



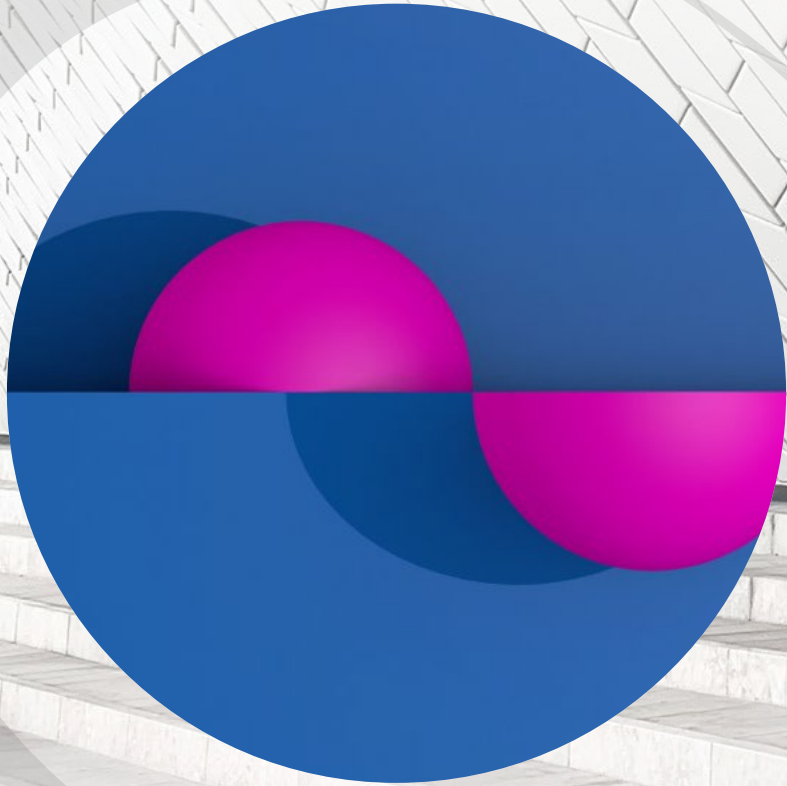
DISPUTES & FRAUDS IN FACTORING & RECEIVABLES FINANCE

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DISPUTES



DISPUTES

What is a Dispute ?

“Difference of opinion”

“A dispute occurs whenever a debtor fails to accept the goods or the invoice or raises a defence, counterclaim or set-off including (but not limited to) any defence arising from a claim to the proceeds of the receivable by any third party.”

FCI GRIF Article 27 (i)

Types of a Dispute

- uncontested
- contested
- fake

WHAT ARE THE CAUSES OF DISPUTES

Buyer Conditions – Purchase Contract

- Penalties for late delivery and right to cancel
- Passing of risk
- Prohibition of assignment
- Third party liability and consequential loss
- Product warranty
- Payment terms
- Discounts – Retrospective Discounts
- Governing law of bilateral agreement

WHAT ARE THE CAUSES OF DISPUTES

How good is the seller's invoice?

- ✓ Are the prices correct ?
- ✓ Are the buyer's **name** and address accurate ?
- ✓ Are the payment terms correct or be misinterpreted?
- ✓ Is the invoice date correct?

WHAT ARE THE CAUSES OF DISPUTES

Disputes arising from the Factoring Process

- Lack of introductory letter
- Wrong or no assignment notice on the invoices
- Indirect payments
- Unallocated cash

WHAT ARE THE CAUSES OF DISPUTES

Industries with high dispute potential

- ❖ Perishable goods
- ❖ High fashion goods
- ❖ Goods with long term warranty
- ❖ Mail order or Catalogue Retailers
- ❖ Internet sales

Other Issues

- ❖ Quality of the goods
- ❖ Seasonal goods

HOW TO AVOID DISPUTES?

“Select the right seller before the contract is signed.”

The Factor must look for.....

Credit notes	Late payments	Partial payments
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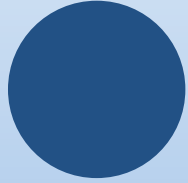
which were caused by.....

