| | |
|---|---|
| **Title:**<br>Measure to nullify ban on assignment clauses in a debtor's terms of sale. | Impact Assessment (IA) |
| **IA No:** RPC15-BIS-3174 | **Date:** 24/02/2015 |
| **Lead department or agency:**<br>Department for Business, Energy and Industrial Strategy | **Stage:** Final |
| **Other departments or agencies:** | **Source of intervention:** Domestic |
| | **Type of measure:** Secondary Legislation |
| | **Contact for enquiries:**<br>Jonathan Gershlick<br>E: jonathan.gershlick@beis.gov.uk<br>Tel: 0207 215 6330 |
| **Summary: Intervention and Options** | **RPC Opinion:** fit for purpose |

**Cost of Preferred (or more likely) Option**

| **Total Net Present Value** | **Business Net Present Value** | **Net cost to business per year** (EANCB on 2014 prices) | **In scope of BIT?** | **Measure qualifies as** |
|---|---|---|---|---|
| £966.0m | £966.0m | - £44.9m | Yes | IN |

**What is the problem under consideration? Why is government intervention necessary?**

Many firms supplying goods and services to other firms are contractually banned from using invoice finance by their customers. These contractual clauses ban suppliers from assigning what is owed to them by customers (their trade receivables) and they are also prohibited from selling the debts from an invoice onto third-party financers. These bans, through custom and practice, are relatively common in contracts, often as a by-product of wider bans on subcontracting which will not be affected by this measure. They are not actively sought or enforced by customers (the debtors) in practice. Nonetheless, customers have little incentive to change the arrangements of their own volition, and disparities in negotiating power can often make smaller suppliers reluctant to raise the issue. Consequently, government intervention is necessary to nullify ban on assignment (BoA) clauses where they exist. This will give firms, especially SMEs, the freedom and flexibility to make best use of invoice financing in a way that benefits them. The measure is not retrospective – it only nullifies bans on contracts commencing after the legislation date.

**What are the policy objectives and the intended effects?**

The aim of the policy is to remove a contractual barrier to invoice financing and therefore improve the ability of firms to access this type of finance. This will be of particular value to firms lacking other assets that could serve as collateral for a bank loan.

**What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)**

Option 0: Do nothing
Option 1: Override bans on the assignment of trade receivables for goods and services (preferred option)
Option 2: Provide that terms are ineffective in relation to certain parties
Option 3: Provide that such terms are effective only in relation to certain persons for certain purposes

**The primary legislation allows us to choose one option, a multiple or a combination of options.**

**Will the policy be reviewed?** It **will** be reviewed. **If applicable, set review date: April**/2021

| | | | | | |
|---|---|---|---|---|---|
| Does implementation go beyond minimum EU requirements? | | | N/A | | |
| Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base. | **Micro**<br>**Yes** | **< 20**<br>**Yes** | **Small**<br>**Yes** | **Medium**<br>**Yes** | **Large**<br>**Yes** |
| What is the $CO_2$ equivalent change in greenhouse gas emissions? (Million tonnes $CO_2$ equivalent) | | | **Traded:**<br>N/A | **Non-traded:**<br>**N/A** | |

***I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.***

***Signed by the responsible Minister***

Andrew Griffiths ***Date:*** 4th July 2018

## Summary: Analysis & Evidence…………Policy Option 1

**Description:** Override bans on assigning trade receivables for goods and services (preferred option)

**FULL ECONOMIC ASSESSMENT**

| Price Base Year 2015 | PV Base Year 2016 | Time Period Years 10 | Net Benefit (Present Value (PV) (£m) | | |
|---|---|---|---|---|---|
| | | | Low: 0.00 | High: 0.00 | Best estimate: £966.0m |

| COSTS (£m) | Total Transition (Constant Price) | | Average Annual (excl. transition, constant price) | Total Cost (Present Value) |
|---|---|---|---|---|
| Low | - | | - | - |
| High | - | | - | - |
| Best Estimate | 0 | | 0.0 | **0.2** |

**Description and scale of key monetised costs by 'main affected groups'**

The legislation is drafted so that it is only invoice financers, rather than the businesses holding the restrictive contracts ("debtors"), who need to be aware of the proposals. The familiarisation costs therefore fall solely on the UK's invoice financers, of which there are around 50. This gives a total estimate of familiarisation costs of £985. Any additional cost due to invoice financers having to check whether the contract date comes before or after the commencement date is expected to be negligible, as invoice financers will already be auditing their clients' sales ledgers. On the debtors side, it will not be illegal to include such clauses - they will simply be invalid. There will be a small additional administrative burden on debtors due to needing to change suppliers' payment details (the average annual cost of of this is estimated at £20,000). There is no evidence from the consultation of any other costs.

**Other key non-monetised costs by 'main affected groups': N/A**

| BENEFITS (£m) | Total Transition (Constant Price) | | Average Annual (excl. Transition) | Total Benefit (Present Value) |
|---|---|---|---|---|
| Low | - | | - | **-** |
| High | - | | - | **-** |
| Best Estimate | 0 | | £44.9m | **£966.2m** |

**Description and scale of key monetised benefits by 'main affected groups'**

Benefits will arise because once legislation nullifies ban on assignment clauses, invoice financers will be able to supply invoice finance to their clients at a reduced cost. Using new evidence available, we have monetised these benefits by analysing the variation in invoice finance interest rates and fees, focusing on the difference in charges paid by clients with and without bans on assignment. We have also estimated the benefits of increased use of invoice finance.

**Other key non-monetised benefits by 'main affected groups'**

Our surveys of Asset Based Finance Association (ABFA) members and businesses have highlighted a number of other benefits that are difficult to monetise. Currently, invoice financers restrict funding when there is a BoA; some financers refuse outright to provide finance when a supplier has a BoA; others impose extra collateral requirements or use other risk mitigation. With nullification we expect restrictions to be lifted. We also expect demand to rise from suppliers that do not currently apply for invoice finance.

**Key assumptions/sensitivities/risks** 3.5

Both costs and benefits are informed by surveys of ABFA members that were carried out specifically for the IA. ABFA has over 95% coverage of the UK invoice finance market. We estimate there are around 50 invoice financers in the market, but the vast majority of finance is provided by the UK's leading retail banks. In the consultation IA, only the benefits of no longer needing waivers and workarounds were monetised. However, the main benefits of the regulation – the fall in rates, charges and increased funding have now been monetised, and the other benefits associated with waivers and workarounds are no longer included in the calculator, as most of these benefits now come within the benefits of reduced rates and charges. All the assumptions are based on survey evidence, consultation with ABFA and other stakeholders.

BUSINESS ASSESSMENT (Option 1)

| Direct impact on business (Equivalent Annual) £m: | | | In scope of OITO? | Measure qualifies as |
|---|---|---|---|---|
| **Costs: 0.02m** | **Benefits: £44.9m** | **Net: - £44.9m** | Yes | IN |

# Introductory Summary

### Invoice finance

Invoice finance is a funding facility provided to firms that is secured against unpaid invoices. Unpaid invoices for goods or services can usually be used as collateral, enabling financers to provide suppliers with funding. Currently around 40,000 firms in the UK use invoice finance; it is estimated that this is around 10%[1] of the total number of businesses that could make use of it. The majority of invoice finance in the UK (by volume) is provided through the "big four" banks. There are also many smaller providers, including challenger banks and non-banks, that support significant numbers of smaller client businesses.

### What is a ban on assignment?

A ban on assignment is where large customers in a supply chain ban their suppliers from sub-contracting the supply of goods and services to a third party. There is broad agreement that it is reasonable to prevent the sub-contracting of the performance of a contract. However in many cases these contractual clauses have the effect of also preventing the assignment of the *debt* that arises under the contract. This prevents the assignment of the suppliers' invoices to a third party for the purpose of accessing finance. Such a ban means that invoices cannot be used as collateral. And without the necessary collateral, invoice financers cannot fund businesses seeking finance. This restricts such businesses' ability to manage their cashflows effectively and to grow.

### What is BIS' policy?

BIS policy is to seek to "nullify" bans on assignment in relation to invoices. Under the policy, bans on assigning invoices will not become illegal, but they will be unenforceable. This nullification will not interfere in any way with provisions which ban sub-contracting and customer firms will retain all their existing rights in this respect. The only effect will be to allow supplier firms (that will often be smaller businesses) to assign the debt that arises in order to access finance. Also, the nullification will not be retrospective. It will not apply to contracts existing prior to commencement of the legislation.

### What is the rationale for the policy?

The purpose of the policy is to give invoice financers greater freedom to fund SMEs. They will no longer need to worry about whether any of the invoices issued by a business are affected by ban on assignment clauses because they will be invalid. Invoice financers will therefore be able to provide small suppliers displaying similar economic characteristics with the same amount of funding and at similar interest rates, regardless of the presence of a ban on assignment. The extra funding will help put firms on a firmer financial footing and give

[1] Currently, around 44,000 firms use invoice finance, according to ABFA. The majority of SME suppliers are likely to continue to choose not to use invoice finance, but there are likely to be some firms for whom invoice finance would become a valuable finance option, once bans on assignment are lifted. We estimate using the Small Business Survey 2014 and the 2015 Business Population Estimates that there are currently around 500,000 SMEs in the business-to-business market and that are suitable to receive invoice financing. The estimate of 500,000 is a midpoint of the total number of business-to-business employers of around 260,000 and the total number of VAT-registered business-to-business enterprises of around 740,000.

them the cash flow to grow. More firms will be able to access invoice finance and it will be possible to provide more finance to existing users of invoice finance whose funding is constrained by the presence of ban on assignment within their debtor book. Nullification of bans on assignment increases the collateral available and thus lowers the risk for invoice finance providers. The removal of the complexities associated with bans on assignment will also reduce financers' workload. Both factors will lead to lower interest rates and fees charged.

**Who will be affected by the policy?**

- **Suppliers** will have access to cheaper and more readily available finance
- **Invoice finance companies** will do more business and their ways of doing business will be greatly simplified
- **Large customers (the debtors)** will be largely unaffected

**What are the main benefits listed in the Impact Assessment and how do they arise?**

The IA discusses how the policy will have the following direct benefits:

- **The fees and interest rates paid by suppliers** (invoice finance clients) **will fall considerably** due to a reduction in losses, risk and labour costs. There are two elements of cost here (the "discount fee" and the "service charge").

- By nullifying the contractual ban on the use of invoice financing, **the proposals will directly increase the amount of finance that invoice financers will be able to offer to their clients**. This will benefit invoice finance clients and financers alike. The evidence collected gives a high degree of confidence in the estimated increase in funding and wider direct benefits.

The following benefits of the policy change are assessed in the IA to be indirect:

- The additional demand for invoice finance from firms not currently using invoice finance, which will arise from the reduction in interest rates and costs of invoice financing

- The reduction in the number of outright refusals to provide invoice finance; and

- The lower collateral and personal guarantee requirements that will be demanded from existing clients.

# I Background

## Problem under Consideration

1. All businesses are highly dependent on cash flow and often require access to external sources of finance in order to invest and grow. A barrier to accessing this finance is a lack of sufficient collateral in order to offset lending risks for financers. This is a particular issue for small and medium sized businesses.

2. Traditionally, bank debt, whether through a loan or overdraft, has been the primary source of external finance for businesses to manage cash flow. However, the volume of lending to businesses has fallen from a peak of £589 billion in 2008 Q4 to £384 billion[2] in 2015 Q2.

3. Given this decline in traditional bank lending, it has become increasingly important for businesses to access alternative forms of finance. Invoice finance is an asset-backed finance product, and so is particularly useful for firms that do not have the standard types of collateral such as property. There is, however, a barrier currently preventing access to invoice finance by many small businesses; many large business customers contractually ban their suppliers from assigning invoices to others, which prevents them from using invoice finance.

## How invoice financing and ban on assignment works

4. For many businesses, a major part of their assets can be in the form of money owed to them for goods and services (accounts receivables). Here, a firm supplies goods or services to a business customer, for which it generates an invoice for payment at a later date. Whilst it is unpaid, the invoice can be used by the supplier to obtain funds from an invoice finance financer, using the invoice as collateral. Alternatively, the supplier can sell the invoice outright to a third-party finance provider. Both these forms of financing are collectively referred to as invoice financing.

5. Invoice financing allows businesses to access working capital against the security of monies owed to them. This type of finance is especially important as a way of managing cash flow for businesses facing longer credit periods or needing to raise additional finance but who lack fixed assets to provide security to obtain a standard loan. Due to economic changes – for instance, a shift in favour of services - there has been a decline in the use and importance of fixed assets within businesses, and this may help explain the growing appetite for alternative forms of finance such as invoice finance. Annex F provides examples of real companies that are using invoice finance to fund their growth.

[2] Bank of England, Bank of England: Quarterly amounts outstanding of monetary financial institutions' sterling and all foreign currency loans (excluding commercial paper) to private non-financial corporations, not seasonally adjusted, [code LPQB4VR].

6. However, the presence of contractual clauses in a debtor's terms of sale that ban the assignment of trade receivables, prohibits the supplier from assigning the invoice (also known as a "trade receivable") to a third-party financer. In some cases, the presence of a 'ban on assignment' clause can be the factor which determines whether an invoice financer can offer any finance at all. Annex F also provides some recent examples of real companies where BoA is preventing financers from extending funds to businesses that are seeking to grow.

7. Invoice financing comprises factoring and invoice discounting. Most financing is invoice discounting (over 90% of the market by value, although much less – around 50% - by the number of businesses). With discounting, the supplier, (typically an SME) will retain responsibility for its sales ledger and will carry on liaising with the debtor for payment of its assigned invoice. This practice means that the debtor is not necessarily aware of the assignment of the invoice.

8. Less than 10% of the invoice finance market by value is factoring, although factoring is used by around 50% of small and micro businesses that use invoice finance. With factoring, an invoice financer will take on the supplier's sales ledger and will interface directly with the debtor. In cases where a ban on assignment (BoA) for trade receivables clause is present in a contract, the financer could ask the debtor for a waiver of the ban on assignment. However, the supplier is normally reluctant to allow the financer to request this, partly because of the imbalance of power between the large debtor and the smaller supplier and partly because large customers are reluctant to change standard terms and conditions in contracts. The BIS 2015 Supplementary Survey on Waivers confirmed that the chances of the debtor agreeing to a waiver are slight.

9. The result is that when there is a BoA, financers will not fund against these invoices. In addition, invoice finance fees will be increased for the remaining, non-BoA portion of the sales ledger, and there will often be further restrictions on the amount of funding offered, including in some cases an outright rejection of the application. These industry practices are explained further in Annex D. We have also prepared a hypothetical case study to illustrate the problems which can be found on page 9, below.

