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KNOWLEDGE GUIDE ON FACTORING REGULATION AND SUPERVISION

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ABBREVIATIONS

AML	Anti-Money Laundering
BIS	Bank for International Settlements
CFT	Combating the Financing of Terrorism
DLT	Distributed Ledger Technology
GRIF	General Rules for International Factoring
GSCFF	Global Supply Chain Finance Forum
KYC	Know Your Customer
MLST	Model Law on Secured Transactions
MLF	Model Law on Factoring
MSME	Micro, Small and Medium Enterprises
NBFI	Non-Banking Financial Institution
OECD	Organization for Economic Cooperation and Development
PRIN	Principles for Business (UK)
RegTech	Regulatory Technology
SCF	Supply Chain Finance
SupTech	Supervisory Technology
UNCITRAL	United Nations Commission on International Trade Law
UNDROIT	International Institute for the Unification of Private Law

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EXECUTIVE SUMMARY

The main objective of this Knowledge Guide is to provide guidance on law reforms seeking to support receivables finance and thereby promote sound and inclusive access to credit in emerging markets. It indicates options and advances recommendations to establish a cohesive regulatory framework for non-banking financial institutions (factoring companies) to extend funds upon the transfer of receivables (factoring activities). The primary audience of this document includes policymakers and decisionmakers involved in the law reform process, such as officials at central banks, supervisory authorities, and governmental departments, including the staff of the World Bank and donor institutions. This Knowledge Guide represents a point of reference for reforms and present and future harmonization projects pertaining to an area that is of critical importance for the attainment of inclusive economic growth and sustainable development.

International Instruments and Law Reforms: A Bird's Eye View

Fostering access to finance through secured lending has been on the agenda of international organizations for decades. Starting in the 1980s, international instruments were enacted to ensure a minimum level of harmonization of the rules governing specific products, such as factoring and leasing in cross-border transactions. However, these efforts were modest in terms of the effect achieved given the reluctance of international organizations to formulate standards affecting property laws or insolvency. A more ambitious agenda was set out in the 1990s and resulted in the adoption of the UNIDROIT Convention on International Factoring (Factoring Convention) in 1988 and the United Nations Convention on the Assignment of Receivables in International Trade (Receivables Convention) in 2001. The next decade was characterized by efforts to develop general soft-law instruments offering a template to harmonize and modernize secured transactions law across the world's jurisdictions. The UNCITRAL Model Law on Secured Transactions (2016) epitomizes these efforts, representing an international consensus on the private law rules governing secured lending, including receivables finance.

Nonetheless, many jurisdictions have been turning their attention to the implementation of rules that are specifically designed for receivables finance, considered as the type of credit product that is most likely to grow in their economies. In response to this trend and in continuity with the approach of the UNCITRAL Model Law on Secured Transactions, the recently adopted UNIDROIT Model Law on Factoring (2023) provides a complete, self-standing framework of rules governing receivables finance, thus, representing the primary point of reference for law reforms in this area.

Law reformers are equipped with key general and transaction-specific instruments to enact a cohesive set of private law rules, but regulatory and supervisory matters fall outside their purview. Yet, the implementation of both private law and regulatory rules governing factoring activities is the focus of many jurisdictions seeking to promote access to finance by leveraging the potential of receivables. In this context, guidance is needed for the establishment of a proportional regulatory framework for factoring companies to protect customers, market integrity, and ensure financial stability.

In the last few decades, the potential of receivables finance has emerged as a flexible financing solution for working capital efficiency, particularly for micro, small and medium enterprises (MSMEs). By freeing up working capital to increase trade volumes, factoring is crucial to the flow of goods and services within supply chains, particularly in cross-border transactions. Despite the growing demand for a coherent regulatory framework for factoring activities, international guidance has not been provided. Jurisdictions wishing to implement private law rules governing receivables finance may benefit from the guidance offered by a variety of international instruments—ranging from broader secured transactions law, such as the UNCITRAL Model Law on Secured Transactions, to product-specific laws, such as UNIDROIT Model Law on Factoring. Still, the design of regulatory regimes for factoring activities and companies is largely left to determinations made at the domestic level. The result is an inharmonious treatment of factoring activities globally and a limited impact of reforms aimed at unlocking the potential of receivables finance domestically, as conflicts between private law and regulatory regimes often limit the development of a sound and inclusive credit ecosystem.

To address these issues, this Knowledge Guide maps the main policy choices that law reforms must address and distills a set of key recommendations to guide the implementation of a coherent legal and regulatory framework for receivable finance. To begin, the guide offers advice on how to determine the best approaches that law reformers can adopt to include factoring activities in the regulatory perimeter. With particular attention to the definition of factoring, there are recommendations on how to ensure coordination between relevant private law rules with the factoring regulatory framework. Thereafter, focus is shifted towards three core areas: licensing and supervision, prudential regulation, and conduct of business regulation. Cognizant of domestic idiosyncrasies, this Knowledge Guide advances recommendations on how factoring activities can be regulated under the different governance models. Authorization and supervisory mechanisms for factoring activities result in a mandatory licensing regime for factoring companies that, in turn, are subject to proportional prudential and conduct of business rules. Prudential regulation for factoring companies requires the establishment of capital adequacy standards and provisioning requirements aimed at maintaining the soundness of financial institutions and the stability of the financial system in its entirety. Conduct of business requirements for factoring companies consist primarily of rules protecting market integrity, by establishing fitness and propriety standards, anti-money laundering (AML) rules, and fundamental consumers protections.

This Knowledge Guide is divided into six sections and one annex:

- **Section I:** examines the increasingly important role of factoring, including within supply chains, in facilitating access to credit for MSMEs.
- **Section II:** considers the main regulatory trends that are driving the demand for the establishment of a comprehensive regulatory regime for factoring.
- **Section III:** provides guidance for policymakers and law reformers to establish a comprehensive legal and regulatory framework for factoring activities.

- **Section IV:** indicates how factoring activities can be supervised under different governance models and indicates the authorization requirements for financial institutions to undertake factoring activities.
- **Section V:** focus on prudential regulation and indicates the key components of a prudential framework for factoring companies.
- **Section VI:** is concerned with the conduct of business regulation applicable to factoring companies.
- **Annex I:** provides a template structure for a legislative instrument that combines within the same statutory instrument both private law and regulatory elements.

This Knowledge Guide offers a blueprint for a coherent legal and regulatory framework for receivables finance, based on a set of recommendations on how to address different policy choices. Focused on the key components of a regulatory framework for factoring, this Knowledge Guide is directed to any jurisdictions irrespective of the status of private law rules governing factoring, receivables finance, or secured transactions more generally. However, it must be noted that the coexistence of and coordination between robust private law and regulatory frameworks are preconditions for the establishment of sound and inclusive factoring markets. Hence, whenever the private law framework is not aligned to international standards, jurisdictions should consider reforming their private law and regulatory frameworks for factoring simultaneously. To this end, Annex I takes as a point of reference the UNIDROIT Model Law on Factoring to provide a template structure of a factoring law that contains both private law aspects and regulatory elements.

Regulatory Framework for Factoring: Key Components

1. **Licensing obligation and requirements for factoring companies:**
    a. General prohibition to undertake factoring activities without authorization.
        i. Establishment of licensing and supervisory authority.
        ii. Coordination with existing licensing regimes.

    b. Licensing requirements:
        i. Incorporation status and governance structure (e.g., limited liability company registered according to the applicable company law).
        ii. Minimum requisites of fitness and propriety for Board of Directors and senior managers, ensuring competence, experience, and integrity.
        iii. Minimum level of capital at the time of incorporation.

2. **Prudential regulation for factoring companies:**
    a. Factoring companies are required to maintain a minimum level of equity at the time of incorporation. Capital might be raised gradually.
    b. Factoring companies are required to adopt a system of risk management and controls that include reserve allowances in compliance with international accounting standards.
    c. Supervisory authority is empowered to impose additional capital and provisioning requirements.

3. **Conduct of business regulation for factoring companies, key elements:**
    a. Fitness and proprietary conditions for Board of Directors and senior management – as per licensing requirements.
    b. Compliance with applicable anti-money laundering requirements.
    c. Fundamental principles which impose the obligation on factoring companies to treat their customers fairly in line with the general approach of customer protection for financial services.

I. OVERVIEW

Factoring has become a key tool to promote access to finance. In particular, it has gradually pushed aside documentary trade, such as letters of credit. According to the Global Supply Chain Finance Forum (GSCFF), factoring is a form of receivables purchase, in which suppliers sell their receivables, represented by outstanding invoices, at a discount to a finance provider, commonly known as the "factor".[1] Unlike in documentary trade, finance is provided against a receivable rather than a package of documents, such as bills of lading and insurance policies. While documentary trade has been traditionally the domain of banks, factoring can be provided by different types of financial institutions.

This Section examines the increasingly important role of factoring in the global economy, with particular emphasis on its role for MSMEs and supply chain finance (SCF). First, factoring as a flexible financing solution is introduced. Second, it clarifies the nature of factoring activities as related to receivables financing. Finally, the technological solutions which have supported the development of new factoring products and business models are examined.

A. Factoring & Economic Growth

In the last few decades, factoring has become a flexible financing solution for working capital efficiency. By freeing up working capital to increase trade volumes, factoring is crucial to the flow of goods and provision of services within supply chains, particularly in cross-border transactions. One of the biggest problems faced by exporters, for example, is the increasing insistence of importers that trade be conducted on "open account terms," which entails payment being deferred for many weeks (or months) after delivery.[2] Factoring has offered a solution to this problem by providing the supplier with immediate payment to cover short-term financing needs.

The UNCITRAL Legislative Guide on Secured Transactions states that "[f]actoring is a highly effective form of receivables financing that can trace its roots back many centuries."[3] Factoring originally emerged to fill the needs of suppliers of goods and services for the granting of "true self-liquidating short-term trade credit to their customer."[4] More recently, factoring has received attention as an instrument to promote finance and supply chain finance for MSMEs. As factoring became a key resource for supply chain finance, the focus has shifted from international factoring to "domestic factoring".

Factoring is a growing source of external financing for MSMEs.[5] In particular, different products using a receivable have been developed to support small businesses trading with a large anchor buyer; a mechanism often referred to as "reverse factoring".

1 Definition of factoring by the Global Supply Chain Finance Forum (GSCFF), available at http://supplychainfinanceforum.org/techniques/factoring/.
2 Id.
3 See UNCITRAL Legislative Guide on Secured Transactions (2007), p. 16.
4 Freddy R. Sallinger, Factoring: The Law and Practice of Invoice Finance (Sweet & Maxwell, 2006), p. 27.
5 See Leora Klapper, The Role of Factoring for Financing Small and Medium Enterprises (World Bank, 2005), available at https://openknowledge.worldbank.org/handle/10986/8939.

One of the advantages of reverse factoring is that whether receivables are purchased is determined according to the creditworthiness of the anchor buyer. In other words, factoring enables high-risk MSMEs to transfer credit risk to high-quality buyers.[6]

In such cases, it is the MSME client's ability to pay that reduces the lending risk and makes accounts receivable an attractive asset class.[7] Banks that offer finance to MSMEs are increasingly looking at factoring as a means of managing credit risk.[8]

Empirical evidence demonstrates that the factoring industry is larger in economies with more developed legal, regulatory, and institutional frameworks.[9] Prior to the COVID-19 pandemic, Europe accounted for nearly 70 percent of the global factoring market, followed by the Asia-Pacific with a 26 percent share.[10] In Europe, factoring has developed at a rapid pace in the last four decades.[11] However, factoring also has great potential in emerging markets, such as in Africa.[12] Although Africa's share of global factoring transactions remains low, the industry has grown from less than €18 billion euros in 2015 to over €22 billion in 2018.[13] In some African jurisdictions, the growth of factoring has been hindered by uncertainty in the relevant laws.[14]

Trade credit took on a much bigger role during the pandemic.[15] A study conducted by the Bank for International Settlements (BIS) indicated that, during the pandemic, the volume of trade receivables globally was comparable to that of outstanding corporate bonds.[16] In turn, global supply and value chains are fueled by receivables finance, resulting in very low default rates and limited loss at time of default.[17] As the shortage of finance for trade transactions persists,[18] while reliance on documentary letters of credit has diminished since the pandemic, open account receivables-based financing have been playing an increasingly important role in the global economy.[19]

6 Id.
7 World Bank Group, Knowledge Guide: Secured Transactions, Collateral Registries and Movable Asset-Based Financing (2019), p. 103, available at https://openknowledge.worldbank.org/bitstream/handle/10986/32551/142346.pdf?sequence=4&isAllowed=y.
8 The SME Banking Knowledge Guide (IFC, 2010), p. 30, available at https://www.ifc.org/wps/wcm/connect/c6298e7b-9a16-4925-b6c0-81ea8d2ada28/SMEE.pdf?MOD=AJPERES&CVID=jkCVrZU.
9 Supra at Klapper, note 5.
10 Peter Mulroy, FCI reports 6.6% drop in global factoring statistics in 2020 (Trade Finance Global, 2021), available at https://www.tradefinanceglobal.com/posts/fci-reports-6-6-drop-in-global-factoring-statistics-in-2020/.
11 Supra at Sallinger, note 4.
12 Robert Lumbuye Tomusange, Factoring as a Financing Alternative for African Small and Medium-Sized Enterprises (Walden University, 2005).
13 Kanayo Awani, Factoring as an Alternative Tool for Financing SMEs in Africa (Making Finance Work for Africa Partnership, 2020), available at https://www.mfw4a.org/blog/factoring-alternative-tool-financing-smes-africa.
14 Marek Dubovec and Louise Gullifer, Secured Transactions Law Reform in Africa (Hart, 2019), p. 94.
15 Atradius Payment Practices Barometer at 10 (November 2020).
16 Frederic Boyssai, Nikhil Patel & Hyun Song Shin, Trade Credit, Trade Finance, and the COVID-19 Crisis, BIS Bulletin No. 24, 4 (June 2020).
17 International Chamber of Commerce, 2021 ICC Trade Register Report, at 20.
18 The Asian Development Bank estimated the global trade finance gap in 2020 to be USD $1.7 trillion, representing 10% of global trade; see Asian Development Bank, 2021 Trade Finance Gaps, Growth, and Job Survey, Brief No. 167, at 2, October 2021, available at https://www.adb.org/publications/2021-trade-finance-gaps-growth-jobs-survey.
19 This is due to different reasons, including technological and operational factors; documentary letters of credit require presentation and verification of voluminous documentation, while the receivables-based financing are more readily digitalized; see International Chamber of Commerce, 2021 ICC Trade Register Report, at p. 6.

