NEWSLETTER / AUTUMN 2022 / ISSUE 23

# EUFederation

Connecting and Supporting the Commercial Finance Industry Worldwide

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# Welcome from Fausto Galmarini

## Chairman of the EUF

Dear Reader,

The publication of the EUF Newsletter Autumn edition gives me the opportunity to share with you some reflections on the current global economic context and the role that factoring can play in supporting the real economy even in complex and difficult situations.

As you know we are facing the effects of the conflict between Russia and Ukraine involving the whole of Europe: lack of raw materials, higher costs not only for energy and inflation rate, with many businesses in financial troubles in particular SMEs, and in some sectors, with the risk of closure. The emergency we are experiencing now is not dissimilar from the one we experienced in the period of Covid-19.

To be able to do this, at the regulatory level it needs greater attention of the Authorities responsible for prudential regulation (EBA, European Commission, Council and European Parliament) to the specificity of factoring that it is not a traditional lending activity but a support to businesses that boast receivables from their customers, anticipating the amounts of the invoices issued or purchasing trade receivables. The risk is often taken towards the assigned debtor (large corporate companies and public sector Entities) without recourse to the assignor. Just for its specificity the riskiness of factoring has always been considerably lower (one third or one quarter) than the one recorded in the traditional bank lending, even in periods of negative economic cycles. The current legislation unfortunately does not recognize this specificity, obliging Factors to apply prudential regulations – which if correct for traditional bank loans – are not for trade receivables, with greater consumption of capital and provisions in excess of the risks actually taken.

The EUF submitted to the Regulators some proposals to reduce the negative impact, especially of the NDOD, on factoring and is meeting some EU Parliament representatives in relation to the revision of Basel III/CRR. The EUF wants to underline that its proposals have not the aim to distort the rules, softing them, but to highlight the real level of riskiness of factoring, significantly lower than the traditional bank lending, and to avoid a capital requirements rule could be used instrumentally to speed up the payments of invoices that it is not among the aims of the Regulator but of the European Commission that with regard to late payments already issued specific legislation some years ago (Late Payment Directive) that has civil nature and has been transposed into the various national laws of the EU countries.

The shift in monetary policy to freeze the inflation will result in a higher cost of financing and a reduction in the liquidity of businesses, in particular SMEs. It is expected an increase in defaults on bank loans. It already happened in the past but factoring was able to manage the negative phases of the economic cycle maintaining the riskiness to low level. So the EUF trust in a positive approach of the Regulators to its proposals to allow Factors to continue to support effectively the real economy in this difficult period.

Best Regards,

Fausto

# The Legal Committee

# What's up in legislation?

MAGDALENA WESSEL
EUF Vice-Chair and Chair of EUF Legal Committee

The EUF Legal Committee not only monitors and deliberates over concrete and ongoing legislative processes and changes, but also takes into account plans and developments that may have a (sometimes still unclear) impact at some point in the future. At the moment of this newsletter's publication, there are quite a few such foreseeable future developments which either address factoring directly or – as so often – may have an indirect effect on factoring.

The UNIDROIT Model Law on Factoring (MLF) is one of those legislative projects whose clear focus is on factoring and which is already at a quite advanced stage of the legislative process. The purpose of the UNIDROIT MLF is to provide an instrument for countries and jurisdictions that want to introduce a new factoring law or perhaps just update their existing laws. Hence, it is a fascinating project that may be of interest also in states where the legal framework for factoring already is well developed, although the assumption is that the MLF's impact on European states and their laws is likely to be limited. Nevertheless, the EUF Legal Committee is keeping an eye on the MLF and the corresponding consultation which ends on October 21, 2022.

Another piece of legislation that is already quite far along is the draft EU regulation on the law applicable to the third-party effects of assignments on claims. Over the last years, the EUF Legal Committee has followed this closely and the EUF has also voiced its views on how the law of the assignor's centre of main interest should be applicable to such third-party effects in several position papers. Currently, the interinstitutional discussions of this draft EU regulation are still ongoing, and in a recent briefing published by the European Parliament regarding this draft EU regulation as a kind summary of its main points, the EUF was mentioned, which is to be welcomed as it strengthens the awareness of both the EUF and factoring in this regard.