Rejected Products	Incorrect Invoices	Late Deliveries	Failure to meet contract conditions	Set-Offs from accounts payable
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as a result of

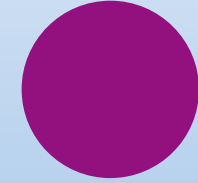
Poor quality products	Poor administration	Conditions of contract of sale	Contra trading
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DISPUTE HANDLING



HOW TO REDUCE THE IMPACT OF DISPUTES

- ✓ Speed
- ✓ Information
- ✓ Invoice verification
- ✓ Early collection procedure



SETTLEMENT OF DISPUTES

- ✓ Uncontested disputes
- ✓ Contested disputes
 - ✓ Amicable settlement
 - ✓ Independent inspectors
 - ✓ Arbitration
 - ✓ Legal Action

THE FCI DISPUTE PROCEDURE

- **GRIF Article 27**
- **Notification of disputes**
- **The EF's responsibility in the settlement**
- **The obligation of the IF**

BIG BAD BUYERS

Automotive parts manufacturer in the UK

- Supplied mainly domestic clients, extended to a well-established international car manufacturer
- Direct export factoring business
- Supplier could not submit copy of the contract
- Invoice payments were delayed, initially justified from business practise but factor was worried
- Seller later disclosed that delays were due to a major dispute, after factors insistence
- Buyer claimed dispute and deducted and stopped payments, including old invoices, cooperation ended.

Lessons

- Factor accepted very easy the non-existence of a contract, quite strange for an international car manufacturer
- Seller could not meet the technical requirements of the specific part (suspension system), performance risk
- Poor due diligence and seller assessment by the factor, delayed reaction