B. Receivables & Factoring

Receivables, also referred to as "account receivables," are monetary obligations owed by a buyer incurred in a purchase of goods or services provided. These underlying transactions generate receivables that are typically financed by factoring companies. However, receivables may also arise under other types of transactions such as for the repayment of owed taxes that may be financed under other types of receivables-based finance products. The understanding of goods and services has significantly expanded in the last few decades. It is no longer limited to "trade receivables", which may be defined as amounts owed to a supplier when a buyer pays in the future for goods or services that have already been delivered.[20]

As commerce grows and new processes are developed, the range of "factorable" receivables expands. Goods now include several intangible components, such as licenses of intellectual property rights.

Most recently, attention has been given to receivables arising from contractual rights to payment for a sum of money relating to a data transaction, for instance, concerning the generation, exploitation, transfer, sharing, or control of data for commercial purposes. Such "data receivables" are a category of receivables that are separate and distinct from receivables arising from the assignment or license of intellectual property and should normally be covered under a modern private law framework for receivables finance.

The international standard for defining "receivable" is contained in the UNIDROIT Model Law on Factoring and encompasses a wide array of transactions. In fact, the law defines receivables as a "contractual right to payment of a monetary sum arising from one or more of the following (i) the supply or lease of goods or services; (ii) the assignment or license of intellectual property; (iii) the provision or processing of data; or (iv) the payment obligation for a credit card transaction".[21] The reference to "contractual right to payment" (emphasis added) is significant because it narrows the definition to receivables that arise by agreement. Not covered are payment rights that arise without an agreement with the debtor, such as from a judgement according to which a tortfeasor must pay a specified sum of money to compensate the plaintiff for damages.

However, some private law and regulatory frameworks may adopt a narrow definition of receivables. Limiting the definition of receivables to those arising from trade transactions in some regulatory frameworks (e.g., in Vietnam) may not correspond to the broader definition of receivables in the associated private law framework, and vice versa. As explored in Section II.A, the regulatory definitions concerned with financial activities and the private law definitions focused on transactional aspects must be carefully coordinated to avoid regulatory arbitrage and to ensure the uptake of factoring business in relevant markets.

20 See definition of "account receivable" from Black's Law Dictionary, available at https://thelawdictionary.org/accounts-receivable-2/ .
21 UNIDROIT Model Law on Factoring (2023), Article 2(g).

It is important to distinguish pure receivables from other payment rights. If the buyer (debtor of the receivables) draws a negotiable instrument to document its obligation to pay the purchase price in the future, finance is provided against the instrument and a different set of private law rules would be applicable (e.g., the law of negotiable instruments).[22] In such cases, the negotiable instrument embodies an independent payment obligation and serves as a substitute for the payment obligation out of the underlying pure receivable.[23] Forfaiting is the finance product underpinned by transfers of receivables embedded in negotiable instruments.

Box 1: Receivable Financing and Securitization

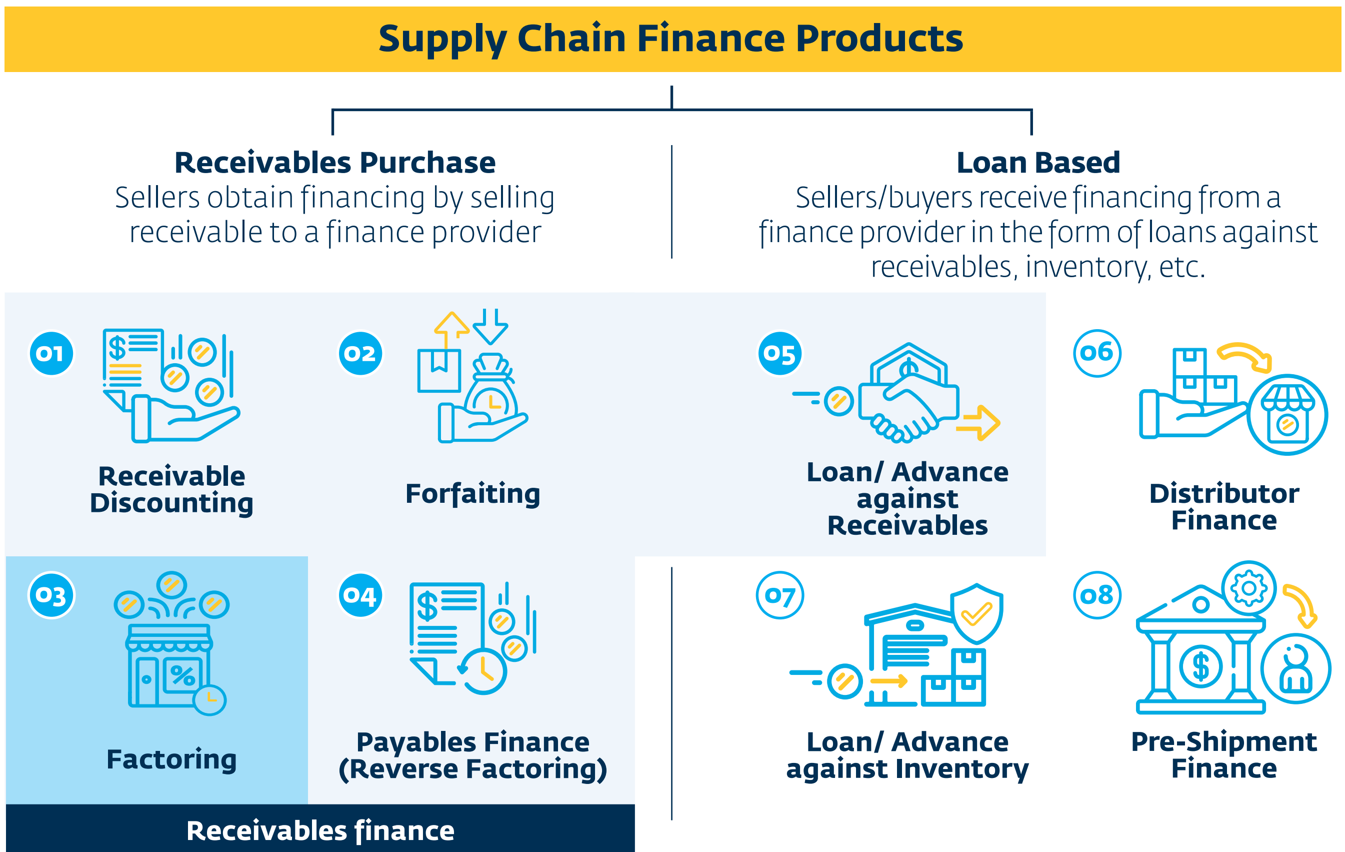
Receivables are an agile asset that may underpin more complex transactions, such as securitization. In securitization, receivables arise from assets, such as music royalties or mortgage loans. While the same type of private law framework governs the transfer of receivables, whether in factoring or securitization, the complexity of the latter requires other legislation to provide certainty to those involved in transactions, such as concerning securities. However, from a regulatory standpoint the regimes that apply to factoring and to securitization differ substantially. Securitization, in fact, follows a separate set of rules to be applied by financial institutions to issue or deal with structured financial products.

Besides serving as an asset that may be used to obtain financing, receivables are the lifeblood of any business organization. Analysis of the amount and quality of receivables allows finance providers to assess a company's overall financial stability and liquidity. For instance, receivables-to-sales ratio assists finance providers to determine how many sales have yet to be paid for. Moreover, receivables turnover ratio measures a company's effectiveness at collecting receivables.

In business contexts, factoring is often intended as a subset in the broader category of receivables finance. It can be either a specific product or a class of receivable-purchasing products within the broader group of SCF mechanisms (see Figure 1). The business definition of factoring tends to be narrow, understanding factoring as a specific type of product, and excluding other modalities of receivables finance, such as invoice discounting, whereby the financier does not provide "factoring services" to the supplier and the buyer isn't notified about the transfer. Yet, as further illustrated in Section III.C, the legal definition of factoring can be broader, and it may include a variety of products that involve a transfer of receivables.

22 David Fox et al., Sealy and Hooley's Commercial Law: Text, Cases, and Materials (Oxford University Press, 2020), p. 866.
23 Id.

Figure 1: Supply Chain Finance (SCF), Receivables Finance, and Factoring



Critically as products are tailored to different contexts, the separation between receivables purchase-based products and a loan-based ones is blurred. In fact, both modes of finance might be present within a single product. The GSCFF, in its Standard Definitions, for instance, indicates that a factoring contract may provide for "[a]dditional security interests [being] taken by the finance provider," either over the receivables themselves or other assets of the supplier.[24] Hence, as further shown in Section III.C, the implementation of a factoring law that contains both private law and regulatory elements can be designed to facilitate the development of a variety of products, mostly entailing receivable purchasing.

C. The Role of Technology

The development of new technological solutions has been supporting the emergence of new factoring products and business models. Technology, including distributed ledger technology (DLT) such as blockchain, has enabled different solutions to limit the risk associated with factoring, for instance by implementing cryptography to create invoice matching solutions.[25]

24 GSCFF, Standard Definitions available at http://supplychainfinanceforum.org/ICC-Standard-Definitions-for-Techniques-of-Supply-Chain-Finance-Global-SCF-Forum-2016.pdf. at p. 40.

25 See BIS and HKMA (2020) Innovation Challenge, https://ebd203e7-a0d2-4e28-b7b2-e4d5f7d7b145.filesusr.com/ugd/25da0a_681a2336fa5241bfaac0607c2ed8c0a6.pdf

New players have also emerged. Traditional factoring involves a financial institution and the seller of receivables or a debtor for reverse factoring. Technology now enables new methods of financing receivables. One example is receivables platforms that allow MSMEs to sell their receivables directly to a wide range of investors.[26] These platforms act as an intermediary that evaluates the receivables using technology.[27] Box 2 offers some examples of such platforms.

Box 2: Receivable Trading Platforms

India

The Receivables Exchange of India Ltd. The exchange maintains a receivables platform called the Trade Receivables Discounting System (TReDS) pursuant to guidelines issued by the Reserve Bank of India.[28] The TReDS accommodates both traditional factoring as well as reverse factoring. The transactions processed under TReDS are 'without recourse' to small businesses.[29] This was established in 2015 as part of a joint venture between the Small Industries Development Bank of India and the National Stock Exchange of India Limited.[30]

United Arab Emirates (UAE)

In 2020, the Emirates Development Bank introduced the *National Supply Chain Finance platform* – a buyer-led receivables platform to provide advance payment based on confirmed invoices.[31] The supplier delivers the goods and invoice to the buyer, who uploads the invoice onto the platform. The Emirates Development Bank provides the supplier with early payment and collects payment from the buyer on the due date of the invoice. According to the development bank, the SCF platform can be adapted to different regulatory and economic environments.

The deployment of new technology solutions is not limited to receivables platforms. Many governments, especially in Latin America, have implemented electronic invoicing (e-invoicing) systems to facilitate the collection of taxes,[32] which are separate from receivables platforms and exchanges. These systems facilitate the establishment of receivables platforms and exchanges for negotiable "electronic assets".[33] In Chile, the mandatory nature of e-invoicing has stimulated the development of factoring due to the greater security and speed with which transactions can be carried out relative to paper invoicing (see Box 3).[34]

26 World Bank Group, Capital Markets and SMEs in Emerging Markets and Developing Economies: Can They Go the Distance? (The World Bank Group, 2020), p. 24, https://openknowledge.worldbank.org/handle/10986/33373.
27 Id.
28 Id. See also RBI Guidelines for setting up of and operating the Trade Receivables Discounting System (TReDS), available at https://rbi.org.in/scripts/bs_viewcontent.aspx?id=2904.
29 Id.
30 See "About RXIL" on the RXIL website, available at https://www.rxil.in/AboutUs/WhoWeAre.
31 See a description of the National Supply Chain Finance platform on the EBD website, available at https://www.edb.gov.ae/ext/pages/national-supply-chain-finance.html.
32 Supra at Dubovec et al, supra n 15 at p. 14.
33 Id.
34 Alberto Berreix and Raul Zambrano (Editors), Electronic Invoicing in Latin America (IBD, 2018), https://publications.iadb.org/publications/english/document/Electronic-Invoicing-in-Latin-America.pdf.

Box 3: Case Study - Trading Receivables in Chile

The Chilean Commodity Exchange (Bolsa de Productos de Chile) offers a public auction platform for the trading of receivables owed by large buyers,[35] which allows small businesses to obtain advances on their receivables.[36] Increasingly, factoring companies participate in the platform selling their portfolios of receivables.[37] Sales are without recourse.[38] The establishment of the receivables exchange in Chile was made possible through the adoption of the Law on the Regulation of a Commodity Exchange for Agricultural Production,[39] which was amended in 2007 to provide "unique legal safeguards for investors that acquire invoices through the exchange, protecting them from any encumbrance that may affect an invoice."[40]

In respect to the regulatory environment enabling the implementation of digital solutions for receivable finance, a jurisdiction-specific diagnostic should be conducted. The establishment of secondary markets for receivables may even benefit from coordination with ongoing efforts to deploy technology for supervision and monitoring purposes – known as regulatory technology (RegTech) and supervisory technology (SupTech). In fact, digital reporting systems combined with data analytics can facilitate compliance with anti-money laundering and combating the financing of terrorism (AML/CFT) rules while monitoring risks.

The introduction of technology-based solutions supporting secondary markets may also trigger different and additional regulatory requirements, as trading platforms for receivables may be considered regulated market activities. Technology-focused regulatory regimes, like those regulating data collection and distributed ledger technologies, may apply to secondary markets.[41] Coordination with these regulatory regimes can further enhance the development and deployment of receivables finance digitally.

However, the digitalization of receivables-based products is likely to intersect with the emerging regulatory regimes for data governance. Numerous jurisdictions are implementing not only data protection and privacy frameworks but also requirements for the sharing of information across a variety of services and activities, generating unique "data governance styles" to assert sovereignty on data and data flows to minimize the risk of monopolistic behaviour in the data economy.[42]

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35 Financing SMEs and Entrepreneurs: An OECD Scorecard (2017), p. 78.
36 Id.
37 Id.
38 Id.
39 The Law on the Regulation of a Commodity Exchange for Agricultural Production is available at https://docs.chile.justia.com/nacionales/leyes/ley-n-19-220.pdf.
40 Supra at OECD, note 38.
41 World Bank Group (2020), Note 1. Collateral Registry, Secured Transactions Law and Practice, Distributed Ledger Technology & Secured Transactions: Legal, Regulatory and Technological Perspectives - Guidance Notes Series (May 2020).
42 For an analysis of "data governance styles" and their impact on cross-border transactions see Douglas W. Arner, Giuliano G. Castellano, and Eriks K. Selga, The Transnational Data Governance Problem, 37 Berkeley Tech. L. J. 623 (2022) http://dx.doi.org/10.2139/ssrn.3912487.

