



EU Federation

Connecting and Supporting the Commercial Finance Industry Worldwide

Contents:

Welcome

Fausto Galmarini
EUF Chairman

2

From Late Payments Directive to Late Payments Regulation?

Magdalena Wessel
Chair of the Legal Committee

4

IH 2023 Statistics - Continuation of an upward trend in factoring

Magdalena Ciechomska-Barczak
Chair of the Economics and Statistics Committee

6

The new ESG Committee

Antoine de Chabot
Chair of the ESG Committee

9

The new Late Payment Regulation: implications for credit risk

Diego Tavecchia
Chair of the PRC Committee

12



Welcome from Fausto Galmarini

Chairman of the EUF



Dear Reader,

The publication of the Autumn edition of the EUF newsletter allows me to share with you some thoughts on the current global economic climate and the role that factoring can play in supporting the real economy, even in a complex and challenging situation like the one we are experiencing.

As you know, the whole of Europe is still facing the effects of the conflict between Russia and Ukraine, and a new war in the Middle East, whose consequences are not foreseeable, is now in front of us. Higher costs not only for energy and inflation rate (two digits) forced the ECB to increase the cost of refinancing, which went from negative to 4.5% in one year.

This policy used to reduce inflation drastically had a significant negative impact on the GDP of the European countries: many businesses are in financial trouble, particularly SMEs, and at risk of closing due to the stricter criterion of the banks on lending.

Despite this unfavorable macroeconomic scenario, in the first half of 2023, the European Factoring market grew 5%, reaching a total turnover of € 1.2 trillion with a GDP penetration ratio of 11,9%. The European market represents more than 66% of the worldwide Factoring market, and factoring has become one of the preferred solutions in short-term financing by businesses, especially SMEs.

What are the main reasons? Why can factoring face better than traditional bank lending the negative cycle of the economy? The replies are simple: factoring is key in reducing the working capital, giving more liquidity to businesses and possibly covering the credit risk by non-recourse assignments of receivables.

Furthermore, there is a big difference from traditional loans: risk concentration. In the latter, Banks have the borrower as the sole debtor, while in factoring, there are many debtors for each assignment. This granularity and the constant monitoring of the invoice payment allows Factors to maintain the credit risk at a very low level and to increase financial advances even during periods of economic recession.

Unfortunately, there is no specific treatment for factoring in prudential regulation. Factors must comply with the exact requirements of traditional banks, with greater consumption of capital and provisions over the risks taken.

For years, the EUF has been carrying out a lot of initiatives with the Regulators to obtain recognition of the lower riskiness of factoring, till now without any concrete results because much more data is needed at the European level, and only a few National Associations have collected it.

Nevertheless, EUF has recently sent to each member of the Board of EBA some proposals to reduce the negative impact, especially of the NDOD, with the revision of Basel III/CRR. The EUF

proposals want to keep the rules the same but highlight that the actual level of riskiness deserves a different capital requirement because a past due in receivable does not have the same insolvency evolution as a loan. A late payment, in factoring, is ultimately a payment and not a default. EUF also wants to avoid a past due of receivables that can cause a reputational risk to the debtors due to its evidence in Anacredit.

Aware of the importance of demonstrating the need for a different treatment for factoring and considering the difficulties of some national associations in collecting these data, EUF is considering the possibility of having the support of a European Consultant to build a data pooling for adopting the IRB Model that allows a much more realistic calculation of the past due. The project will be examined in the following months, evaluating costs and benefits.

EUF underlines the NDOD could not be used instrumentally by the Regulators to speed up invoice payments outside its tasks. In fact, concerning the late payments, the EU Commission proposed a new Regulation to modify and replace the LP Directive of 2011 last September. The new framework provides for a cap of 30 days in payment terms, automatic late payment interest, flat fee compensation of 50 euros for each transaction paid late and administrative sanctions to the bad debtors. It is not yet definitive because the EU Council and the EU Parliament must approve it.

In any case, it is challenging to think that the EU Commission proposal could solve the late payment issue, and the term of 30 days in many cases is shorter than the duration of the operating cycle of the businesses, different from sector to sector and also from business to business of the same sector.

