Receivables financing

A guide for the perplexed

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SOLICITORS

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Receivables financing

- The basic arrangements
  - how the facilities work.
- Terminology
  - factoring, invoice discounting and other names.
- Disclosed and non-disclosed arrangements.
- Recourse and non-recourse agreements.
- Where the financier usually goes
  - the estimated outcome statement.
- Termination fees and charges.

Receivables financing

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  - **how the facilities work.**
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Receivables funding

- The basic arrangements
  - Term loans
    - Agreed advances of principal
    - Principal and interest repaid over an agreed term
  - Revolving credit (eg overdraft)
    - Agreed credit limit
    - Repayments create headroom for future advances
    - Borrower draws on the facility according to their need

Receivables funding

- The basic arrangements
    - Secured loan
        - Security may be for a term loan or revolving credit
        - Borrower owns the asset
        - Borrower continues in possession of it (while not in default)
        - Borrower can sell it (but must repay the secured finance)
        - Finance may be unconnected to the asset
    - Asset finance (eg leasing, HP, etc)
        - Financier owns the asset
        - Rent represents payments of interest and principal
        - Hirer may have the right to buy the asset – or may not have that right
        - Hirer may not have the right to sell the asset

Receivables funding

- The basic arrangements
  - Debt finance
    - It’s not a loan. It’s an arrangement to sell debts (to get cash sooner).
    - The trader sells good or services on credit (eg 30 day terms) to create the debts.
    - The debts belong to the trader.
    - The trader sells them to the financier.
    - The financier immediately pays a discounted price to the trader.
    - The debtor later pays the full debt to the financier.

    - Once the debts have been sold, they always belong to the financier.
    - The trader may have a right to buy them back.

Receivables funding

- How the facilities work
  - Debt finance is usually set up as a revolving facility
  - When the financier takes on the trader as its customer:
    - The financier will buy most of the debtor book at that date
      - Probably excluding old, bad and disputed debts
    - The financier will pay the agreed (discounted) price for the value of the book
      - Its customer (the trader) will probably have to pay set-up fees and expenses
    - The financier will cap the value of the debts that it is prepared to own, at any one time
    - The debtors will be told they must pay what they owe (when it is due) to the financier

Receivables funding

- How the facilities work
  - Debt finance is usually set up as a revolving facility
  - When a debtor pays their debt
    - They should pay the financier
      - The debtors are given the financier's bank details
    - The financier may charge a processing fee
    - The financier will adjust its record of the value of the debts it owns
    - The financier may pay to its customer a second instalment of the agreed price for the debt
  - When a debtor fails to pay
    - The financier – having bought the debt – will probably ask for its money back

Receivables funding

- How the facilities work
  - Debt finance is usually set up as a revolving facility
  - When the trader completes work for a customer:
    - It raises an invoice to its customer
    - The invoice tells the customer to pay the financier’s bank account
    - It lets the financier know it’s owed a new debt
    - It may ask the financier to buy the new debt
    - If the financier agrees, it will agree to pay the first instalment of the price for that debt

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    - Probably the financier will own that debt, even if it is not one it's willing to buy

Receivables funding

- How the facilities work
  - Opportunities for traders to misuse a debt finance facility:
    - Anticipatory invoicing
      - (‘We’ll finish the job next week’)
      - (‘They said they would sign the contract next week’)
    - Overcharging
      - (‘Ooops! Sorry; my mistake. Here’s a credit note. Just pay the difference.’)
    - Credit notes
      - (‘Sorry financier. I can’t think how those got left off our reports to you.’)
    - Imaginary customers
      - (‘Crickey! Where’s the money coming from to pay the wages next week?’)
    - Diverting funds
      - (‘New bank account. Can you please pay this, not the one on our invoice?’)

Receivables funding

- How the facilities work
  - The financier’s books
  - The financier needs accounts to show:
    - The value of the (good) debts it has bought, and now owns.
    - The payments for the (first and second instalments of the) price it has agreed to pay
      - And, how much of that total has yet to be drawn by its customer
    - The fees and expenses it has charged against the prices it has agreed to pay

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  - **factoring, invoice discounting and other names.**
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Receivables funding

- **Terminology**
  - Invoice finance
  - Receivables financing
  - Invoice discounting
  - Confidential invoice discounting
  - Invoice factoring
  - Accounts receivable financing
  - Factoring

Receivables funding

- Terminology
  - Undisclosed agreements (Confidential invoice discounting)
    - The trader's customers are not told that the financier owns the debt
  - Disclosed agreements (Factoring)
    - The trader's customers are given notice of assignment (change of ownership)
    - So they know they owe the debt to the financier (and not the trader)
    - Legally, they still owe it to the financier, even if they pay the trader
    - Legally, the trader's customers may lose the right to make deductions
    - Notice of assignment doesn't always work. Some debts are non-assignable.

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Receivables funding

- Recourse and non-recourse agreements
  - When debts turn bad!
    - Recourse agreements don’t include credit insurance
    - The financier’s customer will have to repay the price it received for a debt that’s bad
      - Perhaps when the debt is 90 or 120 days old
      - Additional fees are likely to be charged
    - Non-recourse agreements include credit insurance
      - It may not fully cover all debts

Receivables funding

- When debts turn bad!
  - The arrangements for debt collection and credit control vary
  - Some debt financing arrangements allow the trader to outsource those
  - Others expect the trader to chase and enforce against late payers

  - The financier is likely to step in and collect the debts if the trader becomes insolvent

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Receivables funding

- The estimated outcome statement
  - For practical purposes

  - The debtor book is shown as an asset
  - The claims of the financier against it is shown as a fixed charge

  - Conceptually, this is probably wrong
  - The finance agreement is a contract
  - It has either a net positive value (it's a debt) or a negative value (a creditor)
  - The debtor book belongs to the financier, not the (insolvent) trader

Receivables funding

- The estimated outcome statement
    - Remember that many debt financiers take back-up debentures
    - That gives them security over the (insolvent) trader's assets if they are a net creditor
    - The security is likely to be:
        - (perhaps fixed charges over some of the trader's assets and also)
        - A floating charge over all the trader's assets
    - It also gives them the right (as holder of a qualifying floating charge):
        - To receive notice of intention to appoint an administrator
        - To appoint an administrator (if they are a net creditor and can call in their debt)

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Receivables funding

- Termination fees and charges
  - These are likely to bite hard when a trader becomes insolvent
  - For example:
    - The agreement may be on a 12 month contract
    - Where the trader would have to give three months notice to end it
    - And perhaps can’t give notice validly if more than six months before the end
  - The financier may claim the right to charge many other fees
    - Discount fees (as a percentage, similar to interest, on the funds in use)
    - Service charges
    - Collect Out fees
    - Refactoring fees
    - Collection expenses

Receivables funding

- Termination fees and charges
  - It can be worth challenging these fees and charges
  - The financier should be able to show you:
    - Which clauses in the contract authorise them to charge them
    - A rate sheet, to show how much each fee should be

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Receivables financing – any questions?

Dates for your diary:

- 16 January 2023 – Coffee break briefing
  - Retention of title claims

- R3 Southern & Thames Valley forum (Reading) – 23/24 March 2023

- 12 May 2023 – **Frettens' Second Annual Insolvency Conference**

If you'd like to contact us…

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