As finance is increasingly digitalized, these rules intersect with; traditional financial regulation regimes, emerging "open banking" and "open finance" policies (requiring financial institutions to share collected information with other market players), data ownership and control requirements (giving the right to the consumer to transfer their personal data), as well as more direct requirements to control the circulation of data and limit its commercial use.[43] Ensuring coordination between these different regimes is a necessary condition to support the development of digital solutions for receivables finance. For instance, to enable data already acquired through open banking initiatives to be shared with alternative lenders or used to assess the riskiness of a borrower.

D. Legal Harmonization: The Role of UNCITRAL and UNIDROIT

UNCITRAL and UNIDROIT have been striving to facilitate access to credit with the definition of international legal standards. These efforts resulted in the adoption of both general instruments, such as the UNCITRAL Model Law on Secured Transactions (MLST, 2016) applicable to all types of secured transactions, and asset or product-specific instruments, such as the UNIDROIT Model Law on Factoring (MLF, 2023), the Factoring Convention (1988), the Receivables Convention (2001) and the Convention on International Interests in Mobile Equipment (Cape Town Convention, 2001). Once implemented domestically, these instruments promote the use of collateral through the establishment of clear private law rules.

In 2023, UNIDROIT adopted the MLF.[44] The MLF provides a comprehensive, standalone private law framework for the creation, perfection, registration, priority, and enforcement of transfers of receivables, both in "security" as well as outright (sales). These rules govern the legal relationship between the various parties to the transaction, including the finance provider, the supplier of goods and services (the transferor of receivables), the buyer of goods and services (the debtor of the receivables), and third parties that have competing interests in the receivables.

The MLF offers a template of private law rules to establish a legal environment that is conducive to domestic factoring, which accounts for 79 percent of global factoring volume.[45] The private law rules governing transfers of receivables in the MLF closely align with those in earlier instruments, including the MLST and the Receivables Convention.

Crucially, as a fundamental instrument for jurisdictions seeking to facilitate trade finance, access to credit and economic development, the MLF has been recognized as a key component of the Legal/Regulatory Infrastructure pillar of the Financial Inclusion in Trade Roadmap launched by the World Trade Board in 2023 to promote fair and equitable access to trade finance.[46] Yet, regulation falls outside the purview of the MLF as well as other secured transactions law instruments such as the MLST.

43 The convergence of these regimes entails a unique form of intersection between branches of the law (see infra note 47 and accompanying text) and generates a phenomenon defined as "financial data governance"; see Douglas W. Arner, Giuliano G. Castellano, and Eriks K. Selga, Financial Data Governance, 74 Hastings L. J. (2023), www.dx.doi.org/10.2139/ssrn.4040604

44 The preparatory works of the Model Law on Factoring and related discussions are available at https://www.unidroit.org/work-in-progress/factoring-model-law/.

45 Id.

46 World Trade Board, Financial Inclusion in Trade Roadmap 2023, https://worldtradesymposium.com/world-trade-views/financial-inclusion-trade-roadmap-world-trade-board-seeks-industry-feedback-collaboration

As indicated by research, harmonious coordination between different branches of the law is essential to support secured lending and, in particular, receivables finance.[47] Based on these findings and on the assistance provided in law reforms, as further elaborated in Section II, IFC has issued a Primer on Coordinating Prudential Regulation and Secured Transactions Frameworks (IFC Primer) to guide coordination efforts at the domestic level.[48] Similarly, in 2019, UNCITRAL adopted the Practice Guide to the MLST, in which it is expressly indicated that law reformers must ensure coordination between secured transactions law and prudential regulatory frameworks to ensure a sound and inclusive credit ecosystem.

As commentators flagged the need for coordinating regulation and private law aspects to support factoring activities,[49] the MLF Guide to Enactment will likely address some regulatory issues indicating the importance of establishing clear regulatory regimes on factoring. Drawing from these findings and in consideration of the actual needs of domestic law reformers, this Knowledge Guide represents a more decisive step to support law reforms in establishing a cohesive legal and regulatory framework for receivables finance.

Thorough guidance on the implementation of a sound regulatory framework is needed at the early stages of the reform process. It is recognized that the primary beneficiaries of a reformed framework for secured lending are financial institutions, borrowers (including and especially MSMEs), lawyers and the public at large. Nonetheless, the primary audience of international legal standards are the authorities leading the reform process, which includes governmental bodies, central banks, and regulatory agencies. For general secured transactions laws, ministries and departments with jurisdictional competence on justice and economic development typically take the lead. In the context of factoring, leasing, and warehouse receipts laws, central banks and independent administrative authorities entrusted with the power to regulate and supervise non-bank (non-deposit taking) financial institutions and other entities are typically leading the reform process. These authorities are concerned with promoting market integrity, ensuring protection for customers and investors, and maintaining financial stability. Hence, the implementation of a new private law regime must fit within regulatory priorities and key policy objectives.

In this context, the enactment of a factoring law at the domestic level entails the implementation of both private law rules and regulatory provisions. This trend emerges from recently implemented factoring laws, such as the one adopted in the UAE, as well as in laws covering leasing and factoring, such as those implemented in Egypt and Turkey, and ongoing efforts to enact such laws, as reflected in the current reform projects in Azerbaijan, Georgia, Jordan, the Philippines, Ukraine, Uzbekistan, West Bank and Gaza. The expectation is that newly enacted laws for factoring govern not only private law aspects, but also, and in particular, regulatory rules.

47 Giuliano G. Castellano & Andrea Tosato, Commercial Law Intersections, 72 Hastings L. J. 2021, 999 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3558378 [hereinafter Commercial Law Intersections 2021].

48 International Finance Corporation, 'Coordinating Prudential Regulation and Secured Transactions Frameworks: A Primer' (International Finance Corporation 2020) http://hdl.handle.net/10986/34813 [hereinafter IFC Primer 2020].

49 This point has been noted by Giuliano G. Castellano and Marek Dubovec, UNIDROIT Access to Credit Instruments, in Ben Köhler, Rishi Gulati, and Thomas John (eds) Elgar Companion to UNIDROIT (Edward Elgar, forthcoming 2023) and reflected in Summary Report of the Third Session, May 26-28, 2021, para 91, https://www.unidroit.org/wp-content/uploads/2021/11/Study-LVIII-A-%E2%80%93-W.G.3-%E2%80%93-Doc.-4-Report.pdf.

Box 4: The Role of Private-Sector Organizations

In addition to international organizations, private-sector bodies are active in promoting factoring. Their role is to provide practical guidance supplementing international standards. In 2016, several of these entities developed the Standard Definitions for Supply Chain Finance (Standard Definitions) as part of the Global Supply Chain Finance Forum.[50] The entities involved include the Bankers Association of Finance and Trade, the Euro Banking Association, Factoring Chain International, Interface Financial Group, the International Chamber of Commerce, and the International Trade & Forfaiting Association .[51] The purpose of the Standard Definitions is to help create a consistent and common understanding of supply chain finance.[52]

Factoring Chain International, in particular, has published a series of key instruments, including the General Rules for International Factoring (GRIF),[53] governing the legal relationship between a supplier, a buyer, an export factor, and an import factor,[54] and the Supplemental Agreement for Islamic International Factoring, which contains some deviations from GRIF to ensure compliance with Shariah principles.[55]

The harmonization efforts advanced by international organizations and industry-led initiatives do not supplant the need for a modern legal and regulatory framework for factoring. Following the adoption of the MLF, economies have a larger menu of options when it comes to the types of private law-focused international standards that they can implement. Economies that wish to undertake broad secured transactions reforms can use the MLST as the basis of their domestic legislation, which includes rules for receivables finance and factoring. For those economies that want to undertake a more targeted legal reform supporting receivables finance and factoring, the MLF provides the best legal standard.

50 GSCFF, Standard Definitions.
51 Id.
52 Id. at 7.
53 A 2013 version of GRIF is available at https://www.tebfaktoring.com.tr/sites/1/upload/files/9_FCI_GRIF-35.pdf.
54 See Art. 2 of GRIF.
55 Id.

II. REGULATORY TRENDS

Financial institutions offering factoring products are not subjected to a uniform set of specialized regulatory standards that are internationally harmonized. Although industry and international best practices are emerging, the regulatory governance of factoring activities and entities remains largely a domestic endeavor. In this context, private law rules, harmonized internationally, coalesce with different domestic regulatory and supervisory frameworks. The establishment of sound regulatory frameworks for factoring activities therefore requires that various elements of domestic legal and regulatory systems are connected and coordinated.

This section examines the main regulatory trends that are driving the demand for the establishment of a comprehensive regulatory regime for factoring. First, international and domestic contextual considerations are presented to frame the problems related to factoring regulation and the broader efforts to ensure legal and regulatory coordination. Second, there is an overview of how factoring is regulated in a sample of selected jurisdictions. Finally, the reasons for the increased demand for factoring regulation are examined.

A. Coordinating Private Law and Financial Regulation

In recent years, coordination between private law and financial regulation has become a critical policy matter in the context of secured transactions to promote access to credit and financial inclusion. An emerging body of academic research has served as the basis for elaborating international guidance and addressing domestic legal and regulatory reforms in this context. In particular, scholarly research has demonstrated that one of the key reasons secured transactions reforms have not always delivered the promised results relates to the lack of coordination between private law rules and regulatory frameworks governing the extension of credit.[56]

Although several elements might hamper the effectiveness of legal reforms aimed at unlocking access to credit through secured transactions, including the lack of capacity of local financial institutions and friction with existing laws,[57] fostering coordination between private law and regulatory frameworks is key to promote both access to credit and financial stability.[58] Crucially, transactions enabling access to credit through the use of collateral are characterized by an overlap between secured transactions law and financial regulation – typically consisting of conduct of business and prudential rules. Such an overlap generates a legal phenomenon that is defined as a "commercial law intersection".[59]

56 Giuliano G. Castellano and Marek Dubovec, ***Credit Creation: Reconciling Legal and Regulatory Incentives,*** 81 Law & Contemp. Probs. 63 (2018) [hereinafter Credit Creation 2018]; Giuliano G. Castellano and Marek Dubovec, ***Global Regulatory Standards and Secured Transactions Law Reforms: At the Crossroad between Access to Credit and Financial Stability,*** 41(3) Fordham Int'l L.J. 531 (2018) [hereinafter Global Regulatory Standards 2018]; and Giuliano G. Castellano and Marek Dubovec, ***Bridging the Gap: The Regulatory Dimension of Secured Transactions Law Reforms***, 22(4) Uniform L. Rev. (2017) [hereinafter Bridging the Gap 2017].

57 See, most notably, Katharina Pistor, ***The Standardization of Law and its Effect on Developing Economies*** (2002) 50(1) Am. J. Comp. L. 97 - 130.

58 Global Regulatory Standards 2018 supra note 56 (noting that access to credit and financial stability are compatible and complementary objectives).

59 See Commercial Law Intersections 2021 supra note 47 (defining a CLI as a transaction or a corporate action which falls concurrently within the purview of two or more commercial law branches engendering an overlap).

Products, in particular factoring and supply chain finance, can only be executed successfully if the convergence between these branches affecting commercial transactions does not give rise to such "coordination failures". Instead, it is important that "legal coherence" is attained.[60] Based on these observations, a series of recommendations have been distilled to guide international organizations and domestic policymakers. Such recommendations are primarily contained in the in the IFC Primer 2020 and in UNCITRAL the Practice Guide to the MLST.

A modern secured transactions framework enables credit-risk management through legal entitlements in virtually any asset that serves as collateral. However, the improved risk profile of loans secured with collateral does not necessarily affect the treatment of such loans for regulatory purposes, under existing prudential requirements. In fact, prudential regulation, in particular capital requirements for banks, consider only highly liquid assets as eligible collateral, such as bank deposits and gold.[61] Hence, loans secured with movable assets, such as inventory and receivables of MSMEs, are likely to be treated as unsecured loans for regulatory purposes. In emerging economies, this situation generates a misalignment of incentives between secured transactions law reforms and prudential regulation. As a result, non-banking financial institutions (NBFIs) – to which less stringent prudential rules generally apply – are more amenable to extend secured loans, whereas banks might be less incentivized to engage in commercial lending through secured transactions.[62] This may limit secured lending in jurisdictions where the NBFI sector is not well developed or mostly focused on micro-lending.

As sound credit ecosystems require a variety of players to support both financial inclusion and stability, the set of incentives established by legal and regulatory rules should avoid unnecessary distortions. To this end, the problem should be addressed both internationally and domestically. Internationally, initiatives to harmonize private law should coordinate with existing regulatory policies and international standards.[63] Domestically, a reform strategy supporting a sound and inclusive credit ecosystem must be devised and tailored to the characteristics of each jurisdiction.[64]

i. International Coordination

At the international level, coordinating private law and regulatory frameworks has entered in the agenda of UNCITRAL. In 2019, UNCITRAL adopted the Practice Guide to the MLST, which features a chapter on prudential regulation.[65] Based on research on the coordination (and lack thereof) of secured transactions law and prudential regulation,[66]

60 Id. at pp. 1020, 1028.
61 Credit Creation 2018 supra note 56 at p. 77.
62 Id. at pp. 82-83.
63 Global Legal Standards, supra note 53.
64 On the concept of "reform strategy" for secured transactions law reforms see Giuliano G. Castellano, Reforming Non-Possessory Secured Transactions Laws: A New Strategy? 78 The Modern Law Review (2015) 611 available at https://ssrn.com/abstract=2625827 [hereinafter Reforming Secured Transactions Law, 2015]
65 See UNCITRAL, Practice Guide to the Model Law on Secured Transactions (2019), Chapter 3.
66 See Credit Creation 2018 supra note 53 at p. 82, noting that UNCITRAL shaped secured transactions law rules based on the assumption "that there are no conflicts [...] with banking regulation and, accordingly, that a modern legal regime governing secured transactions equally benefits banks and non-bank lenders".

UNCITRAL relaxed its original policy (contained in the UNCITRAL Legislative Guide on Secured Transactions) of not dealing with regulatory matters related to banking institutions.[67] A new policy stance indicating the need for coordinating private law and regulatory elements took shape through extensive consultations in different venues, including a UNCITRAL Colloquium on Secured Transactions[68] and The Fourth International Congress of UNCITRAL in 2017.[69] As the need for coordinating secured transactions with prudential regulation was accepted by UNCITRAL, new initiatives of private law harmonization have been covering this critical aspect.

