

CIRCOLARE TECNICA 10/23

Milano, 27 settembre 2023

OGGETTO: Definizione di default. Lettera EUF a Supervisory Board EBA

EUF, nel contesto delle proprie iniziative concernenti le linee guida sulla definizione di default (DoD) emanate dall'Autorità Bancaria Europea (EBA) ed in parallelo allo svolgimento da parte di EBA del processo di "peer review" nei confronti delle Autorità Nazionali su questa medesima tematica, ha proceduto in data 21 settembre 2023 all'invio della lettera allegata, sottoscritta dai membri dell'Executive Committee dell'EUF in rappresentanza di tutte le Associazioni nazionali aderenti e indirizzata ai membri del Supervisory Board dell'EBA.

In questa lettera, la Federazione europea del factoring ha rappresentato le problematiche legate all'applicazione della nuova definizione di default nel contesto del factoring, riaffermando le soluzioni precedentemente avanzate nei confronti dell'EBA. Parallelamente, è stata avanzata la richiesta di considerare, nel quadro delle attività condotte dall'EBA su questa tematica e con riferimento sia alle iniziative già in corso che a quelle prospettate, la necessità di intervenire sul trattamento del factoring nell'ambito della DoD.

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Cordiali saluti

 Il Segretario Generale
 Alessandro Carretta

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Kraainem, 21 September 2023

Re: New definition of default. Impact on factoring and future developments in the CRR

The EU Federation for the Factoring and Commercial Finance Industry (EUF) and the undersigned national Associations for factoring address you to express their grave concerns pertaining to the existing definition of default and its consequential impact on the factoring industry. It is our firm belief

that the current approach, as stipulated within the EBA Guidelines, is exerting significant implications on our operational framework and the wider credit ecosystem.

Remembering the importance of factoring in the EU real economy, as demonstrated by the GDP penetration, higher than 12%, with a total turnover of 2.383 billion euro (more than two-thirds of the worldwide market) in year 2022, the factoring industry has experienced a significant shift in the definition of default, particularly in relation to trade receivables. The introduction of a specific approach by the EBA for non-recourse factoring aims to standardize and streamline the processes involved in identifying non-performing past due exposures. However, despite the efforts made to incorporate certain provisions in the EBA Guidelines to address the unique characteristics of trade receivables, it is regrettable that these measures do not adequately account for the intricate nature and the complexity of the commercial relationships between suppliers and buyers that underlie receivables financing.

In numerous cases, payment delays in this context predominantly arise from organizational and operational factors rather than inherent financial difficulties faced by debtors.

This phenomenon is especially pronounced within the public administration, where payment processes are strictly regulated by law and involve inescapable procedural steps. Consequently, these procedures often lead to significant delays in invoice settlements. However, the risk of insolvency associated with such cases is virtually non-existent due to the public nature of the debtor entities. Furthermore, the internal governance of larger enterprises with established credit standing often involves similar complexities in their procurement processes, mirroring those observed within the public administration. Regrettably, it is precisely the debtors affiliated with the public administration, as well as those with excellent standing and high credit ratings, who are frequently classified as "defaults" owing to delays in commercial payments. This misclassification, in turn, may affect the overall credit exposure of entire banking groups towards these entities, engendering an inflated number of "false" defaults for perfectly solvent debtors triggered by unfortunate late payments of their payables but without any actual deterioration in creditworthiness, negatively impacting the risk sensitivity of prudential regulations.

While we understand that late payments in trade relationships are not desirable and we acknowledge the efforts undertaken by the EU to address the issue, especially with the Late Payment Directive, it is imperative to underline that this situation has significant repercussions across multiple fronts, posing a series of challenges that demand immediate attention:

1. Unnecessarily inflated capital requirements for factoring entities and, for listed banks and intermediaries, a misrepresented portfolio quality, misleading the market perceptions about the actual creditworthiness of their exposures.
2. Potential adverse selection phenomena, whereby factoring entities may be compelled to reject debtors with superior credit profiles to safeguard the overall position of their respective banking groups to that business. Consequently, this might compromise the overall quality of the credit portfolios of factoring companies and lead to a situation diametrically opposed to the desired outcome of reducing risks and inconsistent with sound and prudent management.

3. Greater difficulty in providing access to finance to small and medium-sized enterprises (SMEs) possessing customer portfolios of excellent quality, which are the very entities that could significantly benefit from factoring services.
4. Potential reputational risks for customers improperly reported as insolvent in Anacredit or in national registers and reporting regimes not for overdue financial debts but for commercial payables (in which the payment authorization process takes longer for the numerous checks required).
5. Unlevel playing field, where the same obligor may be deemed in default by institutions using the standardized approach, while being considered as performing by other institutions adopting internal rating models, all other factors being equal.

