FCI | ADB TSCFP TRADE & SUPPLY CHAIN FINANCE PROGRAM

REVERSE FACTORING
Risks, mitigants and examples

November
2021

Risk for banks declines
as we progress down the SCF value chain

RISK FOR BANK

	PURCHASE ORDER	UNAPPROVED INVOICES	APPROVED INVOICES
	Bank provides **loan to supplier against a PO**	Bank provides **loan to supplier against an unapproved invoice**	Bank purchases **invoices previously approved by buyer and provides financing**
RISKS	• Three types of risks are present: **performance risk of supplier, default risk of supplier and dilution risk of buyer** • **Recourse** is only to **supplier**	• **Lower fraud and performance risk** • **Dilution risk** still present as buyer may reject invoices • Recourse typically still **to supplier,** as **invoices have not been unconditionally approved** by buyer payable service agreement	• Fraud, dilution and performance **risks are lower** as risk shifts to credit-worthy buyer • Recourse to **buyer based on the IPU (irrevocable payment undertaking) , without any recourse to suppliers**

Measuring risks in reverse factoring

	Buyers	Suppliers	Environmental
Risks	• Concentration risk on buyer, segment or industry. • Payment terms (reputational) • Consistency between files and real documents • Dilution on approved invoices • Non-payment • Collusion with suppliers (fake invoices), related companies	• KYC/AML procedures and reviews • Sale and assignment perfection • Double financing • Lack of authorization in signature • Bank Account ownership • Concentration of program limit on few suppliers	• KYC – CDD - Compliance challenges • Claw-backs – Insolvency Laws not protecting • Improper enforcement laws for ABL • Basel III implementation • Data and Cross-border finance
Mitigants	• Insurance (under Basel III) • Fix **permitted payment terms at agreement** • Do random checks, add waivers • Set rules to accept credit notes, monitor against segmentation data. • Grace period, penalty fee and link to overdraft. • KYC and due diligence, include prohibitions.	• Simple **"onboarding journey"** including KYCs, but post transaction monitoring. • Waivers in legal agreements, tight up with Buyer's agreement. • Avoid accepting changes in payment account • Control not only buyer but supplier limits.	• Help the industry, help yourself • Education. • Develop a risk-aware culture accoss bank • Transparent reporting

Proactive risk mitigation begins at the very foundation of your supply chain finance program: its design.

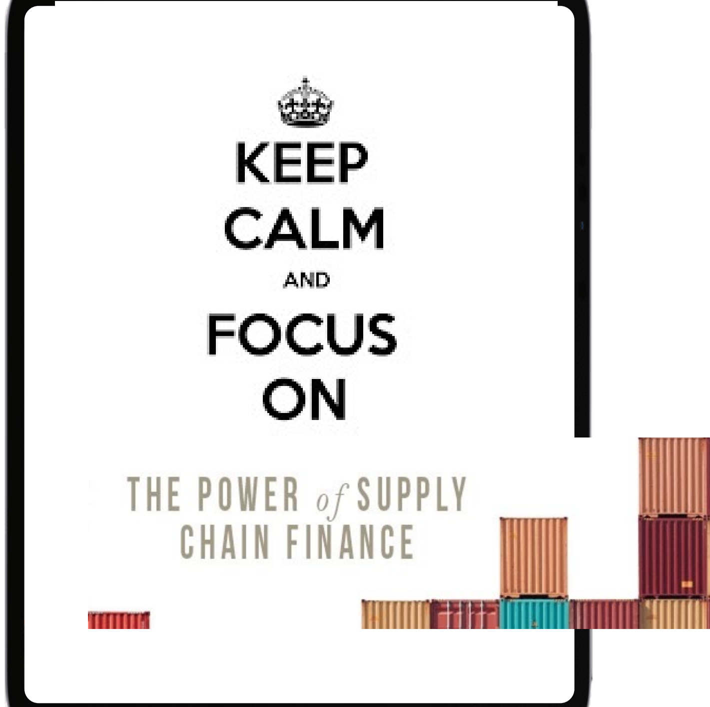
Reverse Factoring's black sheep

When trouble appears is when RF is made to do things it isn't designed to do or when it is used to cover a more exotic scheme.

Concentration / exotic scheme

Differences in file vs invoices/ lack of transparency

Connected companies



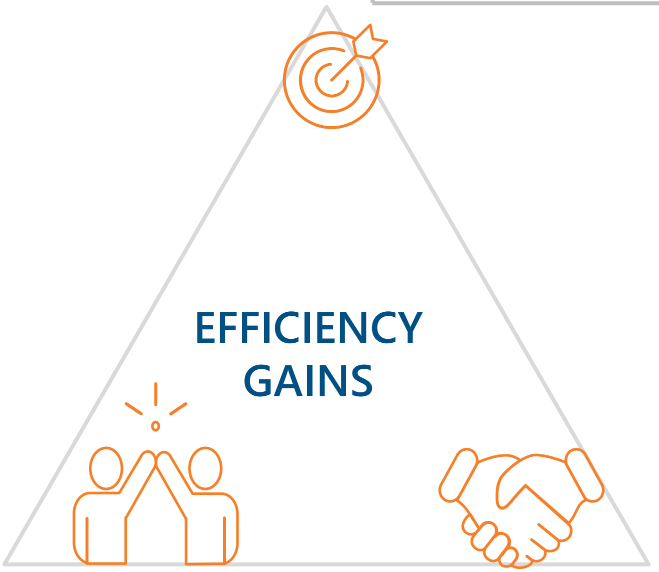
Misuse of the program

Related companies

Supply Chain's strategic perspective

TRUST

- Crucial in **long-term relationships**
- **Effect of trust** in the customer
- Optimal operational **performance**
- **Quick response to needs**



COMMITMENT

- Not committed lines do not mean not commited
- Facilitation of **customer loyalty** (not tied to product)
- **Innovation**

COOPERATION

- **Formal and informal** approaches
- Suppliers are key in **designing buyer's product**

Shukria!

For more information

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