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DEUTSCHER FACTORING VERBAND E.V.

Secretariat of the Financial Stability Board
c/o Bank for International Settlements
CH-4002 Basel
Switzerland
via E-Mail to: fsb@bis.org

Berlin, the 14th of January 2013

*Public Consultation: Comments on Initial Integrated Set of Recommendations to Strengthen Oversight and Regulation of Shadow Banking (documents dated 18th of November 2012)*

Dear Madam or Sir,

As representatives of the German factoring industry, we thank you for giving us the opportunity to present our **comments and viewpoints on the FSB's consultative documents published on the 18th of November 2012 under the title of „Initial Set of Recommendations to Strengthen Oversight and Regulation of Shadow Banking"**. Although factoring is not mentioned explicitly in these consultative documents, the FSB's Global Shadow Banking Monitoring Report 2012 mentions factoring companies as an example of "*non-bank financial entities*" and "*finance companies*", thus suggesting that the FSB considers factoring companies as part of shadow banking. Finance companies, in turn, are mentioned in the aforementioned consultative documents. Therefore, we would like to provide you with **some information on and viewpoints from the German factoring industry**.

Our association currently **represents 24 German factoring companies**, the **large majority** of which are **classified as financial services institutions** ("Finanzdienstleistungsinstitute") according to the German Banking Act ("Kreditwesengesetz"), while **nearly a third** of our members have a banking license and are therefore **classified and regulated as banks**. Therefore, **all our members as well as over 180 other factoring companies are subject to strict supervision and regulation by the German financial supervisory authority BaFin** (Bundesanstalt für Finanzdienstleistungsaufsicht) **and should therefore not be classified as part of the shadow banking industry**. Moreover, out of the large majority of our members which are considered to be financial services institutions, **more than 60% are part of a consolidated banking group**.

All in all, 208 factoring companies are currently registered with and supervised by the supervisory authority BaFin (cf. BaFin's list of finance leasing and factoring companies http://www.bafin.de/SharedDocs/Downloads/DE/Liste/Unternehmensdatenbank/dl_li_fidi_leas_fac.html?nn=2814084).

In 2011, the members of our association attained a **total factoring turnover (i.e. the volume of receivables offered for sale) of more than 157 billion Euro**, which corresponds to approximately 90% of the German factoring market. Due to the short average collection period of 40.7 days (2011), this results in

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permanent accounts receivables and financing needs of less than 10% of the total factoring turnover. More than 50% of our members reached turnovers of under or just over 1 billion Euro. A more detailed examination of the turnover volumes' distribution shows that the financial service of **factoring plays an increasingly important part in financing SMEs.** This is because factoring has proven to be an attractive and (by some 14,600 clients) much appreciated alternative to the classical form of credit financing, in particular during times of financial crises.

As stated in the consultative document "An Integrated Overview of Policy Recommendations" (hereafter: Overview), **finance companies, and thereby apparently also factoring companies** (cf. the aforementioned Global Shadow Banking Monitoring Report 2012), **are encompassed by the works of the FSB's third workstream (WS3)** to examine the systemic risks posed by non-bank financial entities and to develop adequate policy recommendations. The same applies to the consultative document "A Policy Framework for Strengthening Oversight and Regulation of Shadow Banking Entities" (hereafter: Framework), which mentions finance companies in the context of loan provision outside the banking system, with a special focus on loan provision that is dependent on short-term funding. Judging from the FSB's definition of finance companies, factoring companies may well also be included in the scope of application of the Framework. **We would like to explain why, on the one hand, factoring should not be considered as part of shadow banking and that, on the other hand, the factoring industry poses no systemic risk as it merely concerns the purchase of (trade) receivables**. Considering the (generally commendable) five general principles for regulatory measures as stated in chapter 1.2 of the Overview and focusing particularly on the principle of proportionality, **further regulation and supervision of the factoring industry is unnecessary**.

In order for you to understand our objections better, we would like to **explain the factoring business in Germany more in detail**: In factoring, a business continuously sells its receivables, which are based on the delivery of goods and services to customers, to a factoring company. Thus, the business receives liquidity directly from its accounts receivables. The factoring company examines the creditworthiness of the business' customers, i.e. the debtors, both prior to the conclusion of a contract as well as continuously. Also, the factoring company assumes the non-payment or default risk. **In Germany, factoring without recourse prevails**, which means that the factoring company takes on the default risk regarding the debtor and thereby grants the assignor/factoring client full delcredere-risk protection. This form of financing adapts virtually automatically to the factoring client's growing turnovers which is why factoring is considered a "turnover-congruent form of financing". The form of **inhouse factoring** represents approximately 77% of the total factoring turnover in Germany while approximately 19% are allotted to **full service factoring**. In the case of full service factoring, the factoring company not only incurs the turnover-congruent financing and the complete default risk protection, but also takes on the debt/debtor management. In contrast, with inhouse factoring, the debt/debtor management remains with the factoring client (on a fiduciary basis) while the factoring company is entrusted with financing and risk protection.