We would like to underline that the aforementioned issues concern all Countries within the European Union and are not connected to the specific situations of certain Countries regarding late payments in commercial transactions.

As a reminder, we sent to the EBA in December 2020 the results of a quick survey conducted by EUF on the impact of the NDOD on factoring in some EU countries. The impact survey led to the following results, with the first figures referring to the market share covered and the second to the % of new default in the private sector with the NDoD:

- Germany: 15 % of market share, 28 % of new private defaults
- Spain: 61 %, 10 %
- Portugal: 32 %, 20 %
- Italy: 63 %, 25 %
- Poland: 53 %, 6 %

Besides, one French factor sent to the EBA a letter dated 10 November 2021 which notably emphasized material incidence of NDOD on debtors in non-recourse factoring, with more than 3500 debtors in default, reporting 40% of the financial outstanding, with contagion effect at Group level.

To avoid the consequences outlined above, factoring operators have significantly increased the promptness of contact actions with counterparties and, if necessary, credit recovery efforts since the implementation of the new definition of default. However, this has resulted in disproportionate operational efforts compared to the actual credit situation of the debtor, causing inconvenience to both the assignor and the assigned debtor who are operating within their normal commercial activities. In the case of the public administration, there has been an increase in the rejection of assignments by debtor entities (in the jurisdictions where this is possible), contributing to a significant decline in turnover (e.g. in Italy, 8 billion euros less since the entry into force of the Guidelines, equivalent to a 30% contraction), to the detriment of their suppliers.

Considering these challenges, we believe it is imperative to identify appropriate remedies within the primary or secondary regulatory framework governing the definition of default. Over the last years, the EUF, in collaboration with its members, has meticulously explored potential solutions that have already

been widely discussed with the EBA, among which, particularly, it wishes to highlight the following ones:

- a) to increase the threshold for technical past due days provided for factoring from the current 30 days to 90 days, allowing for a more realistic assessment of credit quality.
- b) to extend the applicability of the default definition at the level of individual facility, currently possible only utilizing the AIRB model, to purchased trade receivables, enabling a fair evaluation of the creditworthiness of the debtors.

By implementing these proposed adjustments, which would have a minimal impact on the overall approach set by the EBA, we believe it would be possible to mitigate many of the adverse consequences stemming from the current default definition. These adjustments would indeed facilitate a more precise reflection of the creditworthiness of the account debtors, while concurrently upholding the required prudential standards.

In the meantime, the EUF has actively engaged in formulating proposals within the ongoing process of revising the Capital Requirements Regulation (CRR), which will culminate in the comprehensive implementation of the Basel III agreement.

Specifically, regarding the matter of the definition of default, both the Council's compromise text and that of the European Parliament incorporate amendments that call for EBA to introduce enhanced flexibility in its Guidelines, in particular concerning restructured credits. Although factoring is not explicitly mentioned in the text, the wording does not exclude the possibility of updates of the Guidelines in other areas.

The EUF supports the inclusion of such amendments in the CRR and believes that this could be an opportunity for the EBA and the European institutions, in collaboration with the industry, to review the rules applicable to factoring regarding the definition of default, improve risk sensitivity in the regulatory framework, and avoid the aforementioned adverse effects.

Last point, we have recently been informed that the NDOD is due to be re-discussed in Q3 2023 by the EBA as part of a peer review on the consistency of the application by national supervisors of the Guidelines relating to the treatment of defaults. May be this exercise could be another opportunity to examine the case of NDOD for factoring.

We understand the complexity of these matters and the need for careful assessment. The EUF and the undersigning national Associations stand ready to engage in further dialogue and provide any additional insights, data, examples or information that may assist in finding a mutually beneficial resolution.

With gratitude for your invaluable attention, we eagerly await your feedback and guidance on this pressing matter.

Sincerely,

Fausto Galmarini
Chairman of the EUF



Magdalena Wessel
Vice-Chair of the EUF



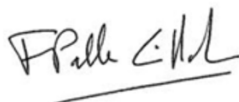
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Associação Portuguesa de Leasing, Factoring e Renting (ALF)	Portugal
Association Française des Sociétés Financières (ASF)	France
Association Professionnelle Belge des Sociétés de Factoring (APBF- BBF)	Belgium
Associazione Italiana per il Factoring (ASSIFACT)	Italy
Croatian Chamber of Economy	Croatia
Czech Leasing and Finance Association (CLFA)	Czech Republic
Deutscher Factoring-Verband (DFV)	Germany
Factoring & Asset based financing Association Netherlands (FAAN)	Netherlands
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