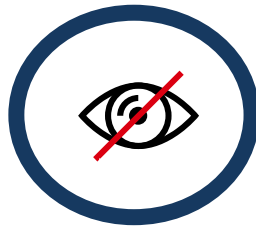
FRAUDS



BE POSITIVE, BUT NEVER COMPLACENT



Fraud is an ever present threat



Fraud is going undetected at this point in time



Material fraud against banks revealed in commodity sector

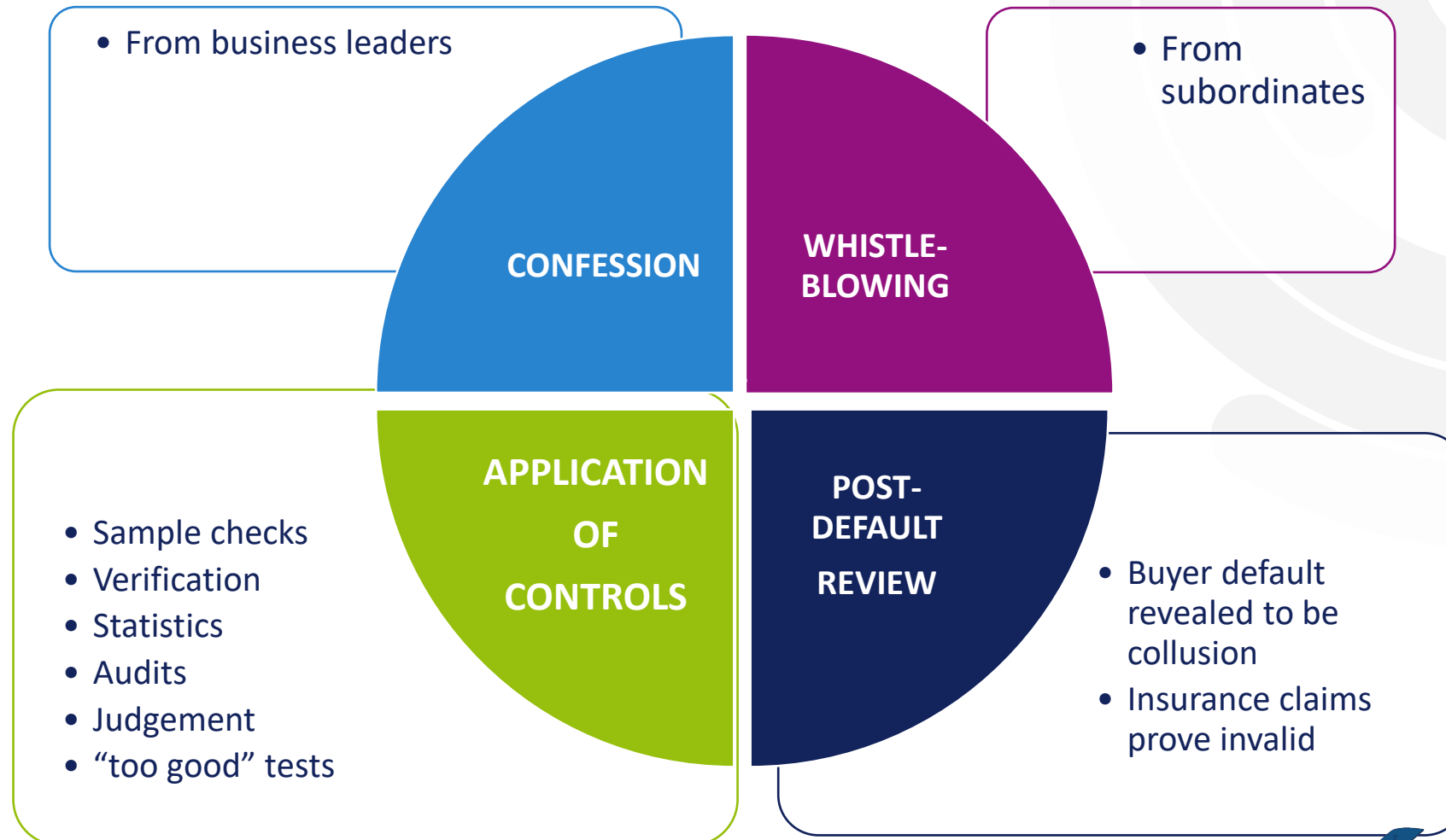


Properly structured RF is proving resilient

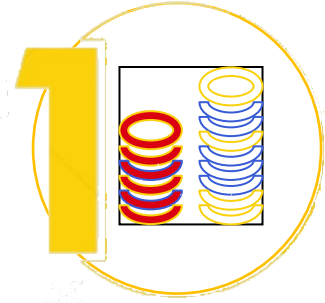


- Set the “tone from the top”
- Coach the skills to prevent fraud and manage recovery
- Complement (and not just invest in) technology

HOW TO DETECT FRAUD



COMMON TYPES OF FRAUD



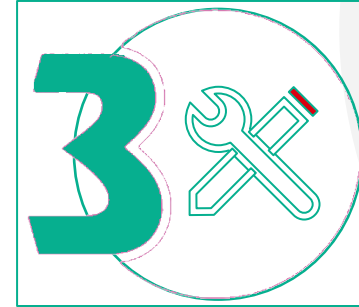
Diversions of cash

- Depositing buyer cash into an account other than the factor's
- Delaying transfer of funds to the factor, where cash dominion is with the customer
- Re-cycling to appear as buyer payments



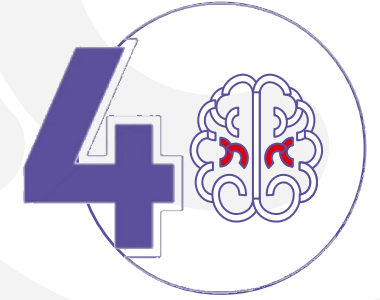
Fraudulent notification

- Pre-billed and pre-assigned invoices
- Overstated invoices
- Fake invoices or fake buyers for products / services never shipped / rendered



Manipulation of reporting

- Due dates artificially extended to overstate eligible debts
- Applying credits and payments to the oldest invoice first



Understating liabilities

- Hide contras by using different names on sales and bought ledgers
- Overstate eligible debts and reduce dilution by not notifying credit notes
- Hide related party transactions

EARLY WARNING SIGNS

Financial



- Covenant breaches
- Other bank facilities at limits
- Frequent requests for 'over-payments'
- Increasing stock turn
- Increasing debt turn
- 'Window dressing'
- Direct payments
- **Previously factored**
- Undisclosed interest