EUF is firmly convinced factoring is a real and concrete solution to this problem, giving businesses the necessary liquidity through the receivables assignments. But it is not recommended in the new regulation despite it being explicitly mentioned in the EU Commission consultation paper of February, and there is no reference to the unfair practices (i.e. ban of assignment) that don't favor the use of factoring.

EUF is meeting the leading industry associations (Business Europe, Eurocommerce) to find a common view on the topic and will collect the comments of the National Factoring Associations for all the necessary initiatives.

Following the announcement in the spring newsletter, I'm glad to inform you that the new Committee explicitly dedicated to the ESG aspects has been set up. The first meeting was held on 6th June, and Mr. Antoine de Chabot was appointed as Chairman on that occasion. I want to congratulate him as I'm sure he will do a great job - together with the members that will collaborate with him - in addressing the topic that is becoming increasingly relevant for the high expectations of the Regulators and the European Authorities.

In conclusion, I firmly believe factoring will continue to make its essential contribution to the real economy despite the challenging global context and the regulatory framework that, till now, has not considered its (low) real risk profile.

Best Regards,

Fausto

The Legal Committee

From Late Payments Directive to Late Payments Regulation?



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

After the somewhat surprising announcement in mid-September 2022 that the EU Late Payment Directive 2011/7/EU (in short: LPD) would be subject to review, the EUF was prepared for the review process and also provided feedback to both the call for evidence and the public consultation launched by the EU-Commission in early spring 2023. More details were already covered in the previous EUF Newsletter for spring 2023.

This September, another surprising development regarding the LPD review occurred: Although a legislative proposal to review the existing LPD was expected to be presented as part of the EU Commission's SME relief package, the EU Commission published an unexpected proposal for a regulation on combating late payment in commercial transactions (COM(2023) 533). This entails harmonizing for the very first time specific rather fundamental aspects of the various national civil laws of the EU member states, which in itself is a premiere and almost seems to disregard and overtake longstanding discussions on the idea of a unified European civil code which were voiced as early as in the late 1980s.

This September, the EU Commission published an unexpected proposal for a regulation on combating late payment in commercial transactions

Setting aside the arguably contentious choice of legislative instrument and the questions it raises regarding the incorporation of the LPR into the different national civil laws, as well as the questionable mix-up of the two different concepts of extended payment terms and late payments, the proposal for a late payments regulation (in short: LPR) presented in mid-September 2023 contains among other things a strict cap on payment periods at 30 days, only allows for procedures of acceptance or verification "where strictly necessary" and with a maximum duration of also 30 days, foresees an automatically due interest for late payments, combined with an increased interest rate and compensation for recovery costs, and stipulates that the EU member states have to designate or set up enforcement authorities to ensure LPR compliance.

According to the LPR, payment periods that exceed the foreseen time limit of 30 days are considered null and void, and since the LPD's concept of "not grossly unfair to the creditor" is not mirrored in the LPR, there are no exceptions or adaptations possible based on contractual negotiations. The EUF continues to reject such a strict cap on payment periods as imbalanced, ineffective and even counterproductive.



As for the automatically due interest for late payments, the LPR's rules raise several questions, starting with the reliable and provable starting point for the calculation of said interest and extending into whether such interest payments can be waived in, e.g. mediation or restructuring

proceedings, despite the LPR denying the creditor any such rights to waive interest.

The enforcement authorities which are to be set up by the member states also lead to questions: How will the separation of powers between the judiciary and executive powers be maintained when civil and public law elements are mixed through these enforcement authorities and their sanctions? How will economic sanctions such as fines (to be paid in addition to the late payment interest and compensation costs) increase the likelihood of prompt or on-time payments when liquidity issues often cause late payments? How can a level playing field be ensured when each member state can decide on the exact sum of a fine?

Moreover, the LPR proposal does not specifically address the issue of late payments of public authorities, although the average actual payment periods in B2G relationships are much longer and exceed the agreed payment periods much further than in B2B relationships.