Both UNCITRAL and UNIDROIT have included legal and regulatory coordination as part of their ongoing projects. The current initiative of UNCITRAL on fostering access to credit is considering the impact of regulatory standards on credit supply.[70] UNIDROIT has been flagging the relevance of coordinating private law rules and regulation in its ongoing projects, in particular the MLF, the Draft Model Law on Warehouse Receipts (jointly with UNCITRAL), the Principles on Digital Assets, and the Bank Insolvency Project. While regulatory aspects are not expected to be addressed in the rules or principles elaborated by UNIDROIT, accompanying guides and commentaries implemented to assist the implementation of rules and principles may cover this matter.

ii. Domestic Strategy

At the domestic level, coordination is ensured through a reform strategy that adopts a common methodology while being tailored to the characteristics of each jurisdiction. Such a strategy aims at setting out a level playing field for different types of financial institutions, having in view three core principles:

1. Reforms should avoid frictions with existing laws by focusing on the implementation of necessary and mechanical rules enabling access to credit.[71]
2. Coordination between private law and regulatory frameworks must be ensured in alignment with international standards and without pursuing unnecessary deregulatory policies.[72]
3. Reforms aimed at coordinating legal and regulatory rules should promote legal coherence, intended as the establishment of a cohesive legal and regulatory framework governing specific products and transactions spurring access to credit.[73]

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67 The UNCITRAL Legislative Guide on Secured Transactions (2010) states that secured transactions laws are "designed to apply equally to a wide range of credit providers: financial institutions and other lenders". Castellano and Dubovec demonstrated that this assumption is not correct; see Credit Creation 2018 and Global Legal Standards 2018, supra note 53.

68 See, e.g., Giuliano G. Castellano, Secured Transactions Law and Capital Requirements Enhancing Access to Credit and Financial Stability, UNCITRAL Fourth International Colloquium on Secured Transactions (15-17 March 2017, Vienna) available at https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/uncitral_colloquium_2017_g_castellano.pdf.

69 See Giuliano G. Castellano and Marek Dubovec, Coordinating Secured Transaction Law and Capital Requirements. Modernizing International Trade Law to Support Innovation and Sustainable Development (Vienna 4 – 6 July 2017, Volume 4: Papers presented at the Congress) p. 166 https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/17-06783_ebook.pdf.

70 See UNCITRAL, Note by the Secretariat, Access to Credit for Micro, Small and Medium-sized Enterprises (MSMEs), 28 July 2021, at 14 highlight the regulatory constraints in accessing trade finance, https://undocs.org/en/A/CN.9/WG.I/WP.124.

71 Reforming Secured Transactions Laws 2015 supra note 61.

72 Bridging the Gap 2017 supra note 56.

73 Commercial Law Intersections 2021 supra note 47.

These high-level principles have been reflected in the initiatives of the World Bank to enhance coordination at the domestic level and globally. In particular, the World Bank's Knowledge Guide on Secured Transactions, Collateral Registries, and Movable Asset-Based Financing of 2019 explores issues of coordinating secured transactions regimes with regulatory frameworks supporting the implementation of the above strategy.[74] As legal and regulatory coordination is a central component of numerous (ongoing) projects in various regions – including Asia-Pacific, Central Asia, Eastern Europe, Latin America and the Caribbean, and Middle-East and Northern Africa –the IFC Primer has been developed to guide such coordination efforts at the domestic level.[75] The IFC Primer, by embracing the notion of Commercial Law Intersection, further elaborates on the core elements of a reform strategy designed to promote legal and regulatory coherence.[76] As this approach is geared to support the development of a variety of asset-based lending and SCF products, including factoring, the establishment of a regulatory regime for factoring stems from the overall efforts to promote legal and regulatory coordination.

B. Factoring Laws and Regulatory Standards

In the absence of a harmonized set of regulatory standards specifically designed for factoring entities and activities, jurisdictions have developed different approaches. Domestic approaches range from the absence of licensing requirements for factoring companies to the extension of regulatory regimes for banks and NBFIs to any entity offering factoring. In some instances, factoring has been considered an "unregulated activity".

Yet, this latter categorization might be misleading. Considering factoring as an unregulated activity might indicate that (i) factoring does not qualify as a regulated activity and there is no specific entry regulation, such as license or authorization, or (ii) that there are some gaps in the regulatory framework for financial services whereby a financing arrangement can be offered to customers without any basic form of protection.

Provided that there are no significant gaps in domestic legal systems, factoring activities and entities are subject to different regulatory regimes. First, at the most basic level, even when factoring entities are not subjected to specific licensing requirements, a series of regulatory standards might still be applicable. Typically, some elements of domestic conduct of business regulation might apply to ensure some basic protections for customers and the maintenance of market integrity through anti-money laundering and counter-terrorism financing (AML/CTF) regulation. In addition, self-regulatory regimes are common in markets where factoring is developed.

74 The Knowledge Guide expressly indicate the need for a cohesive implementation of legal and regulatory standards, while promoting a culture of compliance; see World Bank, Secured Transactions, Collateral Registries and Movable Asset-Based Financing: Knowledge Guide (World Bank, 2019) at p. 32
https://openknowledge.worldbank.org/handle/10986/32551.
75 IFC Primer 2020 supra n 48.
76 Id. at p.12.

Second and more commonly, factoring is considered a regulated activity. Legislative statutes or delegated acts might expressly refer to factoring as one of the regulated financial services. In some jurisdictions, factoring is specifically enumerated amongst the activities that regulated credit institutions – such as banks and NBFIs – may be authorized to offer. Hence, the regulatory regimes applicable to such entities are extended to factoring products. In particular, several jurisdictions restrict factoring to banks. Legislation in Belarus and Tajikistan[77] classifies factoring as a type of "banking activity" that requires a banking license. Even though a license is required to undertake factoring activities within these two jurisdictions, the overarching regulatory framework is specific to banking rather than factoring. Yet, projects for introducing a specialized regulatory regime for factoring are ongoing in Belarus.

Third, when factoring products are offered by regulated entities, the general regulatory framework for such entities applies. For example, if the transaction is carried out by a licensed financial institution, such as a bank or other credit provider, factoring products are offered under the regulatory framework for such regulated entities. Moreover, if a factoring platform was to be opened to the public, it can be subject to the regulatory and supervisory framework for regulated market and trading venues.[78]

In a growing number of jurisdictions, factoring activities fall within the perimeter of financial regulation through a specialized (factoring) law that contains both private law aspects and core regulatory requirements for factoring companies, as shown in table 1. In this context, supervisory functions are clearly allocated and a special licensing regime is established for NBFIs engaging exclusively in factoring activities. Such a separate set of rules complements and coordinates with those normally applied to banks and NBFIs.

77 The Belarusian Banking Code (2000) is available at https://pravo.by/document/?guid=3871&p0=hk0000441; and the Tajik Law on Banking Activity (2009) is available at http://ncz.tj/content/закон-республики-таджикистан-о-банковской-деятельности.

78 See Monetary Authority of Singapore, Securities and Futures Act (Cap. 289), Frequently Asked Questions on Licensing and Business Conduct (2019), available at https://www.mas.gov.sg/-/media/MAS/Regulations-and-Financial-Stability/Regulations-Guidance-and-Licensing/Securities-Futures-and-Fund-Management/Regulations-Guidance-and-Licensing/Guidelines/SFA-FAQs-on-licensing-and-business-conduct-other-than-for-FMCs-updated-on-13-Sept-2019.pdf

Table 1: Specialized Factoring Laws and Regulations

Jurisdiction	Reformed STL	Specialized Factoring	
		Law	Regulation
Asia Pacific			
China (mainland)	●	●	●
Hong Kong SAR	—	—	—
India	●	●	●
Singapore	—	—	—
Central Asia & Eastern Europe			
Armenia	●	●	—
Georgia	●	*Pending*	*Pending*
Kazakhstan	●	●	—
Tajikistan	●	●	—
Belarus	●	●	*Pending*
Bulgaria	●	—	—
Ukraine	●	*Pending*	*Pending*
Uzbekistan	●	—	—
Latin America & the Caribbean			
Brazil	●	—	—
Chile	—	●	●
Colombia	●	●	●
Mexico	●	—	—
Peru	●	●	—
Middle East & North Africa			
Egypt	●	●	●
Greece	—	●	●
Jordan	●	*Pending*	●/*Pending*
Saudi Arabia	●	—	—
Turkey	●	●	●
UAE	●	●	*Pending*
Sub-Saharan Africa			
Malawi	●	—	—
Nigeria	●	*Pending*	*Pending*
Uganda	●	—	—
Zimbabwe	●	—	—

Table 1 shows which jurisdictions, in a representative sample, have implemented a reformed secured transactions law ("STL") and/or have implemented specialized factoring law (●), and which don't (—). The twenty-four (24) jurisdictions in the sample are divided into five regions: 1) Asia-Pacific; 2) Central Asia & Eastern Europe; 3) Latin- America and the Caribbean; 4) Middle East and North Africa; and 5) Sub-Saharan Africa. The key takeaway is that reformed secured transactions law and factoring law are quite common and often followed by regulatory reforms.

Whether a specialized legal framework for factoring is enacted as a standalone law or as a complement to a general secured transactions law, many jurisdictions lack a specialized regulatory framework. For instance, in Armenia, Kazakhstan, and Tajikistan, general secured transaction laws and specialized factoring laws coexist. Nonetheless, the regulatory treatment for NBFIs undertaking factoring activities is not subject to any specific rule. One of the main motives to introduce a dedicated regulatory framework for factoring relates to the benefits that a clear licensing requirement entails, as the ongoing reform project in Ukraine demonstrate. In 2023, the (National Bank of Ukraine issued a concept paper for the adoption of a specialized factoring framework, comprising both private law and regulatory elements.[79] While factoring represents the second largest financial service offered by NBFIs in the country, it primarily entails the purchasing and transferring of non-performing loans (and their subsequent collection). To unlock the potential of factoring for the local economy, the National Bank of Ukraine is leading an ambitious reform project with a dedicated licensing mechanism for NBFIs engaging in the financing of receivables. Similarly, in Jordan, where new regulation has been enacted requiring a license for any type of financial activity undertaken by NBFI, including factoring,[80] an ongoing reform project aims to establish a specialized licensing regime for factoring activities. Even in jurisdictions where companies may offer receivables finance products without a license, such as Kazakhstan and the UAE,[81] the implementation of a specific factoring regulatory regime with licensing requirements for NBFIs is under consideration.

Although different approaches can be adopted to bring factoring into the regulatory perimeter, each path chosen poses specific challenges. When factoring is enumerated as one of the activities that regulated entities can offer, the applicable regulatory regimes for such entities are generally straightforward. A bank or an NBFI engaging in receivables finance, must comply with all prudential and conduct of business requirements that normally apply to banks and NBFIs. However, it might be uncertain whether an unlicensed financial institution can operate a factoring business without any licensing requirements. In such a grey area, factoring companies might be established, but their potential to grow could be limited by uncertainties and limited liquidity.

C. The Growing Demand for Factoring Regulation

Demand for a regulatory framework establishing a factoring license for NBFIs and a set of simplified prudential and conduct of business rules has been increasing due mainly to two reasons. First, factoring laws – as other product-specific laws – are primarily implemented by financial regulators. As the mandate of regulators is to maintain the stability of the financial system and to protect its integrity, the introduction of a new financial product within the domestic market should respect these core policy objectives. Second, financial institutions are the primary beneficiaries of a clear, transparent, and efficient legal and regulatory framework for factoring. The existence of clear rules advances confidence in the market and promotes its development.

79 National Bank of Ukraine, Factoring Regulation Reform Concept for Ukraine (2023)
80 Finance Companies Regulation No. 107 of 2021, which came into force on 30 May 2022
81 The Kazakh Law on State Regulation, Control and Supervision of the Financial Market and Financial Organizations (2003) is available at https://online.zakon.kz/Document/?doc_id=1041467.

These dynamics emerge also in advanced economies. For instance, in Hong Kong, there is no specific regulatory framework for factoring. However, new digital platforms offering trade finance, and specifically receivable financing products, have demanded to be regulated. This is the case, for example, of Velotrade, a trade finance digital platform that has been granted from the Securities and Futures Commission a Type 1 license to place, trade, and underwrite securities for clients.[82] In a similar vein, advanced companies operating in this space, such as Qupital that implements a data-based risk and machine learning model to facilitate e-commerce finance, operates under a money lender license. This trend has been noted also in Singapore, where factoring is not enumerated as a regulated activity but some financing groups offering factoring products often operate through licensed companies to provide their services, including receivable financing.[83]

The demand for factoring regulation stems from specific benefits. Inclusion in the regulatory perimeter and the adherence to established regulatory standards to increase liquidity for factoring companies. In fact, existing limitations on investing in non-regulated markets may block regulated entities, such as institutional investors, to invest in factoring companies or platforms that are not licensed.[84] In addition, regulatory regimes entail a signaling effect as licensed financial institutions, as they are subject to regulatory requirements and ongoing supervision, are considered more reliable, increasing investors' confidence.

More broadly, the establishment of a sound and clear regulatory framework reflects critical public policy objectives. The undertaking of factoring activities under a well-defined licensing framework provides for a higher level of customer protection. The establishment of clear conduct of business rules and proportionate prudential requirements for financial institutions engaging in receivables finance promote market integrity and financial stability.

As regulatory standards directly contribute to the organic development of a sound credit market, they are often a critical component in the context of factoring law reforms. As shown in Table 2, most of the jurisdictions that, in the considered sample, have implemented a private law framework for factoring transactions, have also implemented an ad hoc regulatory framework. Whereas jurisdictions that are currently considering the implementation of factoring legal frameworks are also considering the implementation of new regulatory frameworks.

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82 World Bank Group, Note 2: Regulatory Implications of Integrating Digital Assets and Distributed Ledgers in Credit Ecosystems, Distributed Ledger Technology & Secured Transactions: Legal, Regulatory and Technological Perspectives - Guidance Notes Series (May 2020) p. 36.

83 This is the case of IFS Consumer Services Private Limited, a licensed moneylender and a part of the IFS Capital Group which provides factoring and loans to MSMEs in the region. Their services include working-capital loans to companies that alleviate their cash flows gaps while their "next payments arrive". See Friday Finance, Loan Types & Features (2021) available at https://www.fridayfinance.sg/loan-types-features.