10. Bans on assignment are highly prevalent in business contracts. BIS's 2014 survey of ABFA members[3] found that: a) 100% of financers offering factoring services had come across ban on assignment clauses; and b) 93% of financers offering invoice discounting had come across ban on assignment clauses.

**Large firms/ debtors use of bans on assignment**

11. Discussions with invoice financers suggests that bans on assignment are very common in contracts across most sectors and are especially common in contracts issued by larger businesses. The anecdotal evidence includes separate conversations BIS has conducted with a number of large retailers and construction firms. These conversations have confirmed that their standard

[3] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/383714/bis-14-1233-measure-to-nullify-ban-on-assignment-clauses-in-a-debtors-terms-of-sale-impact-assessment.pdf

commercial contract will contain a ban on assignments which extends to the assignment of trade receivables.

12. BIS also conducted an online survey of large firms, as part of the development of wider prompt payment policy which included questions relating to ban on assignment. The survey received 35 responses. When these large firms (debtors) were asked whether they included a ‘ban on assignment’ clause in contracts with suppliers that prevented the assignment of invoices to third parties, 30% of respondents said yes with a further 21% saying they did not know. Over half of the debtors who said they applied bans on assignment of invoice finance said that they did so on all of their contracts with suppliers.

13. The evidence available to BIS suggests that large customers’ objective is to prevent sub-contracting of the supply of goods and services. At present, the ban on sub-contracting may be inadvertently extended to a general ban on assignment. The consultations with debtors and stakeholders did not produce any evidence that nullifying the ban on assignment with respect to invoices will harm large customers, because the measure will not have any impact on other contractual assignment bans, which will remain untouched by the planned legislation.

14. Furthermore, as the nullification of BoA clauses will begin from the commencement of the regulations, it will not apply to retrospective contracts. This means debtors will not incur costs in having to redraft their standard form of contracts, as nullification of the ban will not make the clauses illegal.

15. During consultation, the risk of compromising commercial confidentiality was cited as an explanation as to why large businesses might seek to ban the assignment of trade receivables.[4] However, there was a shortage of examples of where this could be a problem in practice. During the consultation, we were told that businesses with a strong need for confidentiality will already have other safeguards in place to protect it.

16. Based on our discussions with large contractors in the sectors where BoA clauses are most prevalent a lack of evidence from customers suggested no substantive concerns about the policy and its impact in practice. This contrasts with the considerable need of SMEs to have access to finance, so that they can continue to trade, operate efficiently and have the capacity to invest and grow.

17. Logic would suggest that the inclusion of BoA clauses in so many contracts between large purchasers and their suppliers should mean that purchasers derive some benefit from the clauses. We therefore made significant efforts during the consultation period to gauge the views of large firms and major stakeholder groups as to whether or not BoA is important to them. As Annex D suggests, we had responses in particular from several large firms in the retail and constructions sectors.

[4] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/408130/bis-15-165-nullification-of-ban-on-invoice-assignment-clauses-summary-of-responses.pdf

18. In the vast majority of cases a ban on the assignment of trade receivables is an unintended consequence of a wider ban on assignment within the contract, normally designed to prevent sub-contracting. These historical and unrevised contractual arrangements demonstrate an unequal bargaining position between the debtor and supplier, with little positive incentive on the part of the debtor to address this concern, meaning that the market cannot deliver the desired outcome[5].

19. Our discussions with stakeholders such as the Asset Based Finance Association (ABFA), and our responses from the consultation, which included major UK banks and smaller invoice financers, suggest that ban on assignment clauses may be present for reasons of inertia rather than as a deliberate choice. We also received evidence from a variety of large businesses that were consulted at stakeholder events. (See Annex D for the list of firms and stakeholders that were consulted, including retailers and construction companies). These again confirmed that bans on assignment are unintentionally written into contracts as a by-product of wider bans on subcontracting (which the measure will not affect), rather than expressing an intention to prevent suppliers from accessing invoice finance.

20. During the consultation, we were not made aware of any instances of large debtor firms seeking to enforce such clauses in circumstances where the supplier continues to trade. The clauses only become relevant in an insolvency situation when invoice financers can face difficulties enforcing a claim for payment because the debtor will argue that the invoice is invalid because it should not have been assigned. At the same time, there has been little motivation to amend contracts with suppliers that are much smaller and there are very few examples of smaller suppliers having been able to negotiate waivers of the bans, such is the disparity in negotiating power. In many cases, there is even a reluctance on the part of smaller businesses to raise the issue because of concerns about losing a contract[6]. So, the clauses have not been, and without intervention are unlikely to be, removed from standard contracts between large customers and small suppliers.

[5] See paragraph 33 for further information.
[6] Evidence from ABFA during the consultation

**Hypothetical case study: Wessex Cocoa Ltd, the chocolate factory, the role of invoice finance and Ban on Assignment.**

Wessex Cocoa Ltd ("WCL" or "Wessex") is a small business supplying tailored chocolate creations for special events for the last 25 years. Wessex Cocoa's turnover has been stable in recent years at around the £2m level and the firm is profitable, with profit margins of around 10%.

WCL now wishes to expand the business and start supplying supermarkets. The firm is successful in winning initial orders from two customers, Britannia Supermarkets plc and Saver Stores plc worth £125k each. The expected profit margin on the new contracts is expected to remain in line with the firm's existing business.

The goods are delivered as per the contract but the two supermarkets inform WCL that they will not be paying for at least 60 days after delivery, in line with their normal practices. This will cause WCL significant problems as it has wages, suppliers and other bills that must be paid by month-end.

WCL has a long-standing relationship with Megabank plc and requests a corporate loan or overdraft. The application is rejected as it cannot offer any standard collateral (the factory is leased and the director's main asset, the family home, is mortgaged). But the bank suggests speaking to Megabank Invoice Finance plc (MIF). MIF agrees in principle to advance up front funds worth up to 85% of the value of its invoices subject to satisfactorily completing due diligence.

However, after due diligence, Megabank advises Wessex that it will not fund invoices to Britannia Supermarkets, as it finds the contract has a ban on assignment (BoA). So Wessex cannot fulfil the order and loses the profit on the initial, and all future, orders. The contract with Saver Stores looks clean of BoA and so funding is agreed to be provided against these invoices. Wessex can therefore fulfil that order. But Wessex is prevented from trading with Britannia and it decides to put a hold on further expansion.

Later in the year, Megabank discovers that a mistake was made and that the contract with Saver Stores also has a BoA. Megabank withdraws funding on the Saver Stores invoice financing facility unless Saver Stores agrees to remove its BoA. Saver Stores refuses as it is too much work to alter its standard contract terms and conditions and so Wessex suffers an immediate loss of cash. There is a contagion effect with Wessex unable to pay its own suppliers or wages on time and losing its business with Saver Stores. It comes close to ceasing to trade.

The episode has a last effect on Wessex's prospects. Relationships with its suppliers are damaged, and those suppliers that agree to continue trading with Wessex, increase their prices to cover the increased risk of dealing with Wessex; Wessex's credit rating is also dramatically reduced, reducing Wessex's profitability and putting its future in jeopardy.

**Barrier to Finance: Ban on Assignment**

21. Despite the lack of enforcement of bans on assignment by debtors, (as explained above in paragraph 20), the negative impact on suppliers in terms of increased costs and reduced availability of funding remain.

22. Bans on assignment restrict invoice financing because when an invoice financer is considering advancing money to a client against the value of their trade receivables, the financer will primarily base its decision regarding the terms of any advances on the ability of the client to repay monies advanced by the financer. A ban on assignment (BoA) increases the risk of providing invoice finance because:

    a) With BoA, the debtor has the upper hand and would theoretically be entitled to terminate the contract and refuse to pay monies owed to the supplier/client on the grounds of breach of contract; and/or

    b) In the case of the supplier/client becoming insolvent, the debtor may refuse to pay their trade debts already owed under contract with the suppler/client on the grounds that the contract was invalidated by the assignment, or on the grounds that due to the ban on assignment, they do not recognise the security interest of the third party financer. In cases of equitable assignment (under discounting arrangements), the financer does not legally have the right to pursue the debt owed in their own name and so must rely on the administrator of the insolvent client to pursue debts, which it may not do successfully.

    Either way, the risks to the financers results in less funding being made available and the cost of funding being increased. This affects most SME suppliers, as invoice financers have advised us that the vast majority of small firms have a ban on assignment in their sales ledger.

23. Once bans on assignment are nullified, this will put invoice financers back in control and they can either ensure that payment is made to them by the customer or they will have a much stronger legal position to chase debts if the supplier is unable to pay.

24. This increased risk impacts in differing ways on the provision of invoice finance, often depending on factors such as the operating model and risk appetite of the financer, the financer’s relationship with the client and the reputation and credit history of the debtor. These include:

    a) The finance provider may decline to offer any invoice financing to the client. This can often occur when the sales ledger of the client is predominantly taken up by one debtor (concentrated) and the invoices in question are subject to bans on assignment. Invoice finance trading platforms may also refuse to offer finance to clients/suppliers submitting an invoice for trading where there is a ban on assignment.

b) When the existence of a ban on assignment is known, it will almost invariably necessitate resource expenditure (time and expertise) on the part of the invoice financer and/or client to remove the ban on assignment or mitigate the increased risk to repayment. The finance provider may seek a waiver of the ban from the debtor which removes the obstacle of the ban. But evidence from our recent survey suggests that these are rarely sought or obtained, which leads to the need for risk mitigation, and increases in discount and service fees for suppliers.

c) Bans on assignment may also result in a reduction in the amount of financing available to the client, and at the same time increase the cost of the financing that is offered to them by the invoice financer. If a financer is concerned that a number of invoices on the loan book of the client may be subject to contractual bans on assignment, the financer may decide to advance finance against only a reduced percentage of the value of the invoices, or against a reduced number (volume) of invoices on the loan book. As traditional 'whole loan book' invoice financing is priced both by the discount rate against the financing used by the client and a fixed service fee (either fixed quantum or fixed % of turnover), the cost of financing is therefore increased as the 'value for money' of the service fee is reduced.

25. Annex E below provides further detail on the history of the proposal and technical aspects of the proposed legislation.

## II Rationale for intervention

26. The availability of bank lending to small and medium sized businesses has fallen since the financial crisis and affordability is also an obstacle for firms accessing finance. Typically, a business would use their accounts receivable as collateral for invoice financing, but a ban on assignment restricts the possibility of accessing invoice finance in some cases. We believe these bans are relatively commonplace in contracts yet serve no benefit to effective market functioning. Such bans remain in place because of the disparity in negotiating power between the two parties – evidence suggests few (if any) frictional costs may deter debtors from altering the contract, whilst suppliers feel the main impact of the ban but have limited ability to negotiate a change.

27. Therefore, an intervention is needed to nullify ban on assignment clauses so that small and medium sized businesses can use their accounts receivable as collateral for invoice financing.

28. We have sought evidence from trade representative bodies. For example, the FSB said: "Different types of finance will be appropriate at different times and small businesses must be free to choose the type of finance that suits their current business needs. The FSB supports the Government's approach to remove the contractual barrier to selling invoices, as set out in clauses 1 and 2 of the Small Business, Enterprise and Employment Bill. This should increase the availability of invoice finance as an option to small businesses".

29. Despite the restrictions imposed by ban on assignment clauses, the market for invoice finance has grown in recent years, boosted by increased funding to larger firms for whom ban on assignment is far less of a problem. And the market has the potential to grow strongly in the future if bans on assignment are lifted (see benefits section of this IA). According to recent figures from the Asset Based Finance Association, £19.3 billion of asset based finance was used by UK businesses as of the end of June 2015[7]. This is up 2% since June 2014, which indicates a sharp moderation in the growth rate of invoice finance, since it follows growth of 10% in each of the preceding years.[8]

30. Invoice finance can enable those who might otherwise struggle to obtain debt funding to secure external finance, especially those small and medium sized businesses that may have few assets other than their trade receivables.

31. Before invoice finance is advanced to suppliers, invoice financers will consider the risk of providing funding. For example, the concentration of a sales ledger, (how much a sales ledger is taken up by a single or small group of debtors) is a factor in calculating the risk of funding against a firm's trade receivables. Ban on assignment clauses are also an element of risk that invoice financers need to consider. Please see paragraph 22, above, for a fuller discussion of the risks to invoice financers of providing funding when there is a ban on assignment.

32. Invoice financers can consider two options to manage a ban on assignment clause in a supplier's contract. Firstly they can seek a waiver from the debtor allowing invoice finance to occur. This option still costs money to assess whether a waiver is feasible and a rejection is probable, damaging relationships between the supplier and debtor. More common methods to manage the risk associated with ban on assignment clauses would be to ask the supplier to provide more collateral, to increase fees associated with risk, to increase interest rate charges and/or to lower the amount of funding available to the supplier.

33. The evidence suggests that nullifying bans on assignment would therefore:
    - reduce fees,
    - reduce interest costs,
    - increase access to invoice funding for SMEs,
    - reduce labour costs for invoice finance firms reviewing contracts and negotiating with clients when there sales ledgers contain BoA.

**Alternatives to Legislation**

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[7] Q2 2015, ABFA industry statistics. This includes the UK and Irish market. But any over-coverage due to inclusion of some Irish invoice finance is offset by ABFA's lack of coverage of the whole UK market (over 95%). However, the IA relies on a lower base of invoice finance (£17.8bn rather than £19.3bn) as we exclude funding that is unrelated to receivables.

[8] http://www.abfa.org.uk/news/statistics.asp

34. We have considered alternative options other than legislating to nullify ban on assignment of trade receivables. We could have considered offering guidance to businesses on the merits of nullifying ban on assignment of trade receivable clauses or we could have requested that businesses join a voluntary code. An example of this is the recruitment industry, which has also sought to address BoA on a voluntary basis[9]. Despite support from the Office of Government Commerce in helping to launch the initiative, it has had very little impact. We are therefore not convinced that we could create any strong voluntary incentive for large debtors to re-write their standard contractual terms. Moreover, a voluntary effort would entail significant cost and effort on the part of businesses, as debtors would need to produce and coordinate their own code of conduct. A voluntary approach would also inevitably result in a disjointed response by debtors to resolving the problem, adding further complexity to the invoice finance market, and potentially increasing costs to invoice finance firms and suppliers. However, a mandatory response by government would reduce inertia.

35. We have also considered using sector regulators to create binding orders in order to rule out ban on assignment clauses in certain regulated sectors of the economy. This approach was not supported because evidence from invoice financers and small business representative bodies[10] suggests that BoA clauses are prevalent in multiple sectors of the economy. There is therefore a clear rationale for an economy-wide solution that provides clarity to businesses and invoice financers.