The EUF is particularly disappointed that the LPR proposal does not mention measures to support and foster factoring or other forms of receivables finance, despite indications to the contrary leading up to and during the call, as mentioned earlier, for evidence and public consultation processes. In addition to the points discussed above of critique to the LPR proposal, the EUF will therefore continue to object to the introduction of maximum payment periods without any leeway whatsoever and instead advocate for more support for innovative forms of financing such as factoring that offer solutions to the late payment problem, including the introduction of limits to or even prohibitions of bans on assignments and similar contractual clauses. Currently, a new EUF position paper is being discussed in the Legal Committee and the Executive Committee, and we have reached out to other interest groups who have similar viewpoints to perhaps join efforts.

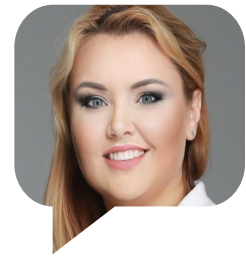
The EUF is particularly disappointed that the LPR proposal does not mention measures to support and foster factoring or other forms of receivables finance

Considering that elections for the EU Parliament are scheduled for June 2024, that the current EU Commission's term of office ends in October 2024 and that first impressions from early discussions in the Council of the EU show only slow progress so far, it is far from self-evident that this legislative process will be finalized before the EU Parliament elections. Nevertheless, the EUF will continue to treat this lobbying issue as one of its top priorities.



The Economics & Statistics Committee

IH 2023 Statistics – Continuation of an upward trend in factoring turnover



MAGDALENA
CIECHOMSKA-BARCZAK
Chair of the Economics and
Statistics Committee

Data gathered by the EU Federation for Factoring and Commercial Finance for the European factoring market for IH 2023 has shown that there was still positive growth of factoring turnover, reaching 5% y/y.

This growth is significantly lower than in IH 2022 and IH 2021 when we observed remarkable growth mainly due to economic rebound after the pandemic and uncertainty caused by the war in Ukraine. This year's statistics indicate rather normalization of the industry after two years of spectacular growth.

Total factoring turnover for European countries in the first half of 2023 reached 1 trillion 202 billion euros compared to 1 trillion 144 billion euros in IH 2022.

The GDP penetration ratio also increased y/y and reached 11,9% as of the end of June 2023, compared to 11,8% in IH 2022.

European Union countries only represented 79% of the market in IH 2023 and had 5,6% y/y growth with 13,6% GDP penetration when their country's average nominal GDP increased by 0,4%.

All EUF members and partner countries represented 95,4% of total European turnover with 5,2% of turnover growth y/y and had 13,4 % of GDP penetration and 0,4% of GDP growth.

Graph 1. Factoring Turnover by Country in H12023 (Millions of €)

30 June 2023	Notes	Total Turnover	pct var. on the previous year (Total)	GDP Penetration	European Market Share	GDP pct var. on the PY **
Austria*		18 065	3,1%	7,7%	1,5%	-0,3%
Belgium*		65 908	11,5%	23,1%	5,5%	0,9%
Bulgaria	(1)/(2)	3 250	0,0%	7,9%	0,3%	1,8%
Croatia*	(1)	692	4,9%	1,9%	0,1%	2,5%
Cyprus	(2)	1 800	0,0%	13,0%	0,1%	2,3%
Czech Rep*	(1)	5 961	-1,4%	4,0%	0,5%	-0,4%
Denmark*	(1)	10 065	-21,1%	5,4%	0,8%	1,2%
Estonia	(2)	1 950	0,0%	10,7%	0,2%	-3,0%
Finland	(2)	7 000	0,0%	5,1%	0,6%	0,4%
France*		216 737	6,5%	15,7%	18,0%	0,9%
Germany*		192 779	5,7%	9,7%	16,0%	-0,1%
Greece*		11 452	7,4%	11,5%	1,0%	2,1%