Relationships



- Regular breaching of procedures
- 'Errors' in operational procedures
- **Unwillingness to provide supporting information**
- Recurrent operational problems in customer's business
- **Cancelled or postponed visits inc. Audits**
- Complex Group structures
- Non-resident directors
- Domineering owner

Information



- Unpredictable
- **Insufficient**
- **Not in line with covenanted requirement**
- Inaccessible - particularly financial / control
- Frequently estimated figures
- Full cross guarantees not available
- Un-reconciled accounts

Business Structure



- **Weak management structures and expertise**
- Poorly resourced, and/or inefficient resources
- Heavy reliability on product and/or service
- Poor administration
- Little or no internal segregation of duties
- **Cross border transactions**
- Limited industry experience
- Short and changing terms

PREVENTATIVE TOOLS



Statistical

- Debt turn
- Dilution- credits issued before invoice due date
- Funds utilisation
- Historical comparison
- Market norm comparison
- Special care with concentrated buyers



CAUTION: 'JAWS'- sales accelerating and cash lagging



Verification / validation

- Legitimate receivables
- Appropriate documentary evidence
- Genuine set of independent buyers
- Absence of 'offsets'
- Diligent care in documentary and receivables verifications



CAUTION: Scanned documents can be tampered with



Financial appraisal

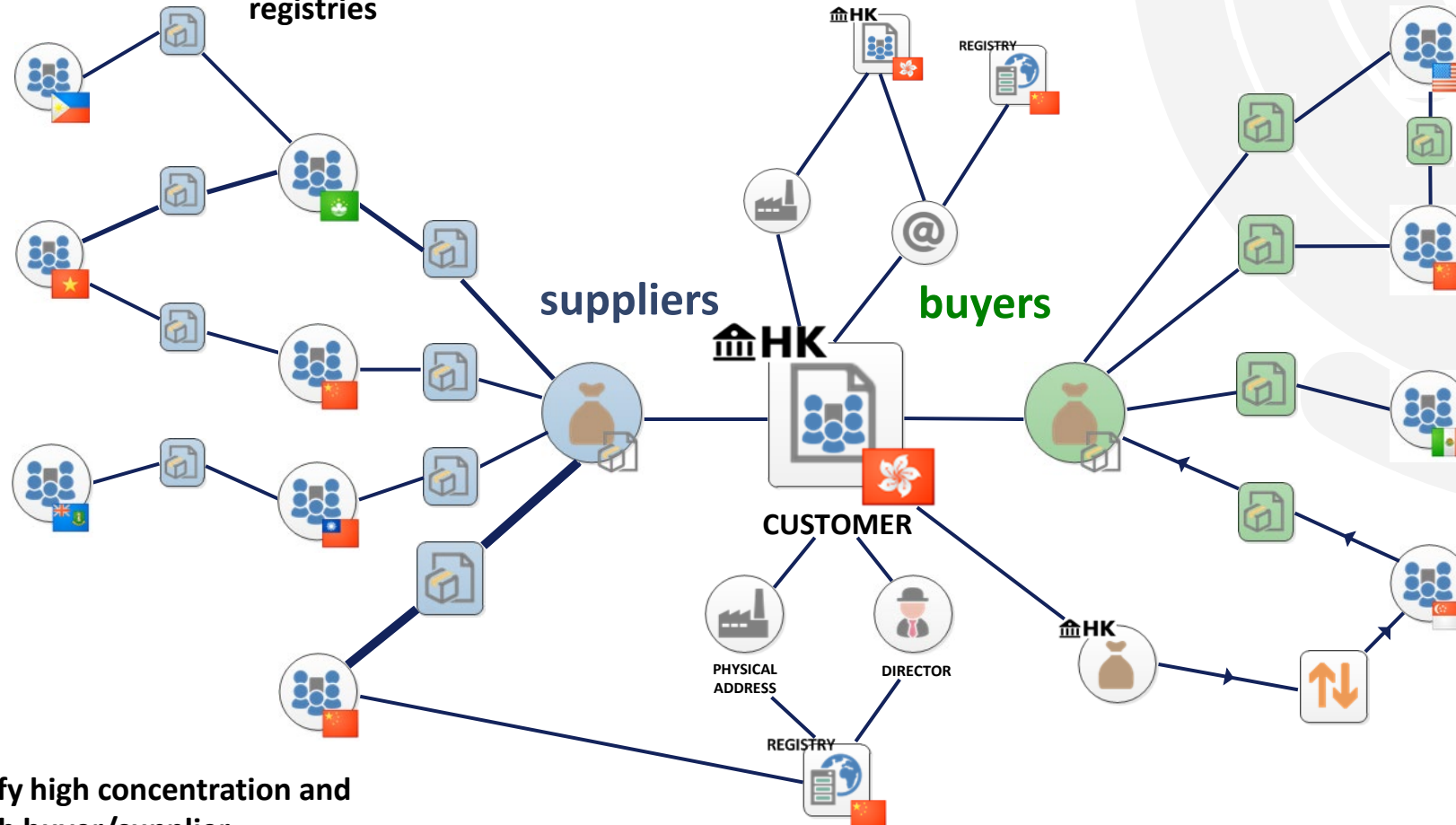
- Formal review of accounting information
- Testing against statistics
- Understanding cash requirements and cash cycle of the customer's
- Fluid communication with the RM and/or other product teams