36. We have therefore concluded that only through legislation will we be able to remove this contractual barrier to invoice finance.

## III Policy objective and options

37. The aim of this policy will be to remove a contractual barrier to invoice financing in order to improve business access to finance.

### Description of options considered

38. Four high level policy options have been considered:
    a. Option 0: Do nothing.
    b. Option 1: Override bans on the assignment of trade receivables for goods and services (preferred option).
    c. Option 2: Provide that terms are ineffective in relation to certain parties.
    d. Option 3: Provide that such terms are effective only in relation to certain persons for certain purposes.

### Option 0: Do nothing

#### Proposal

[9] http://www.apsco.org/about-us/apscode_rpo_and_msp_code_of_conduct_.aspx#6 RULE 6 FINANCIAL RESPONSIBILITY

[10] A full of list of firms and rep bodies consulted with during stakeholder meetings is contained at annex D

39. Bans on contractual invoice assignment are currently allowed in debtors' terms. It allows debtors to write clauses in their terms of sale which prevent suppliers from assigning their trade receivables. This option would not change this.

**Option 1 (Preferred option): override bans on the assignment of trade receivables for goods and services**

**Proposal**

40. This is the option being taken forward. Under this option, we would provide that 'ban on assignment' of trade receivables for goods and services terms on contracts dated after the commencement date would have no effect at all. This would allow for the outright nullification of bans on assignment of trade receivables only.

41. We think this will have a positive impact for small businesses, the FSB said: "[we] welcome this approach as it will avoid additional legal costs and administrative burden on businesses amending contract documentation".

42. The measure would provide an exemption to ensure that contracts for financial products or services could be outside the scope of the nullification. The measure included sufficient flexibility to allow certain financial services to be included within scope of the anti-assignment regulations. However we received few requests to do so.

43. Under this option, the proposal would be implemented as follows
    - Apply to business to business contracts only (and not business to consumer contracts).
    - Extend to all businesses, regardless of size.
    - Financial services contracts will be exempted from the nullification. This is because the functioning of some financial market products is dependent on non-assignment. For instance, in the case of derivative products between the debtor and the creditor, a ban on assignment may compromise mutuality for set off purposes
    - Exclude contracts with interests in land. This is because there are already significant laws in place which these regulations do not seek to interfere with.
    - Not create any special provisions for supply chain finance arrangements. This will allow suppliers to opt into supply chain financing arrangements or seek alternative arrangements with other invoice financers.
    - Permit terms safeguarding commercial confidentiality provided they do not prevent an invoice financer from determining the validity or value of a receivable, or hindering their ability to enforce it.
    - Begin from commencement of the regulations. This means it will not apply to contracts retrospectively.
    - Exclude contracts where none of the parties has an establishment in the UK.
    - Provide an exemption on national security grounds.
    - Only apply where the parties conduct a business-to-business transaction using English contract law and one of them carries on business within the UK.

**Option 2: Provide that terms are ineffective in relation to certain parties**

**Proposal**

44. This option would make the assignment ineffective in relation to certain finance lenders. For example, it could provide that the only financers to whom assignments can be transferred are invoice financiers. There is complexity in this option because invoice financers are not legally defined. If a definition were found, this would limit the institutions that could offer invoice financing, narrowing down the available providers to those who specifically offer invoice finance.

45. Work to define invoice financers may delay the introduction of the regulations, depriving businesses of significant savings. As a result we are not taking this option forward.

**Option 3: provide that such terms are effective only in relation to certain persons for certain purposes**

**Proposal**

46. Under this option the nullification of ban on assignment for trade receivables would still be in place as is the case in option one. However, there would be additional terms to protect a debtor if damages are incurred by an assignment, (e.g. providing that damages are payable for assigning in breach of a term, without affecting the validity of the assignment or the interests of the assignee). We are not making any provision to protect a debtor if damage flows from an assignment because we have not uncovered evidence that there is a problem in practice, yet including such a provision could have the effect of discouraging assignments.

**Conclusion**

47. We believe option 1 is the best fit to achieve our policy objectives, and will be the easiest to implement and for businesses and invoice financers to understand. Our consultation has supported this preference.

## IV Cost and benefits of options

48. In order to gather evidence on the impact of these proposals on UK businesses, individuals, the public sector, and to inform thinking around policy and implementation, BIS has used multiple approaches for data gathering. This includes:
    - an online survey aimed at large firms (see Annex D for methodology),
    - online surveys distributed to Asset Based Finance Association (ABFA) members (see Annex D for the methodology),
    - face to face meetings with academic researchers, invoice financers, debtors, suppliers and business representative bodies,
    - publicly available industry data,
    - stakeholder meetings,

- formal consultation.

The results gathered from these approaches are used to inform the analysis of benefits below. Since the consultation Impact Assessment was published, we have tested our assumptions on the impacts of the policy through our consultation and stakeholder meetings. This has led to a further development of the evidence base, provided further analysis and updated our costings.

**Option 0: Do nothing**

49. The ‘Do nothing’ option will not meet the policy objectives which is to help firms lacking the sorts of assets that usually serve as collateral for a bank loan to access alternative forms of external finance. Under this option, debtors will continue to be able to place a ban on assignment.

**Costs / Benefits**

50. There would be no additional costs or benefits associated with this do-nothing option.

**Option 1: Override bans on the assignment of trade receivables for goods and services (preferred option)**

**Firms in Scope**

We propose that the nullification will apply to all UK law contracts that contain these specific clauses and are established after the commencement date. BIS' 2014 survey of ABFA members[11] found that 100% of respondents that offer factoring services and 93% of respondents that offer invoice discounting have come across ban on assignment clauses over the last twelve months in the context of their providing funding. The invoice finance industry and small firms (the suppliers) have told BIS that the vast majority of smaller firms have ban on assignment at least somewhere in their sales ledger.

51. This is supported by the responses to the official consultation. ABFA and other key stakeholders point to the overwhelming prominence of ban on assignment clauses. BIS' survey of large firms (see paragraph 12, above,) showed 30% of companies said they included ban on assignment in their contracts. Of those who said they did[12], 56% said it applied to 96-100% of their contracts. This indicates both the widespread use of bans on assignment of invoice finance and that the vast majority of invoice financers have awareness and experience with bans on assignment.

52. The three main groups that will be most affected by the nullification will be:
    a. suppliers,
    b. debtors - with a ban of assignment clause in their contracts,
    c. invoice financers.

[11] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/383714/bis-14-1233-measure-to-nullify-ban-on-assignment-clauses-in-a-debtors-terms-of-sale-impact-assessment.pdf

[12] Minus one respondent who did not answer the question

### Estimate of number of invoice financers

53. Through stakeholder engagement, ABFA have informed us that they have 31 UK members and 3 Republic of Ireland Members who provide factoring, invoice discounting and Asset Based lending. ABFA cover approximately 95% of the value of the UK and Irish invoice finance market.

54. There is not a definite answer on how many other firms may provide invoice financing who are not members of ABFA. However, we are aware that some international banks and some smaller firms do provide invoice financing. To provide an estimate of total number of firms in this market, we know there are at least 31 invoice financers as they are members of ABFA. We understand that an additional 16 invoice financers in the UK are not ABFA members. Therefore, our best estimate of the number of UK invoice financers is around 50. Discussions with the British Business Bank and responses from consultation support this estimate.

## Benefits

55. In this IA we seek to identify, describe and where possible monetise the benefits. We will arrange these benefits by direct and indirect impacts on businesses.

56. During our consultation, we collected evidence from ABFA and invoice financers that following nullification of BoA, there would be direct benefits from three sources: reduced fees, reduced interest rates and increased availability of funding for invoice finance clients. Although it has always been part of the rationale of the policy, these impacts were not monetised previously. Now, with the availability of new survey evidence, we are able to monetise these benefits.

### Rationale for how nullifying BoA will expand the invoice market and the total finance market.

57. This section discusses why the legislation will expand the invoice finance market and also the overall funding of SMEs i.e. that the increase in invoice financing will not be at the expense of a decline in finance available elsewhere.

58. Since the financial crisis, SMEs have found it harder to access finance[13]. Increased risk-aversion by banks and businesses, and a need for higher capital buffers have led to a persistent reduction in access to affordable credit for SMEs. Recently, over the past year, SMEs' credit acceptance rates by banks for loans and overdrafts have improved considerably[14]. Despite this, the long period of low acceptance rates since the financial crisis has contributed to a sharp decline in the usage of bank finance.

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[13] http://www.publications.parliament.uk/pa/cm201415/cmselect/cmtreasy/204/20404.htm

[14] SME Finance Monitor, BDRC Continental 2015Q1

59. High rejection rates also dent SMEs' confidence to seek credit in the future and this helps to explain the continued weakness in demand we are seeing even now that capacity has started to recover.

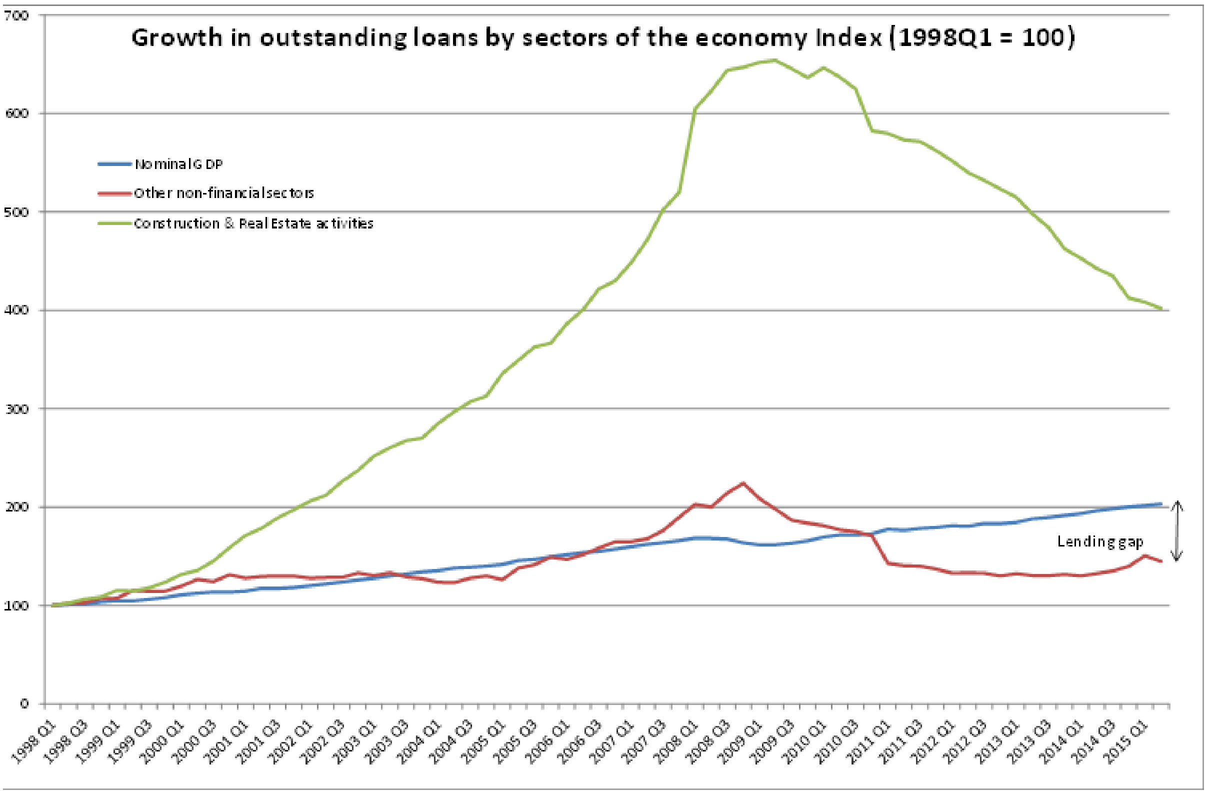
60. Recently updated BIS analysis[15] (using Bank of England data on lending) suggests that a large SME finance gap has emerged since the financial crisis, and this underlines the importance of developing alternative funding such as invoice finance to help fill the gap. The gap is the difference between the actual quantity of finance being used by the SME sector of the economy and what we would normally expect to be used based on the level of GDP. Prior to the financial crisis, there was a long–standing relationship between GDP and the outstanding stock of loans and overdrafts owed by businesses, as is shown in the chart below.

61. The chart below shows how during the financial crisis, a finance gap opened up, and this has still to be closed. The analysis separates out lending to the construction and real estate sectors which historically was always a small component of overall corporate lending but by the end of the credit boom, it comprised around half of lending, despite contributing less than 10% of output in 2015[16]. The vast majority of this lending supported financial investment in the property sector (asset accumulation) rather than real economic activity[17]. Lending to the sector has consumed significant resources, leaving less for the real economy. We estimate the 'lending gap' to the real economy to be currently around £89bn.

[15] The analysis was first used in the "Breedon Review", report to BIS of an industry-led working group to boost finance options for businesses, published March 2012, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/32230/12-668-boosting-finance-options-for-business.pdf

[16] http://www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm%3A77-380167 www.ons.gov.uk/ons/rel/naa2/quarterly-national-accounts/q2-2015/rft-1-gdp-o-.xls

[17] Not only is real estate and construction sector a relatively small component of GDP compared to its new-found importance in corporate lending, but economic activity in this sector has also shrunk relative to GDP since 1998, despite the rapid expansion in lending to it – which confirms that the bubble in credit associated with this sector funded an asset bubble rather than any increase in activity.




62. The SME lending gap is a more binding constraint on the economy than the overall gap of the stock of loans and overdrafts to all businesses of £89bn. This is because large businesses have access to many other sources of finance, most notably equity and bond finance from the capital markets. Such funding has become more prevalent since the financial crisis, and at least to some extent, is filling the lending gap for these businesses. SMEs in the UK on the other hand do not typically have access to finance from the capital markets and are directly affected by any weakness in lending by banks. The stock of lending to SMEs (outstanding loans and overdrafts) currently comprises around 39% of the total outstanding lending stock to the corporate sector. Applying this percentage to the 'lending gap', the current shortfall in lending to SMEs relative to the pre-crisis trend is estimated at around £35bn.

63. Alternative sources of finance, such as invoice financing, have the potential to play a key role in helping to offset the SME finance gap. Invoice financing provides finance for those businesses that lack collateral through conventional assets such as property and allows them to use invoices in their stead. Because of the clause written into contracts between debtors and their suppliers allowing debtors to ban assignment, many SMEs are unable to access invoice financing. The nullification will address this and will open up more finance for them.