30 June 2023	Notes	Total Turnover	pct var. on the previous year (Total)	GDP Penetration	European Market Share	GDP pct var. on the PY **
Hungary	(1)/(2)	6 019	0,0%	6,7%	0,5%	-2,3%
Ireland	(2)	14 309	0,0%	5,7%	1,2%	2,8%
Italy*		141 339	1,1%	14,5%	11,8%	0,4%
Latvia	(2)	460	0,0%	2,4%	0,0%	-0,5%
Lithuania	(2)	2 750	0,0%	8,1%	0,2%	0,9%
Luxemburg	(2)	170	0,0%	0,4%	0,0%	-0,4%
Malta	(2)	348	0,0%	3,8%	0,0%	3,2%
Netherlands*		86 647	9,9%	16,9%	7,2%	-0,1%
Poland*	(1)	50 726	1,9%	14,6%	4,2%	-1,3%
Portugal*		21 624	7,8%	17,0%	1,8%	2,3%
Romania	(1)/(2)	3 924	0,0%	3,0%	0,3%	2,7%
Slovakia	(2)	1 457	0,0%	2,5%	0,1%	1,3%
Slovenia	(2)	1 095	0,0%	3,4%	0,1%	1,6%
Spain*		127 507	8,2%	18,1%	10,6%	1,8%
Sweden	(2)	10 737	0,0%	3,9%	0,9%	-0,8%
Other EU countries	(1)/(2)	55 267	0,0%	4,8%	4,6%	0,7%
EU Total Turnover	(1)/(2)	1 004 769	5,3%	12,3%	83,6%	0,5%
EU Members (*)	(1)/(3)	949 502	5,6%	13,5%	79,0%	0,4%
Norway *	(1)	13 202	1,0%	6,0%	1,1%	1,5%
Switzerland	(2)	297	0,0%	0,1%	0,0%	0,7%
United Kingdom*	(1)	183 603	3,6%	14,1%	15,3%	0,4%
European Countries	(1)/(2)	1 201 870	5,0%	11,9%	100,0%	0,5%
EU Members or Partners (*)	(1)	1 146 307	5,2%	13,4%	95,4%	0,4%

* EUF Members

** on the basis of data provided by members and/or Eurostat

Notes:

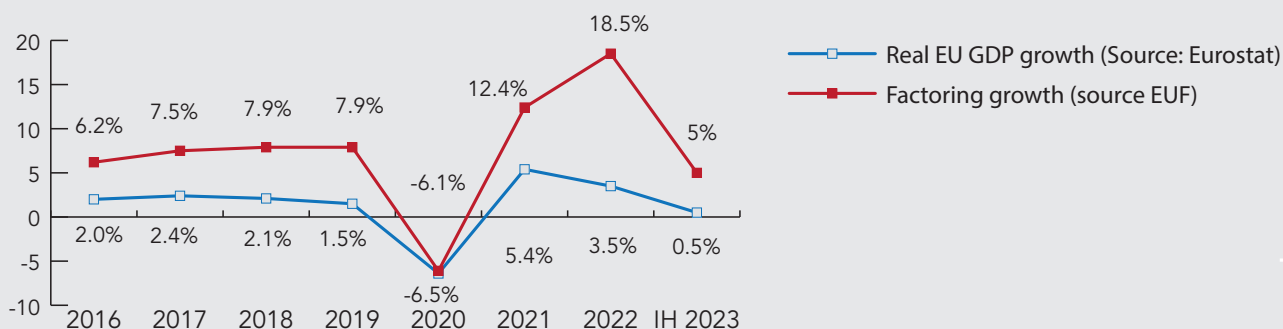
1) Pct variation has been corrected in order to avoid biases due to exchange rates fluctuation.

2) Estimates on the basis of available information

Source: EUF Members, countryeconomy.com (GDP values in current market prices)

