Response of ITFA to the EU Late Payment Directive Consultation by the European Commission

The International Trade and Forfaiting Association (ITFA) is pleased to submit this letter on behalf of its members in response to the call for evidence relating to the proposed revision of the EU Late Payment Directive (2011/7/EU) (ref. Ares (2023) 219034 of 12th January 2023).

ITFA (www.itfa.org), founded nearly 25 years ago, is one of the largest global associations for banks, financial institutions, fintechs, insurers and advisers engaged in origination and distribution of trade and supply chain finance. ITFA has nearly 350 members in over 40 countries and has been active in producing guidance and documentation for its members and the wider market in a number of areas. All the major European banks providing supply chain finance to corporates of all sizes are members of ITFA.

You can find more information on ITFA and its members here. ITFA is registered in the Transparency Register of the EU under registration number 659141434941-88.

ITFA supports the European Commission's goal of protecting SMEs from abusive payment behaviour of large buyers. Upon analysis of the Commission's proposal, ITFA believes that certain provisions seem to go against the Commission's objective while also introducing obstacles to the establishment of a robust, sustainable and benign environment for working capital in the European Union. These are:

- the proposed uniformity of payment terms capped at thirty days without regard for the underlying value creation chain and,
- the lack of distinction between negotiated commercial terms on the one hand and abusive late payment behaviour on the other.

In addition, it is worth underlying how the current 30 days payment term applicable to governmental organisation is not ensuring a timely fulfilment of payment of obligations. In this context it must me pointed out that a non-negotiated late payment ("abusive late payment") has a much worse impact on the working capital management of a corporation than pre-agreed payment terms, which can easily managed through various solutions available for SMEs as well as Large Corporates. If the 30 days payment term will become applicable to all commercial intra-EU transactions it may widen the problem of the delays already existing for governmental organisations. This would also increase considerably the administrative burden related to the follow up, penalties and other obligation. Some background is helpful. According to the study commissioned by DG FISMA published in 2020 written by VVA/Aite, the European market in 2018 for different forms of working capital such as factoring, receivables discounting and

payables finance (often called reverse factoring) was € 1 633.5 billion or 10 % of the EUs' GDP. Receivables discounting amounted to €481.6 billion and payables finance €84.3.

The amounts of working capital provided have risen significantly since then. It is noteworthy that the SCF industry was called on to provide significant additional liquidity for working capital during the initial pandemic period including allowing corporate buyers to extend payment terms without harming their suppliers and that the industry responded very successfully to this call.

The above observations can be addressed through targeted amendments to the proposal. ITFA is preparing draft language to that end.

Uniformity of payment terms

Commercial negotiations between buyers and sellers are more complex than solely the payment term variable. Corporate buyers' supply chain sourcing is complicated and there are industry specific reasons why the supply chains are organized the way they are (for example long manufacturing cycles or long shipping times for various parts assembly). Capping payment terms at a one-size-fits-all level that are below the needs of industry, may cause the following:

A corporate buyer may be pushed to pay for a shipment that has not yet arrived (the 30 days imposed maximum acceptance period may be too short) and as such introduce more quality issues and risks to the Buyer. The Buyer could compensate by deploying risk-reducing financial techniques, but the result would likely translate to higher retail/end prices to the customer.

- Supply chain constructs and resilience may also be altered. Through Supply Chain Finance, buyers ascertain that their mostly more favourable rating leads to lower and more stable financing costs, allowing for a fairer remuneration of suppliers and a close interaction between all players involved in the supply chain.
- Buyers will have to pay all their EU sellers by day 30 instead of any more flexible payment terms they currently have. This would impact particularly buyers exporting outside of the EU with longer credit terms, as their ability to absorb the shortened payment terms would not mirror payment terms with their onwards buyers.