As for legislative projects which have come far in some EU member states but are still at very early stages in other EU member states as well as on the EU level itself, the introduction of (digital) reporting requirements for invoices (inter alia linked to combating VAT-related fraud) is a good example: In Italy, the Sistema di Interscambio already exists, and in France, the facturation électronique and e-reporting are well underway, while similar ideas are still being deliberated in e.g. Germany, but also



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on the EU level. The EUF Legal Committee is also monitoring these developments and their (possible) effects on factoring.

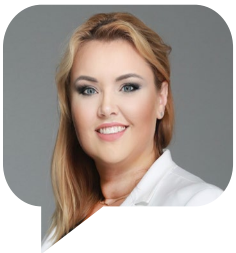
Most recently and rather contrary to the information the EUF has gathered so far, a review of the Late Payments Directive was announced by the EU Commission in mid-September. So far, this announcement was only made during the State of the Union Address by EU Commission President von der Leyen and also mentioned in a statement of EU Commissioner Breton, but without providing closer details on possible contents of and timelines for such a review. Therefore, it remains to be seen what changes will be made to the Late Payments Directive and whether or how these will affect factoring.

The EUF Legal Committee will keep a watchful eye on all of these legislative projects over the next months – and perhaps even years!

- Magdalena Wessel

# The Economics & Statistics Committee

## IH 2022 Statistics – Year of Spectacular Growth of Factoring Turnover



MAGDALENA CIECHOMSKA-BARCZAK
Chair of the Economics and Statistics Committee

Data gathered by EU federation for Factoring and Commercial Finance for European factoring market for IH 2022 has shown that there was a spectacular growth of factoring turnover, which exceeded 20% y/y. It is a highest half-year growth ever recorded.

This growth was almost two times higher than yearly growth in IH 2021 (11%).

Total factoring turnover for European countries reached 1 trillion 144 billion euro comparing to 953 billion euro in IH 2021.

The GDP penetration ratio also increased y/y and reached 12,5% comparing to 11,4% in IH 2021.

European Union countries In IH 2022 represented 83% of the market, had 21,5% y/y growth, 12,5% of GDP penetration, when their countries average nominal GDP increased by 10,2%.

EUF members and partners represented almost 95% of total European turnover with 21,2% of turnover growth y/y and had 13,5 % of GDP penetration and 9,2% of GDP growth.

According to information gathered from member countries – such big growth was possible due to:

1. Still strong surge of post covid demand
2. Necessity to pay off government support
3. Inflation
4. War in Ukraine - further growth in prices of goods and commodities and additionally, especially in eastern Europe countries, war caused higher demand due to support actions for Ukraine and rapid inflow of immigrants.