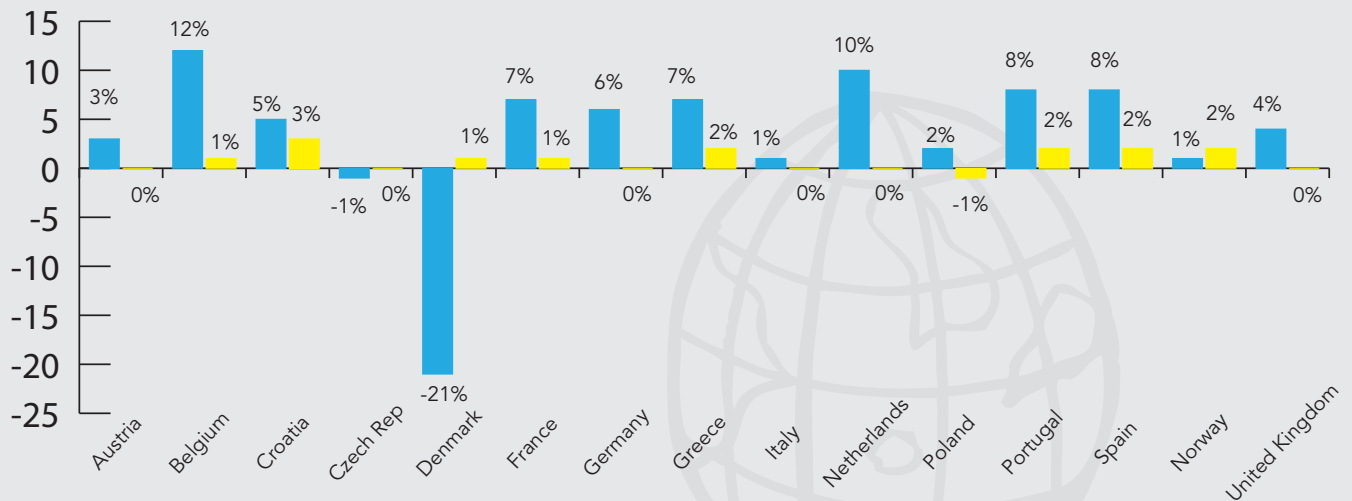
As was observed in previous years, a strong and predictable relationship between factoring turnover growth and GDP growth was still presented in IH 2023. Their correlation was positive, but factoring growth rates had changed more rapidly than GDP.

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



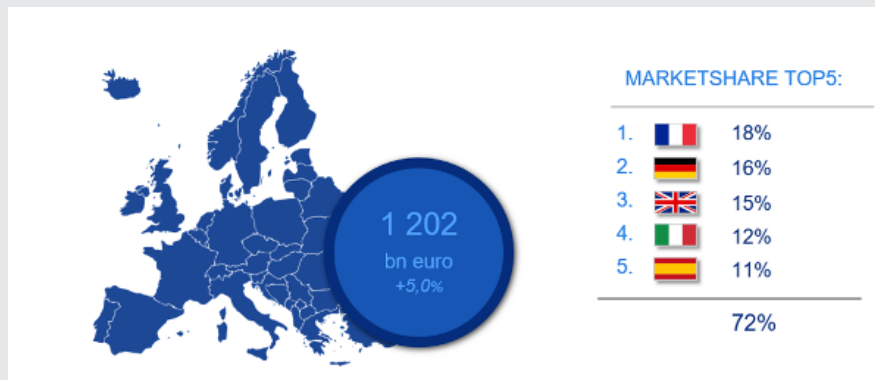
The correlation trend differed between countries. In almost all EUF members and partner countries, apart from the Czech Republic and Denmark, the factoring increase year on year was higher than the country's nominal GDP change. In the case of Denmark – a significant decrease in factoring was observed, allegedly caused by the loss of reverse factoring programs due to the late payments initiative.

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



France maintained the leader's position in the EU market in IH 2023 with 18% of the market. The next was Germany with 16% of the market share, the UK with 15%, Italy with 12% and Spain with 11%. These top 5 countries represent 72% of the EU factoring market (1% higher than the previous year).

Graph 4. Top 5 countries



In conclusion – data for IH 2023 shows a return on the standard growth path of the factoring industry after two years of outstanding growth, and it also indicates that this year should be the next year of positive growth for the factoring industry.

Due to that expected growth, there should likely be a delicate increase in the number of clients who use factoring facilities in 2023. This growth of clients should also be supported by the fear of recession, which can also cause non-recourse factoring to be the most preferred type of factoring solution, and credit risk could be slightly higher than in previous years.

The new Environnement, Social et Gouvernance (ESG) Committee



ANTOINE DE CHABOT
Chair of the ESG Committee

The new ESG Committee had its first meeting in June. Eight countries are represented: the Czech Republic, Germany, Italy, Poland, Portugal, Spain, the UK, and France.

From the very beginning, it appeared that ESG matters have become increasingly important, and the industry is in front of a double challenge: contributing to the success of sustainable ESG growth and the challenge of being able to feed the economy without regulatory impediments.

