

Factoring and liquidity facilities: making the best of both worlds



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Factoring volumes in Romania have seen a marked increase over the last year, up to EUR 3.68bln in the first half of 2022, according to public sources. While part of this 31.6 % year-on-year surge was driven by inflation rates, local businesses do appear to show a growing appetite for this type of financing product.

When do companies opt for factoring?

Usually, what pushes a business to search for supply chain financing options is either a so-called "liquidity gap" (short payment deadlines agreed with suppliers, coupled with long(er) payment term agreed with clients) or an urge to expand the business to cater to increased demand of one's product or service. Sometimes it is both.

In practice, some businesses may turn to factoring at a later stage, after having already tested the usual bank liquidity products (working capital lines, borrowing base facilities, etc.) and having created security over their inventory in favour of those initial creditors. They may even be quite content with those products and unwilling to renounce them, but just wish to add factoring to the mix.

Practical legal challenges and how to tackle them

Under current legal provisions in Romania, potential clashes can be anticipated between the initial creditors' first-ranking collateral over inventory and the factors' legitimate expectation that the receivables/invoices they purchase from the client are free of encumbrances.

The Civil Code provides that products sold in the ordinary course of business will be transferred to their purchaser free of any encumbrances. Put plainly, a bank holding a security interest over those product inventories can no longer enforce their security against the purchaser. Instead, the security interest reattaches to the receivable or the amount collected from the purchaser for the benefit of the bank. The security provider will also have to deposit the respective collected amount into a dedicated account and notify the bank.

Issues may arise if, down the line, the client intends to assign their trade receivables or invoices to a factoring services provider. The reasonable expectation of the factor would be to purchase invoices/claims that are free of any other encumbrances, which in this case is not true (further to reattachment, the bank has a first-ranking interest in those claims/invoices/amounts).

One way to address this would be to talk to both financial institutions and try to split the collateral between them, i.e. limit the bank's security interest over inventory to certain types of assets, while keeping the other types free of

encumbrances in order to facilitate the factoring transaction.

Another option, admittedly more complex and requiring a degree of readiness to discuss on the side of the two financial institutions, would be to get both lenders to agree that the initial lender's security interest no longer reattaches to the claims/invoices against the purchaser (thus leaving them free of encumbrances). Instead, the amounts collected by their joint client from the factor would be deposited into a dedicated bank account over which the initial lender holds a first-ranking security interest, while the client is still allowed to operate the respective account.

Conclusion

The above is just a simple example of how one can stay flexible while being mindful of the legitimate interests of one's creditors. All in all, we believe legal provisions should not deter businesses from accessing financial products designed to enhance liquidity and/or facilitate their growth.