From an economic-scientific viewpoint, the **definition of the shadow banking system is inaccurate and requires clarification**: The exact meaning of "*credit intermediation involving entities and activities (fully or partially) outside the regular banking system*" (cf. p. 1 of the Overview and p. ii of the Framework) is unclear. As we already explained, factoring companies in Germany are either classified as banks and have the corresponding license, or they are part of a consolidated banking group, or they are financial service institutions and use banks for refinancing purposes. Therefore, **German factoring companies do not operate "*outside the regular banking system*"**. Insofar as the concept of "*entities and activities (fully or partially) outside the regular banking system*" refers to companies which are not subject to financial supervision or regulation, this does not apply to German factoring companies, either: **German factoring companies are already classified as financial service institutions or banks and are according-**

ly regulated and supervised by the German Banking Act and the supervisory authority BaFin (cf. § 1 para. 1a nr. 9 and § 32 of the German Banking Act KWG).

Moreover, the apparent inclusion of factoring companies under the term finance companies and thus under the aforementioned definition of the shadow banking system is inaccurate: Despite the facts that factoring is a form of financing and that factoring companies provide their customers with liquidity and default risk protection in return for the sale and assignment of receivables, factoring is equal neither to providing loans nor to granting credits or credit guarantees. Factoring is rather the mere purchase of (trade) receivables. In order to create a clear and unambiguous scope of application for future provisions on shadow banking, the definition of the shadow banking system and the areas and business models related to it should be amended by clearly stating that factoring companies are not part of the shadow banking system.

The advantages and risks attributed to the shadow banking system in the FSB's consultative documents (cf. p. I of the Overview and of the Framework as well as p. 1 ff. of the Overview) support the need for such a clarifying amendment with regard to factoring: Factoring provides several of the advantages, but none of the risks which are mentioned by the FSB apply to the factoring industry. Over the last 50 years, factoring has established itself in Germany as an alternative form of financing, particularly for SMEs and during times of crisis. Furthermore, some factoring companies have specialized in certain industries or sectors. Accordingly, many factoring companies offer adapted financial services to small and micro-segments, without being systemically relevant. Typical key industries are trade, trade negotiation and services, specific examples include factoring of B2C-receivables of dentists, undertakers and legal or tax counselors as well as factoring of B2B-receivables from construction companies and traders in B2C-online shops. The assessment that finance companies, despite playing an important role, do not give cause for "*serious concern from a systemic point of view*" (as stated on p.27 of the FSB's Global Shadow Banking Monitoring Report 2012) can also be applied to factoring companies: Notwithstanding the aforementioned statistical data about the German factoring industry and its significant role especially for SMEs, the relative size of the factoring industry proves that the sector is not systemically important.

In contrast to these advantages, none of the risks mentioned in the aforementioned FSB's consultative documents apply to the factoring industry: In the absence of financing structures that are comparable to taking deposits or have deposit-like characteristics, "runs" as well as massive redemptions and a build-up of high, hidden leverage cannot occur in the factoring industry, because the purchase of the receivable is always to be seen alongside the provision of liquidity in form of the purchase price for the receivable (cf. the article of Prof. Dr. Thomas Hartmann-Wendels from the University of Cologne in FLF 3/2008, pp. 116 ff.). Thereby, collateral funding will not be churned several times.

Also, factoring cannot be used for regulatory arbitrage – improving the liquidity situation, offering protection against the default or delcredere risk and the clear and permanent relief for the factoring client's balance sheet is not to be considered as bypassing rules on e.g. equity/own funds or accounting.

Furthermore, there is no risk of disorderly failures of factoring companies affecting the banking or financial system: In the very rare event of a factoring company's insolvency, the immediate effects are felt by the factoring clients and not by banks or financial services institutions. Experience from the few insolvencies of factoring companies which occurred over the last decades shows that other factoring companies are able to fill the emerging gap speedily and in an uncomplicated way by offering continued financing through factoring to the large majority of factoring clients affected by the insolvency. Hence, the risks stated in the FSB's consultative documents related to a "*contagion risk*", a "*spill-over effect between the regular banking system and the shadow banking system*" or to the "*interconnected-*

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*ness between banks and non-bank financial entities*" (cf. p. 1 ff. of the Overview) do not apply to the factoring industry.

Due to the aforementioned arguments, in particular the already existent supervision, the definition of the shadow banking system should be amended so as to clearly state that factoring does not form part of the shadow banking system. Moreover, more attention should be paid to the fact that the factoring industry entails none of the risks generally attributed to the shadow banking system and that it is of no systemic relevance.

Please do not hesitate to contact us should you have questions or require more information about the German factoring industry.

With kind regards
Deutscher Factoring-Verband e.V.

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