64. In addition, invoice financing is potentially uniquely suitable as a substitute for bank overdraft lending, the supply of which has been additionally constrained since the crisis. Invoice financing is a financial product designed to help businesses fund their working capital requirements; this was traditionally a role played by bank overdrafts. However, the availability of overdraft lending has been restricted by regulatory rules that increase the price and reduce the

quantity of such lending. In addition to the general increase in capital requirements, banks have to set aside capital to cover the whole value of overdraft facilities offered, even though only a fraction of such facilities are ever drawn[18]. Consequently, there is now a greater opportunity than before for invoice financing to play a significant role in business finance. This gives greater importance to the need to nullify BoA which is currently such a major impediment to further growth of the invoice finance market.

65. If the proposals are successful, we expect the following beneficial effects:

- the fees and interest rates paid by suppliers (invoice finance clients) will fall considerably due to a reduction in losses, risk, labour costs, and
- by outlawing the contractual ban on the use of invoice financing, the proposals will directly increase the availability of finance offered by invoice financers to their existing clients. This will have benefits for invoice finance clients and also financers themselves. The increase in funding is extremely certain and will lead to a mixture of direct and indirect benefits for invoice financers and financers,
- the impact assessment also discusses the broader effects of nullifying BoA on the invoice finance market through lowering the interest rate and costs of invoice financing. These include:
    - additional demand for invoice finance from firms not currently using invoice finance (i.e. additional applications),
    - lower refusal rates and
    - lower security requirements for existing clients.

66. There have been two other significant changes to the IA since the consultation. In response to our consultation, ABFA advised that the use of waivers was extremely rare. Because this appeared to contradict evidence gathered before the consultation stage, we decided to gather new evidence on waivers. Following the receipt of new evidence from a supplementary waivers survey, we have downgraded the benefits previously attributed to waivers compared to those presented in the consultation IA. Meanwhile, on the debtors' costs side, we have added an estimate of additional administrative costs.

67. The following section of the IA now discusses the benefits in more detail.

## *Direct benefits calculations* ***(further details and explanations of all the calculations are provided at annex B)***

## Reduction in interest costs and fees

68. One of the major benefits of the new legislation is likely to come from a reduction in interest costs and fees. There are two main fees levied by invoice financers on their clients that vary according to the perceived risk from the point of view of the financer. The two fees are:

[18] BIS has been told that even during the height of the financial crisis, only around 50% of banks' corporate overdraft facilities in aggregate were drawn down.

- the discount fee which is levied only on finance drawn by the supplier and,
- service charge which is levied on all or the part of clients' sales ledger (turnover) assigned to the invoice financer.

Both charges are paid four times a year. The fees vary amongst different financers but information from Business Money magazine in March 2015 suggests that on an annual basis the fees typically start at around 1.5% above Bank Rate[19] for the largest invoice finance clients, rising to 9% above Bank Rate for higher-risk, small firms.

69. First, we identify the direct benefits deriving from the policy. If the proposals are successful, we expect to see a reduction in the fees charged to suppliers when they take out an invoice finance facility. A reduction in fees is classified as a direct benefit as it will allow the businesses that currently use invoice financing to make direct savings, increasing their profitability. We also estimate the direct benefit of lifting the funding restrictions which are a direct result of bans on assignment and how this will allow businesses that are supply constrained to increase their activity.

70. To get an idea of how bans on assignment impact the charges, we asked ABFA members in a new survey how the presence of a ban on assignment affects their pricing in typical scenarios that they currently face. In the consultation impact assessment, we did not monetise this benefit due to a lack of evidence at the time, though all our stakeholders agreed that fees would be reduced. In this final impact assessment, we are now able to monetise this benefit using new evidence.

71. There are low barriers to entry to the invoice finance market, which is highly competitive. Therefore, it is very likely that the reduction in costs and risk will be passed onto clients. We have evidence on the degree of pass-through from the 2015 ABFA survey for BIS, where financers gave evidence that lower-risk, small firms without BoA enjoyed better terms than similar firms with BoA clauses.

**Benefit 1(direct): Reduction in discount fee (interest rate paid on funds drawn)**

72. When suppliers' invoices are subject to a ban on assignment, invoice financers are highly unlikely to advance funding against such invoices due to the risk of not receiving payment and the risk of a total loss if the supplier were to become insolvent. When debtors discover that their invoices have been assigned, they will often refuse to pay the invoice financer[20]. This leaves the financer with the prospect of a potential loss because the debtor might pay the invoice direct to the supplier and the supplier might not pass on the payment to the invoice financer. Suppliers are especially likely to retain payment when they are in financial difficulty, which raises the prospect of a loss if the supplier goes bankrupt as the invoice has already been discharged so can longer be used as collateral.

[19] Also known as Bank of England base rate or policy rate (currently 0.5%)
[20] As reported to BIS by ABFA during the consultation

73. An alternative problem when there is a ban on assignment is that if the supplier were to go out of business before the debtor has paid, the debtor might seek to avoid payment altogether.

74. If there were no ban on assignment, both of these problems would not occur as the financer would be able to demand or enforce payment direct from the debtor - customer.

75. But under current circumstances, the consequence of BoA is twofold. First, the financer will typically avoid funding against the invoices affected by BoA, and second, the ban on assignment on these invoices taints the rest of the sales ledger – as it restricts the remaining amount of headroom that the financer needs if funding this particular client is to be viable. Ultimately, the financer will seek additional compensation on any funding provided, both to reflect the extra risk and the considerable extra effort[21].

76. In many cases, the extra fees are paid through the financer charging a higher ‘discount charge’ or interest rate to the supplier. This charge is paid as a percentage of the money advanced by the financer.

77. In order to calculate the total cost passed onto suppliers of bearing the financers’ extra risk due to Ban on Assignment, we have estimated the increase in the discount charge using a new survey carried out for BIS by ABFA. The survey was based on their treatment of a typical £1m turnover client. This example was chosen as it is where most of the ban-on-assignment problems occur, according to suppliers and the finance industry. As part of the survey, we asked ABFA members to describe the discount charges levied on such a typical client with and without BoA.

78. In analysing the benefit of the new legislation, it is also important to correct for the increase in the discount charge that is due to a high degree of concentration[22] of debtor invoices and not due to BoA being present. We single out concentration for the purposes of this analysis, as it is a key risk that invoice financers profile, other than ban on assignment. Invoice financers profile concentration based on the number of contracts a supplier has with its debtors. The smaller the number of contracts, the more concentration, which increases the risk to financers in the event of a default on payment, making them less likely to fund. We therefore needed to be able to separate out the issue of

[21] Once it is determined that there is a BoA, a key challenge for the supplier and funder is deciding what to do next which involves various people at the funder including client managers, risk and sales managers and, underwriters. It is time consuming at a point when time is critical and costly. Questions arise such as whether the invoice with BoA can still be funded, as otherwise the supplier has little improvement in cash flow. If it is included, then how much by value and percentage, and how much extra will the supplier have to pay? Other questions to be resolved include should any contact be made with the debtor-customer and by whom? The supplier’s priority at this stage is not to lose the extra business.

[22] In order to simplify the survey and maximise the response rate from the industry, a highly concentrated sales ledger was defined as having 50% or more of the ledger attributed to a single debtor. A non-concentrated ledger was defined as having no single debtor taking up more than 20% of the ledger. In practice, we were advised by the industry that a mid-point close to between 50% and 20%: around 35%, provided a good guide to the distinction of whether the sales ledger was concentrated or not.

concentrated versus non-concentrated sales ledgers from the issue of BoA. Even after BoA has been nullified, the issue of concentration will remain; and so invoice financers will continue to need compensation for the element of extra risk that is due to concentration. Therefore, we asked survey respondents for separate information on their typical clients with and without concentration in their sales ledgers – so that the specific benefit due to the lifting of the BoA could be identified separately and the effect due to concentration removed.

79. Our data from invoice financers split each financer's clients up into different client turnover bands, and this allowed us to calculate the average finance size for each turnover band. We used ABFA's published statistics on the whole industry to enable us to gross up the data from survey respondents according to the relevant weighting for each of the turnover bands. On advice from ABFA, we also made adjustments to take into account both the fact that smaller suppliers have a higher chance of having ban on assignment present, and that larger suppliers generally have been around longer, and therefore have a stronger negotiating position with debtors.

80. The estimates were calculated according to the following formula:

**Total amount saved from reduction in the discount fee =**
**Average size of loan in the turnover band**
**× Change in the discount charge**
**× Number of invoice finance clients in the turnover band**
**× Weighting of each turnover band**
**× Grossing up to the total value of invoices assigned**

81. The weightings ensure that the benefits of the legislation rapidly shrink away for turnover bands above the £1-£5m turnover level[23]. This follows advice from ABFA that bans on assignment become less of an issue for larger clients both because of a decline in the incidence of ban on assignment in ledgers and because larger suppliers are usually in a stronger position with both the debtor and financers to cope with any ban. The average size of loan in the band was calculated from ABFA's public data, which gives the number of clients and the total outstanding invoice finance balances for each turnover band, allowing us to calculate the average. The total amount saved from the discount fee is £13.7m in a full year. ABFA was consulted on these estimates and they have been confirmed as being reasonable.

82. The breakdown of the saving from a reduction in the discount fee is shown by the following table: (further details of calculations are in Annex B).

| Turnover band | Benefit from reduced discount fee for clients with concentration | Benefit from reduced discount fee for clients with no concentration | Total benefit from discount fee reduction |
|---|---|---|---|

[23] As a result, most of the existing invoice finance client beneficiaries are assumed to be in the bottom two turnover bands in the data published by ABFA. Based on ABFA advice, we assume that all <£1m turnover firms and 75% of <£1-5m firms have at least one case of BoA on their sales ledger. This equated to almost 32,000 firms in 2015Q2.

| | | | |
|---|---|---|---|
| UP TO £1M | £4.1m | £0.6m | £4.7m |
| £1-5M | £3.8m | £1.9m | £5.7m |
| £5-10M | £0.8m | £0.7m | £1.5m |
| £10-25M | £0.4m | £0.7m | £1.1m |
| £25-50M | £0.1m | £0.3m | £0.3m |
| £50M+ | £0.0m | £0.4m | £0.5m |
| **Total** | £9.2m | £4.5m | £13.7m |

Rounded to nearest £100,000

*Source of the Statistics*:

83. Data on the variation in the discount fee was taken from the 2015 ABFA survey commissioned by BIS. Respondents provided us with information on the variation in the discount change for both the “with concentration” and the “without concentration” scenario. We did not ask for data on total discount charges for competition reasons; we only asked for the variation.

### Benefit 2 (direct): Reduction in service (turnover) charge

84. As noted above in paragraph 75, when suppliers’ invoices are subject to a ban on assignment, invoice financers will seek additional compensation on any funding provided. As well as the prospect of losses and the higher risk of not receiving payment, cases of BoA on a sales ledger cause a significant increase in labour costs for the invoice financer, and this requires compensation, in this case by the financer levying a higher service charge on the value of all invoices assigned by the supplier. That is, the service charge is paid as a percentage of invoices assigned to the financer regardless of the amount of funding drawn or made available.

85. In order to calculate the additional costs passed onto suppliers due to Ban on Assignment, we have estimated the increase in the service charge using the 2015 survey carried out for BIS by ABFA - based on their treatment of a typical £1m turnover client. As with the discount fee calculation, we asked ABFA members to describe the service charges levied on a typical client with and without BOA.

86. In analysing the benefit due to the reduction in the service charge, we also took into account of the issue of concentration, as explained in paragraph 78, above.

87. The estimates were calculated according to the following formula:

**Total amount saved from reduction in the service charge =**
**Average size of loan in the turnover band**
**× Change in the service charge**
**× Number of invoice finance clients in the turnover band**
**× Weighting of each turnover band**
**× Service-charge deflator for large companies**
**× Grossing up to the total value of invoices assigned**

88. Our data from invoice financers split each financer's clients up into different client turnover bands, and this allowed us to calculate the average finance size for each turnover band. We used ABFA's published statistics on the whole industry to enable us to gross up the data from survey respondents according to the relevant weighting for each of the turnover bands. On advice from ABFA, we also made adjustments to take into account both the fact that smaller suppliers have a much higher chance of having ban on assignment present than larger suppliers, and that larger suppliers generally have been around longer, and therefore have a stronger negotiating position with financers and the debtor. The average size of funding in the band was calculated from ABFA's public data, which gives the number of clients and the total outstanding balances for each turnover band, allowing us to calculate the average. The total amount saved from the service fee is £46.1m in a full year.

89. Larger companies benefit from better terms and so incremental benefits from BoA being nullified will be smaller for them - since their starting point on service charges is already lower. We ensure the lower starting point is incorporated into our modelling of large-company benefits by using a service charge deflator. This deflator is applied in addition to the regular weighting of each turnover band. The deflator is crucial in reducing the size of the marginal benefit of nullification on the service fee. According to ABFA, in practice, firms with more than £10m per year of turnover would pay minimal additional service fees due to ban on assignment. So, the large company deflator in our model serves the purpose of ensuring that our estimates are in line with market practice.

90. The breakdown of the saving from a reduction in the service charge is shown by the following table:

| Turnover band | Benefit from reduced service charge for clients with concentration | Benefit from reduced service charge for clients with no concentration | Total benefit from service charge reduction |
|---|---|---|---|
| UP TO £1M | £13.4m | £3.7m | £17.1m |
| £1-5M | £10.2m | £12.4m | £22.6m |
| £5-10M | £0.5m | £3.9m | £4.3m |
| £10-25M | £0.0m | £1.9m | £2.0m |
| £25-50M | £0.0m | £0.0m | £0.0m |
| £50M+ | £0.0m | £0.1m | £0.1m |
| **Total** | **£24.1m** | **£22.0m** | **£46.1m** |

Rounded to nearest £100,000

*Source of the Statistics*

91. Data on the variation in the service fee was taken from the 2015 ABFA survey commissioned by BIS. Respondents provided us with information on the variation in the discount change for both the "with concentration", and the "without concentration" scenario. We did not ask for data on total service fees for competition reasons; we only asked for the variation.

92. The estimated benefit from the reduced service charge is higher because the charge is levied on the whole sales book[24] not just on funds advanced. As

[24] i.e. the service charge is not levied on the supplier's total turnover, rather on all invoices assigned.

above, ABFA was consulted on these estimates, noting that the benefit of £46m compares to total service fee income for the invoice finance industry currently between £700m to £800m. Separately, we discussed the issue of fees with MarketInvoice, a rapidly growing technology provider of invoice finance with a current UK market share of 1%. To protect itself from BoA, MarketInvoice requires all clients to sign a power of attorney (PoA) before they are allowed to trade an invoice on their on-line platform. The cost of a PoA works out at around £450 per trading customer, which increases the average client's fees by around 5% per year. The PoA would be redundant once BoA is nullified. The removal of this additional PoA cost gives a benefit that is in line with the total benefit estimated to accrue to all invoice finance clients in the market, of £46m[25].

