

Late Payment Regulation – Febelfin Position

The Belgian financial industry welcomes the Late Payment Regulation and supports the goal of the Commission to combat late payments but has, in this respect, some practical remarks concerning the financing of corporates in the EU. The industry strives for a clear distinction between late payments (=“overdue” payments) and deferred payments (=“long” payments). While late payments have many negative repercussions, deferred payments are for many industry players, a desired, in some cases required, flexibility. Giving smaller market participants more power to effectively enforce contractual payment terms and reclaim associated costs is positive but taking away all forms of flexibility would have many unintended effects.

Febelfin believes the EU needs to achieve 3 goals

- Protect contractual freedom
- Support adequate financing opportunities for EU corporates
- Allow for effortless (international) trade

In subject position paper, we highlight the effects of a cap of 30 days on all payment terms and the effects of this cap on the access to finance for businesses.

Protecting contractual freedom

The assumption that payment terms are solely based on market power is incorrect. In trade relations, there is a close relation between on the one hand the tenor of supplier’s credit and on the other hand, the nature (lifetime) of the underlying goods, the type of business, and the length of the underlying supply chain. The economic realities contradict a “one size fits all” approach. Let’s take the example of a starting fashion store, if the Commission’s proposal would be approved, the store will get a maximum 30-day credit from its supplier, while it may take many months to sell the collection. They will require other sources of finance. Well-capitalized corporate clients won’t face any difficulty in attracting other sources of financing, but for growing SME’s, this is more of a challenge.

Applying a “one-size-fits-all” payment term of 30 days does not necessarily mean this will and/or can be respected by buyers. Overdue invoices will increase the collection workload as well as the non-payment risk for the factoring companies. The EU nor banks are well placed to intervene drastically in market customs, mechanisms and trade practices that have evolved over time and which take into account the economic specificities of each type of business and the unique character of each buyer/seller relationship. This proposal has many unintended consequences.

Eliminating the possibility for economic actors to find tailor-made solutions undermines the entrepreneurial character of European business. This does however not mean Febelfin and its members are oblivious to the existence of unfair payment practices. In cases where there is a misuse of market power, authorities should enforce fair and even competition rules. Creditors should be empowered to claim interests in cases where contractual agreements are not respected.

Supporting adequate financing for businesses

If the proposal would be approved, banks will have to substitute for a big chunk of current supplier's credit. It is at present difficult to estimate the amounts of capital that will be required but moving from supplier's credit and factoring to bank lending is not very evident, nor always opportune. Businesses have a substantial amount of short term commercial debts that mature on a period longer than one month, a large part of which is financed by allowing for deferred payments. On suppliers side, this debt can be sold through factoring. Switching to the situation as proposed by the commission would limit the possibilities for factoring and push companies towards other forms of financing.

The extent of the impact varies greatly across sectors and even individual companies. From a buyer's perspective, for solvent corporates this will not be a big issue but the reality is that particularly starting SME's aren't financially strong. Banks must rely on balance sheets (which specially for SME are not always reliable and up to date) while a supplier has a better sight on the flow of the goods sold and on the capabilities of its off-taker to run its business successfully.

From a supplier's perspective, cash-rich businesses will no longer be able to leverage their competitive advantage, which will be disadvantageous for buyers. Suppliers can insure their credit risks on the private or public insurance market, which banks cannot. Furthermore, trade credit insurance companies will need to review their position as payment risks, collection efforts, payment incidents will most likely rise. This will impact the creditworthiness evaluations of companies (SME's) and likely reduce the access to working capital financing.

It is not entirely clear whether the regulation applies to credit agreements granted by banks. We assume that this is not the intention, also in view of Article 3, which refers to "commercial transactions" and "invoice". However, no explicit exception is provided. It should not be the intention of the regulation to regulate payment periods for loans and to impose a certain penalty in the event of non-payment. Banks are often open to negotiate tailor-made solutions for commercial clients, or even provide for industry-wide allowances for deferrals. This was the case during the COVID-19 pandemic where banks provided for a moratorium system for business loans.

Furthermore, it is important to note that banks have to keep defaulted payments in account when performing a risk assessment on a corporate client. This means that if a business doesn't make a payment within the strict 30-day limit, it will have a detrimental effect on its risk classification and thus future ability to access financing, even when fundamentally, there is no issue of creditworthiness.

Effortless (international) trade

The proposal would mean a loss of competitiveness for EU businesses. Their non-EU counterparts will be able to offer more attractive payment terms, while EU businesses are bound to a hard limit. The commission estimates the impact on competitiveness to be limited as some other countries¹ also have legislation on late payments. However, in the Commission's own impact assessment (annex 18), it is clear that the legislation in these countries allows for much more flexibility and longer payment periods. The lack of a serious estimation of the effects on EU competitiveness and the knowledge that other jurisdictions allow for greater flexibility show that the EU needs this as well. A very static and limited system of national derogations does not solve the issue of intra-EU fragmentation which the regulation was supposed to resolve in the first place.

The 30 day payment period for commercial transactions would start from "delivery". This doesn't take into account that most import is done on basis of the Incoterm FOB (Free on Board). In this Incoterm the "delivery" takes place when the goods are loaded on board. It can take weeks before these goods arrive at the premises of the buyer which implies that in practice these 30 days are much shorter or even negative! The same goes for CFR/CIF deliveries, where delivery (passing of liabilities from seller to buyer) occurs in the port of departure. Additionally, there is insufficient consideration given to other specificities, such as the approval procedures for medicine, perishable goods, food, etc by health authorities and the like.

The regulation should contain provisions to have an EU-wide clear ban on anti-assignment clauses, promoting the discounting of receivables is the best way to prevent late payments. At least the regulation should contain an exception to the 30 days for receivables discounted to or purchased by a financial institution (as it enables the supplier to get immediate payment, while still having granted more extensive payment terms to an importer). Such financing techniques allow SME's and Corporates alike to either profit from, or offer themselves, deferred payment terms (also beyond a 30 days limit) as appropriately required under common commercial circumstances. Moreover, this will result in an optimized balance sheet for all commercial parties in a transaction. Consequently, payment terms in itself are then becoming less of an issue, whereby the involved industries can continue to play adequately and efficiently their economic role as intended in a highly competitive globalized world.

¹ Canada, the US, Turkey, and the UK