So far, a significant focus has been made on regulation monitoring; an answer has been given to a consultation, and a reflection has been started on the specificity of factoring regarding ESG.

Regulation monitoring

The scope of the regulation monitoring is broad, but the basics are :

- taxonomy (which activity is sustainable), with the question: should factoring be considered taxonomy eligible?
- CSRD (extra financial information for companies from an ESG perspective), with the question: could the alleviated reporting regime provided in the directive for credit institutions be extended to other types of factors?
- CSDD (prevention and mitigation of adverse impacts from an environment and human rights perspective of the activity of companies of a specific size), with the question: could the financial sector be set out of the scope of the directive, as it had at a time been envisaged during the legislative process?
- CRR (with the three pillars of supervisory monitoring, ranking from transparency and information to capital requirements as such).

A mention should also be made of the PCAF initiative, a partnership of financial institutions that work together to develop and implement a harmonized approach to assess and disclose the greenhouse gas emissions associated with their loans and investments. Through PCAF's work, financial institutions should be able to utilize a defined methodology to measure, better understand and manage the full impact of their business activities.

In the context of the regulation monitoring, an answer was made in October to a consultation of the Bank of International Settlements on integrating ESG risks in the set of core principles based on which supervisors set their supervision.

EU welcomed the introduction of targeted changes to explicitly reference climate-related financial risks and the inclusion of "bank business model sustainability" in the Core Principles and recalled the need to maintain a high level of innovation and a culture of entrepreneurship and free enterprise, together with the need to find fine tuning between accompanying funding of climatic transition and maintaining appropriate support to classical activities: for this reason, reporting duties for

An answer was made in October to a consultation of the Bank of International Settlements on integrating ESG risks in the set of core principles based on which supervisors set their supervision

mid-size lenders should be calibrated in a spirit of proportionality principle, without prejudice of respect of level playing field.

The Committee has stressed that ESG is sometimes unduly accused of helping institutions withdraw from the market. Besides remains the question of the correlation between E & S (a measure can be in favour of the environment while entailing some kind of prejudice for the society/economy)

For the Committee, regulation monitoring also goes with the design of best practices if/ where needed, particularly in the absence of general consent on what is correct from an ESG perspective.

General considerations on factoring and ESG

Factoring is backed by the European real economy, with room for ESG enhancements. So, from a certain point of view, one could consider that factoring does not materially finance the transition. Besides, for factors acting as subsidiaries, ESG initiatives are generally governed by the policy of the banking group to which most of them belong: it can limit the initiatives that are the sole responsibility of the factoring subsidiaries.

All the more that for an ESG appetite from the perspective of factors, there must indeed be a genuine interest to intervene: beyond instructions by the head of the group (mother bank, ...), the existence of subsidies and tax inducements or capital relief or guarantee scheme or absence of pecuniary sanctions.

Factoring is not financing an asset, as banking credit is: factoring directly financing suppliers to the real economy against their commercial invoices, providing liquidity. As factors do not finance assets, it is less easy for them to communicate their participation in green finance and, more broadly, in anything to do with ESG.

But, in any case, factors can finance the cash flow of companies involved from an ESG point of view.

How can one distinguish the specificity of factoring for ESG (Environmental, Social, and Governance) matters compared to plain vanilla credit?



Factoring as a tool for ESG identification and ESG sake?

As a product financing working capital, factoring shares common points with other classical short-term fundings (such as bank overdrafts). Nevertheless, the reflections within the ESG Committee seem to sketch specificities of factoring from an ESG perspective; beyond the politics of exclusion of factors (gambling, coal mining, etc.), there are several means to flag ESG within factoring, depending on the ESG rating of the assignor, but also on the ESG tenor of the debtor:

- for clients who are “pure players” from an ESG point of view, every product provided could have the ESG flag; if the seller is a pure player, factoring can be considered as ESG;
- for clients whose sustainability commitment is verified by factors using Key Performance Indicators (KPIs), if the seller has a sustainability strategy and commits to ESG, factoring will be ESG should KPIs be met. For that, a check by factor should be made periodically; one has to be careful KPIs are precisely matching for the sector, ambitious, and not misleading; it is still to be confirmed whether this approach would fit any type of factoring;
- lastly, an ESG flag could be set on the goods that are financed, with a check to see if the good is linked to taxonomy, with all the difficulties related to scrutiny invoice checking; support from rating agencies would be useful for that, but clarification is still necessary on methodology applicable to ESG rating agencies (the same company shouldn't be the subject to different ratings by different agencies).