  Therefore, it is envisioned that buyers may have to raise financing, leading to increased financial debt and costs, and potentially lower profitability that result in reduced tax revenue; in such a scenario, the parties that stand to benefit would be the banks and lenders. To protect their profitability, these increased financial costs in the supply chain could translate either into higher retail/ end prices in the EU fuelling inflation and harming the end customers, or in additional pressure put on SMEs suppliers to reduce their own pricing, hence harming the profitability of supplier SMEs.
- The regulation assumes that SMEs are supplying large firms/buyers – but it does not consider the other side and its consequences – namely that many SMEs are purchasing from large firms, e.g., beverages in restaurants/pubs, car spare parts in garages, small

independent retailers, etc. These buying SMEs are benefitting from payment terms possibly far beyond 30 days that are financing their inventory today.

- Should the SMEs have to pay their suppliers on day 30 latest, they may need to borrow money – something which may be challenging with their financial standing, and if doable, most likely at much high interest rates. In addition, the SMEs may equally need to pay the punitive interest to large corporates without possibility for the Buyer to waive interest payment, alongside the flat fee of EUR50. The adverse impact of this is far larger on the SME than on the large corporate Buyer.

Another, perhaps better effort, to combat late payments, is to encourage further digital adoption across the supply chain ecosystem.

Digital platforms and tools can both enable faster processing invoices and payment processing cheaply for corporate buyers and the collection of debts by seller SMEs even within a 30-day period and giving less scope for breaching any such time-limits.

Recent legal developments in the adoption of drawing on the UNCITRAL principle set out in the Model Law on Electronic Transferable Records (MLETR) published by the United Nations (also influencing legal change in France and Germany) are widely seen as a gamechanger in the enabling the use of more electronic instruments (e.g., bills of exchanges, bills of lading, promissory notes) in Trade and encouraging a similar regulatory development within EU could also boost digital adoption of these instruments to enable corporate Buyers and Sellers to get both greater assurance and visibility over their payments cycles as well as supply chain resilience.

The availability of these digital platforms and tools will be constrained if the overall environment for the provision of working capital is adversely affected.

Level playing field

ITFA understands that one of the reason the regulatory changes is proposed is because late payments may lead to a higher risk of SME bankruptcy and may reduce the participation of SMEs in public procurement.

Whilst the proposed Regulation is beneficial for public sourcing, we are concerned that shortening an already tight one-size-fits-all payment tenor conflicts with the right for contracting parties to freely contract and negotiate payment terms. In addition, if the restriction only applies to SMEs, large corporate buyers may even seek to source from non-SMEs to avoid this operational burden, resulting in a conflicting end result from what the Regulation would like to achieve.

It seems to be better to let the proposed Regulation address the public sector for distinct audience and execution (i.e., monitor compliance and enforcement).

If the private sector is to be included, perhaps it is better to rather consider, as the appropriate measure, an enforcement to combat late payment (i.e., on current terms) without regulation on the maximum term itself. That would still solve the perceived problem of SMEs in practice not claiming on late payment interest/overdue amounts to maintain relationship with the larger corporate Buyer. In other words, one could move forward with the concept proposed of late payment interest but consider removing the current prohibition on parties' ability to waive late payment interest.

Distinction between negotiated terms and abusive late payment

In a commercial contract two main components are at the core of the negotiation between the Buyer and the Seller: price and commercial terms in procurement activity.

ITFA thinks it is very important to distinguish between two scenarios:

- A supplier and a buyer have negotiated commercial terms in line with the value creation chain of the production. One important component of these terms are payment tenors / maturities, which can vary largely depending on the underlying goods. Once agreed, the supplier should be able to rely on the agreed tenors, so that it can rely on them and plan the financing accordingly. In ITFA's view this is a healthy component of a liberal economy.
- Supplier and buyer have agreed commercial terms, but the buyer does not respect them and pays late – this is an abusive late payment and ITFA agrees that this could be regulated more strictly as this is then difficult for suppliers to plan and finance. A potential option to combat late payments would be to make it easier to charge penalties and remove the possibility for Buyer to waive the penalty.