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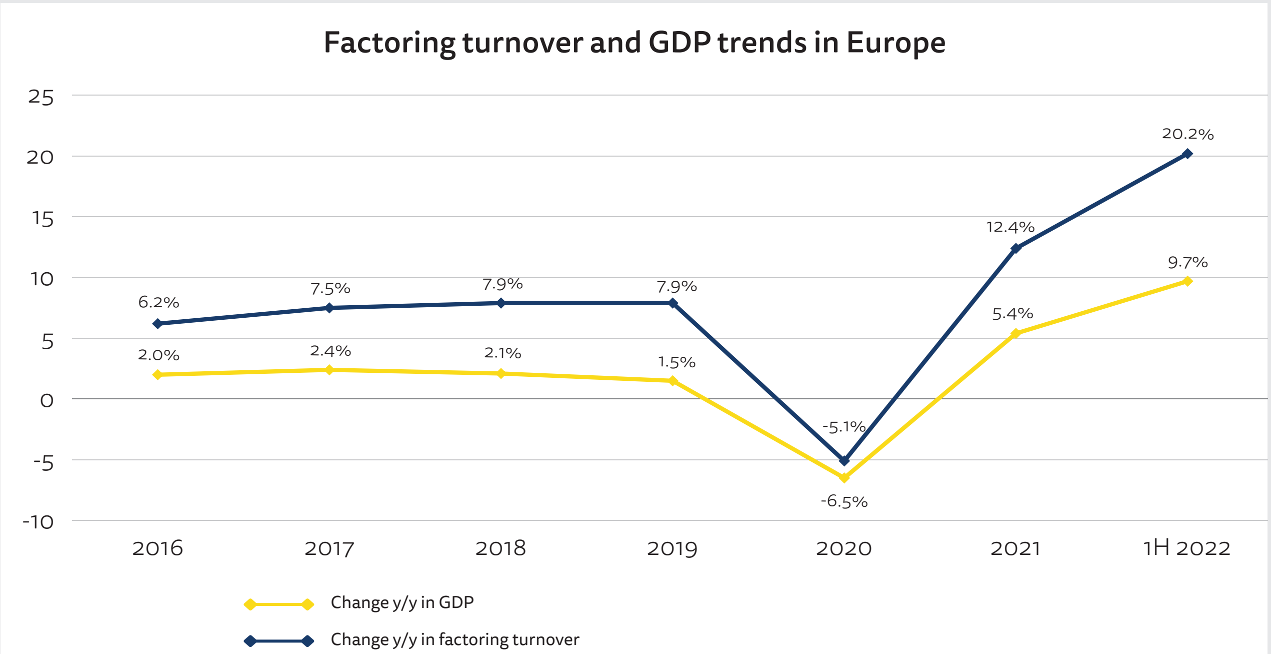
Graph 1. Turnover by country IH 2022

| Turnover volumes by Country (Millions of €) | | | | | | |
|---|---|---|---|---|---|---|
| 30 June 2022 | Notes | Total Turnover | pct var. on the previous year (Total) | GDP Penetration | Country GDP change y/y | Market Share |
| Austria* | | 17 516 | 23.2% | 8.1% | 12.3% | 1.5% |
| Belgium* | | 59 097 | 25.5% | 21.6% | 12.1% | 5.2% |
| Croatia* | (2) | 660 | 17.6% | 2.2% | 16.3% | 0.1% |
| Czech Rep* | (1) | 5 796 | 32.6% | 4.4% | 16.2% | 0.5% |
| Denmark* | (1) | 12 763 | 36.2% | 7.0% | 12.9% | 1.1% |
| France* | | 203 478 | 16.8% | 15.7% | 6.3% | 17.8% |
| Germany* | | 182 345 | 24.5% | 9.7% | 8.2% | 15.9% |
| Greece* | | 10 667 | 33.9% | 10.9% | 17.1% | 0.9% |
| Italy* | | 139 784 | 16.6% | 15.4% | 7.1% | 12.2% |
| Netherlands* | | 78 840 | 27.1% | 17.1% | 10.3% | 6.9% |
| Poland* | (1) | 47 654 | 34.4% | 15.7% | 13.6% | 4.2% |
| Portugal* | | 20 054 | 27.1% | 17.7% | 12.0% | 1.8% |
| Spain* | | 117 802 | 26.1% | 18.5% | 10.0% | 10.3% |
| Other EU Countries | (1)/(2)/(3) | 58 186 | 5.5% | 5.4% | 13.5% | 5.1% |
| EU Countries | (1)/(2) | 954 644 | 21.5% | 12.5% | 10.2% | 83.4% |
| Norway* | (1) | 14 812 | 16.5% | 5.9% | 36.7% | 1.3% |
| United Kingdom* | (1) | 174 930 | 11.9% | 13.6% | 2.9% | 15.3% |
| European Countries | (1)/(2)/(3) | 1 144 386 | 20.2% | 12.5% | 9.7% | 100.0% |
| EUF Members or Partners (*) | (1) | 1 086 200 | 21.2% | 13.5% | 9.2% | 94.9% |

Notes:
1) Pct variation has been corrected in order to avoid biases due to exchange rates fluctuation.
2) Due to the lack of information - previous years' 1H Y turnover was taken
3) Nominal GDP estimates on the basis of the available information.