**Benefit 3 (indirect): Impact of removal of funding ceiling on existing invoice finance customers with bans on assignment: benefit of increased funding for existing customers**

93. Nullifying BoA will remove a severe market restriction. At the macroeconomic level, we discussed at the start of the section on benefits how the increase in invoice funding will contribute to the closing of the SME funding gap that has opened up since the financial crisis.

94. At the microeconomic level of the invoice finance market, there is also a funding gap. When there is a high probability of a ban on assignment, we have explained above that invoice financers reduce the risk of not receiving payment from clients by charging extra fees (by increasing the discount and service charges). However, in addition to this, many invoice financers minimise or avoid the risk completely by restricting the amount of funding that they make available to clients. This reduction in funding available to firms from their sales ledgers restricts the amount of working capital available and restricts opportunities to take on new business. By nullifying bans on assignment, suppliers previously facing bans on assignment will start to have access to comparable funding that has hitherto been available to suppliers without bans on assignment.

95. At a practical level, nullifying BoA will give existing invoice finance clients more funding. Currently, invoice financers restrict the funding they are prepared to advance to suppliers with BoA by reducing the amount of funding also known as the 'prepayment percentage' that is advanced to the client. The prepayment percentage is the proportion of the value of invoices assigned that the financer is prepared to advance to the client and it might typically be around 80% if the sales ledger is free of ban on assignment and any other problems.
The higher the risk from the point of view of invoice financers, the lower the prepayment percentage i.e. the more they restrict funding to the small firm. Invoice financers will restrict funding to small firms, where they perceive there to be a higher risk. Once BoA has been nullified, a key restriction will automatically be lifted and so the prepayment percentage of funding offered to clients that had

[25] The estimate of £46m is based on the survey of traditional invoice finance providers covering over 95% of the invoice finance market. Comparing this benefit to that for MarketInvoice clients: we can divide £46m by the total service fee income of £700m - £800m. This comes to > 5%, but this is reasonable as over 95% of the invoice finance market is supplied by traditional providers who have a different business model and cost base.

BoA will increase to levels of funding already offered to invoice finance clients that did not have BoA.

96. We expect there to be significant demand for the increased funds extended as industry participants have told us that the current restrictions actively cut-off the funding of typical suppliers with BoA. (See paragraph 106, below, for more detail). Consequently, the increasing funding due to nullification is classified as direct. However, because the economic impact on suppliers (in terms of increased profit) falls outside of the original market where the legislation takes effect, the benefit of the increased funding to suppliers is classed as indirect. By contrast, the economic impact of the legislation on invoice financers ("benefit 4", see paragraph 123, below) falls within the original market (the invoice finance market) and so in this case the benefit is classified as direct.

97. Evidence of the existence of current restrictions on funding due to BoA also came from the ABFA Members Survey 2014. ABFA asked "Generally, what is the impact of a ban on assignment on your decision to offer factoring?" In total they received 17 responses (Table 4, consultation IA[26]). The number of participants who replied 'reduce funding available against contracts subject to ban on assignment' was 15 respondents (88% of respondents).

98. From the specific perspective of the supply of invoice finance, there is also clear scope for additionality to both finance and business performance. Most invoice finance is still provided by the major banks that are able to use their own internal modelling system (the Internal Ratings Based [IRB] approach), and they tend to weight invoice finance provision (without BoA etc) as being lower risk than other forms of SME finance. So if more cash is advanced to SMEs through invoice finance, less capital is required, allowing banks to make more efficient use of capital with clear scope for additionality. This is discussed in paragraphs 124-125.

99. In this Impact Assessment, in order to calculate the increase in funding to suppliers, we estimated the increase in the proportion of the value of invoices that the financers were willing to advance, referred to as the "prepayment percentage". This was done using data from BIS' new 2015 survey carried out in association with ABFA. The prepayment percentages were broken down by where BoA was present and whether there was concentration or not, allowing us to control for the effect of concentration on the prepayment percentage. As part of the survey, invoice financers returned data breaking down their clients into different client turnover bands; this allowed us to extrapolate the results for firms with turnover of £1m per year to firms with higher-turnover. We also made adjustments to take into account both that smaller suppliers have a higher chance of having ban on assignment present, and that larger suppliers are more established and generally have a better credit rating, and a stronger negotiating position with debtors. This reduces the anticipated benefits of nullification for larger firms. We used ABFA's published statistics on the invoice finance industry

[26] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/383714/bis-14-1233-measure-to-nullify-ban-on-assignment-clauses-in-a-debtors-terms-of-sale-impact-assessment.pdf

to gross up the data from the survey according to the relevant weighting for each of the turnover bands. The calculations are explained more fully in Annex B.

100. We also had to take into account the changes in the discount charges when concentration was present in the ledgers, and we used percentages for each turnover band. Finally, we consulted with ABFA on the new estimates produced in the Impact Assessment.

101. The estimates were calculated according to the following formula:

**Increase in funding for existing invoice finance clients =**
**change in prepayment percentage**
**× total value of invoices assigned to invoice financers**

102. The total value of invoices assigned is given in ABFA's published statistics, and the change in prepayment percentage is calculated from our 2015 ABFA survey, which gives each individual invoice financers' pre-payment percentage, and this was then weighted by each financer's market share.

103. This calculation is less straightforward in those cases where funders will not fund invoices at all due to there being a ban on assignment. It means that in the 2015 ABFA survey, they did not report any "prepayment percentage" for their Ban on Assignment business, because they do no business on these particular invoices. Consequently, for financers with such policies, we had to separately estimate the increase in funds advanced when ban on assignment is nullified. These calculations are discussed in Annex B (page 66, paragraphs 246-7):

104. The total amount of extra funding that could be provided in a full year to existing clients of invoice financers is estimated at £833m.

| **Turnover band** | **Increased funding for clients with concentration** | **Increased funding for clients with no concentration** | **Total increase in funding** |
|---|---|---|---|
| UP TO £1M | £97m | £36m | £132m |
| £1-5M | £105m | £238m | £342m |
| £5-10M | £18m | £114m | £132m |
| £10-25M | £7m | £95m | £102m |
| £25-50M | £2m | £48m | £50m |
| £50M+ | £0m | £74m | £74m |
| **Total** | £229m | £603m | £833m |

Rounded to nearest £1m

*Source of the Statistics:* Data on the change in the pre-payment percentage was taken from the 2015 ABFA survey commissioned by BIS. This provided us with the change for both the "with concentration", and "without concentration" scenarios.

105. This additional funding is not in itself a direct benefit to small firms, but the extra funding allows suppliers to take advantage of opportunities including doing more business and increasing sales. We assume in these calculations that for any additional turnover to be sustainable (i.e. additional to the economy as a whole), the profit margins on the extra business have to gradually increase after 5 years to be on average as high as the profitability of average SME business

activity (Otherwise, the extra turnover will not be sustainable, as it will be replaced by other turnover generated by the same firm or substitute activity coming from potential rival firms).

106. Our estimate of additional funding drawn down by existing suppliers is far less than our estimate of additional funds made available by invoice financers. ABFA data suggests that overall 64% of invoice finance funding made available to client companies is actually taken up. What appears to be a fairly modest drawdown rate is due to larger invoice finance clients that are typically offered finance facilities larger than they need. By contrast, invoice financers report that smaller suppliers typically use their facilities to the full. In addition, ban on assignment always leads to a hard restriction on funding made available to the affected firms, and many of these firms are micro or small firms that cannot obtain finance from other sources. Consequently when firms facing BoA-see their BoA-induced funding restrictions lifted, we are likely to see marginal take-up rise by more than the current average level of facility usage. Nevertheless, we have cautiously decided to apply the current average take-up figure of 64% to the expected additional level of funding and this equates to £532m per year.

107. In order to ascertain whether its estimates generated using responses to the 2015 ABFA survey were reasonable, BIS has requested further evidence from invoice financers representing most of the current market. Financers were asked the following question: “In terms of additional funding, what would be your estimate of the likely benefits to current clients of effective nullification of contractual clauses which ban the assignment of debts? In response, BIS has received submissions from three leading invoice financers (comprising two of the major high-street banks and the UK’s leading independent UK invoice financer). Together, these financers support close to 50% of the total current invoice finance market (by client number) and their submissions said that effective nullification would allow an increase in funding to existing clients of around £295m. In percentage terms, they said this would represent an increase of almost 4% in funding to existing clients. These submissions represent just under half of the current market, and so we are confident that our estimate of additional funding for all existing clients of around £532m, equivalent to a 3% increase in funding to existing clients, is a reasonable estimate of take-up of extra funding once bans on assignment have been nullified[27]. The submissions BIS has received from financers are reprinted in full from page 67, at the end of Annex B.

108. In terms of the economic impact of the extra funding, we also assume no leverage on the additional funds drawn, so on average we assume a 1 for 1 impact on turnover which means that £1 of additional funding drawn leads to only £1 of additional turnover on average. This ratio is applied to current invoice finance client turnover and we are confident that this is a modest, conservative assumption for the following reasons:

[27] The proportional increase in funding to invoice finance clients we are projecting is very modest. It is given by the ratio of additional funding that is drawn down to the total current funding. The additional funding is the amount offered (£833m) multiplied by the proportion drawn down (64%), to give £532m. Existing funding is £17.8bn. Therefore the proportional increase in funding used by clients is 3% (=£532m/£17.8bn).

a) Invoice financing has a leveraged impact on a firm's turnover and business activity. On average, SMEs face a two-month gap[28] between sale and receiving payment; for firms that need invoice financing to fund such a 2-month gap, £1 of additional funding would support up to £6 of additional annual turnover.
b) ABFA statistics show that for the current invoice finance market as a whole, the level of leverage is £4 of turnover for every £1 of invoice finance used.
c) By assuming that the additional funding used has no leveraged impact (i.e. only a 1 for 1 impact on turnover), this produces just a 0.7%[31] increase in invoice finance clients' turnover after BoA has been fully nullified. Because of our phase-in assumptions, (see paragraph 114) the projected increase in turnover is even less than this in the early years after nullification.

109. Finally, in considering the basis of the assumption of the link between funding and business activity, we compare the relationship between turnover and growth of recipients of invoice finance to recipients of the Enterprise Finance Guarantee (EFG)[29]. Recent analysis carried out for BIS[30] shows that employers using invoice finance had a higher propensity to grow (with 38% reporting growth) than employers not using invoice finance (with 24% reporting growth). The analysis also shows that the growers are more likely than not to find cashflow an obstacle, despite having access to invoice finance. This analysis is summarised in the table below which breaks down the findings for firms reporting growth according to whether they found either late payment or cashflow to be an obstacle.

110. By contrast the EFG evaluation suggested that around 60% of recipients were growing and the evaluation showed that for every £1 of extra finance, £2 of extra turnover was generated. Given the evidence above, we know that only 38% of firms that are using invoice finance are reporting growth. As argued above, EFG evidence can be applied to the firms that are going to benefit from this regulatory change. However, we do need to scale this benefit down by two thirds due to the relative difference in the incidence of growth - as expressed by the fraction (38%/60%). After scaling down, this would give a ratio of additional turnover to additional funding for invoice finance recipients of on average of £1.3[31] of additional turnover for every £1 of funding. Hence our assumption of £1 of additional turnover is a low estimate.

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[28] Analysis carried out by ABFA in 2015 using Companies House data: average number of days for small companies to receive payment for their invoices is 53-72 days (smaller companies average towards the top of that range; www.abfa.org.uk

[29] Please see a short discussion below, paragraphs 115-118, comparing the EFG and evidence from its evaluation to nullifying BoA and the evidence in this impact assessment. More details on EFG and the evaluation can be found here https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/85761/13-600-economic-evaluation-of-the-efg-scheme.pdf

[30] Analysis for BIS carried out by BMG research based on 1) the Small Business Survey 2014 and 2) a follow-up survey of B2B employers. Please see annex D for further details of the follow-up B2B research

[31] The raw funding ratio of 2:1 has been multiplied by (38/60), so as to enable us to take account of the difference in growth rates between EFG recipients and the beneficiaries of this policy change. Hence, this calculation is done as follows: (38/60)*2, which gives an adjusted funding ratio of 1:1.3.

| Employers reporting growth (%)[32] | | Of which late payment an obstacle | | Of which cashflow an obstacle | |
|---|---|---|---|---|---|
| | | Yes | No | Yes | No |
| All employers that did use IF in the last 12 months | 38% | 31 | 46 | 39 | 37 |
| All employers that did **not** use IF in the last 12 months | 24% | 25 | 23 | 22 | 25 |

111. We calculate the additional profit from the additional funds available, used and hence turnover generated as follows:

**Profit generated by additional funding available =**
**Additional funds available (£millions)**
**× Proportion of available funds that are taken up**
**× Turnover**
**× (extra profitability* – interest rate charged on funds used)**

*where the extra profitability from the additional funds used and turnover generated is calculated as follows*:
***Extra profitability from increased funding of existing SME invoice finance clients** (I.e. gross profit margin before cost of finance) **=**
(Gross value added – Employment costs) / Turnover

112. In this equation, we input the latest available national statistics (2013) data[33] which are as follows: gross value added by SMEs is £532bn, employment costs are £243bn and turnover is £1,523bn. This gives SME profitability as 19%. From this, we deduct the additional cost of finance (the interest charged on funds used). We use 3.1% as an estimate of the interest rate[34]. The service charge remains the same because at least initially the main response is that funds advanced rises from an unchanged value of invoices assigned. This gives a net profit (i.e. less finance costs) on the increased turnover of 15.9%.

113. However, we scale down the benefits in the first few years to take into account of the fact that the profitability of business expansion may be lower in the short-term than that of existing business, and also that expansion by growing businesses will not be immediate. Ultimately, for the purposes of the IA calculation, we opt for a lower level of profitability derived from this benefit in the first few years. These scaled down benefits are incorporated into calculations shown in the table after paragraph 139 below.

114. In principle, the use of average SME profitability is a reasonable proxy for the marginal profitability of suppliers using extra invoice finance. Unpublished

[32] To note from the proportion of employers reporting growth of 38% and 24%, (shown above) the rest of the analysis shows that both invoice finance users and non-users contain more non-growers than growers.
[33] http://www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm%3A77-370194
[34] Typical invoice finance discount rates paid by small firms from "Business Money" magazine, March 2015

analysis carried out for BIS using data on business credit scores showed that businesses with a track record in terms of growth are from a finance point of view a more risky-than average proposition. Such businesses are given a lower credit rating which makes it more likely they will have difficulties accessing funding (in terms of cost and availability). The analysis showed that such lower credit ratings applied to SMEs that would appear to be higher-than-average quality on other criteria such as size and profitability.

