – thus leaving a lot of room for interpretation and "grey zones".

Due to the fact that our industry has "lived in the shadow" (even being considered as shadow banking) for decades – the attention from local regulatory side was very different: Some countries are not regulated at all – some are under local bank regulation already – some have specific factoring regulation….

As the factoring volume in Europe has now reached 10,1% of the global EU GDP we have stepped out of this shadow – and consequently EBA & ECB is increasingly focusing on our industry. Whether we like it or not: regulation is going to come for all of us !

The problem now is, that the knowledge of factoring from regulator side is quite limited – and – as we painfully experience in the various EUF committees - very much "lending based". **We therefore risk ending up with classic bank regulation limiting our scope of action in the future – even questioning our survival.**

I strongly recommend, that both FCI and EUF turn from a reactive approach towards EBA/ECB and IASBoard to a much more proactive one. We need to lobby actively and explain to the decision taking bodies how we manage and run our business and point out the main differences between classic bank lending and factoring. This will cost more time and funding – but would be well invested considering the potentially long term damage caused by wrong regulation.

The only way to achieve this in my view is that we internally (within FCI and EUF) agree on one regulatory framework – and proactively propose it to EBA/ECB. Even though this can/will be for some of us a painful process I see this as the last chance to avoid major harm to our industry.

AND… TIME IS OF ESSENCE !

The Legal Committee

Update from the Legal Committee

MAGDALENA WESSEL
Chairman of the Legal Committee

Over the last months, **the EUF Legal Committee has put a special focus on the EU Commission's proposal for a directive „on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 32012/30/EU"** which was published on 22nd of November 2016 (cf. document 2016/0359 (COD) http://ec.europa.eu/information_society/newsroom/image/document/2016-48/proposal_40046.pdf).

The background to this directive proposal for an EU insolvency framework lies in the general idea that insolvencies of companies should be avoided and that rather, companies should be encouraged and assisted in „surviving" through restructuring measures. As shown by an improvised survey within the Legal Committee, this is a view which is apparently shared by many national legislators within the EU – it could even be called a legislative trend. The Legal Committee foresees various effects the implementation of such a EU directive could have on the national level, ranging from the risk of factoring companies being forced by e.g. a court decision to continue a factoring relationship during a restructuring process over factoring companies being considered as equivalent to banks in terms of creditor classes to so called cross-class cram-downs causing negative consequences for factoring companies who as creditors may unsuccessfully vote against a restructuring plan.

Another issue which the Legal Committee has followed closely is **the review of the 4th Anti Money Laundering (AML) Directive which are currently underway**. Triggered apparently not only by the terrorist attacks which have taken place across Europe since the 4th AML-directive entered into force, but also by the scandal surrounding the so called „Panama Papers", this directive has not yet been implemented into the national laws of all member states (the implementation-deadline was set for mid 2017), but is already being reviewed. The proposed amendments are intended to complement the existing preventive legal framework by setting out additional measures to better counter the financing of terrorism and to ensure increased transparency of financial transactions and legal entities, e.g. by applying enhanced checks towards high risk third countries, giving the Financial Intelligence Units (FIU) enhanced powers and better access to information and focussing more on areas such as virtual currencies and pre-paid cards. Over the last half year, discussions have also been ongoing regarding how to tackle the transparency of beneficial ownership. This entailed a review of the definition of beneficial ownership, too, and the EU-legislators' opinions have been divided on whether and how to change this definition, with views inter alia including lowering the threshold for the determination of beneficial owners from 25% to 10%.

The Legal Committee is monitoring these and other issues closely and is e.g. deliberating draft position papers to be issued by the EUF in order to be able to advise the EUF Executive Committee on how to best react and defend the European factoring industry's interests.