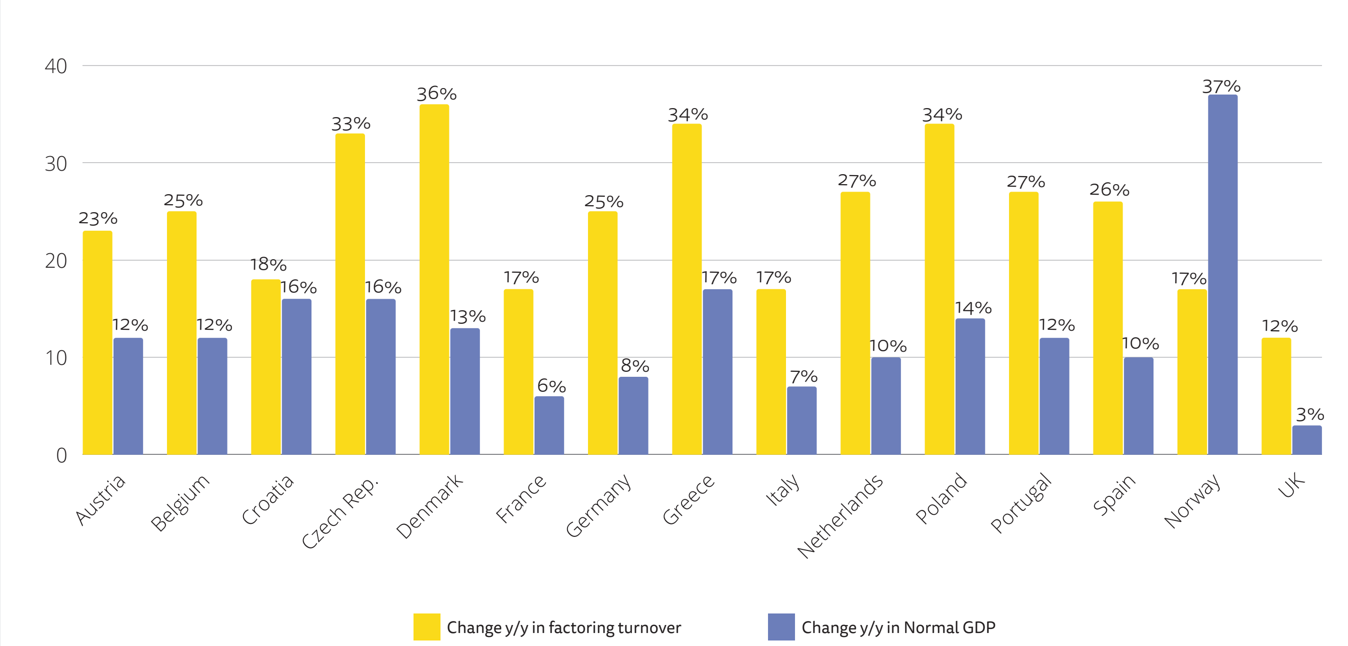
European factoring turnover graph shows that there is a strong and predictable relationship between its growth and GDP growth. The correlation between them is positive but factoring growth rates change more rapidly than GDP.