115. The theoretical total indirect benefit (not including the initial years' phase-in) is as follows:

| **Turnover band** | **Indirect benefit to existing invoice finance clients from additional funding, based on effective nullification i.e. before adjusting for phase-in.** |
|---|---|
| UP TO £1M | £13.5m |
| £1-5M | £34.8m |
| £5-10M | £13.4m |
| £10-25M | £10.3m |
| £25-50M | £5.0m |
| £50M+ | £7.5m |
| **Total** | £84.6m |

Rounded to nearest £0.1m

116. We compare the results of these IA calculations to an evaluation of the Enterprise Finance Guarantee (EFG) published in 2013. The EFG is a close parallel to this policy, as EFG firms are credit-constrained (similar to firms facing BoA) and both policies are intended to increase access to finance for these groups of firms. The published evaluation of the EFG shows high levels of finance additionality. We expect similar from nullifying BoA due to the evidence that firms with BoA are in a similar position, with the bans on funding acting as a hard cut-off to their ability to access finance.

117. We can also draw on the EFG evaluation’s evidence of significant business performance additionality:

- 55% of EFG firms said more funding “definitely” led to an increase in turnover in the 2009-12 period,
- 79% said EFG led to maintained or increased sales (72% said increased),
- 62% said EFG improved business growth prospects,
- 78% said EFG enabled “moderate” or “substantial” growth of the business, and
- 61% said more funding led to higher profit.

118. Comparing the characteristics of firms helped by EFG to those of firms seeking to overcome BoA also suggests that firms facing BoA may include higher-quality firms with a greater ability to make use of the extra funding received. This is because in the EFG evaluation:

- EFG businesses were typically young. Around 50% of businesses were <5 years old,

- 72% of EFG loans were small (less than £100k in size), and
- 71% of EFG firms had turnover of <£1m per year, including 16% start-ups.

By contrast, firms seeking invoice finance so that they can supply large customers are typically:

- older,
- larger with much higher turnover (turnover around £1m per year), and
- already have a high incidence of growth, as explained above in paragraphs 109-110.

119. To test the robustness of our estimates, it is also useful to compare the projected additional turnover generated by nullifying BoA to that from the EFG evaluation. In the EFG evaluation, we know that £670m of funds drawn in 2009 led to additional turnover of £1,344m between 2009 and 2012. The evaluation also shows that turnover growth of the 2009 EFG cohort was 33% (up to 2012), whereas we are expecting the extra turnover generated from nullifying the ban on assignment to be less than 1%[35], and so we are confident that this IA's estimate is cautious.

120. Based on evidence from the invoice financers (who have a close understanding of clients' business model and cashflow issues), the additional funding offered and used by existing invoice finance clients will also have a number of other additional beneficial effects. All of these effects will be material, but are not included as direct due to a lack of sufficient evidence to enable us to monetise their impact. The effects are as follows:

- Suppliers' profitability will be boosted as they will have the cash to negotiate better terms and they will be able to take advantage of prompt payment discounts on their purchases;
- Suppliers will be able to take advantage of opportunities to become more efficient e.g. lowering their cost base by buying in bulk;
- Suppliers' credit ratings will improve; this will feed back to other effects i.e. allowing them to negotiate better terms and reduce the price of purchases;
- Suppliers that had faced cash flow difficulties will be less likely to make late payment to their own suppliers as well as to HMRC. Having access to this extra funding will help avoid late fees, interest charges and penalties. Meeting obligations on time will additionally improve cash flow through the supply chain.

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[35] We calculate that the estimated benefit of extra funding generates turnover growth of 0.7% for existing invoice finance clients. The proportional increase in turnover for invoice finance clients is given by the ratio of additional turnover to total current turnover. The additional turnover is the same as the additional funding used, £530m. Additional funding used = additional funding offered, £830m, multiplied by the proportion drawn down, 64%. Existing turnover is £73.1bn. Therefore the proportional increase in turnover is 0.7% (=£530m/£73.1bn). This is not the % turnover growth of firms where BoA problems are most pervasive(mostly clients with turnover <£5 million a year), but ABFA statistics and the BIS 2015 survey suggests that nullification will cover a significant proportion of total invoice finance client turnover, and so 0.7% is fairly representative of the scale of the impact.

121. Finally, we also calculate the impact of this benefit (increased funding and turnover) on the other key element of GVA, labour costs. Using the calculations outlined in paragraphs 111-112, above, the wage bill (employment costs) as a percentage of turnover is 16%. Applying this to the additional turnover, the increase in the benefits to labour (i.e. the increased wage bill benefits) is very similar in profile and scale to the figures shown in the table at paragraph 115.

122. And unlike the profit estimates which take time to build up, the additional benefits to labour come in at the same time as the increase in turnover. However, these are not business benefits and so are not included in the calculator.

**Benefit 4 (direct): Impact of removal of funding ceiling on profitability of invoice financers – due to their ability to do more business.**

123. The removal of BoA, which is a market restriction implemented by large debtors, will have benefits for invoice financers as well as their clients. The analysis in this section suggests that by year 5 following implementation, for every £8 of benefit to SMEs from increased funding, a £1 benefit to financers can be expected.[36] Our best estimate based on consultation with finance industry sources is that financers make an operating profit margin of 2% on invoice finance (interest rates and fees minus cost of funding) and that this operating profit margin would also apply to additional finance supplied to firms that had faced BoA. Applying this to the extra funding drawn down gives an expected benefit to them of around £11m per year once all benefits have been phased in.

| | **Profitability of extra funding** | **Additional financer profit** |
|---|---|---|
| Low estimate | 1% | £6m |
| **Best estimate** | **2%** | £11m |
| High estimate | 3% | £17m |

124. In arriving at this estimate, we have considered the question of to what extent the extra profitability from invoice financing business will be additional to financial institutions or whether it will be displacing other income streams generated elsewhere. In the post-financial crisis environment, the answer to this question is dependent on regulatory standards of capital adequacy. There are two points to note here: first, a number of significant invoice finance providers are not part of banking groups, and so here the issue of displacement from other regulated banking business does not arise; second, the larger financial institutions that are able to use their own internal modelling systems (the "internal-ratings-based" approach) tend to weight invoice finance as being low risk. So if more cash were advanced to SMEs through invoice finance, comparatively little extra capital would be required, compared to that needed to support other banking activities.

125. Both these factors point to an addition of funding rather than displacement from other types of credit already being made available in the economy.

[36] See table in this IA after paragraph 132, which shows that the vast majority of the benefits are expected to be on the supplier side.

Moreover, the UK's major banks are no longer constrained in their asset growth by a lack of capital adequacy. The Bank of England reports that the major UK banks have all significantly improved their risk-based capital and leverage ratios, which are now well above internationally-agreed requirements[37]. Commentators are expecting that UK lenders will soon start returning excess capital to shareholders and increasing dividend payouts. This suggests lenders perceive there to be a lack of secure, profitable lending opportunities available. Nullifying BoA, by removing the legal restriction that currently prevents financers advancing funding against otherwise good assets, will offer opportunities to financial institutions to profitably deploy any excess capital that they have.

## Indirect benefits from nullification of bans on assignment

126. There are two other indirect benefits arising from the nullification of ban on assignment. These benefits stem from invoice financers being able to fund new customers to whom they are currently unable to provide any finance. The benefits comprise:

  a) benefit to new invoice finance clients from funding and
  b) benefit to financers from funding to new clients.

127. Invoice finance has great potential to provide a new stream of funding for suppliers not currently using it and this is likely to be of particular benefit to credit-constrained SMEs lacking the type of collateral required by most financers. In these cases, invoice finance may be a final option for SMEs seeking external debt finance. Consequently, when credit-constrained SMEs are denied invoice finance because of BoA, it is very likely that these businesses will be left without any lines of external debt finance and potentially profitable opportunities will be passed up or they will be at higher risk of becoming insolvent.

128. Since the consultation, BIS has received statements from financers which allows us to make an assessment of the scale of this indirect benefit. One major UK bank which provides invoice finance, with an estimated market share of around 18-20% (by number of clients) stated that there are likely to be further and wider benefits in terms of making businesses, for which invoice finance is not currently an option due to BoA, more viable funding propositions. The bank expects nullification to lead to "hundreds of millions of pounds" of additional funding to businesses. Meanwhile, the largest non-bank provider of invoice finance in the UK, representing around 10% of the current market (by number of clients), stated that effective nullification would lead to the provision of £10-£15 million of new funding to an additional 70-100 additional businesses, to whom invoice finance cannot currently be provided.

129. Using the combination of evidence above from one of the major UK high-street banks and from the independent invoice financer provider, we expect a range of £100m to £150m[38] of new funding to be provided to new clients that are not

[37] http://www.bankofengland.co.uk/publications/Documents/fsr/2015/fsr37sec7.pdf pages 34-35

[38] This is calculated as follows: £10-£15 million for a bank with a 10% market share; hence this scales up to £100-£150 million for the market as a whole. This is, if anything more conservative than the expectation from the high-street bank of "hundreds of millions of pounds" of additional funding for businesses that are not currently viable funding propositions.

currently viable funding propositions. We take the mid-point of the range, £125m and apply this new funding to obtain estimates of additional profitability to suppliers and financers using the same methodology deployed to calculate benefits 3 and 4, (as described in paragraphs 108-125, above). This gives rise to the following indirect benefits:

| | | | | | |
|---|---|---|---|---|---|
| **Benefit to new clients from extra funding (indirect)** | £6.6m | £9.9m | £14.9m | £17.9m | £19.9m |
| **Benefit to financers from extra funding to new clients (indirect)** | £2.5m | £2.5m | £2.5m | £2.5m | £2.5m |

130. The classification of the *additional funding* provided to *new* clients is different to the estimate of *additional funding* provided to *existing* invoice finance clients. The *additional funding* for existing clients is "direct", even though the ultimate benefits may not always be direct – for instance, the benefits to the suppliers in increased profit are indirect). However, additional funding for new clients is indirect.

**Reduction in labour costs due to removal of the need for work-arounds and waivers**

131. The consultation IA estimated benefits arising from a reduction in labour costs associated with work-arounds and waivers. These costs still exist but are not explicitly included in the final IA calculator.

132. In the case of invoice discounting there are often workarounds which mitigate the risk of retrieving monies owed to a client in the event of that client becoming insolvent. This typically involves the invoice financer agreeing arrangements with the supplier so that in the event of non-payment by the debtor or the supplier, the invoice financer can recover the funds that have been advanced. These arrangements can include the supplier offering a personal guarantee, a charge on the family home or a debenture[39]. Finance providers may also require a power of attorney to be established from the outset, so the invoice financer can pursue monies owed in trade debts to the client in the case of client insolvency.

133. Arranging workarounds uses up resources. If ban on assignments are nullified, there will be no need for workarounds and financers will be able to provide their services at a reduced cost to suppliers due to administrative savings.

134. Some invoice financers also currently assess the potential for seeking waivers from debtors on their contractual bans on assigning invoices. By nullifying bans on assignment, this will also remove the need for waivers, and so financers will no longer need to spend resource on assessing the use of waivers on behalf of suppliers and potentially requesting them from debtors. This will also allow administrative savings that can be passed on to the financers' clients.

135. The estimated benefits of removing the need for workarounds are broadly comparable to those in the consultation IA. As for waivers, following the

[39] Any other charge on a business asset or personal asset taken by the financer

consultation, we were advised by ABFA that usage was rare. BIS investigated this further by conducting with the help of ABFA a supplementary survey of invoice financers on waivers. The survey showed that although a number of financers often assessed their clients' suitability for waivers, they did not normally end up seeking waivers from debtors. This is primarily because of the work involved in altering standard contract terms and conditions (which often requires legal advice). And even when they did seek a waiver, they were unlikely to be granted, as explained earlier in paragraph 8. Separate evidence from stakeholders suggested this is often due to reasons of inertia.

136. In both the cases of waivers and workarounds, there is also a concern that the final IA should not double count these savings with the benefit of reduced fees and charges. Currently, the resource costs of waivers and workarounds are passed onto clients in the form of higher fees; but the final IA also now includes estimates of the benefit of lower fees once BoA is nullified. To avoid, any element of double counting, we have decided not to include the waiver and workaround benefits in the final IA calculator. In any case, as demonstrated by the calculations in the consultation IA, the benefits of not needing waivers and workarounds are expected to be modest.

## Total monetised benefits after adjusting for phasing in

137. Before summing the four benefits outlined above, we need to consider whether the benefits will come in immediately or be phased in. In this IA, we take a conservative approach and assume that the benefits outlined in this section will materialise slowly over time. The legislation is not being implemented retrospectively and applies to new contracts. Based on discussion with the invoice finance industry, typical contracts between customers (debtors) and suppliers (invoice finance clients) have a duration of 3 years. This means that the IA needs to take into account that from the date of commencement of the legislation the average remaining duration on a typical contract is likely to be around 18 months. A significant minority of existing contracts have longer durations than this, and of these a small number of business relationships are permanent and ongoing. On the other hand, customers and suppliers are striking new business relationships all the time: for all these new contracts and business activities, bans on assignment will be lifted immediately.

138. Consequently, in all the benefit estimates, we assume a slow phasing-in of the benefits based on how the business world is likely to react in practice to the new legislation. We have only 50% of what we could call the theoretical benefit coming in over an 18 month- 2 year period. There is a further phasing in of the benefits over a further 3-year period. This takes us to only 80% of the theoretical benefit after 5 years. The final 20% of the theoretical benefit is now assumed to never come in, as a small but sizable minority of contracts are unending.