In practice, concrete examples have already been given of ESG factoring, such as green reverse factoring, with invoices from assignors complying with ESG criteria and a bonification in case objectives contractually determined are reached (specific criteria, labels or sustainable development objectives).

It is evident that as an industry, factors have a hand on transactions, and this is where factoring, despite still pending questions (emphasis on assignor or debtor, possibility of application of a proportionality principle, interest of creating a label), could bring an added value in the ESG turn, with a real potential to leverage the economy in that sense.

In practice, concrete examples have already been given of ESG factoring, such as green reverse factoring, with invoices from assignors complying with ESG criteria and a bonification in case objectives contractually determined are reached



The Prudential Risk Committee

The new Late Payment Regulation: implications for credit risk



DIEGO TAVECCHIA
Chair of the PRC Committee

A proposal was issued by the European Commission on 12 September, 2023, to reform the Late Payment Directive, signaling a decisive step in combating late payments.

The proposal, hence Late Payment Regulation or LPR, entails a straightforward approach, which mainly provides for the change in the nature of the discipline from a directive into a regulation (which means that it will be directly applicable across the Member States, without the need for national implementation) and the introduction of a very strict limit to the contractual payment terms to 30 days.

Although the purpose of the LPR is commendable, the pitfalls of this approach are numerous and warrant analysis from various perspectives. One such perspective should be that of the risk manager, and I will delve into this in the following discussion.

Should the LPR succeed in altering the payment behavior of businesses and public administrations, payments will be collected within 30 days. However, this also implies that businesses must settle their debts within the same timeframe. Given that the cash-to-cash cycle of businesses rarely falls below 30 days, there's a likelihood that businesses, especially SMEs, may still face financial challenges in funding their net working capital, but with limited access to cheap sources of working capital support, such as trade debt and invoice finance, due to the constraints posed by the LPR. Therefore, they will likely need to resort to banking financial instruments, resulting in:

1. Higher costs
2. Increased difficulty in accessing credit
3. Rise in indebtedness and riskiness.

Despite the intention to safeguard SMEs, they are likely to bear the brunt of this situation as they typically possess fewer eligible assets to pledge, often relying on trade receivables as their most valuable assets. Moreover, SMEs generally have weaker financial structures and less negotiating power with banks.

Despite the intention to safeguard SMEs, they are likely to bear the brunt of this situation as they typically possess fewer eligible assets to pledge, often relying on trade receivables as their most valuable assets

Prudential risks could escalate as the impacts on businesses mentioned earlier intensify, given a scenario in which businesses adhere to the Late Payment Regulation (LPR) only on paper while continuing their existing payment practices.