Therefore, ITFA supports a stricter handling of abusive late payments but is concerned about of regulating and interfering in the private economy for the fixing of payment terms between Buyers and Sellers.

If large buyers are forced to pay a seller after 30 days regardless of the underlying value creation chain, the buyer will be forced to turn to direct bank lending to finance the gap between acquisition of raw materials and the sale of the final product. This will increase the cost for the buyer and lead to pressure on the price negotiation.

Also, this would constitute a real interference into the free economy of the EU as the Deutsche Richterbund (German Association of Lawyers) already underlined in their comment #27/2023 (#27/2023 - Deutscher Richterbund (DRB))

Further considerations

ITFA would also like to share some further considerations.

- Trade receivable securitisation, with an outstanding amount of financing estimated at European level at EUR72bn provides very cost-efficient receivables financing and access to this capital market for hundreds of European companies in a very secure and stable way, as demonstrated during the 2009 financial crisis. (Source: AFME/European Datawarehouse report November 2021). The proposed reduction of payment terms would lead to a reduction of the size of these programmes and their attractiveness to the investors.
- Longer or shorter payment terms will often be impacted by the supply chain dynamics of different industries. Longer payment terms can mean more sales for a supplier as the buyer has the ability to use that period of credit to create and distribute their product. These payment terms can change over time depending on many factors. Rather than attempt to regulate terms (which could have unintended adverse consequences) market participants can take advantage of supply chain finance tools that exist to accelerate cash flow. In our view the rapid growth of supply chain finance in all its forms (dynamic discounting, approved payables, receivables discounting) is a more effective solution for the impact of longer payment terms as compared with increased regulation.
- As pointed out by the German Bundesrat (Federal Council), a strict limitation to 30 days would also impact the possibility of the European Union to react flexibly to crisis situations, such as the Corona crisis (see their statement: https://www.bundesrat.de/drs.html?id=450-23%28B%29)
- ITFA feels it is important to look how other jurisdictions are dealing with this topic: in some countries where late payments are regulated (like US or UK) allow the agreement between the parties beyond 30 days (and longer than 60 days if they are considered fair for both businesses) and some others are limiting the regulation to specific industries (like Canada). It is important that the EU keeps this in mind in order to preserve the competitiveness of its market.

Supra-regional concerns

The proposed changes may also have an impact on socio-economic issues which shouldn't be ignored:

- As research for the European Parliament has set out Resilience of global supply chains (europa.eu), supply chains are long and complex subject to exogenous shocks and geopolitical tensions. The region's vulnerability to shortages of critical raw materials is well known but is only one example of where supply chain disruption could impact Europe as a whole European Critical Raw Materials Act (europa.eu).
- Through the use of new technologies, supply chains can be measured for compliance with ESG targets. This is not only desirable in its own right but can result in lower costs for SMEs who will benefit from a reduction in financing margins usually funded by the

banks themselves. Current and upcoming European legislation such as the Supply Chain Act is emphasising responsibilities for supply chains which remain difficult to measure in practice.

Conclusion

As the European Commission suggests in it Questions & Answers, payment terms, as long as they are reasonable, are not the underlying issue of abusive late payments; access to liquidity is.

ITFA supports the European Commission's objective of addressing abusive late payments and of a number of the provisions in the proposal, such as alternative dispute resolution, the use of digital tools, credit management or financial literacy training to help SMEs.

However, ITFA believes that uniform payment terms without regard to the underlying value chain, a possible unlevel treatment of the private and public sector, as well as the lack of distinction between *negotiated commercial terms* and *abusive late payments* would go against the Commission's objective of supporting the SMEs while also introducing obstacles to trade and supply chain finance and possibly risking delocalisation.

These concerns can be addressed through targeted amendments to the proposal. ITFA is preparing draft language to that end.