84 Id.

Table 2: Relationship between Factoring Law and Regulatory Regimes

Jurisdiction	Specialized Factoring	
	Law	Regulation
Armenia	●	▬
Chile	●	●
China (mainland)	●	●
Colombia	●	●
Egypt	●	●
Greece	●	●
India	●	●
Kazakhstan	●	▬
Tajikistan	●	▬
Turkey	●	●

III. FACTORING AND THE REGULATORY PERIMETER

In light of the regulatory trends discussed in Section II and given the growing demand for a cohesive and clear regulatory framework for factoring, domestic policymakers and authorities would benefit from some guidance as they embark on the process of establishing a comprehensive legal and regulatory framework for factoring. While the private law elements of a factoring law apply to any type of financier, be it a bank or an NBFIs, anytime a transfer of receivables occurs, regulatory standards have a more limited scope. They are not concerned with regulating factoring contracts per se, rather they focus on entities offering such product as part of their business activities. Because banks are normally subject to specific regulatory and supervisory requirements, a regulatory framework for factoring is primarily concerned with the establishment of a clear framework for NBFIs, such as factoring companies, while ensuring coordination with existing regulatory regimes and, in particular, those applicable to banks.

In view of these considerations, this section introduces the fundamental choices that law reformers must consider when implementing a factoring regulatory framework. First, it examines the possibility of enacting a regulatory framework for factoring through different statutory instruments. Second, it provides an overview of the main regulatory areas. Finally, it expounds key definitory matters to ensure coordination between private law and regulatory elements.

A. Factoring Law and Regulation: Legislative Choices

A fundamental policy choice concerns whether the regulatory framework for factoring activities should be included in a legislative act or in secondary or tertiary (administrative) acts. The choice is bound to specific legal and regulatory considerations, mostly dependent on domestic constitutional and administrative law.

The enactment of a specialized legislative act is the preferred approach to bring factoring into the regulatory perimeter and under the purview of domestic supervisors. In general, regulating factoring implies the establishment of a mandatory licensing requirement, which will impose some limitation on private business activities to maintain the stability of the financial system and preserve its integrity. If licensing requirements and supervisory functions are linked to a primary legislation, any limitation to market activities is clearly framed in an act with the highest constitutional ranking. In this context, supervisors can be mandated with delegated regulatory powers allowing them to enact more detailed requirements.

The inclusion of general requirements and regulatory powers in a legislative act also has strong signaling effects. The enactment of a law has the effect of flagging a clear and credible commitment that local policymakers intend to establish a sound regulatory environment to promote factoring activities.

Finally, a factoring law that governs private law aspects while covering key regulatory areas enhance legal and regulatory coordination and coherence. The implementation of a single legal statue ensures the avoidance of "coordination failure"[85] that typically emerge when a transaction is governed by different branches of the law and regulation. As illustrated in Section II.C coordination between private law rules and regulation is of critical importance. If the legal and regulatory elements of factoring are contained within the same legislative act, legal coherence can be bolstered, the risk of interpretative ambiguities and regulatory arbitrage will be reduced given that core legal and regulatory definitions are coordinated.

Figure 2: Connecting Private Law and Regulatory Elements

Reformed Factoring Framework

SECURED TRANSACTIONS LAW REFORMS	FACTORING LAW	DELEGATED ACTS
Domestic secured transactions law affects registration and priority of the rights of factors.	Comprehensive framework for financial institutions engaging in factoring.	Specific aspects defined by local authorities.

PRIVATE LAW		REGULATORY FRAMEWORK	
Coordination with the new factoring law might be needed to ensure legal coherence.	• Definitions (legal) • Receivable finance • Outright and security transfers	• Definitions (reg.) • Processes • Supervision	• Requirements • Delegation • Adiustments

The resulting (reformed) framework for factoring is designed to connect to different components of domestic legal and regulatory systems (Figure 2). On the private law side, coordination with secured transaction law and relevant statutes is ensured through definitions that are organic and in alignment with general principles.

Second-best solutions entailing the implementation of separate statutes covering private law and regulation elements might be considered, as long as conformity with fundamental constitutional principles, clear regulatory commitment, and coordination are ensured. Although it is generally preferable to insert the regulatory regime for factoring in the same legislative act containing private law rules, local constraints might block this route. In such an instance, different jurisdiction-specific strategies can be devised. For instance, administrative and constitutional frameworks of a given jurisdiction might allow for extending existing licensing, supervisory, and regulatory powers for NBFIs to factoring products. In any respect, the above-mentioned regulatory areas must be clearly addressed.

85 See Commercial Law Intersections 2021 supra note 47 and accompanying discussion in text.

B. Regulatory Areas: Core Elements

In particular, a factoring regulatory framework must cover the following three core regulatory areas, as illustrated in Figure 3:

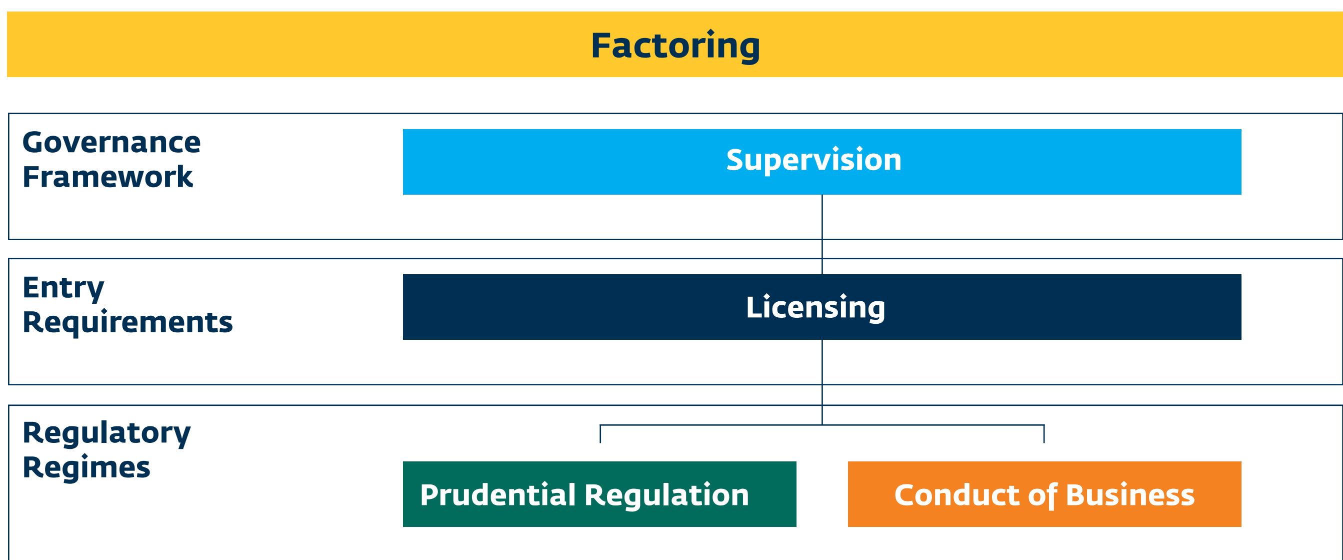
1. **A governance framework.** These rules should:
- allocate supervisory functions and regulatory powers to a designated authority, and
- ensure coordination between existing authorities for licensing and supervisory purposes.

2. **Entry requirements for financial institutions undertaking factoring activities.** This area should include:
- a general license obligation to undertake factoring activities,
- a coordination mechanism to ensure continuity under existing licensing regimes, in particular banking license, and
- a set of licensing requirements and processes for newly licensed NBFIs (factoring companies).

3. **Regulatory regimes for licensed factoring companies.** The regulation of factoring companies should provide for:
- a simplified set of prudential regulatory standards, and
- core conduct of business rules.

The connection between these regulatory areas follows a consequential and logical order. This means that once the governance framework is clear and supervisory and licensing powers are set out, entry requirements can be established and implemented. Applicable regulatory regimes will then be consequently applied to factoring companies, defined as financial institutions operating under the factoring license. If, however, the jurisdictional competences of supervisory authorities are not clear, the application of licensing requirements may be problematic and financial institutions might be uncertain about the appropriate regulatory compliance requirements.

Figure 3: Regulatory Areas



C. Coordinating Private Law and Regulatory Definitions

From a legal standpoint, factoring can be intended as a specific transaction, entailing the outright assignment (or transfer) of receivables or, more commonly, a family of transactions entailing either the outright transfer or the security transfer of receivables. These different understandings result in different definitions. For instance, the UNIDROIT Convention on International Factoring, which applies to assignments of receivables under international factoring contracts, provides a definition of factoring contract in its Article 1(2) that is limited to transfers of receivables arising from the sale of goods and provision of services.[86] Differently, the UN Receivables Convention has a broader scope and defines receivables as any right to payment other than those specified in Article 4 (e.g., bank deposits).[87] It separately defines assignment in its Article 2 as "the transfer by agreement from one person ("assignor") to another person ("assignee") of all or part of or an undivided interest in the assignor's contractual right to payment of a monetary sum ("receivable") from a third person ("the debtor"). The creation of rights in receivables as security for indebtedness or other obligation is deemed to be a transfer."

Intended to cover different types of receivables finance, the MLF does not specifically define "factoring". Instead, it covers any transfer of receivables, defined to include both outright transfers of receivables by agreement and security transfers of receivables.[88] Receivables, in turn, are defined as contractual rights to the payment of a sum of money which arises from the (i) supply or lease of goods or services; (ii) assignment or license of intellectual property; (iii) provision or processing of data; or (iv) payment obligation for a credit card transaction.[89]

Box 5: Defining Factoring Transactions in Law Reforms

Domestic policymakers have two fundamental options when a new factoring regime is implemented. A first option entails enacting a law to facilitate assignments of receivables in any type of transaction. This approach is common when a civil code is reformed or when a comprehensive secured transactions law framework is implemented. A second option consists of implementing a new law that, irrespective of the existence of the general framework for assignment of claims, offers a specific set of rules limited to a series of credit products, such as factoring and its varieties (e.g., reverse factoring). The UAE 2021 Factoring Law follows the second approach. In mainland China, a specific definition of factoring was preferred and has been contained in the 2020 Civil Code.

86 UNIDROIT Convention on International Factoring (Ottawa, 28 May 1988).
87 See https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/ctc-assignment-convention-e.pdf.
88 See Art. 2(j) UNIDROIT Model Law on Factoring
89 Id, Art 2(g).

In a similar vein, domestic legal systems can also display different approaches to the definition of “factoring transaction”. The legal definition of factoring may be contained in a dedicated law, typically a factoring law, or it might be contained in a general regime on the assignment of claims, for instance set out in a general secured transactions law or in a civil code. Although a factoring law normally contains a definition of “factoring transaction”, secured transactions law generally contain definitions of receivable and assignment or transfer, while civil codes often do not provide a definition of receivables but apply general rules for the assignment of claims.

Moving from the definition of factoring transaction, a definition of “factoring activities” should be included. Regulation is not directly concerned with factoring transactions per se, instead it is concerned with the business activity of offering this type of financial services to the public. Such a distinction is reflected in the separation between “factoring as a transaction” and “factoring as a regulated financial activity”. The former is governed by private law rules applicable to any party of factoring contract; the latter is a regulated activity that is subject to licensing requirements. To this end, the definitions of *factoring transaction* and *receivables transfers* (for private law purposes) must be aligned and coordinated with a definition of *factoring activity* (for regulatory purposes).

Box 6: Factoring as a Regulated Activity

Two main approaches can be used to qualify factoring as a regulated activity:

- In jurisdictions where factoring is not expressly defined for private law purposes as they fall under the general definition of transfer of receivables, a definition of factoring activities must be provided by referring to the same general notion. The definition can be provided in a separate act (such as a factoring law) or in a dedicated regulatory instrument if the legal system of the jurisdiction allows for it.
- In jurisdictions where a specific definition of factoring (or factoring transaction) is provided in a dedicated factoring law, the definition of factoring activity should reflect this definition and should be contained in the same act.

Regardless of the legislative approach adopted, any factoring operation, product, or service that falls within the definition of factoring activity should be regulated. Hence, a series of considerations must be advanced.

First, the definition of factoring activities should have a scope that is sufficiently broad to encompass a variety of factoring products and services. Narrow definitions of financial activities typically favor regulatory arbitrage (or norm entrepreneurship) strategies. In fact, regulatory arbitrage often occurs when financial institutions design products and transactions in a manner that is formally compliant to existing requirements but, in practice, contravenes the aims of regulatory rules or circumvent more stringent requirements while posing the same types of risks.

A broader definition, such as the one advanced in the MLF, is less formalistic and focused instead on the economic substance of the transaction considered. Hence, factoring activity should encompass all products involving receivable purchasing as well as products entailing the use of receivables as collateral.

Second, the definition should indicate that a factoring activity is not an occasional occurrence, but a business activity, notably offered by a financial institution for a profit. Financial institutions might routinely engage in the purchase of receivables for a variety of reasons. For instance, in the context of corporate lending or refinancing operations a lender might (among other collateral) take some receivable or ask for an assignment of receivables. This arrangement – while governed by private law rules concerned with the establishment of security rights on receivables or their assignment – should not fall under the scope of regulatory regimes designed for factoring companies. Similar considerations can be advanced in the context where individuals transfer an invoice in lieu of payment; private law rules applies but licensing obligations should not be triggered. Hence, the definition of factoring activity should refer expressly to the activity or operation involving the offering of financial services to the public as part of a business organization. In this regard, factoring activity can be defined as a "business activity". [90]

Box 7: Regulated Activities as Business Activities

Regulated activities are often defined as activities that are carried out by financial entities as part of a business organization. In the United Kingdom, for example, "[a]n activity is a regulated activity if it is an activity of a specified kind that is carried on by way of business and relates to a specified investment or property of any kind" (emphasis added).[91]

Third, the definition of factoring activity should be coordinated with relevant legal and regulatory notions. This is to say that the definition should connect to assignment and/or transfer of receivables as expressed in the local private law framework. Coordination with other key terms, such as "factoring company", should also be ensured.

90 For example, the locution "business activity" is already deployed in the UAE, under the general operational licenses granted to companies, pursuant to the Commercial Companies Law.
91 S 22 of the Financial Services and Markets Act 2000.

Box 8: Examples of Key Definitions

Factoring Transaction: A transaction pursuant to which one party (the assignor) transfer and/or will transfer to another party (the assignee or factor) existing or future receivables.

Transfer: A transfer of a receivables is either an outright transfer or a security transfer.

Factoring Activity: A business activity that consists in offering financing solutions through the transfer of receivables. Such an activity includes the maintenance of records relating to receivables; the collection of receivables; and providing protection against default of the debtor of a receivable.

Factoring Company: A non-deposit taking financial institution that is authorized to undertake factoring activities.