CAUTION: Third party evidence can be subject to collusion

MITIGATION: CUSTOMER SURVEILLANCE

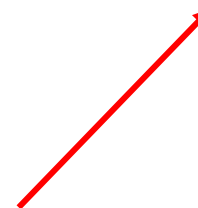
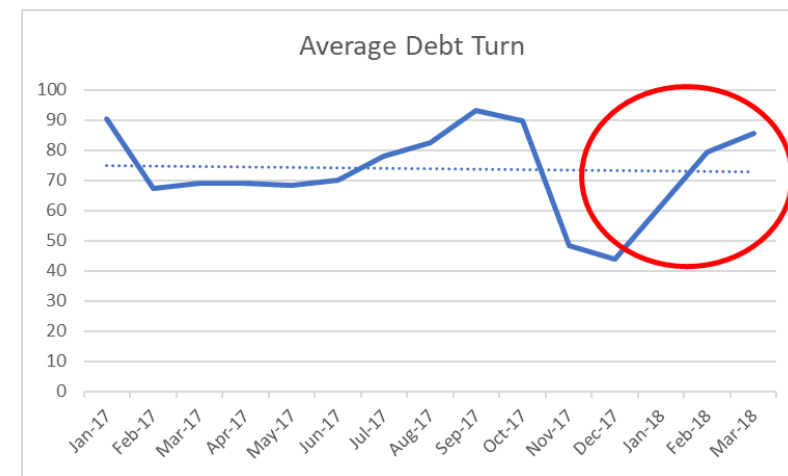
1. Understand social linkages to other customers by networking the bank's internal data or external registries