Graph 2. Trends of factoring turnover growth and European GDP growth



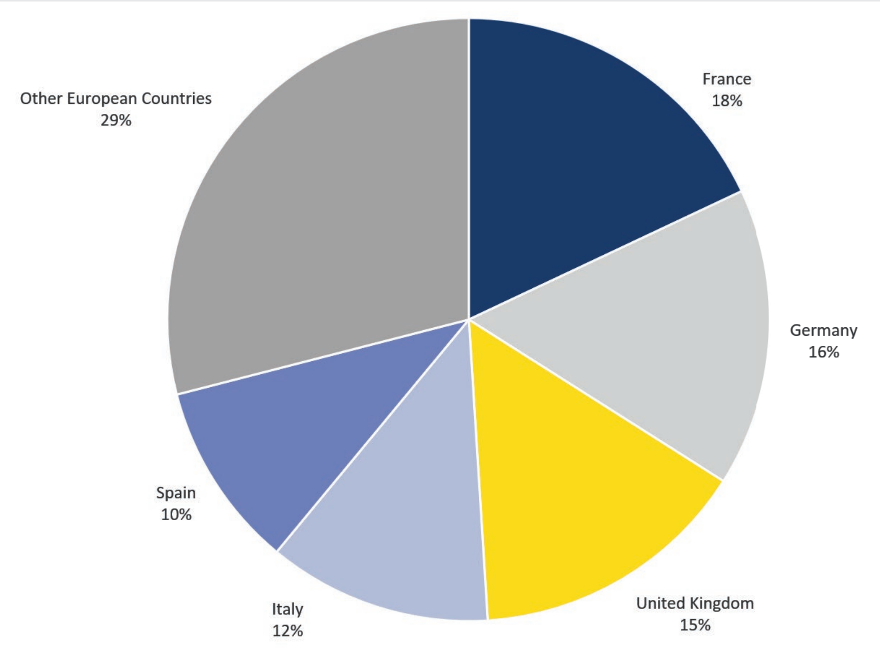
The trends differ between countries. In almost all countries, apart from Norway, the increase of factoring y/y was higher than country's nominal GDP change. And there was one country where growth of factoring turnover was similar to country's GDP – it was Croatia.

Graph 3. Changes y/y in factoring turnover compared to country's GDP




The leader of the EU market in IH 2022 was still France with 18% of the market, the next were: Germany with 16% of marketshare, United Kingdom 15%, Italy 12% and Spain 10%. These top 5 countries represented 71% of the EU factoring market (1% less than in previous year).

Graph 4. Top 5 countries




In conclusion – data for IH 2022 shows clearly that whole 2022 should be next very good year for factoring industry. And due to that growth, it is expected that there will be also an increase in number of clients which use factoring facility. But due to macroeconomic situation and high uncertainty it is also expected that portfolio credit risk will be higher than in previous years and non-recourse factoring could become dominant one.

- Magdalena Ciechomska-Barczak

# The CRR reform and factoring: more of the same or a step forward, at last?

DIEGO TAVECCHIA
Chair of the PRC Committee

During 2022, the EUF engaged an extraordinary effort in order to create consensus on its positions regarding the CRR reform that will complete the transition from Basel II to Basel III. The legislative process at the EU, that is currently ongoing, started from the publication by the European Commission of a proposal of a Regulation amending Regulation (EU) No 575/2013.

The paper, that was submitted to public consultation, presented some very interesting news from the point of view of factoring.

First of all, the proposed Article 506 mandates the EBA to report to the Commission on the eligibility and the use of credit insurance as a credit risk mitigation technique and on the appropriate risk parameters they should be associated with under the SA-CR and foundation IRB approach. Credit insurance is a well-established product which, in its most basic form, provides protection against the risk of non-payment of receivables from the trade of goods or services. It is offered worldwide by specialist insurers (or via specialised units), but it is primarily found in European markets. As a result, the majority of (re)insurers active in the credit insurance sector are EU-based and regulated under the Solvency II regime.

The EUF has always believed there is room for a recognition, within the prudential framework, of its validity as a risk mitigation tool in relation to exposures to purchased receivables without the need to twist its fundamentals, so this development is fully consistent with the desires and needs expressed by the industry. However, the job is not yet done as the EBA will thoroughly analyse the issue and will definitely need data to support any decision on this topic.

With regard to purchased receivables, the EC proposal provides for the introduction of new exposure classes dedicated to purchased receivables (namely "corporate purchased receivables" and "retail purchased receivables"). It also states that EBA shall develop draft regulatory technical standards to specify the treatment applicable to exposures belonging to the exposure class 'corporates purchased receivables' and the exposure class 'retail purchased receivables', for the purposes of calculating risk-weighted exposure amounts for the default risk and for the dilution risk of those exposures, including for the recognition of credit risk mitigation techniques. Again, the factoring industry has always supported the need to introduce a specific treatment for purchased trade receivables, and the Commission's proposal seems to be oriented in this direction.