The regulatory framework for factoring develops from these key definitions. Once factoring activities are defined to reflect the private law definition, the governance framework and licensing requirements for factoring activities as well as the regulatory regimes for factoring companies can be established.

IV. GOVERNING FACTORING ACTIVITIES: SUPERVISION AND LICENSING

The governance framework for financial services and markets varies across jurisdictions. Different architectural frameworks allocate responsibilities, regulatory powers, and supervisory functions to one or more administrative authorities.[92] In particular, three core issues typically define the core traits of a given governance model: (i) the number of authorities involved in the regulation and supervision of financial markets and services in any given jurisdiction; (ii) the distribution of regulatory powers and supervisory functions between different authorities (or within the department of one authority, if only one exists); and (iii) the allocation of jurisdictional competence for banks and non-banking financial institutions.

This section examines how factoring activities can fit within different governance models. First, it introduces the key policy choices regarding the allocation of supervisory powers over factoring activities. Second, the key elements of a licensing regime for financial institutions engaging in factoring activities are introduced. In particular, the key licensing requirements for factoring companies are examined.

A. Architectural Frameworks

The inclusion of factoring activities in the regulatory framework should dovetail with the existing architectural framework. It must be established which authority will grant license to factoring companies and will supervise factoring activities. If several authorities exist, coordination mechanisms must be designed when jurisdictional competences overlap.

To this end, a diagnostic should be performed to map the institutional settings of the jurisdictions that intend to implement a regulatory framework for factoring activities. Although the number of authorities, their jurisdictional roles, powers, and functions vary significantly across jurisdictions, the following four archetypical models can be identified:[93]

1. *The integrated model,* which brings within a single authority the supervisory responsibilities towards all segments of financial markets, both from a prudential and conduct of business perspective.
2. *The twin peaks model,* whereby two administrative authorities are responsible for prudential regulation and conduct of business supervision respectively.
3. *The institutional (or entity-based) model,* whereby different sector-specific authorities are responsible for supervising regulated entities based on their type of license, e.g., banking and non-banking.

92 On the connection between regulatory styles and institutional models see Giuliano G. Castellano, Alain Jeunemaître, and Bettina Lange, "Reforming European Union Financial Regulation: Thinking through Governance Models" (2012) 23(3) European Business Law Review, https://ssrn.com/abstract=2099669. For an analysis of different institutional model see David Llewelyn, 'Institutional Structure of Financial Regulation and Supervision: The Basic Issues' presented at a World Bank seminar "Aligning Supervisory Structures with Country Needs' in Washington on 6th and 7th June 2006 for a complete discussion.

93 See Niamh Moloney, Ellis Farran, and Jennifer Payne, The Oxford Handbook of Financial Regulation (OUP 2015).

4. *The functional model,* whereby different authorities are responsible for prudential and conduct of business supervision depending on the economic function of the activity, or product offered, by a given financial institution.

Most jurisdictions adopt an institutional or a functional model, or a combination of the two. The demarcation between these models is often blurred. However, the main difference between the institutional model and the functional model is that in the former, jurisdictional competences are established by the type of license granted to a given financial institution. For instance, this is the case in mainland China, Hong Kong, and Mexico. A functional model, on the other hand, establishes the jurisdictional competence of different authorities by focusing on the type of regulated activity as reflected in its underlying economic nature. In both instances, the responsibilities are allocated to different authorities, giving rise to some complexities whenever a new type of regulated entity or activity is introduced.

Where an entity-based model is adopted, powers and responsibilities tend to be divided between banking institutions and NBFIs. Banking institutions are generally associated with deposit-taking and loan extension, whereas NBFIs often encompass a wide variety of entities, ranging from alternative lenders to insurance companies and securities firms. In jurisdictions adopting a functional model, powers and responsibilities are allocated between different authorities depending on the economic classification of regulated activities. Any type of financial institution may be under the jurisdictional competence of several supervisory authorities.

Although a case-by-case analysis is needed, general considerations can be advanced based on two scenarios. The first scenario includes jurisdictions that adopt an integrated model. The second scenario entails jurisdictions that implement a multi-authority model, such as the institutional, the functional, the twin-peaks model, or a combination of the above.

i. Integrated Model

In jurisdictions where only one authority is entrusted with regulatory powers and supervisory functions across all segments of financial markets, factoring activities will naturally fall within its remit. Colombia, Germany, Japan, Singapore, and several Scandinavian countries, among others, are adopting this approach to financial system regulation.[94] As is evidenced below, even within this model, there are differences in the way in which factoring is regulated.

In Germany, for example, the Federal Financial Supervisory Authority (BaFin) is the single authority empowered with the supervisory responsibilities for all banks, insurance companies, and other financial institutions.[95] Factoring is regulated under the German Banking Act.[96] Factoring companies are required to apply to the BaFin for a license should they wish to conduct factoring operations.[97]

94 See https://www.bis.org/fsi/publ/insights8.pdf p. 39.
95 See https://www.bafin.de/EN/DieBaFin/AufgabenGeschichte/aufgabengeschichte_node_en.html.
96 Banking Act (Kreditwesengesetz, KWG).
97 See https://www.bafin.de/EN/Aufsicht/BankenFinanzdienstleister/Markteintritt/markteintritt_node_en.html.

In Japan, the Financial Services Agency is the single authority empowered with the supervisory responsibilities for all bank and insurance business operators, and other financial institutions.[98] In general, there are no specific licensing requirements for factoring transactions and invoice discounting in Japan. However, in some instances the assignment of receivables may only be performed by a company licensed under the Act on Special Measures Concerning Claim Management and Collection Businesses.[99]

In Singapore, the Monetary Authority of Singapore (MAS), is responsible for the regulation and supervision of financial entities and all licenses on banking, capital markets, financial advisory, insurance, and payments.[100] Factoring is not regulated in Singapore, but whenever a non-regulated activity is performed jointly with a regulated activity this is overseen by MAS. In addition, as indicated in Section II.C, there has been a trend in Singapore in which financing groups offering factoring products often operate through licensed companies to provide such services, including receivable financing.[101] There appears to be a growing preference among factoring companies to fall within the auspices of the regulatory perimeter.

ii. Multiple Authority Models

In jurisdictions where several authorities coexist, a key determination is whether factoring activities should fall under the purview of the authority (or authorities) entrusted with the regulation of banking institutions and activities. As further illustrated below, banks should be permitted to undertake factoring activities without the need to apply for an additional license. If factoring activities fall under the jurisdictional competence of the non-banking supervisor, specific coordination mechanism must then be put in place to ensure that banks can perform factoring under their existing licenses while uniform oversight over the local factoring market is ensured.

Whether factoring falls under the jurisdiction of the banking authority reflects domestic choices. In Hong Kong, for instance, where an institutional model is adopted, organizations offering receivable-purchasing products fall under the purview of the Securities and Futures Commission.[102] In mainland China, on the other hand, where different regulatory authorities coexist, factoring has been traditionally under the jurisdiction of the banking regulator[103] and is promoted through initiatives advanced by the central bank. In other regions of the world, the role of the banking authority extends over factoring activities. This is the case, for example , in Greece, where the Bank of Greece is the competent regulatory authority for licensing and supervision of any credit institution, including those engaging in factoring activities.[104]

98 See https://www.fsa.go.jp/common/about/organization/fsa_responsibility_en.pdf.
99 See https://www.noandt.com/wp-content/uploads/2018/12/cp_gpg_StructuredFinanceDerivatives_2019_japan.pdf p. 9.
100 See MAS, Regulation, 2021, retrieved from: https://www.mas.gov.sg/regulation.
101 This is the case of IFS Consumer Services Private Limited, a licensed moneylender and a part of the IFS Capital Group which provides factoring and loans to MSMEs in the region. Their services include working-capital loans to companies that alleviate their cash flows gaps while their "next payments arrive". See Friday Finance, Loan Types & Features (2021) available at https://www.fridayfinance.sg/loan-types-features.
102 HK SAR Securities and Futures Ordinance, Cap 571 (See https://www.elegislation.gov.hk/hk/cap571).
103 See Notice by the General Office of the China Banking and Insurance Regulatory Authority Commission of Strengthening the Supervision and Administration of Commercial Factoring Enterprises (2019) https://www.cbirc.gov.cn/en/view/pages/ItemDetail.html?docId=854187&itemId=981.
104 See Articles 4.2 and 5 of its Factoring Law as well as Chapter I.A of the Bank of Greece Governor's Act on Requirements for Licensing and Supervision of Leasing and Factoring Companies.

In the UK, often considered the quintessential example of the functional model, factoring falls within the regulatory perimeters of the Prudential Regulation Authority only if offered by regulated financial institutions, such as banks and other finance providers. However, NBFI undertaking factoring activities (factoring companies) are not currently regulated by the Financial Conduct Authority (FCA), focused on the business conduct of financial services firms;[105] albeit there is an ongoing debate as to whether a reform is needed.

The allocation of jurisdictional competence over factoring activities should be unambiguous. For instance, in Egypt, the Central Bank of Egypt (CBE) has exclusive jurisdictions over banks,[106] whereas the Financial Regulatory Authority (FRA) focuses chiefly on NBFIs.[107]

The Egyptian Factoring Law, however, defines factoring as a non-banking activity, falling under the sole supervision of FRA.[108] As a result, it might be unclear to which extent banks offering receivable-purchasing products should apply for a different license under the supervision of the non-banking authority. Depending on the jurisdiction, the resolution of any jurisdictional ambiguity may entail different types of efforts, ranging from the issuance of simple regulatory interpretation to the amendment of existing legislative or regulatory definitions.

B. Authorization and Licensing of Factoring Activities

To bring factoring within the regulator perimeter, an authorization regime must be established. The authorization to undertake financial activities occurs through different channels. The first step requires to establish a general prohibition to undertake factoring activities unless authorized. The second step is the establishment of an authorization mechanism, primarily a licensing regime that, if necessary, is supplemented by a notification process for financial institutions already licensed under a regime that normally include different forms of receivable financing.

i. General Prohibition to Undertake Regulated Activities

Regulated activities are those activities for which a prior authorization is required from the relevant licensing authority. Primary legislations often establish a general prohibition to engage a regulatory activity without being licensed or authorized to do so by the relevant regulatory authority. This is the approach adopted in the UK, where Section 19 of the Financial Services and Markets Act 2000 establishes a general prohibition to undertake regulated activities without prior authorization. Secondary and tertiary legislation provide a list of the regulated activities and possible exemptions to the general prohibition.

105 Firms regulated by the FCA include investment firms, asset managers, hedge funds, brokers, financial advisers and insurance intermediaries.
106 See Section 2, Chapter 1 of the Banking Law.
107 See Law Regulating Non-Banking Financial Markets and Instruments, No. 10/2009.
108 See Part I Article 2 of Factoring Law.

As the definitions of factoring activity and factoring transaction are separated, the general prohibition will only affect those services, operations, and products that fall under the definition of factoring activities. However, the prohibition to undertake factoring activity still apply to financial institutions that offer factoring products or services under their existing license. Hence, it should be clarified whether financial institutions that are subject to a licensing and supervisory framework that is considered substantially similar, or stricter, than the one envisaged for factoring companies should still be required to obtain a new factoring license.

In general, banks should be permitted to undertake factoring activities without the need to apply for an additional license. This is the case where "banking activities" are legally defined broadly enough to include factoring activities within the remit of banking business. For example, in Jordan, the Banking Law specifies that banks can "grant all types of credit, including financing commercial transactions", which is sufficiently broad enough to enable banks to undertake factoring activities.[109] In Turkey, factoring can be offered by NBFIs upon obtaining a factoring license granted.[110] Banks, however, may offer receivable finance products under their banking license, without the need for additional authorization.

Where banking and non-banking supervision is undertaken by different authorities and factoring falls under the purview of a non-banking supervisor, a different authorization mechanism might be implemented to ensure coordination. Banks might be demanded to notify their intention to undertake factoring activities to the authority entrusted with licensing and supervisory powers over factoring activities. Ordinarily, the notification process forms part of a regulated entity's general conduct of business obligations. In the UK, for example, regulated entities are required to engage with the FCA and the PRA in an open and cooperative manner and to report matters of which both regulatory authorities would reasonably expect notice.[111]

Through a notification, a bank informs the supervisor the intention to undertake factoring activities under its existing license. Delegated acts typically indicate the form of the notification (normally electronic), the key information that must be contained therein, and any supporting documents. A template of the notification and a checklist are normally provided. Upon reviewing the notification, supervisory authorities may request additional information. If no follow up is requested by the competent authority within a stipulated period, the bank is deemed to be authorized to undertake factoring activities.

109 Art. 37.2 of the Banking Law No. 28 of 2000.
110 Art. 7 Factoring Law (Financial Leasing, Factoring and Financing Companies Law No. 6361 (13 December 2012).
111 FCA Handbook, PRIN 2.1, Principle 11 and PRA Rulebook, Fundamental Rule 7.

Box 9: Notifications in Practice

Notification is an administrative act that is commonly used in the context of financial service regulation. In the European Union, for example, notification is routinely deployed as part of the passporting mechanism, whereby a financial institution licensed in one Member State can offer financial products and services to customers in any of the other 26 member states, by notifying the (home) supervisory authorities.

Notification has also been used within different domestic markets when financial institutions intend to undertake a new regulated activity. In Azerbaijan, for example, NBFIs are allowed to establish new branches using a notification process.[112] Similarly, banks are allowed to undertake factoring activities under their existing licenses by notifying the banking regulator.[113]

The obligation to seek authorization through notification to the authority entrusted to regulate and supervise factoring activities ensures uniform compliance without requiring additional licenses. Notification enables banking and factoring supervisors to respond speedily to matters that require coordinated action, while ensuring that a supervised entity has the appropriate risk management framework in place before engaging in a new type of business activity. Supervisors provide guidance as to when they should be notified.[114]

ii. Licensing Requirements

Licensing requirements for factoring companies at the time of incorporation are similar to those applied for any regulated financial institution. Such mandatory requirements, to be documented in an application for a factoring license, typically cover the following aspects: corporate structure and ownership, minimum level of capital, and probity of senior management. The minimum level of capital at the time of incorporation is typically connected to the prudential regulatory framework and is generally significantly lower than the one required for banks or any other deposit taking institution.

The licensing requirements for factoring companies depend largely on the type of entity that is seeking the authorization to perform such activities. Generally, more stringent requirements apply to banks, as opposed to NBFIs. However, NBFIs undertaking factoring activities must demonstrate that they are sufficiently capitalized and that they have implemented adequate risk management policies in order to be granted a license. These requirements form the foundation for the applicable prudential regulation and conduct of business standards by setting a benchmark below which the relevant regulatory authority can take supervisory actions, such as license suspension or withdrawal.