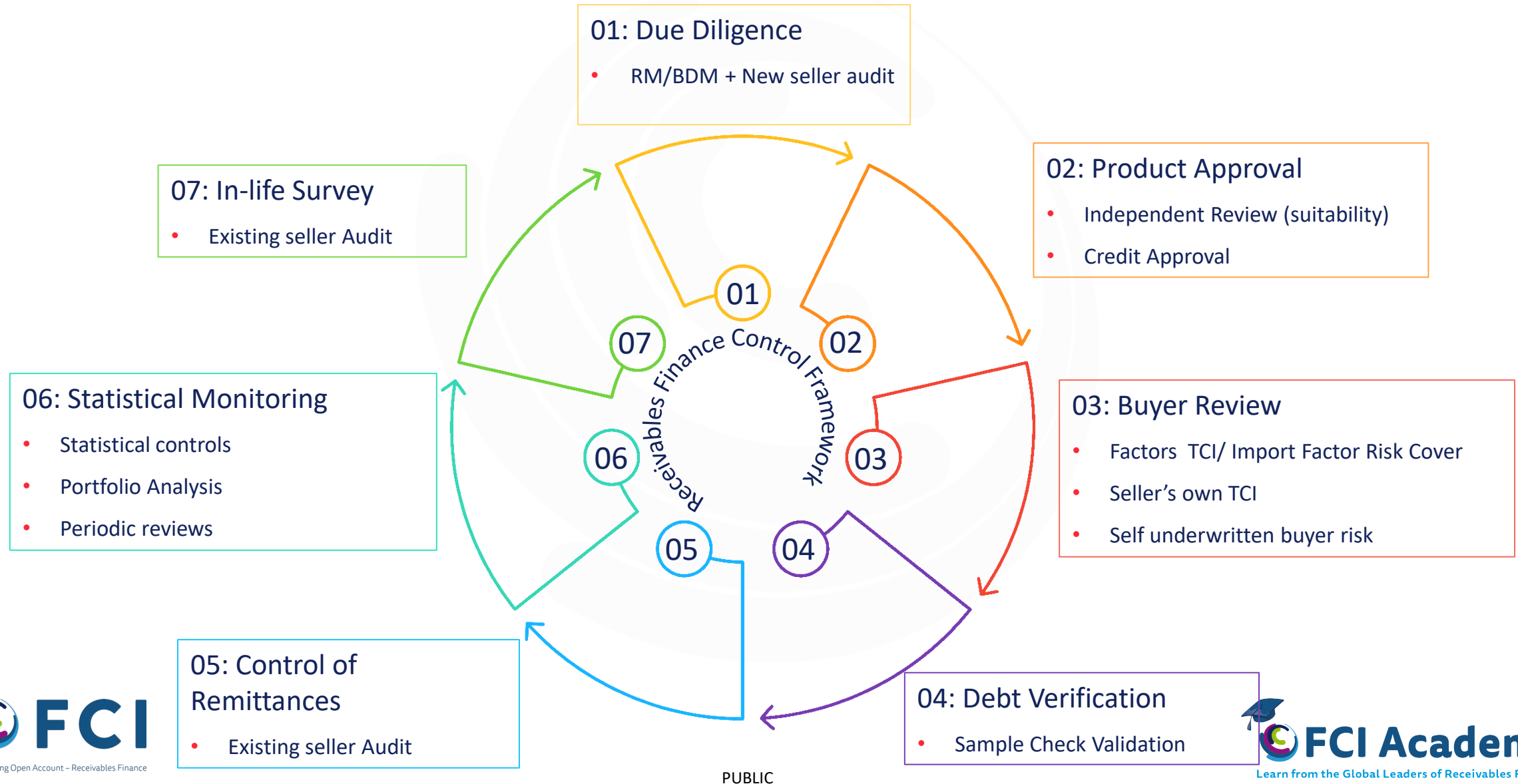
2. Identify high concentration and links with buyer/supplier

MITIGATION: STATISTICAL MONITORING

	Turnover 000's	Credit Notes 000's	Dilut. %	Cash Rec'd 000's	Debts O/S 000's	Max FIU 000's	Average Debt Turn
Jan-17	14,108	0	0	5,515	40,172	26,380	91
Feb-17	1,892	0	0	15,852	26,207	24,807	67
Mar-17	16,126	0	0	15,671	23,978	20,689	69
Apr-17	9,709	0	0	14,112	19,575	22,663	69
May-17	18,170	0	0	904	28,635	21,185	69
Jun-17	11,857	0	0	14,382	26,110	27,003	70
Jul-17	7,664	0	0	4,037	29,738	22,881	78
Aug-17	6,637	0	0	9,858	26,516	24,930	83
Sep-17	6,432	367	7.8%	6,656	25,656	22,741	93
Oct-17	15,493	0	0	12,675	28,139	19,595	90
Nov-17	16,111	0	0	15,567	25,523	22,711	48
Dec-17	17,428	0	0	15,428	24,556	20,549	44
Feb-18	2,154	0	0	14,016	16,196	16,443	80
Mar-18	18,497	0	0	2,047	29,687	18,743	86



A CONTROL FRAMEWORK



SUSPECT FRAUD ? WHAT TO DO:

01 Identification

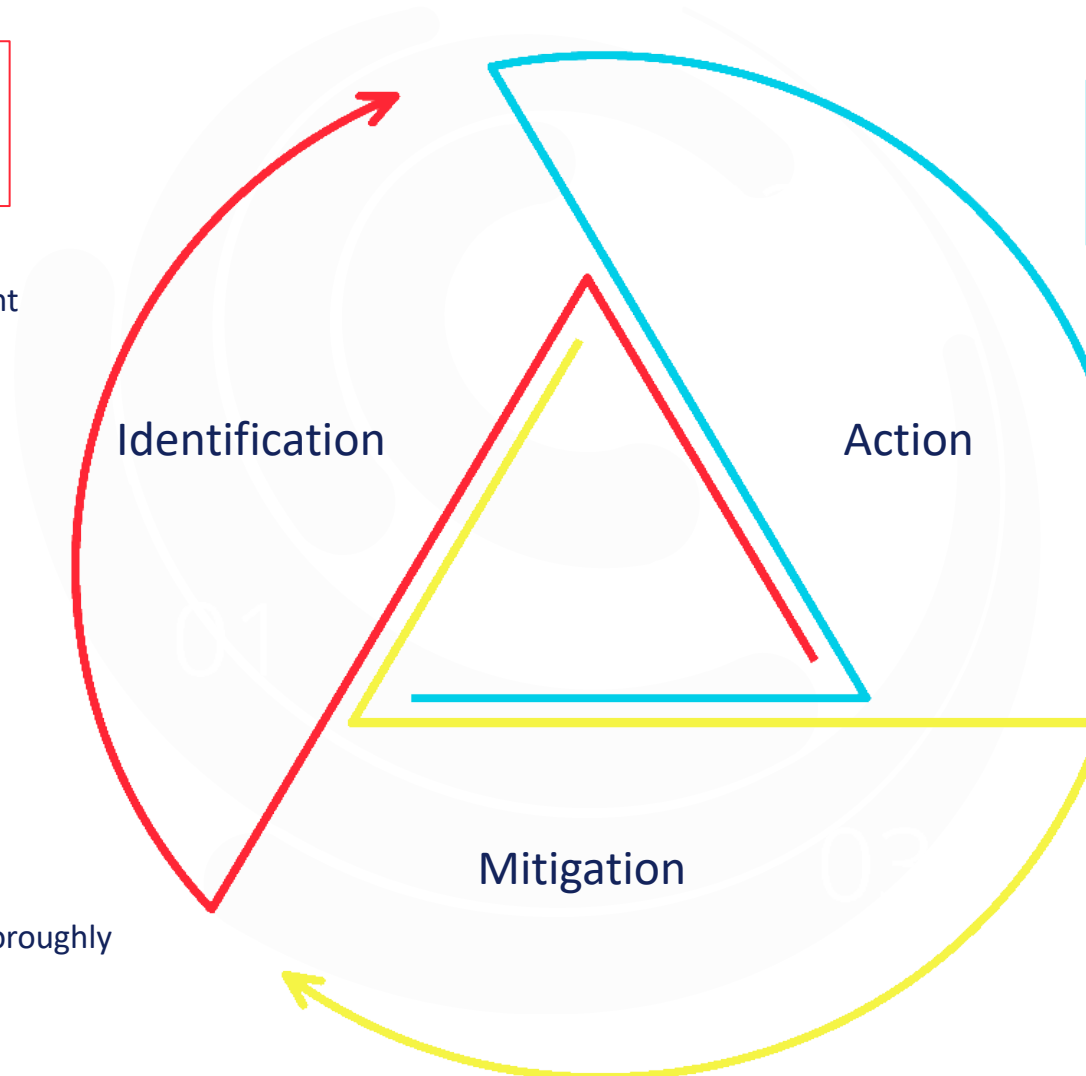
- Fraud response plan
- Communication within the Factor/Parent Bank
- Create time to focus on dealing with this

03 Mitigation

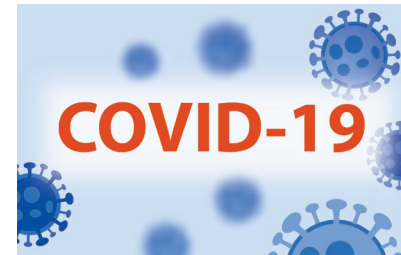
- Take additional security
- Put the guarantors on notice
- Make demand on the facility
- Collect out
- Secure all evidence of debt quickly and thoroughly
- Select a strategy and execute it