EUF: The Economics and Statistics Committee

Constant and stable growth – EU Factoring market in 2016

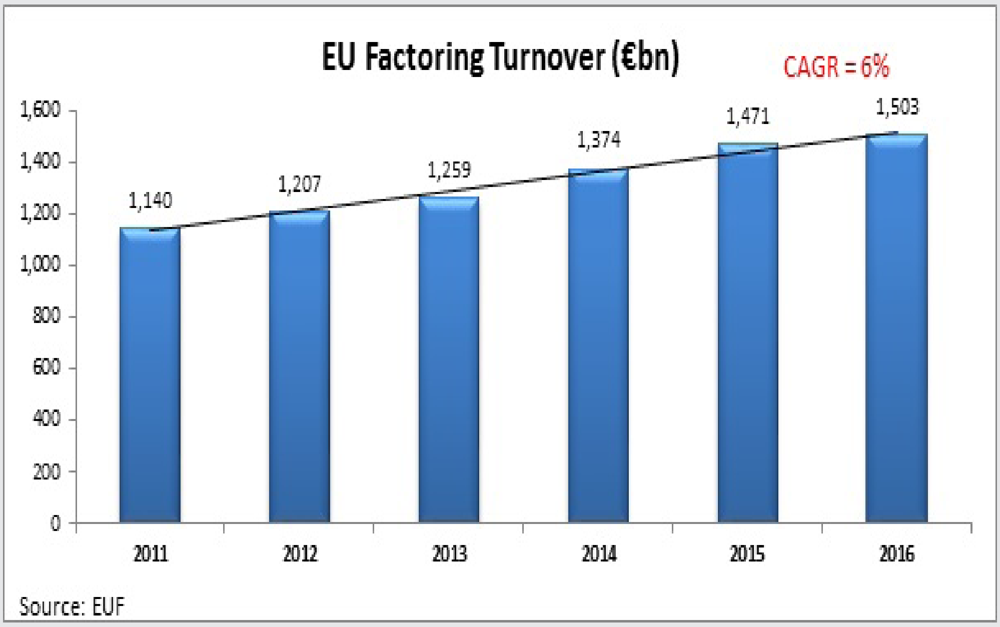
MAGDALENA CIECHOMSKA-BARCZAK
Chairman of the Economics and Statistics Committee

The EU Federation for Factoring and Commercial Finance recently collated the 2016 turnover results for EU factoring market. Responding countries represented 97% of the 2016 EU factoring turnover.

In 2016 factoring turnover for EU countries reached 1,5 trillion euro, a year on year increase of 6,2%. This is the next year of continuous growth of factoring turnover in Europe - during the last 6 years compound annual growth rate reached 6% - and it confirms growing popularity of this form of funding, which in addition to speeding up the cash flows, provides also additional benefits for entrepreneurs, including:

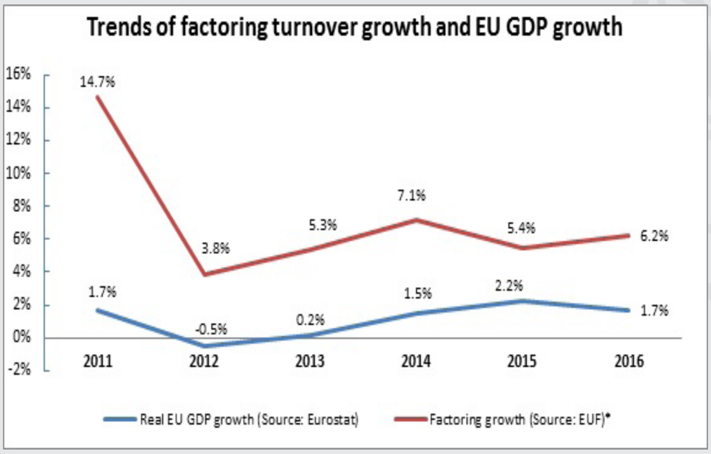
- protection from bad debts (in case of non-recourse factoring),
- outsourcing of sales ledger management,
- information about customers' credit worthiness and
- professional collection.

Not without significance is the fact that factoring can provide access to funding even for companies which have difficulties obtaining traditional bank financing.



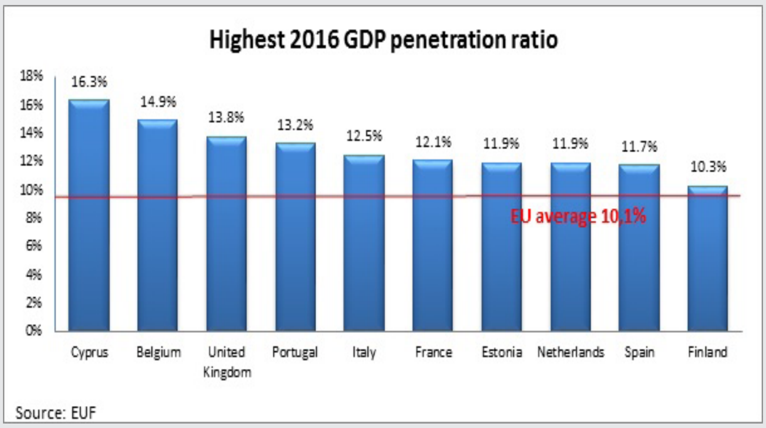
EUF: The Economics and Statistics Committee

These benefits of factoring mean that factoring has been growing regardless of the economic situation of the EU – it is especially visible when comparing factoring annual rates of growth with real EU GDP growth.