**Summary table of aggregate direct and indirect, monetised benefits**

| | year 1 | year 2 | year 3 | year 4 | year 5 onwards |
|---|---|---|---|---|---|
| **Reduction in Discount Charge (direct)** | £13.7m | £13.7m | £13.7m | £13.7m | £13.7m |

| | | | | | |
|---|---|---|---|---|---|
| **Reduction in Service Charge (direct)** | £46.1m | £46.1m | £46.1m | £46.1m | £46.1m |
| **Benefit to existing SME invoice finance clients from extra funding (indirect)** | £27.9m | £42.3m | £63.4m | £76.1m | £84.6m |
| **Benefit to financers from extra funding to existing clients (direct)** | £3.5m | £5.3m | £8.0m | £9.6m | £10.6m |
| **Benefit to new clients from extra funding (indirect)** | £6.6m | £9.9m | £14.9m | £17.9m | £19.9m |
| **Benefit to financers from extra funding to new clients (indirect)** | £0.8m | £1.3m | £1.9m | £2.3m | £2.5m |
| **Sum of all benefits, before phase-in** | £98.7m | £118.7m | £148.1m | £165.7m | £177.5m |
| **Benefits taper to adjust for phase-in of contracts** | *25%* | *50%* | *65%* | *75%* | *80%* |
| **Sum of all benefits after phase-in (actual benefits, best estimate)** | **£24.7m** | **£59.3m** | **£96.2m** | **£124.3m** | **£142.0m** |
| **Sum of *direct* benefits after phase-in (actual *direct* benefits, best estimate)** | **£15.8m** | **£32.6m** | **£44.1m** | **£52.1m** | **£56.4m** |
| **Sum of *indirect* benefits after phase-in (actual *indirect* benefits, best estimate)** | **£8.8m** | **£26.7m** | **£52.1m** | **£72.2m** | **£85.6m** |

139. On balance, we go for a slow phasing-in of the benefits, with 50% of the benefits outlined above coming in by year 2. And to reflect the existence of those long-term business relationships that are ongoing, with contracts that are permanent, ongoing and unlikely to be revised, the rate at which the benefits accrue slows over time. We assume no additional accrual of benefits beyond year five, meaning that the benefits are capped at 80% of those estimated in this section. This gives a profile of benefits as per the table above:

## Non-monetised benefits from nullification of bans on assignment

140. We have identified various other indirect benefits arising from the nullification of ban on assignment, listed as follows:

a) Increased demand for invoice finance from new customers
b) Reduction in refusal rates
c) Reduction in other frictions and barriers in the market discouraging entrepreneurs from using invoice finance  such as personal collateral requirements

141. Whilst they may be difficult to quantify, these indirect benefits are important because they apply to SMEs that may be more credit-constrained than existing invoice finance clients who currently receive at partial funding, albeit more costly, due to BoA.

### a) Increased demand from SMEs not currently using invoice finance

142. If the proposals are successful, the fees faced by suppliers are expected to fall considerably (as shown above). Some SMEs perceive that invoice finance is expensive relative to other forms of short-term finance[40]. Consequently, by lowering the rate of interest and costs of invoice financing, the proposals are expected to help widen the market for invoice finance.

143. In practice there are currently around 400,000 SMEs that are in the business to business market which implies that they are suitable to receive invoice financing. Currently, around 10%[41] of these firms use some sort of invoice finance. The vast majority of SME suppliers are likely to continue to choose not to use invoice finance, but there is likely to be a portion of B2B firms for whom invoice finance would become an affordable credit channel, where it was once too expensive, once market restrictions associated with bans on assignment are lifted.

144. In assessing the size of the potential market response to the success of the proposal, one would need to take into account that the invoice finance market is already on a growth trajectory, with a market size of £18.9bn in 2015Q1, up from £14.1bn in 2010Q1, and from £17.8bn a year earlier. There is also a trend of an increasing number of invoice finance clients. Discussions with the industry also confirmed that lifting the ban on assignment would increase the size of the invoice financing market. For illustrative purposes, if the proposals were successful in freeing up the invoice financing market, the market could expand by around 10% over a 5-year period, which would be equivalent to around an extra £2bn in finance for SMEs.

145. Survey evidence[42] shows that around 40% of firms that have used invoice finance in the past are stable or growing, compared to 20% of firms that have not used invoice finance in the past. This suggests that usage of invoice finance can be associated with better business performance, and so if more firms have access to such finance, there could be wider (albeit indirect) benefits to business.

146. Although evidence suggests that following the introduction of the new legislation, demand for invoice finance from SMEs not currently using it could increase, we have not found any empirical evidence on the likely scale of the response. Consequently, we have decided to class this benefit as indirect and it has not been monetised for the purposes of this impact assessment.

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[40] http://british-business-bank.co.uk/wp-content/uploads/2014/12/BBB_Small-Business-Finance-Markets-2014_Online_Interactive.pdf

[41] See footnote 1, page 3 of this IA for how the "10%" figure is calculated.

[43] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/383714/bis-14-1233-measure-to-nullify-ban-on-assignment-clauses-in-a-debtors-terms-of-sale-impact-assessment.pdf

### b) Reduction in refusal rates

147. Some SMEs whose contracts contain a ban on assignment currently face an outright rejection by some invoice financers. If Bans on Assignment are nullified, these firms will now have increased access to finance, and/or access to a wider range of financers.

148. It is not possible to monetise the business benefits of these effects. But one of the factors that will lead to an expansion in the size of the invoice finance market is a decline in the rejection rate. One of the largest financers in the invoice finance market has told us that they do not provide SMEs with any invoice finance if any of the sales ledger is subject to bans on assignment. More typically, financers will only completely refuse to provide any funding if a significant proportion of the sales ledger is tainted by a ban on assignment. At any rate, since BoA is prevalent in the sales ledgers of most micro business, this severely curtails funding at this end of the market and once BoA has been nullified, we would expect the supply of invoice finance to expand to include more SMEs.

### c) Reduction in alternative/personal collateral requirements

149. ABFA has provided BIS with evidence that when BoA is present, invoice financers require further security in the form of collateral linked to assets other than receivables (for example, debentures, personal guarantees, the director's home), if they are to extend credit against invoices. These extra requirements increase the true cost of invoice finance beyond the discount and service charges. These negative consequences such as extra collateral requirements, are a disincentive for entrepreneurs to use invoice finance, and so if bans are nullified, we expect these extra requirements (when they previously related to BoA) to be removed, which will promote usage of invoice finance by SMEs. It is not possible to monetise these effects.

## *Costs*

150. The costs that those businesses in scope may face due to the nullification of the ban can be split into transition and recurring costs. Transition costs are one off costs that relate to the implementation of the measure whereas recurring costs are those that are likely to reoccur for the time that the policy measure is in force.

151. The transition costs for this policy option will be the costs for nullifying the ban and the burden of familiarisation with administrative requirements.

### Cost of nullification to suppliers

152. From discussions and responses to our consultation, the statements in the consultation IA have been confirmed that ban on assignment clauses in contracts may technically remain even though any contracts established after the commencement date with such clauses left in will be legally invalid. Also, as the legislation is not retrospective, all existing contracts will remain in force. For these reasons, the legislation is not associated with any compliance costs on suppliers.

153. As we discussed above in the benefits section of the IA, the nullification may take time to come into effect. The legislation will not obligate any party to re-write existing contracts in order to nullify the ban on assignment, nor will debtors have any incentive to do so. So the policy will be implemented naturally when suppliers and debtors voluntarily enter into new contracts.

154. There are no additional burdens to the supplier; rather, the prospects of suppliers being granted invoice finance will have increased. For suppliers, the change will be very easy to understand and so any cost will be extremely insignificant, especially as it is an outright nullification.

**Cost of nullification to debtors**

155. Based on our consultations with industry experts and businesses, we do not believe that an outright nullification of bans on the assignment of trade receivables as proposed will impose any significant burdens on debtors or deny them contractual freedom to reserve commercial confidentiality.

156. In our survey aimed at large firms, we asked those respondents who said they did include a ban on assignment in their contracts 'What level of resource would be incurred by your organisation if these 'bans on the assignment' were made legally invalid?' (See Table 1, consultation IA[43]).

157. There were a variety of results, the median of which lay between low and medium. The survey then asked those who responded 'high', 'very high' or 'don't know'; "*What level of resource would be incurred by your organisation if these 'bans on the assignment' were made legally invalid?*" We only received three responses, one of which said it cannot be assessed; another misinterpreted the policy as they believed it would impact on the ability of a business to restrict the supplier from sub-contracting to a third party (which the regulations would not allow). The third said a number of its departments will be impacted but does not explain how.

158. Using a combination of the survey results gathered and expert advice on invoice finance, the consultation IA interpreted the cost as being negligible for debtors in this instance. This was confirmed by subsequent discussions. During the consultation, meetings with the CBI, whose members include final customers in supply chains and are often debtors, plus discussions with large-company (debtors) directly confirmed that legislation nullifying bans on assignment would not adversely affect them. One respondent to the consultation, an invoice financer, said that debtors had nothing to lose from the supplier having better access to finance; they can only gain from it.

159. BIS' understanding of the reason behind the statements from debtors that they would not be affected by nullification is as follows:, at present, when there is a supplier bankruptcy and BoA, debtors could in theory avoid paying for goods and

[43] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/383714/bis-14-1233-measure-to-nullify-ban-on-assignment-clauses-in-a-debtors-terms-of-sale-impact-assessment.pdf

services, as invoice financers are unable to legally enforce the invoices assigned to them; whereas after bans on assignment have been nullified, debtors will no longer be able to avoid making payment for goods and services received in the event of supplier bankruptcy, as financers will be able to use the invoices assigned as collateral and will be able to enforce any debts. However, in practice this is not the case, as nullification will not lead to debtor losses: even currently, debtors cannot avoid making such payments, precisely because financers are strict in ensuring that suppliers are not funded when there is a ban on assignment. If they were not strict, debtors *would* have the opportunity to delay payment.

160. The increase in funding to existing invoice clients that stems directly from nullification may however be associated with some additional administrative cost on the part of the debtors. As a consequence of their increased funding, many existing invoice finance clients will have to ask those customers[44] that have a BoA clause, to change payment from the supplier's bank account to a separate trust account that is operated by the invoice financer and into which monies owed to the supplier are paid. Changing an account number, a sort code, and in some cases the name and address of the bank or financer is a straight forward task. However, because of rising concerns about fraud, especially electronic fraud, debtors now need to show significant care in handling supplier data and verifying that requests to pay money into a different account are legitimate. Financers may not always be approached to help verify that fraud is not involved, due to client confidentiality.

161. As a result, the final version of the Impact Assessment includes an estimate of additional administration costs to debtors associated with changing payment details. This estimate comprises time spent by various employees of the debtor to do the work associated with the payment change. There is significant variation between organisations as to how they undertake the task, but the components can be grouped as follows:

- clerical staff to update the data,
- purchasing manager or a clerk to verify that there is no fraud and
- Treasurer or employee with the clerical team to sign-off the change.

162. The table below expounds the estimated administrative cost of making a single payment change, showing a breakdown by the amount of time required to complete the task, the ASHE 2015 provisional hourly wage rate for each staff member involved with the task and the uprate for employer non-wage costs.

**Wage costs associated with a payment change**

| | Wage Rates | Non-wage uprate % | Uprated wage costs / full on-costs | Minutes taken | Total Cost |
|---|---|---|---|---|---|

[44] Under invoice finance rules, even where there is BoA against an invoice, the client is required to technically "assign" the debt to the invoice financer and the financer collects a fee against that part of the sales ledger; however, in this situation, the financer does not require the client to ask the debtor to change payment arrangements; the debtor continues to pay the supplier directly as if the debt had not been "assigned".

| | | | | | |
|---|---|---|---|---|---|
| Inputting changes (clerical) | £10.53 | 19.8% | £12.61 | 22.5 | £4.73 |
| Sign-off the changes (treasurer or local supervisor) | £28.66 | 19.8% | £34.33 | 10 | £5.72 |
| Verification (clerical or relationship manager) | £13.19 | 19.8% | £15.80 | 15 | £3.95 |
| **Total cost of changing one debtor payment** | | | | | **£14.40** |

163. The cost of the task comes out at around £14. We then have to estimate the number of times this task will be required consistent with the additional estimated direct funding increase of £532m. The table below shows how this is calculated. We start by using the ABFA data on the number of small suppliers facing BoA problems, 31,740,[23] (see footnote 23 on page 23 for an explanation of how to calculate the number of businesses affected[45]). However, the number of suppliers facing BoA issues that are likely to need to put a request in to their customer to change payment details will be considerably less than the total number of suppliers affected by BoA. This is because, as discussed in paragraph 7, above, around 50% of suppliers use invoice discounting; and with this type of invoice financing, the supplier has already asked **all** customers/debtors on the sales ledger to change payment to a trust account (even in respect of those debts that the invoice financer

[45] The main beneficiaries of nullification will be in the turnover bands either side of £1m per year.

| | | | |
|---|---|---|---|
| **Estimated Number of Firms Affected by BoA** | 31,740 | | |
| **Estimated Number of Additional Firms Requesting Payment Change** | 15,870 | | |
| | **Low** | **Best Estimate** | **High** |
| **Estimated Number of Total Requests To Debtors From Existing Suppliers (with sensitivity analysis)** | 7,940 | 15,870 | 31,740 |
| **Number of Additional Requests To Debtors per Year** | | | |
| Number of Additional Requests to Debtors in year 1 (25% phase in) | 1,980 | 3,970 | 7,940 |
| Number of Additional Requests to Debtors in year 2 (25% Phase in) | 1,980 | 3,970 | 7,940 |
| Number of Additional Requests to Debtors in year 3 (15% Phase In) | 1,190 | 2,380 | 4,760 |
| Number of Additional Requests to Debtors in year 4 (10% Phase In) | 790 | 1,590 | 3,170 |
| Number of Additional Requests to Debtors in year 5 (5% Phase In) | 400 | 790 | 1,590 |
| Number of Additional Requests to Debtors in year 6+ (0% Phase In) | 0 | 0 | 0 |
| **Estimated Number of Debtors (with sensitivity analysis)** | 1,200 | 600 | 300 |
| **Number of Changes per Debtor per Year** | | | |
| Number of Changes per average debtor year 1 | 1.7 | 6.6 | 26.5 |
| Number of Changes per average debtor year 2 | 1.7 | 6.6 | 26.5 |
| Number of Changes per average debtor year 3 | 1.0 | 4.0 | 15.9 |
| Number of Changes per average debtor year 4 | 0.7 | 2.6 | 10.6 |
| Number of Changes per average debtor year 5 | 0.3 | 1.3 | 5.3 |
| **Cost Per Average Debtor Per Year** | | | |
| Cost per average debtor year 1 | £24 | £95 | £381 |
| Cost per average debtor year 2 | £24 | £95 | £381 |
| Cost per average debtor year 3 | £14 | £57 | £229 |
| Cost per average debtor year 4 | £10 | £38 | £152 |
| Cost per average debtor year 5 | £5 | £19 | £76 |
| **Total Additional Admin Cost per Year** | | | |
| Total Additional Admin Cost for All Debtors in Year 1 | £29,000 | £57,000 | £114,000 |
| Total Additional Admin Cost for All Debtors in Year 2 | £29,000 | £57,000 | £114,000 |
| Total Additional Admin Cost for All Debtors in Year 3 | £17,000 | £34,000 | £69,000 |
| Total Additional Admin Cost for All Debtors in Year 4 | £11,000 | £23,000 | £46,000 |
| Total Additional Admin Cost for All Debtors in Year 5 | £6,000 | £11,000 | £23,000 |

The numbers in this table have been rounded as appropriate.

cannot fund against due to a ban on assignment). Consequently, the cases where **additional** requests for payment changes need to be made - associated with factoring – will be reduced by around 50%, to 15,870, as shown in the table overleaf.