However, the current text limits the introduction of the new exposures' portfolios and the analysis of the EBA to the IRB approach, which is notoriously less much less common in institutions specialized in factoring that the standardized approach (also because often…there are not enough losses to provide for statistically significant estimated of the risk parameters!). Therefore, the EUF welcomed the innovative approach but asked to extend the scope of the analysis also to the SA, in order to evaluate the possibility to reduce the "risk-weighting gap" for factoring: indeed, while the SA approach requires to use a 100% risk weight for exposures to unrated companies, an industry-wise estimate of the "real" risk weight for exposures to purchased receivables would probably be under 30% and that would already consider conservative hypothesis. That's a large gap, that doesn't fit well with the low risk, the short duration of the exposure and the asset-based nature of factoring.

The estimates of the EUF (based on the White Paper survey on the cost of risk for factoring companies) are showed in the following table:

| Serial No. | PD | LGD | Effective Maturity (days) | Effective Maturity (years) | RW% (without 1.06 scaling factor) | RW% (with 1.06 scaling factor) | Remarks |
|---|---|---|---|---|---|---|---|
| 1 | 0.09% | 100% | | 2.500 | 62.0% | 65.7% | Super-conservative maturity (2.5 years vs 90 days) |
| 2 | 0.09% | 100% | 90 | 0.247 | 26.7% | 28.3% | Using 0.09% as PD and 100% as LGD with 90/180/365 days as maturity |
| 3 | 0.09% | 100% | 180 | 0.493 | 30.5% | 32.4% | |
| 4 | 0.09% | 100% | 365 | 1.000 | 38.5% | 40.8% | |
| 5 | 0.20% | 45 % | 90 | 0.247 | 23.1% | 24.4% | If EL = 0.09%, using 45% LGD as proxy, generating PD = 0.2% (by dividing 0.09% by 45%); using LGD as 45% and 90/180/365 days as maturity |
| 6 | 0.20% | 45% | 180 | 0.493 | 25.3% | 26.9% | |
| 7 | 0.20% | 45% | 365 | 1.000 | 30.0% | 31.8% | |

The EUF believes that exposures to purchased receivables might deserve a lower risk weight (in the range of 50 to 75% would imply a maturity of 2.5 years and already be super-conservative!), but that's not the only way to reduce the aforementioned gap: other ways to reach the same goal would be i) to consider purchased receivables as eligible CRM tools under the Standardized Approach, allowing the possibility to opt for the risk weight of the account debtor, in the case where the agreement provides partial or full recourse to the client and the weighted average of the underlying debtor's risk weight is more favorable and ii) to apply, for purchased receivables, the definition of default at the level of a particular facility (invoice) as already provided for retail exposures, amending accordingly art. 178.

What is important to underline is the fact that these changes would not represent "softer" rules for factoring but actually a mere alignment between the rules applied to the IRB framework (that provides for a much better recognition of factoring specificities and in particular exactly the desired items) and to the standardized approaches. In particular, a change in the definition of default as provided for in art. 178 would be a game-changer for the factoring industry and would help avoiding the detection of unnecessary default of the whole exposure to healthy clients for delays on the payment of purchased receivables.

The EUF submitted all the above-mentioned proposals (along with others) to the EU institutions and amendments in line with them have been tabled during the process. The EUF is currently liaising with key MEPs and Permanent Representations in order to build consensus around them. The likelihood of any significant change looks particularly low, as all the parties involved in the trilogue apparently tend to prefer a compromise that can be agreed quickly and that doesn't differ much from the original text from the Commission. However, the EUF proposals have been considered as risk based by many counterparties and are still on the table at the time of writing, which is a very good place to be for the time being!

Time will tell if the reform of the CRR will be "more of the same" or, at last, a step forward, toward a relevant and proportionate prudential regulation for factoring.

- Diego Tavecchia

# 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.

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