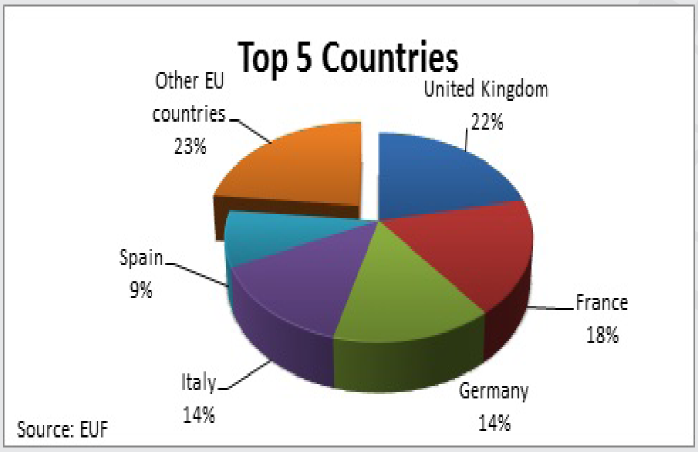
* Exchange rates fluctuation biases were eliminated.

Analysis of GDP penetration ratio by country reveals that in 10 countries GDP penetration ratio was higher than EU average – see table below.



EUF: The Economics and Statistics Committee

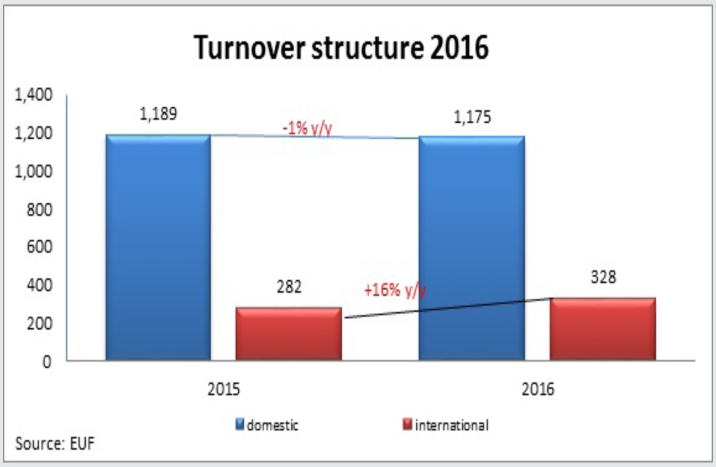
Still the EU factoring market remains highly concentrated, with the top five countries in 2016 representing almost 80% of the total market. The main players were United Kingdom, France, Germany, Italy and Spain.



Also the type of ownership was similar to the one in previous year – almost 96% of total EU factoring turnover was serviced by banks or companies owned by banking groups (91% in 2015).

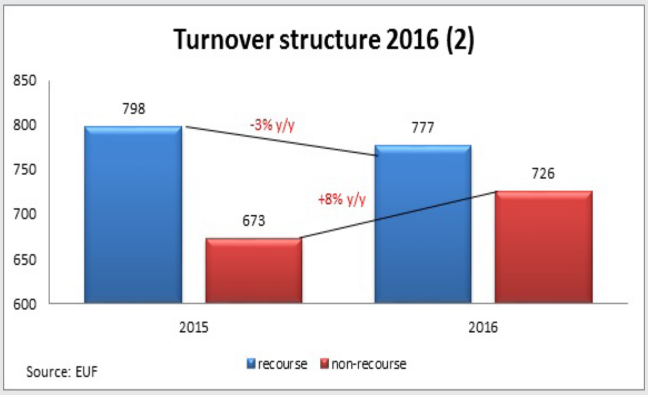
The dominant type of factoring, according to EUF estimates, is domestic and it represents 78% of total turnover. There was slight decrease in this type of factoring comparing to previous year's volume (-1% y/y). But a higher growth rate was observed in international factoring, which in 2016 increased by 16% y/y.

This reflects not only economic development of EU companies, but also development of their cooperation with new, international partners. And it is projected that this type of factoring will increase further proportionally to the development of international trade.