02 Action

- Change Funding Structure:
- Prepayment
- Concentration
- Customer limits
- Stop Funding
- Disclosure
- Letters of assignment



KEY FINDINGS



51% of organizations have **uncovered more fraud** since the onset of the pandemic

71% expect the **level of fraud** impacting their organizations to **increase** over the next year

38% of organizations increased their budget for **anti-fraud technology** for fiscal year 2021, making this the most common area for **increased investment** within anti-fraud programs



HOW ARE FRAUD RISKS EXPECTED TO CHANGE POST-PANDEMIC?

➤ Most anti-fraud professionals expect increases in all types of fraud risks, except one; financial statement fraud

- **Cyber-fraud:** business email compromise, hacking, ransomware, and malware
- **Identity crime:** identity theft, synthetic identity schemes, and account takeovers
- **Unemployment fraud, and payment fraud:** credit card fraud and fraudulent mobile payments
- **Social engineering:** phishing, brandjacking, and baiting

CASE STUDY: PROFESSIONALLY ORGANIZED FRAUD

SME client of the parent bank

Wholesaler

- New sector for the seller
- New buyer for the seller
- No export sales before
- First invoice
- Real owner vs. fake owner of the buyer

Lessons

- ❖ Invoice verification by ?
- ❖ Role of the agent
- ❖ Goods were sent to another address
- ❖ Role of the Factors



CASE STUDY: BREXIT & PANDEMIC

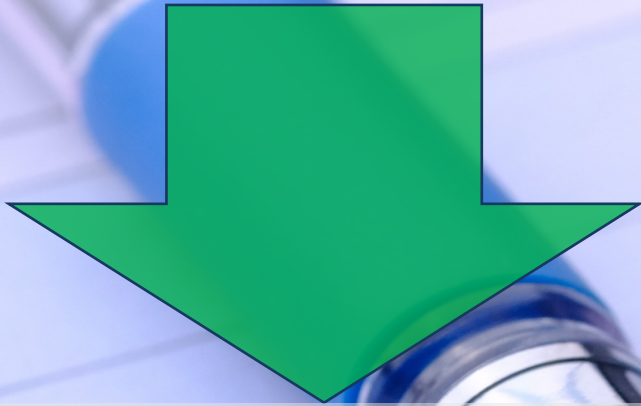
Company selling sunflower seeds

- Buyer is a supermarket chain
- First order is for 3 trucks sunflower seeds
- Need of the goods urgently before BREXIT
- Buyer use emails with different domains

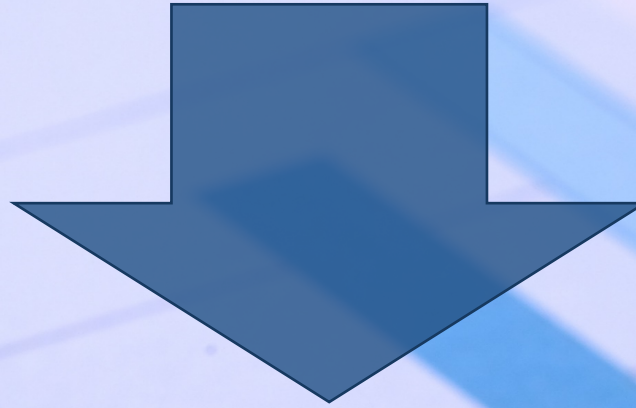
Lessons

- EF investigates the buyer: not great quality website, two different email domains
- EF asked a third-party for verification in France
- Buyers force the conditions by using the pandemic situation
- Effective internal control mechanism

CONCLUSION



Technology can make a Factor's work easier if used correctly, but technology will never replace the human element.



There is no substitute for knowing your client. Need to always be aware that the client may not be as good as initially thought.....



Must identify changes and be rigorous in following them through!!



Facilitating Open Account – Receivables Finance



THANK YOU

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