112 Art 9, The Law of the Republic of Azerbaijan on Non-Bank Credit Institutions of 25 December 2009 No. 933-IIIQ.
113 Art 32, The Law of the Republic of Azerbaijan on Non-Bank Credit Institutions, of 25 December 2009 No. 933-IIIQ. These rules apply also if there is a change in the original licensing arrangement and a regulated entity intends to offer a new product, such as factoring.
114 FCA Handbook, SUP 15.

C. Key Policy Options and Recommendations

i. Governance Framework

The policy considerations that need to be addressed to establish a governance framework for factoring varies depending on the institutional framework adopted in any given jurisdiction. The licensing of factoring companies, the mandate to issue more detailed regulation, and the supervision of factoring activities tend to be clearly defined whenever jurisdictional competences over financial markets and services are straightforward. Two main scenarios can be identified, depending on whether a jurisdiction adopts an integrated or multiple authority model.

In jurisdictions adopting an integrated model, all supervisory and regulatory responsibilities will be naturally attributed to the single authority overseeing all segments of financial markets. Still, attention should be given to the allocation of responsibilities within the departments and units of the single regulator and supervisors. It is not uncommon that the organizational capacity in an integrated structure follows an internal separation of responsibilities that is sector-based. In this context, while a new unit might be established, competences and capacities to regulate factoring should be sought in departments concerned with the oversight of banking institutions and NBFIs.

In jurisdictions where multiple authorities operate, the following three aspects must be carefully considered when a new regulatory regime for factoring activities is implemented:

1. Banks should be able to offer receivables financing products (both purchase-based and loan-based) under their existing banking licenses. Given that banks are subject to a set of larger and more stringent regulatory requirements than NBFIs, regulatory regimes are directed to factoring companies such as NBFIs with a license to undertake factoring activities. The implementation of a regulatory framework for factoring should leave banking regulation largely unaffected. Although coordination mechanisms and notification procedures might be needed to ensure uniform market oversight, banks should be able to undertake factoring activities without applying for a new license.
2. Given that both banks and NBFIs are expected to undertake factoring activities, a coordination mechanism between banking and non-banking supervisors must be ensured. Such coordination should cover the licensing and authorization requirements, notably clarifying that banks do not need a new license to undertake factoring activities, as well as day-to-day and ongoing supervision when banks and NBFIs are involved, notably by indicating the lead supervisor. A memorandum of understanding (MoU) between the different regulatory authorities is often necessary when regulated entities fall within the supervisory remit of more than one regulatory authority.

3. From a supervisory standpoint, factoring activities can be assimilated to credit products and the supervision over such activities should be allocated to the authority with jurisdictional competence over credit-based products and/or credit institutions. This will leverage existing institutional capacities when a new (simplified) regime for factoring companies is established. As the authority responsible for supervising banking and other NBFIs is, overall, better placed to supervise factoring companies, possible conflict between supervisors is averted. The expertise in implementing prudential standards for banks and NBFIs and the efforts to maintain stability would facilitate the emergence of a sound and inclusive market for factoring.

ii. General Prohibition to Undertake Factoring Activities without Authorization

A general prohibition to undertake factoring activities without authorization must be established. The process to obtain the authorization follows two paths, one for factoring companies and one for banks. For factoring companies, the authorization is obtained when the factoring license is granted. Factoring companies cannot undertake factoring activities without a license or if their license is suspended, withdrawn, expired, or otherwise invalid. The authority with jurisdictional competence over factoring activities establishes the methods and processes that factoring companies must follow to apply for a factoring license.

For banks, given that an additional license to undertake factoring activities should not be required, the authorization to undertake factoring activities can be either considered included in the banking license or granted upon completion of a notification procedure. The first option is better suited for jurisdictions where the authority supervising banks and factoring companies is the same. The second option is better suited for jurisdiction where the authorities supervising banking institutions and factoring activities are different.

Regardless of how authorization is granted, the private law elements of the factoring law apply to banks and NBFIs alike. Private law elements govern any transactions entailing the transfer of receivables; regulatory elements are, instead, concerned with the undertaking of factoring activities. Authorization to undertake factoring activities includes, at least, all activities that are ancillary to factoring services, such as managing a ledger of operations and clients. Domestic authorities can include other activities included in the factoring license, such as the provisioning of guarantees.

iii. License Requirements for Factoring Companies

Licensing requirements for factoring companies should indicate at least the following elements:

1. Incorporation status. Normally, a factoring company must be a registered company with limited liability status, according to the applicable company law. Depending on the legal system, it is possible for factoring companies to have a cooperative or mutualistic structure.
2. Ownership structure. Shareholders, beneficial owners, and relevant participation in the factoring companies should be disclosed.
3. Corporate governance. Key roles, responsibilities, and reporting lines should be disclosed.
4. Fitness and propriety requisites for Board of Directors and senior managers.
5. Minimum level of capital at the time of incorporation.

V. PRUDENTIAL REGULATION

Prudential regulation primarily comprises capital adequacy standards and provisioning requirements. The policy goals underlying the imposition of these standards and requirements is to maintain the soundness of financial institutions and the stability of the financial system. These goals are usually represented in the form of micro-prudential policies, concerning the ability of financial institutions to absorb losses, and macro-prudential policies concerning the resilience of the financial system in its entirety.[115] Law reforms aiming at promoting access to credit through secured lending should ensure coordination with private law elements.[116]

The prudential regulation for factoring companies is significantly simpler than the one normally applied to banks and other deposit-taking institutions. The prudential framework is largely aimed at ensuring that NBFIs are sufficiently capitalized through requirements that include a fixed, non-risk-weighted, minimum level of equity and accounting allowances. Other areas, such as risk management policies, reporting and disclosure requirements as well as investigation and enforcement powers and procedures for supervisors, are normally covered by the general regimes applicable to financial institutions.

This section examines the prudential regulatory framework applicable to factoring companies having in view the establishment of a proportionate set of capital and provisioning requirements. First, it examines the capital adequacy rules established for factoring companies in different jurisdictions. Thereafter, the key issues pertaining to loan-loss provisioning requirements for factoring companies are considered. Finally, it elicits a set of considerations to guide the key policy choices that domestic law reforms should address when implementing a prudential regulatory framework for factoring companies.

A. Capital Adequacy

The principal objective of capital adequacy standards is to strengthen the ability of financial regulated entities to absorb unexpected losses. Furthermore, capital requirements are meant to address the moral hazard considerations that are intrinsic in the banker-depositor relationship. Factoring companies, however, are not deposit taking institutions. Hence, the primary function of capital requirements is to ensure that a factoring company is well capitalized.

115 IFC Primer 2020 supra n 48 at p.12.
116 Id.

In light of these considerations, capital regulation for factoring companies is limited to the minimum capital at the time of incorporation. Jurisdictions deploy different methods to define the minimum regulatory requirements applicable to factoring companies. The minimum level of capital applicable to factoring companies might be determined with reference to the minimum level of capital required for banks. In Greece, for example, the minimum level of capital for factoring companies "may not be less than one quarter (1/4) of the minimum share capital required for the establishment of banks".[117] In other cases, it can be a fixed sum of equity.

Even without referring to bank capital requirements the amount of initial capital for factoring companies is significantly lower than the one requested for banks. In Egypt, for instance, the minimum level of capital for factoring companies is EGP10,000,000,[118], whereas for banks it is EGP 500,000,000.[119] Further, in Singapore, the paid-up capital requirement for NBFIs is SGD 100,000,[120] whereas for banks it is not less than SGD 1,500,000,000.[121] In the UAE as well, the minimum level of capital for specialized lenders is AED 150,000,000.[122] This amount is considerably lower than that applicable to banks, which is based on Basel capital requirements.

While approaches to calculate capital might vary, factoring companies are not required to have risk-weighted regulatory capital unlike the regulatory capital for banks. Supervisors, instead, might increase the level of minimum capital in specific circumstances, e.g., when fearing some instability in the market. In Egypt, for example, no additional reserve is prescribed in relation to the minimum share capital for the establishment of a factoring company. In Singapore, similarly, all moneylenders are required to retain a paid-up capital that is equal only or greater than the initial prescribed amount for the license to be retained.[123] In the UAE, NBFIs engaging in factoring activities are required to allocate "at least 10 percent of their annual net profits to the establishment of a statutory reserve until the point that the statutory reserve equals 50 percent of their paid-up capital", in addition to their minimum required paid-up capital.[124]

In some jurisdictions, factoring companies are not required to comply with any capital adequacy requirements, such as in Jordan.[125] In other jurisdictions, a stricter regulatory strategy is adopted to regulate factoring companies. In Greece, for example, factoring companies are required to comply with the same standards applicable to banks when calculating credit risk.[126] Factoring companies are thus not required to comply with the Basel Framework in its entirety, but are obliged to use the same methods used by banks to calculate risk-weighted capital charges.

117 Art. 4.3 of the Factoring Law (Law No. 1905/1990 on Factoring).
118 See Art. 58.2 of the Factoring Law (Law No. 176/2018 on regulating the activities of financial leasing and factoring, 14 August 2018).
119 See Art. 32.3 of the Banking Law (Law No. 88 of 2003 on the Central Bank and the Banking Sector).
120 See s 3A of the Moneylenders Rules 2009.
121 See s 9(1(a)) of the Banking Act (Cap 19).
122 See Art. 11.3 of the Circular on the Regulation of Finance Companies.
123 See s 6A(1) and s (2) of the Moneylenders Act (Chapter 188, 31 March 2010).
124 Arts11.3 and 11.7 of the Circular on the Regulation of Finance Companies.
125 See European Bank for Reconstruction and Development, Factoring Survey in EBRD Countries of Operation (2018 3rd Ed).
126 Contained in the Bank of Greece Governor's Act on the Calculation of Capital Requirements for Credit Risk According to the Standardized Approach of 20 July 2007, No. 2589.

If factoring activities are undertaken by banks, banking capital regulation will apply. In most cases, domestic banking regulation reflect the Basel Capital Accords (or Basel Framework). Depending on the domestic implementation of the Basel Framework, receivables might not be considered as eligible collateral but receivable purchasing might be subject to a special prudential treatment. In any respect, these considerations rest outside the perimeter of the regulatory framework for factoring activities.

B. Prudential Provisioning

Loan-loss provisioning requirements are established domestically. They represent an addition to the relevant accounting allowances and are intended to establish a prudential backstop to further facilitate the absorption of expected losses. At present, there is no harmonized international approach, but general trends and guidelines do exist recognizing that coordination between capital requirements and loan-loss provisioning is crucial for promoting resilience in the banking sector.

In general terms, prudential provisioning might not apply to factoring companies. In some jurisdictions, such as Jordan, only banks are required to calculate provisioning allowances.[127] Differently, all credit institutions in Greece (including banks and NBFIs) must comply with the same prudential provisioning requirements, accounting standards,[128] and IFRS9 (see below).[129] A similar approach is followed in the UAE where all banks and finance companies are required to comply with provisioning rules.[130]

However, in most jurisdictions, factoring companies are required to establish accounting reserves based on international standards. In this context, factoring companies are required to implement applicable accounting standards, such as the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board. Of particular relevance is the IFRS9 in replacing IAS39 to establish a forward-looking approach to estimate losses on credit facilities.

Under IAS39, provisioning allowances were determined based on incurred losses, i.e. after a credit facility has been reported as being impaired. Under IFRS9 financial entities are instead required to determine whether a financial asset is unlikely to be repaid prior to incurring any loss and prior to its impairment or potential impairment. Under this regime, financial entities make use of historical data which should be adjusted to consider present conditions and objective determinations of losses, and those which might occur in the future (expected losses).

127 See the Instructions for the Classification of Credit Facilities and the Calculation Provisions.
128 See Bank of Greece Governor's Act on Provisions.
129 Art. 1.3 of the Law on Greek Accounting Standard (Law 4308/2014).
130 Regulation for Classification of Loans and their Provisions (Circular 28 of 2010).

Box 10: IFRS and Factoring

The accounting treatment of factoring depends on the structure of factoring agreements, regardless of the financial institution offering factoring products. The terms of the factoring agreement are used to determine the initial recognition in the balance sheet and the subsequent de-recognition.[131] For example, in the case of undisclosed factoring with recourse, the collection risk resides with the assignor, which retains the contractual right to collect the relevant receivable and may have no obligation to remit any collections to the assignee (factor), save for when collections are deposited to a designated bank account. In this scenario, the assignee's credit exposure will be with the assignor and the provisioning is calculated using the default risk of the assignor.

However, the treatment might be different in a scenario where a factoring agreement (without recourse) provides for transferring a significant portion of the risks and rewards of the receivables based on a reverse factoring arrangement. In such a circumstance, the assignee must recognize the receivable in the balance sheet and calculate it initially at fair value net of the transaction costs.[132] The default risk of the assignee is used to measure the provisioning.

C. Key Policy Options and Recommendations

Capital adequacy and loan-loss provisioning requirements vary depending on the legal system and the type of financial entity undertaking factoring activities. Banks are ordinarily required to comply with both prudential regimes, while this is not the case for factoring companies. Factoring companies are more commonly required to comply exclusively with accounting standards, such as those recognized internationally.

Capital requirements and prudential loan-loss provisioning requirements for factoring companies can be implemented either by applying existing prudential frameworks to factoring companies or by establishing a new prudential framework. Hence, law reformers have the following options:
- Extending the prudential framework for banks to factoring companies.
- Extending the prudential framework for NBFIs to factoring companies.
- Implementing a dedicated prudential framework for factoring companies.

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131 De-recognition is the removal of a previously recognized financial asset or financial liability from the balance sheet of an entity. According to the test provided in IFRS9 B3.2.1., this occurs when the entity's contractual rights to the asset's cash flows have expired or the asset has been transferred to a third party (along with the risks and rewards of ownership).

132 KPMG, Invoice Factoring IFRS9 Update, Capital Markets Accounting Advisory Services, 12 June 2018, available at: https://assets.kpmg/content/dam/kpmg/nl/pdf/2018/advisory/invoice-factoring-ifrs-9-update.pdf.

The choice between these different options depends on various factors, including the resilience of the domestic credit market, the capacity of regulators and supervisors to implement new rules, and the objectives of a factoring reform. Assuming that there are no specific justifications for the application of a blank set of prudential standards across banking and NBFIs sectors, a determination should be made based on which option better ensures the development of a sound and inclusive credit ecosystem where factoring services are provided by a diverse range of financial institutions. Through this prism, it can be noted that the first option, entailing the application of banking regulation to factoring companies, is likely to provide less support for the development of factoring businesses external to the banking industry.

