WORLD BANK GROUP
Finance, Competitiveness & Innovation

Product Card & Credit Infrastructure Requirements

Reverse Factoring

What is Reverse Factoring?

Reserve factoring is a financing product that allows a financial company ("factor") to provide liquidity to companies, particularly small enterprises that may have weak or less than ideal credit ratings. It operates by allowing the sale of such companies' accounts receivable or invoices ("receivables"), for sales of goods or services to a larger buyer, with solid credit-worthiness (the "anchor customer" or "anchor"). Reverse factoring relies on the anchor customer's ability to pay its commercial obligations to suppliers, while allowing the suppliers to sell their A/Rs to the factor. Suppliers then finance the receivables via a sale to the factor, which becomes the owner of the receivable and the payment obligation of the anchor customer. The factor generally establishes a reverse factoring limit on the anchor customer's receivables, within which its suppliers are eligible to sell their receivables to the factor.

How is Reverse Factoring structured?

The factor performs a full credit analysis of the anchor customer, including a qualitative and quantitative analysis, as well as its payment terms to suppliers. To provide incentives to anchor customer, structuring can include increased payment terms to suppliers, or reverse factoring income sharing. Structuring can also include the supplier's concentration limits. Once the facility is implemented and the anchor customer accepts or confirms payment of certain owed receivables, the beneficiary supplier can sell receivables to the factor under the anchor customer's facility. The supplier bears the financing cost. However, financing terms and costs are greatly improved by leveraging the anchor's creditworthiness. From an operational standpoint, all reverse factoring day-to-day operations are completed via an electronic system developed and operated by the factor or a third-party fintech platform (*see* diagram below).

- Availability: The factor performs a credit analysis for the anchor customer, including analysis of suppliers and the structure of current credit terms. In establishing the credit facility, the factor takes into account the balance of the anchor customer's accounts payable, including new extended credit terms (and rotations). The factor also conducts a KYC analysis of all suppliers, which are then authorized to sell their receivables from the anchor so long as the term is under the approved limit and the anchor has accepted or confirmed the receivable for payment.

- Reverse Factoring acceptance: By way of confirmation of its payment obligation, the anchor makes an irrevocable promise to pay to the factor for all of the accepted or confirmed receivables. The confirmation takes place via a reverse factoring platform. Once the process is completed, the supplier can decide to finance the corresponding receivable with the factor or wait until end of term and collect payment directly from the anchor.

- Reverse Factoring parties: Reverse factoring is dependent on the anchor's willingness to confirm and pay the receivables owed to its authorized suppliers, which the anchor provides in a list to the factor for inclusion in the reverse factoring facility.

- Reverse Factoring Payments: At the end of term, the anchor is required to pay to the factor the amount due under the confirmed receivable. The factor can also become the anchor customer's payment agent for the confirmed receivables, if they were not sold to the factor by the related supplier(s).

- Legal Structure: Reverse factoring requires tri-party agreements. It is documented using two legal agreements: i) a reverse factoring agreement between the factor and anchor, which governs the product operation, limits of the credit facility, and conditions for the anchors irrevocable promise, among others; ii) receivables sale and purchase agreement, between each supplier and the factor, which governs the terms and conditions under which the factor will purchase the receivables from the supplier. Receivables purchased are generally without recourse in case of non-payment.

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- Credit Information Systems:

  In reverse factoring, the credit approval is based on creditworthiness of the anchor customer, who is the ultimate payor of the purchased invoices. Consequently, the factor performs a full credit analysis of the anchor, making existence of a credit bureau desirable, since it would provide related payment history.

- Secured Transactions Law:

  A secured transactions or factoring law are not required for reverse factoring, since the payor/anchor subscribes an agreement with the factor and makes an irrevocable promise to pay confirmed invoices pursuant to established terms (i.e. date and amount).

- Collateral Registry:

  Reverse factoring does not require a collateral registry since the factor has direct ownership of the receivables as well as a direct contractual relationship with the anchor. In addition, the anchor uploads confirmed receivables directly in the technological platform, establishing a priority in the platform itself in favor of the factor and eliminating the possibility of competing interests from third parties.

- Extrajudicial Enforcement:

  Reverse factoring requires anchor customers to make irrevocable promises to pay confirmed invoices acquired by the factor. As a result, enforcement takes place via general procedures for enforcing contracts (which contain the payment clause). In cases of non-payment, the factor can also limit its risk by immediately discontinuing purchase of future confirmed invoices.

- Secondary Market:

  A secondary market for invoices is not necessary for reverse factoring, given that the factor relies on the creditworthiness of, and contractual obligations contracted by, the anchor. Additionally, since the factor relies solely on the anchor's willingness and ability to pay, it performs a full credit analysis of this party, sets the financing facility based solely on the anchor's ability to service the debt, and the eventual factor's exit strategy relies only on these factors. Consequently, it is not necessary to have a secondary market. It is desirable and perhaps necessary to have access to credit insurance (depending on the anchor's ability to pay).

- Banking Regulation:

  Having a favorable banking regulation that does not impose high credit reserves is desirable, but not required, since reverse factoring relies on a strong anchor with a good credit rating, with corresponding low credit reserves. Banking regulation must also allow for structuring the credit facility based on the anchor's credit rating (instead of the supplier's), given that it is the anchor that is ultimately responsible for payment of the debt. Finally, in order not to discourage use of reverse factoring, bank regulation must allow the anchor's irrevocable promise to pay to qualify as commercial debt, rather than as a bank loan.

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