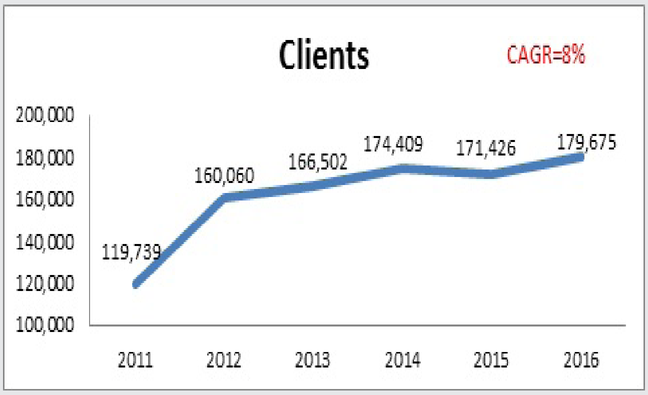


EUF: The Economics and Statistics Committee

There was also decrease observed in **recourse factoring, so far dominant type of factoring - it fell by 3% y/y in 2016, when non-recourse factoring has grown by 8% y/y. It confirms growing role among entrepreneurs of credit protection from buyers' insolvency.**



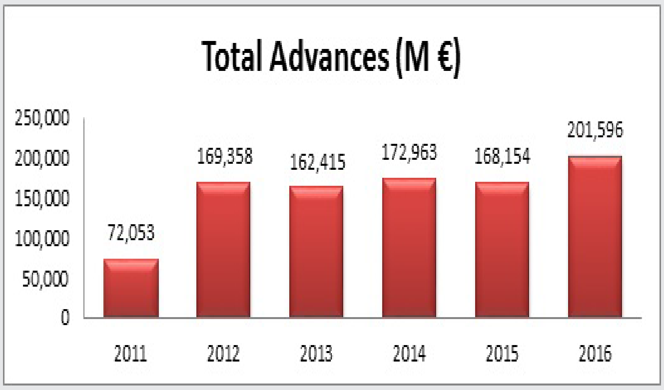
Each year factoring gains more clients. The estimated number of active relationships in 2016 increased by 5% y/y, reaching almost 180 thousand businesses. Compound annual growth rate of clients' number in last 6 years reached 8%. This is more evidence of growing popularity of factoring.



EACH YEAR FACTORING GAINS MORE CLIENTS, REACHING ALMOST 180 THOUSAND BUSINESSES

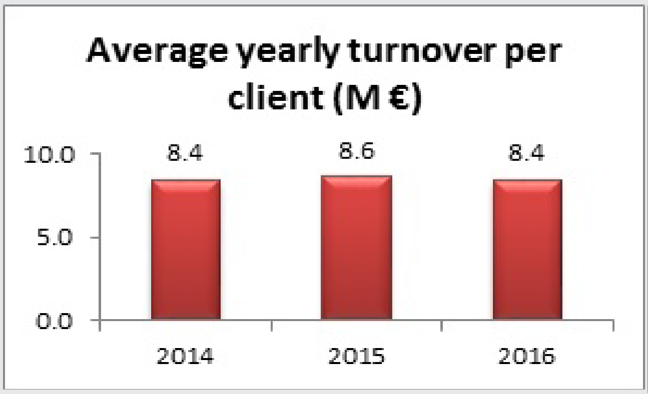
EUF: The Economics and Statistics Committee

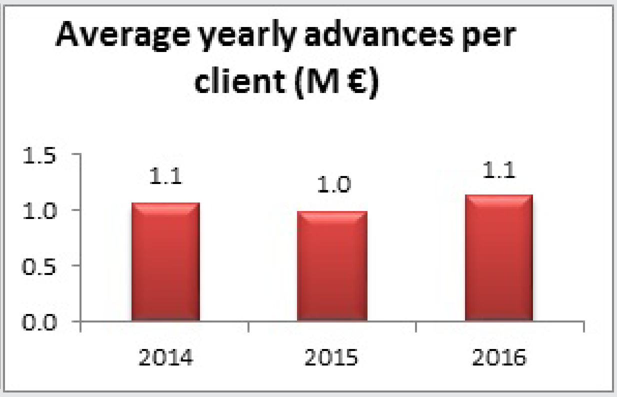
The estimated amount of funds made available to clients by European factors exceeded 201 bn euro, as at the end of 2016, with year on year increase of 20%.



Those advances were secured by assets valued at 262 bn euro. The ratio between advances granted and security values (77%) reflects the low risk profile of factoring transactions.

In the last three years both average turnover per client and average funds granted to clients remain on a similar level.





It shows that growth of factoring turnover was a consequence of the increase in number of clients on European market. And stable level of average amount advances per client shows that the risk exposure of European factoring companies remains unchanged, regardless of growing turnover.

