Impact of EBA´s new Definition of Default in Factoring. How Distribution Financing can help.

The European Banking Authority (EBA) has established tougher standards for the Definition of Default (DoD) that banks in the EU had to implement as of the 1st of January 2021. These are covered in the Article 178 of the Capital Requirements Regulation.

The new DoD significantly affects one banking product in particular: Factoring without recourse. There was a change in the past due calculation causing that an increased number of credit obligations must be categorized by banks as default. In turn, this produces higher capital requirements for the banks providing this type of facilities.

Without going into technical details, the new DoD framework dramatically changes the counting of days past due. The new approach heavily penalizes debtors that show a repeated delay in payment of different credit obligations, considering small but superimposed delays in the same way as a consecutive delay in the payment. Purchased receivables are normally subject to delays due to the specific nature of trade receivables. One of the main sources of delays is the formal procedures particularly among the most complex buyers, which have to carry out numerous controls on the invoice before approving the payment. At this point, it is evident that the DoD penalizes the larger most creditworthy debtors the most! The situation is worsened by the fact that the bank's default might involve the total exposure to the debtor of the whole banking group, enlarging the extent of the issue.

Now, this is why we think that Distribution Financing (DF) can be of assistance:

- DF is another type of receivables financing that is similar to Factoring, in that it allows the seller (vendor) to collect earlier and reduce DSO[1], but with the key distinction that it also allows the buyers to obtain an extension of payment terms. This generates a win-win situation for vendor and buyers.

[1] Days of Sales Outstanding

- Having more days before invoices are due, will give buyers more time to run the control procedures and hence, reduce the occurrence of late payments. This will be beneficial for banks, as it will reduce the occurrence of default cases.
- Banks in Europe being affected by this new regulation, should consider shifting their Factoring arrangements to Distribution Financing programs that are more convenient for all parties involved.

Alternative Distribution Finance Ltd. (ADF), is an alternative financing entity that aggregates liquidity from institutional investors and banks, and fronts the financing of receivables and payables based programs for companies worldwide. ADF is part of the GSCF Group that specializes in Distribution Financing and has successful experience in structuring and managing such programs in collaboration with funding partners and credit insurers. ADF programs are serviced by Global Supply Chain Finance Ltd. (GSCF), the world's leading processing technology within the Supply Chain Finance market.