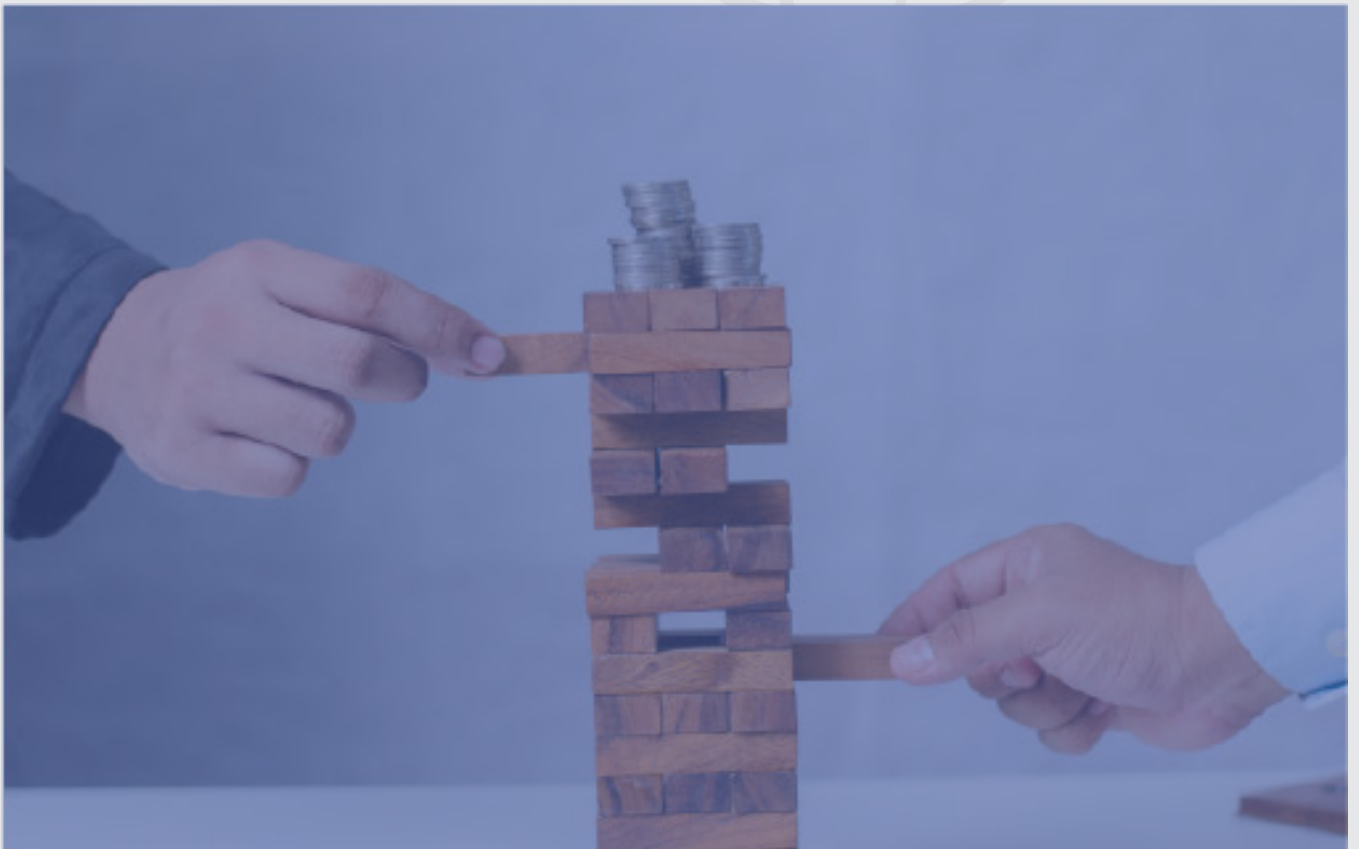
It has always been said that trade debt is not financial debt, that a delay in the payment of trade debt is not (necessarily) a sign of default risk and that the enforceability of a trade debt is conditioned not only by the expiration of the agreed due date but also by the compliance of the supply with what is stipulated in the contract. However, prudential regulations have often linked past-due invoices to default risk, a connection reinforced and narrowed by the new definition of default.

Factors across Europe are already struggling to limit the impact of the NDOD on purchased receivables in the current framework: if facial payment terms decrease from the current average

of 60-90 days to 30 days, and actual payment terms will stay the same as they are, there will be a dramatic increase in past due invoices and a huge impact on the capital requirements of the factors who in turn could, possibly, decide to withdraw the support they provide by purchasing those invoices.

The primary goal of the LPR is to support and safeguard SMEs while enhancing their liquidity through improving their Days Sales Outstanding (DSO). However, there's a substantial risk that this outcome might remain theoretical. In reality, SMEs could face unintended and adverse consequences, particularly through the potential replacement of traditional working capital support, like factoring, with unsecured bank financing. This substitution might escalate costs and debt and impede access to credit, adversely affecting liquidity and solvency. As the old adage goes, "the road to hell is paved with good intentions."

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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.



EU Federation for Factoring and Commercial Finance

A subdivision of FCI

Keizersgracht 559,
1017 DR Amsterdam
The Netherlands

Rue François Vander Elst 4,
1950 Kraainem
Belgium

Tel: +31-20-6270306

Email: info@euf.eu.com

Web: www.euf.eu.com