In conclusion, *data collected by the EU Federation for 2016 shows that factoring is still developing faster than the EU economy and this is due to its growing role in the financing of companies. Factoring helps to maintain liquidity and avoid payment bottlenecks, which is especially important for companies operating in the present, highly competitive market, which is forcing them to offer deferred payments terms to their customers.*

The Prudential Risk Committee

Factoring in prudential regulation: some misunderstandings to clarify

DIEGO TAVECCHIA
Chairman of the PRC Committee

As we all know, **factoring is a very important source of finance to European SMEs**, based on the assignment (or other – more or less - equivalent legal form) of their receivables to a bank or a specialized company that provides a unique blend of services encompassing finance, administration and collection and guarantee of the trade receivables.

While the idea of factoring is very simple, it looks like the National and (now) the European Regulators are still facing some difficulties in fitting it in the applicable existing and new prudential regulation frameworks.

A big source of confusion, in particular, stems from the variety of regulatory environments across Europe in which non banking intermediaries operate, ranging from totally non-regulated markets to markets subject to full bank-like regulation, with many "shades of grey" in between. European regulators themselves appears to be sometimes puzzled by this variety, which is usually in contrast with their beliefs about factoring being always regulated or never regulated, depending on the case in question. Nevertheless, to bring even more confusion, factoring happens to be offered by banks, who are (should be) all regulated in the same way. Just understanding what applies to whom results in a very difficult and complicated exercise.

What's even more tricky is the attempts to fit factoring to the requirements. **Much of the banking regulation simply does not make sense when applied to factoring**. I'll spent the next few lines explaining the biggest challenges factoring facing through regulation.

A breach in the level playing field stems from the big misunderstanding about the (in)famous 90 days past due rule: it seems like it is difficult for regulators to accept the idea that a past due trade receivables is not the same as, e.g., a past due mortgage or leasing installment. While (at least in some Countries) 90 days due invoices are not at all a sign of deterioration in the creditworthiness of the account debtor, 90 days could be even too late to detect default in the other case. Uniform application of such rules to heterogeneous Countries in term of late payments in trade relationships brings **unnecessary classifications to default and unfair capital burden to factoring companies, in compensation for a very much lower cost of risk**. Statistics in Italy, where late payments show themselves in all their beauty, demonstrate that while 90 days past due exposures represent the larger share of defaulted exposures in factoring (60% for Public Administrations and 40% for private companies, respectively 42x and 21x the same ratio in bank lending!), migration from 90 days past due to unlikely to pay is very low (1,72%) and losses are extremely infrequent (if not absent, as in the case of PA debts).

Moreover, accounting is complicated. Non-standardised accounting rules around Europe creates non comparable balance sheet reporting, adding confusion and practical difficulties. These difficulties also have consequences on the prudential risk side (as the basis for assessing credit risk capital requirements is the balance sheet exposure) as well as in the future Anacredit reporting, about which a lot of discussion is still ongoing. Also the TLTRO were not free from bias due to reporting rules: purchased trade receivables to PA, when accounted in the balance sheets of the assignee, were not included in the amount of "lending to the real economy" as targeted by the ECB because they were accounted as exposures to a PA, resulting in factoring specialized banks not being able to participate such operations. In this way, one of the financing techniques most related the the real economy was excluded by the ECB. Not to say that the same limit excluded also financing granted by companies not organized as banks, even if part of a banking group, thus creating another bias discriminating against factoring.

The Prudential Risk Committee

Most recently, the forthcoming introduction of the Net Stable Funding Ratio will need some adjustment (as the EBA correctly understands) to be applicable to factoring. Basically, the idea to ask for a very large amount of "stable" (namely: medium - long term) funding for factoring would be extremely detrimental to factoring if not corrected to take into account the (very) short term nature of our activity and the low (if any) systemic risk.

These are just a few of the important consequences of the misunderstandings about factoring. It will be crucial for the EUF to continue proactively to contact the European Regulators to "educate" them on what factoring companies do and on how to unfold the risk-mitigating secrets of the "trinity" of factoring (assignor, factor and account debtors) in order to get the most fitting rules for our industry, to the benefit of the European businesses, mostly SMEs, that widely use factoring to optimize their working capital and foster their growth.


*


*

* The picture is downloaded from European Commission`s Facebook page

EU FEDERATION FOR FACTORING AND COMMERCIAL FINANCE

The 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.

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, acts as a platform between the factoring and commercial finance industry and key legislative decision makers across Europe bringing together national experts to speak with one voice.

EUFederation
Factoring & Commercial Finance

EU Federation for Factoring and Commercial Finance
Avenue Reine Astrid 452
1950 Kraainem
Belgium

Tel: +32 2-772-6969
Fax: +32 2-772-6419
Email: info@euf.eu.com
Web: www.euf.eu.com