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LATE PAYMENT DIRECTIVE PANEL – MADRID JUNE – ITFA NEWSLETTER ARTICLE, July 2024

Contributed by the ***ITFA Insurance Committee***

ITFA panellists debate impact of proposed EU late payments legislation

Efforts by European regulators to enforce new limits on payment terms could have unforeseen negative consequences on small businesses and the supply chain finance market, said panellists speaking at ITFA's Southern European Regional Committee event hosted by Banco Santander in Madrid on June 6th. The event was chaired by Silja Calac, Head of Private Debt Mobilisation for Trade and Supply Chain Finance at Banco Santander.

"I don't think the awareness is there among regulators about the seismic impact of this legislation on both large and small corporates," said panellist Alex Farrugia, European Head of Supply Chain Finance, Banco Santander.

The discussion followed last year's decision by the European Commission to issue a consultation on the Late Payment Directive first issued in 2011, proposing that it should be revised to enforce a 30-day payment term limit on all business-to-business transactions across all member states.

It also proposed that each country must set up specific authorities with enforcement powers to oversee these transactions.

Since the consultation was launched, ITFA in conjunction with its lobbying consultant Afore, has been in talks with the European Parliament and the European Commission as the various arms of the EU formulate their positions on the proposals. ITFA submitted its response to the commission's consultation last year.

ITFA has put forward an argument that the proposed legislation does not differentiate between a "late" payment and a negotiated "deferred" payment. The 30-day limit has the potential to impair a company's ability to manage their working capital and there are alternative ways to tackle late payments, the organisation has said. [*Click here for a more comprehensive overview of ITFA's position*].

"We see it as ITFA's responsibility as specialists in the finance industry to explain there is this concept of 'deferred' payment terms and they are not imposed on suppliers to make them angry, rather it is a result of international value creation," said Markus Wohlgeschaffen, Managing Director, Head of Markets and Sales at Traxpay.

The panel agreed that the political discussion on late payment took the wrong track at an early stage.

"While it is agreeable to all market participants that late payments are detrimental to the economy, the political discussion at some point in time focused on payment terms instead of late payments," explained Christian Hausherr, Product Manager of Supply Chain Finance, Deutsche Bank and Chair of the Global Supply Chain Forum.

As a result, the proposal that was put forward to the European Commission was more a payment term regulation than a late payment regulation, he explained, which has led to the intensive debate and opposition to this proposal that has inflamed in the industry.

He added that longer payment terms are often required by certain types of businesses, depending on the goods and services they sell.

"Payment terms are not 'late payments', they are a reflection of the working capital cycle of a company and one company might take a bit longer to sell a product compared to another," Hausherr said.

“There are studies in the market that suggest if you force someone to reduce payment terms there is an increased likelihood of late payment. If your working capital cycle is 90 days and you have to pay within 30 days – the payment will be late as you simply don’t have the money,” he added.
There have been signs that the organisation is being listened to with the European Parliament issuing proposed amendments earlier this year to the original European Commission’s proposal, panellists noted.
These amendments included that payment terms could be extended to 60 days if specifically agreed in the contract and up to 120 days for slow moving goods and seasonal goods.
While panellists welcomed these amendments as a sign that the debate was moving in the right direction, they argued that there was still a need for more clarity.

Financing tools to prevent late payments

The panellists all agreed it was important to propose alternatives to the 30-day payment limit proposal, and they discussed how harnessing the potential of digitisation and using financing tools such as supply chain finance or negotiable instruments could ensure SMEs are paid in a timely manner.

“The disadvantage of a late payment rather than a payment term is that a late payment cannot financed. A mutually agreed deferred payment can be financed,” explained Hausherr. “There are solutions out there – such as payables finance – that are not so well known to those discussing this on the political side,” he added.
Imposed limits on payments could also negatively impact ESG-related payables finance programmes, where financing conditions for the seller are based on a sustainability-linked rating, he added.
“But the whole construct only works if there is a substantial tenor for financing,” he explained.
Farrugia argued that supply chain finance (SCF) offers corporates an improved level of certainty around when they will get paid: “SCF could be the solution as it offers SMEs and all corporates the ability to see when they are getting paid the moment the invoice is uploaded.

“It is not that longer payment terms are an issue. It is an issue when payments are late and that throws SMEs cash plans out of the window. They don’t have €1 million revolving credit facilities to fall back on,” he added.
Encouraging greater digitisation of trade could also help tackle the problem of late payments and the difficulty SMEs face when enforcing their claims, said Wohlgeschaffen.
“We do not need an additional administrative institution, but simply by using digital negotiable financing instruments such as bills of exchange or promissory notes - you have powerful instrument which is standardised… and you can enforce it quickly,” he said.
Luca Giusti, VP, Regulatory Policy and Advocacy Expert at MUFG concluded that there is an increasing willingness to understand what supply chain finance is and why the proposed legislation could be problematic. “Our message has been well received and we have seen progress in the European Parliament and openness in the council”.

Update on progress of negotiations

Since the panel last month, ITFA has had intensive discussions with several representatives from the member states. A total of 14 member states have now asked for the withdrawal of the proposed revision, which has effectively blocked the proposal at the council level. The European Parliament had already agreed to its negotiating position in April.

ITFA believes there is a good chance that the European Commission will withdraw the proposal for the revision by the end of July. The European Commission could now follow up with a revised proposal after the withdrawal, but this would mean that the rules of the existing Late Payment Directive would for now remain in place. ITFA will particularly focus its future advocacy efforts related to the late payment regulation on presenting suggestions on ways and instruments to avoid late payments.

Commenting on recent developments, ITFA Board member Silja Calac noted how important it is that the trade finance industry explains and guides lawmakers on such technical matters. For this reason, the ITFA Board announced this month its decision to create a new function focused on advocacy.

To read more and to access all documents related to ITFA's position on the late payment directive – members can click here.