Banks will have a competitive advantage. Yet they might not be incentivized to develop new products and prefer to offer traditional commercial lending services. Similar considerations can be levied in respect of the second option, as existing NBFIs can utilize their existing compliance structures to undertake factoring activities. Nonetheless, this option is preferable to the first one, as NBFIs can effectively undertake factoring activities while implementing existing prudential regulation. The third approach would be the most effective at ensuring a level-playing field in which new and small entrants would be less discriminated vis-à-vis incumbent financial institutions. However, a dedicated prudential framework must be coherent with existing prudential regimes.

Regardless of whether a dedicated framework is established, capital requirements for factoring companies should set a fixed amount of equity that can be raised periodically or adjusted depending on business or market conditions. The definition of a minimum level of capital reflects a balancing act: excessively stringent requirements can pose a barrier to the entrance of new factoring companies, whereas excessively lax rules can compromise the soundness of the domestic credit market. Different levels of capital can be established reflecting the total business of factoring companies or the composition of their balance sheets. As a result, to factoring companies presenting lower risk corresponds a lower amount of regulatory capital.

The full and correct implementation of international accounting standards to calculate allowances should be ensured. In addition, provisioning requirements can be introduced as a prudential backstop if local authorities fear that accounting standards are not uniformly applied. Hence, the prudential framework for factoring companies must at least indicate that:

1. Factoring companies must be required to maintain a minimum level of equity at the time of incorporation throughout their life. The minimum level of equity, which can be graduated and raised periodically, is a condition to both obtain and retain the factoring license.
2. Factoring companies must be required to adopt a system of risk management and controls. Reserve allowance must be increased to meet idiosyncratic and market risks, expected or potential.
3. Factoring companies are required to comply with international accounting standards.
4. The authority is empowered to impose additional capital and prudential provisioning requirements.

VI. CONDUCT OF BUSINESS REGULATION

Conduct of business regulation consists primarily of the rules that are applicable to how firms carry out their business and how they treat their customers. The central aims of conduct business regulation include safeguarding market integrity by fostering transparency in the financial system and protecting customers. Ordinarily, market integrity is defined with reference to the fairness and efficiency of financial services to ensure that financial entities do not facilitate illicit activities.

This section examines the conduct of business regulation that applies to factoring companies. First, it examines the regulatory requirements applicable to factoring companies internally and domestically, often set out in specialized factoring laws. Second, it considers the applicable regulatory framework protecting market integrity, including the standards for independent auditors. Finally, it suggests a set of policy considerations to apply to conduct of business regulation for factoring companies.

A. Market Integrity Rules

The fundamental basis for market integrity rules is provided by domestic regulatory regimes and international standards. Generally, market integrity requirements include conduct of business rules such as those elaborated by the Basel Committee on Banking Supervision,[133] AML/CTF rules formulated by the Financial Action Task Force (FATF),[134] and consumer protections, such as those enumerated in the principles endorsed by the Group of Twenty (G20) and set out in the recommendations of the Organization for Economic Cooperation and Development (OECD).[135]

i. Conduct of business

Conduct of business requirements are aimed at ensuring that financial entities are managed under stringent 'fitness and propriety'.[136] The process of safeguarding market integrity is risk-based in which the riskiness of financial entities and their customers are assessed prior to and after the granting of a license. Explicit conditions are set for authorization and approval of individuals during the licensing process. Typically, individuals holding key positions in regulated entities must be vetted when applying for a factoring license.[137] For instance, these individuals are required to have no criminal record.

For example, in Egypt individuals holding key positions must not have been convicted of a felony offence or a misdemeanor for dishonesty or a breach of trust the five years prior to the application for license.

133 See, e.g., the Basel Committee on Banking Supervision, Corporate Governance Principles for Banks (2015); and the Basel Framework setting out the Core Principles for Effective Banking Supervision (BCP rules).
134 See FATF, Recommendations on Combating Money Laundering and the Financing of Terrorism & Proliferation.
135 The G20/OECD High-Level Principles on Financial Consumer Protection are set out in the OECD Recommendation on High-Level Principles on Financial Consumer Protection, updated in 2022, https://www.oecd.org/finance/high-level-principles-on-financial-consumer-protection.htm.
136 Id.
137 Art 55(4) and (5), Factoring Law (Law No. 176/2018 on regulating the activities of financial leasing and factoring, 14 August 2018).

At least two thirds of the board of directors of applicant entities are also required to have suitable practical experience in the disciplines of banking, financing, or legal business in line with specified conditions.[138] Similar requirements apply in Turkey, where the founders of factoring companies are required to not have been convicted of "infamous crimes", which include money laundering.[139]

ii. AML/CFT

AML/CFT requirements are aimed at ensuring the combatting of money laundering and terrorist financing, in addition to the financing of the proliferation of weapons of mass destruction.[140] Generally, these rules operate to assist with the detection of and reporting of suspicious activity. When the rules operate effectively, they do so in mitigation of the adverse effects of criminal economic activity and assist with the promotion of the integrity and stability of the financial system.[141] A common approach is to extend the applicability of already existing AML/CFT requirements in the domestic regulatory framework to factoring companies.

For example, Egyptian factoring companies are required to comply with controls for AML and terrorism financing.[142] All credit institutions in Egypt, including both banks and NBFIs, are required to comply with AML rules. Additional legislation, such as Know Your Customer (KYC) rules, is also developed by the relevant regulatory authorities within the frame of the broader conduct of business regulatory framework.[143] In Saudi Arabia, all forms of financing are placed under the guise of the Implementing Regulation to the AML Law.[144]

iii. Fair treatment of customers

Ordinarily, in most jurisdictions the general regulatory regimes provide for rules that establish general obligations on regulated entities, such as the fair treatment of customers, adequate disclosures, and a complaint mechanism.[145] In the UK for example, the conduct of business rules for 'treating customers fairly', applicable to regulated entities, are contained in the FCA's Handbook's Principles for Business (PRIN). PRIN provides implicit and explicit guidance on the fair treatment of customers and Principle 6 specifies that 'a firm must pay due regard to the interests of its customers and treat them fairly'.

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138 In line with general corporate governance principles for financial institutions, considerable attention is given to the practical experience and educational background of the board of directors of the factoring company as well as the appointment of independent members on the Board.
139 See Art. 6(1)ç) of Factoring Law (Financial Leasing, Factoring and Financing Companies Law No. 6361 (13 December 2012).
140 https://www.fatf-gafi.org/publications/fatfrecommendations/documents/fatf-recommendations.html.
141 See https://www.imf.org/external/np/leg/amlcft/eng/.
142 In Egypt, AML/CFT requirements and controls are established in the Anti-Money Laundering Law, No. 80/2002.
143 The main purpose of KYC policies and programmes is to prevent identity theft fraud, money laundering and terrorism financing. One of the steps of the KYC process is the Customer Due Diligence (CDD) which requires the bank to obtain information to verify the customer's identity and assess the risk. In addition, the CBE and the EFRA develop specific AML/CFT and KYC rules for their regulated entities. See, for example, the EFRA Board of Directors' Decision Regarding Regulations on Anti-Money Laundering Activities for Non-Banking Financial Institutions, No. 120/2019 and the recent CBE regulatory sandbox introducing electronic KYC (eKYC) based on blockchain technologies.
144 See s 1/2.B. of the Implementing Regulation of the AML Law.
145 In Jordan, see Instructions on Dealing with Customers Fairly and Transparently.

In the UAE for example, the regulatory rules applicable to each type of financial entity sets out the rules for the protection of customers. For example, finance companies are required to give their borrowers "sufficient and transparent information, including costs and risks associated with the loan, to enable the borrower to make an informed assessment of the suitability of the loan to their needs and financial circumstances".[146] In Egypt, the relevant regulatory authority "shall receive complaints filed by participants who deal in financial lease and factoring about violation of the provisions of the law or decisions promulgated for its enforcement".[147]

B. Capital Adequacy

Generally, the principles that govern the auditing process of financial entities can be extended to factoring companies. In some jurisdictions the principles that govern the auditing process for factoring companies are contained in special factoring laws. In Turkey, for example, the auditing process for factoring companies is established with reference to the "the principles and procedures specified by the Public Oversight, Accounting and Auditing Standards Board".[148]

In other jurisdictions, the principles that govern auditing processes for factoring companies are set out in the empowering provisions of general statutes. In Saudi Arabia, for example, banks and companies must comply with auditing processes set out in the provisions of their respective applicable legislative texts. In addition, both banks and companies are permitted to appoint their auditors. However, banks are required to appoint auditors from an approved list of auditors registered with the Ministry of Commerce and Industry.[149]

However, in some jurisdictions, there is no reference to auditing requirements for factoring companies. In Greece, for example, there is no mention of the auditing process applicable to factoring companies as auditing is usually applied to any financial institution.

C. Key Policy Options and Recommendations

The conduct of business regulation applicable to factoring companies are largely aligned with the approach adopted for other financial entities. The implementation of the conduct of business rules should be straightforward. For basic requirements for conduct of business, specialized factoring regimes ordinarily establish minimum standards to be complied with at the time of incorporation included in the licensing requirements. For AML/CFT conduct of business regulation, the usual approach is to refer to general AML/CTF and to expand their applicability. In addition, AML/CFT rules should be coordinated with technology to favor onboarding practices. AML/CFT RegTech has been used in several applications and case studies.

146 Art.16.2 of the Circular on the Regulation of Finance Companies. See also the Federal Law on Anti-Money Laundering and Combating the Financing of Terrorism together with the Cabinet Resolution, No. 10/ 2019.
147 Art. 71 of the Factoring Law (Law No. 176/2018 on regulating the activities of financial leasing and factoring, 14 August 2018).
148 See Art. 14(3) of the Factoring Law (Law on Financial Leasing, Factoring and Financing Companies Law No. 6361 (13 December 2012).
149 See Art.14 of the Banking Control Law Royal Decree No. M/5 Dated 22.2.1386.

For example, in Hong Kong a bank incorporated non-traditional AML/CFT data elements, such as IP addresses, to identify relationships between customers which would otherwise be undisclosed at the time of onboarding.[150]

Conduct of business regulation for factoring companies must include the following:

1. Fitness and proprietary conditions for Board of Directors and senior management as a condition to both obtain and retain the factoring license.
2. Reference to applicable AML/CFT requirements.
3. Obligation to treat consumers fairly and act in their best interest.
4. Obligation to appoint independent auditors and to undergo auditing on a regular basis.

Alignment with existing legislations is to ensure the uniform implementation of conduct of business requirements across the financial sector. As a result, the establishment of a dedicated set of conduct of business requirements for factoring companies might not be necessary. Local authorities, in fact, can complement existing regime with the implementation of additional guidance and/or issue more detailed standards to address the specific risk related to receivables finance.

In addition, the authority with jurisdictional competence over factoring companies should be vested with the power of:

1. Issuing additional guidance detailing AML/CFT rules and compliance processes for factoring activities,
   if needed.
2. Establishing mechanisms and rules to manage complaints.
3. Removing or suspending directors and senior managers in case of grave misconduct.

150 Hong Kong Monetary Authority, AML/CFT RegTech: Case Studies and Insights (January 2021) https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2021/20210121e1a1.pdf.

ANNEX I: TEMPLATE STRUCTURE OF FACTORING LAW WITH REGULATORY ELEMENTS

This template structure is intended to map the connection between private law (PL) and regulatory (Reg) elements when they are both included in the same legislative act. As explained in this Knowledge Guide, additional delegated acts may be necessary to detail specific regulatory requirements and mechanisms to ensured coordination between different supervisory authorities. As any regulatory framework for factoring activities should be coordinated with a sound and comprehensive set of private law rules, this template structure takes as point of reference the UNIDROIT Model Law on Factoring to indicate applicable private law provisions and ensure thorough coordination.

Area	Content	MLF
PL/Reg	**Chapter 1: Scope and general provisions**	Chapter I
PL/Reg	*Scope of Application*	*Art 1**
PL/Reg	*Definitions*	*Art 2**
Reg	*Prohibition to Undertake Factoring Activities without Authorization*	-
PL/Reg	*General Standards of Conduct*	*Art 4**
Reg	**Chapter 2: Authorization to Undertake Factoring Activities**	-
Reg	*Authorization Methods: Notification and Licensing*	-
Reg	*Withdrawal and Termination of the Authorization*	-
Reg	*Notification from a Bank to Undertake Factoring Activities*	-
Reg	*Licensing for Factoring Companies*	-
Reg	**Chapter 3: Supervision of Factoring Activities**	-
Reg	*Supervisory Authority*	-
Reg	*Powers and Functions*	-
Reg	*Delegation and Coordination*	-
PL	**Chapter 4: Transfers of Receivables**	Chapter II
PL	**Chapter 5: Effectiveness Against Third Parties of Transfers of Receivables**	Chapter III
PL	**Chapter 6: The Registry System**	Chapter IV
PL	**Chapter 7: Priority of a transfer**	Chapter V
PL	**Chapter 8: Rights and Obligations of the Transferor, Transferee, and Debtor**	Chapter VI
PL	**Chapter 9: Collection and Enforcement**	Chapter VII
Reg	**Chapter 10: Factoring License**	-
Reg	*Requirements and Minimum Conditions*	-

Reg	*Application Process*	-
Reg	*Duration and Renewal*	-
Reg	*Withdrawal and Suspension*	-
Reg	**Chapter 11: Factoring License Invalidity**	-
Reg	*Causes of Invalidity*	-
Reg	*Consequences of Invalidity*	-
PL/Reg	*Effects on Transfer of Receivables*	-
Reg	**Chapter 12: Prudential Regulation for Factoring Companies**	-
Reg	*Capital Requirements*	-
Reg	*Loan Loss Allowances and Accounting Standards*	-
Reg	*Internal Systems of Control*	-
Reg	**Chapter 13: Conduct of Business Regulation for Factoring Companies**	-
Reg	*Conduct Standards*	-
Reg	*Fitness and Propriety of Board of Directors and Senior Managers*	-
Reg	*Disclosure and Auditing*	-
PL	**Chapter 14 Conflict of Laws**	Chapter VIII
PL	**Chapter 15 Transition**	Chapter IX
PL/Reg	*Transitional Rules*	*Articles 47-54**
PL/Reg	*Effects on Other Laws*	-

PL the Article is primarily concerned with Private Law elements (not covered in this Knowledge Guide)

Reg the Article is primarily concerned with Regulatory aspects.

PL/Reg the Article covers both Private Law and Regulatory aspects.

* the Article takes as a point of reference the MLF but additional elements are needed to ensure coordination with Regulatory aspects.

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