164. We then assume that once BoA has been nullified effectively, each supplier (i.e. excluding those suppliers doing invoice discounting) needs to make on average one request to a customer to change payment details. These requests are dependent on the ban on assignment clauses being effectively nullified, which means they are also subject to the same assumptions around phase-in that have

been applied to all the benefits. The phase-in assumptions, as applied to the debtor admin costs, are shown below. The main table, above, shows how due to the phase-in assumptions associated with the increased funding, the payment changes are spread over a 5-year period, with an estimate of around 4,000 requests initially, tapering to around 800 requests by year 5.

| | *Year 1* | *Year 2* | *Year 1* | *Year 2* | *Year 5 onwards* |
|---|---|---|---|---|---|
| **Benefits taper to adjust for phase-in of contracts** | *25%* | *50%* | *65%* | *75%* | *80%* |
| **% of new payment requests per year as BoA gradually nullified** | *25%* | *25%* | *15%* | *10%* | *5%* |

165. To assess the impact on individual debtors, we assume a best estimate of 600 debtors, based on advice from ABFA on how many debtors the industry is dealing with. This means that on average, only seven additional requests per debtor are expected in years 1 and 2. Even if we have underestimated the number of requests by a factor of two and overestimated the number of debtors by the same amount, the average debtor will face around 27 additional requests in the first two years.

166. These estimates suggest that although each payment change would be an inconvenience, they would not be of a scale that would require a change in labour deployment or any new systems. Additional cost in the first two years is expected to be in a range from £29,000 to £114,000 with a best estimate of £57,000. Either way, the additional cost is expected to be negligible in the context of the estimated benefits.

167. Based on discussions that BIS has held with retailers and construction companies, we are confident that these estimates of debtors' additional admin costs are more likely to be over-estimates than under-estimates. The crucial parameter is the expected time taken. A number of debtors have recently provided BIS with actual evidence of how long it takes to conduct a payment change process in their company. For construction companies the range was between a total of 1 minute and around 30 minutes. One retailer reported a total time of 7 minutes. These times are significantly below the time-estimates contained in the wage costs table after paragraph 162, above. The reason for being conservative in the IA is that one IT contractor that BIS spoke to, highlighted the potential for running into snags when seeking to verify supplier requests. However, this contractor did not provide BIS with any evidence as to the actual length of time for the process in this particular company. But the company did suggest that verification would be easier and smoother, cutting down time needed, if the industry produced standard guidance for their clients as to how best to request payment changes.

**Cost of nullification to invoice financers**

168. We envisage that the relevant clauses will remain in contracts but become legally invalid if the date when the contract was established is after the commencement date of the policy. Invoice financers will be required to check this but we have been unable to monetise this cost. After discussions with ABFA, we

think it is reasonable to assume the cost to be negligible as financers will still need to audit clients' sales when assessing how much funding to offer and the additional check adds very little burden to this process overall.

169. In the 2014 survey of ABFA members[24] we asked "*What level of resource would be incurred by your organisation if these 'bans on assignment' were made legally invalid*?" There were 19 responses to the question. 53% (10) of respondents said that resources would be freed up, 11% (2) said there would be no impact on resources, 26% (5) said a very low level of resources would be required and 11% (2) said the level of resource incurred would be low. The respondents were asked to briefly explain why, but only a limited response was received. Those who said it would free up resources suggested that *"it would free up time of people at all levels"* and *"reduce risk profiling"*.

170. Our consultation responses agreed that the costs for invoice financers will be negligible. For this reason, we assume that the cost of nullifying the clause in the contract for invoice financers will be negligible**.**

171. In theory, there could be due diligence costs for invoice financers as the legislation will apply to contracts established after the commencement date of the policy. Invoice financers will want to check the dates of contracts as contracts pre-dating the commencement date will not benefit from the change. However, from discussions with invoice financers during the consultation, we believe any additional costs will be negligible as financers will still need to audit clients' sales when assessing how much funding to offer.

**Familiarisation costs to invoice financers**

172. Firms may need to become familiar with the change in law and how this affects them. The familiarisation cost will include any additional management time needed to understand the change in the law and the impacts on contracts.

173. We believe that the nullification will affect invoice financers primarily because the change to the law will have the largest impact on their calculations of funding risk.

**Familiarisation costs to suppliers**

174. Most suppliers have a limited awareness of ban on assignment clauses before they seek finance from invoice financers. Suppliers will not need to gain new knowledge in order to choose invoice financing as a finance option.

175. The calculation of the risk to funding is a burden for the invoice financer and not the supplier. There are no additional burdens to the supplier; in fact, the chances of a supplier being granted finance have increased. For the supplier the change will be very easy to understand. This is supported by our consultation, as this shows that most suppliers do not realise that a contractual ban on assigning their invoice exists until they attempt to access finance.

**Familiarisation costs to debtors**

176. There will be no requirement on debtors to familiarise themselves with the change. Although ban on assignment clauses in contracts will become non-enforceable with respect to contracts established after the commencement date, the legislation will not require such clauses to be omitted. There will therefore be no requirement on large businesses to familiarise themselves with the legislation.

**Familiarisation costs to invoice financers**

177. The 2014 survey of ABFA members asked the question: *"What level of personnel would be required to become familiarised with the change in the law to nullify the effects of bans on assignment of trade receivables?"* There were 19 responses to this question and some respondents selected more than one answer choice (See Table 2, consultation IA[46]).

178. The majority of invoice financers surveyed answered that managers, directors and senior officials would be responsible for familiarising themselves with the nullification of bans on assignment. Our consultation respondents agreed with this answer. We feel that this is an accurate assumption going forward.

179. The survey then asked "*Approximately how long do you think it would take for that person to become familiarised with changes in the law?"* There were 19 responses to this question (See Table 3, consultation IA[23]).

180. There was no conclusive estimated time taken for the person to become familiar with the change in the law. To arrive at our best estimate, we used the midpoint of each time range weighted by the number of responses to provide us a weighted average of around **45 minutes**. Our consultation responses broadly agreed with this estimate except for one respondent who claimed it would probably take less time. As 5% of respondents (1 member) indicated that they think familiarisation will take 5-10 minutes, we have chosen **10 minutes** as our lower estimate. Similarly, as the survey received 3 responses stating 1 to 2 hours, we have chosen the midpoint of the time bracket, **90 minutes**, as our high estimate.

181. We have assumed that other staff will only need to know that a ban on assignment clause is no longer valid and so should not be taken into consideration for the assessment of invoice finance. We assumed, which was corroborated with by our consultation responses, that it will be a very low burden to distribute the message across an invoice financer's organisation, such as an email.

**The one off familiarisation cost:**

[46,24] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/383714/bis-14-1233-measure-to-nullify-ban-on-assignment-clauses-in-a-debtors-terms-of-sale-impact-assessment.pdf

182. Utilising the pieces of data as explained above extracted from the 2014 survey of ABFA members and response from our consultation we can estimate the one-off cost of familiarisation.

183. We have assumed:

a) The level of employees who are responsible are corporate managers and directors
b) It will take a manager approximately 45 minutes to familiarise themselves with the change in the contracts. For the purposes of the calculation we have converted the 45 minutes into a proportion of an hour, 45 minutes is the equivalent to 0.75 of an hour (45 minutes/60 minutes).
c) There are around 50 invoice finance firms in scope of the policy (best estimate) as previously outlined in paragraph 53.

184. Using the Annual Survey of Hours and Earnings, 2015 provisional results[47] the median hourly wage excluding overtime of full-time corporate managers and directors is £21.93. This hourly rate is then uprated by 19.8% to account for employers' non-wage costs[48]; the hourly cost per employer is therefore estimated to be £26.27.

The total cost of familiarisation is estimated as follows:

*= total number of invoice financers (best estimate) × no. of hours × cost per hour*

*= 50 × 0.75*[49] *× £26.27*

**<u>= £985</u>**

**Rationale and evidence that justify the level of analysis used in the IA**

185. In order to gather evidence of the impact of these proposals on UK businesses, individuals, the public sector, and to inform thinking around policy and implementation, BIS has used multiple approaches for data gathering. Please see annex E for a further discussion on this:

186. In post-consultation stage discussions with ABFA, we discussed the impact of waivers and work-arounds, and more generally how to monetise the benefits arising from reductions in fees, interest rates and increased funding. We decided that further evidence gathering was needed to monetise these impacts and therefore conducted two further surveys.

187. The consultation *Nullification of Ban on Invoice Assignment Clauses* set out our initial views on what should be in the secondary legislation. The proposal we tested proposed to nullify the term outright with some exemptions. Our consultation

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47 http://www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm%3A77-337425. Table 14.6a, full time employee jobs, median.
48 This estimate is based on Eurostat figures for employers' labour costs and non-wage costs in the UK, 2012, for the whole economy excluding agriculture and public administration.
49 43 minutes is equivalent to 0.72 hours

asked whether we should limit this proposal to business to business contracts and exclude financial services. We received 20 responses to the consultation, coming mainly from business representative bodies, invoice financers and law practitioners. We also had some responses from large businesses in the retail and construction industry. The RPC gave the consultation impact assessment a verdict of amber.

**Risks and assumptions**

188. The key assumptions and risks underpinning the cost-benefit analysis are:

a. There is a risk of unintended consequences due to debtors seeking to subvert the intention of the legislation through continued use of master contracts. We do not have any evidence regarding the likelihood of such behaviour. However, if such risks were to materialise, then the benefits would take longer to build up and would be spread over a longer period. BIS will seek to monitor the implementation to evaluate how the legislation is bedding in and whether it is achieving its objective.

b. On the costs side of the IA, estimates have been informed by information gathered from the 2014[50] and 2015 surveys of ABFA members. The surveys were sent to ABFA who distributed it to their members. ABFA have 31 UK based (including Northern Ireland) members with another 3 Republic of Ireland members. Potentially, three respondents to the 2014 survey could have been from Ireland, although we are unable to identify or filter these responses out. However, this was not an issue in the case of the 2015 surveys as responses came from UK financers.

c. The surveys cover the majority of the invoice finance market and therefore the resulting estimations provide a reasonable best estimate of the likely impact of the policy. In the case of the 2015 surveys, financers comprising the vast majority of the invoice finance market responded.

d. The exact number of invoice financers is unknown. We do know that ABFA currently has 31 UK members which represent the majority of invoice financers. However, in discussions with ABFA we were aware that some invoice financers are not members of ABFA. To account for this, the final IA continued the practice at the consultation stage and conducted sensitivity analysis around the number of financers. This means the best estimate assumes around 50 invoice financers.

e. ABFA statistics cover both the UK and Irish markets and this has been made clear in the IA where any statistic covers both markets. Therefore they provide an overestimate of the UK market. However, Irish members of ABFA are a small minority in terms of the overall funding provided. Discussions with industry experts lead us to believe that the potential overestimate is likely to be very small -amounting to a few percentage points.

[50] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/383714/bis-14-1233-measure-to-nullify-ban-on-assignment-clauses-in-a-debtors-terms-of-sale-impact-assessment.pdf

f. In terms of the analysis in this IA of the calculation of benefits, the very slight over-estimate due to some ineligible Irish coverage is cancelled out by an opposite effect of the same magnitude: our calculation of total market size is a slight under-estimate due to ABFA statistics' incomplete coverage of the invoice market. Discussions with industry participants suggest that the two opposing factors cancel each other out.

g. This policy will not cover contracts that use Scottish law. Invoice financers are national and offer invoice finance on invoices that are both UK and Scottish law; therefore all invoice financers will need to become familiar with the nullification. From our consultation, it is clear that a very small minority of contracts assessed by invoice financers are under Scottish Law. A large multinational IT equipment company does not have any contracts under Scottish law and an online invoice financer, a major UK bank and a leading organization representing recruiters in the IT sector have no more than 5% of contracts under Scottish law. To the extent that a small number of contracts under Scottish law may not be effectively nullified, we do not need to estimate this separately, as the IA already includes a much larger assumption that even after 5 years, 20% of the expected benefits may not come through due to a lack of effective nullification, as discussed above in paragraphs 137-139. It also seems unlikely that bans on assignment would become more frequent under Scottish law based on what our consultation respondents have said.

h. We have assumed only invoice financers will need to become familiar with the nullification and that there will be no on-going costs in our preferred option, option 1. One of our consultation respondents questioned this assumption and argued that there could be more parties required to acknowledge the nullification. However, they did not provide any further detail and we would assume that if other parties were made to be aware, it would be significantly less strenuous than the efforts of invoice financers. Monetisation of the costs assume the time of a particular task and employee who will be performing this task. We have assumed there are only costs to invoice financers because they need to understand the changes to the law in order to assess the risk of providing finance in their market. Sensitivity analysis around the hours the tasks required has been performed; we have assumed that it will take an invoice financer 0.75 hours to become familiar.

i. As the nullification on ban on assignment will only come into effect on those contracts that are established after the commencement date of the policy, invoice financers will be required to check the date of each contract. Invoice financers have to check the dates of contracts in any case, so this effort will be negligible.

j. We have assumed for invoice discounters if they arrange a workaround they will not need a waiver. We also assume that the cost of a waiver and workaround are the same. Our best estimate is that it takes 5 hours of a solicitor's time to arrange a waiver or workaround.

k. Unless specifically stated, all of our consultation respondents agreed with our risks and assumptions above.

189. The preferred option (option 1) is in scope of the business impact target as it is a new measure that regulates business. This measure is net beneficial to businesses as it delivers significant benefits to suppliers using invoice finance and to invoice finance providers.

190. The quantified costs have a best estimate present value of £0.2m over a ten year period. The quantified benefits have a best estimate present value of £966.2m over a ten-year period. Therefore the total Net Present Value (best estimate) is £966m over the ten-year period.

191. The total Net Present Value equates to an equivalent net annual cost for all direct and indirect monetised impacts of -£106.7m i.e. an equivalent annual benefit of £106.7m (using the BRE calculator, 2014 prices). For direct impacts only, the equivalent annual cost is -£44.9m.

**Enforcement**

192. The implementation of this measure will apply automatically to contracts agreed after the measure is brought into force. Government will not have an enforcement role as it affects contract law. Disputes will be dealt with through the courts.

**Review clause**

193. Within the Small Business, Enterprise and Employment Act there is a duty to review secondary legislation as created by the Act 5 years after implementation.

**Evaluation post implementation**

194. BIS has collected data on firms' invoice finance costs and usage before the implementation of legislation using a follow-up survey to the Small Business Survey conducted by BMG.[51] BIS intends to collect similar data post-implementation.

**Equalities impact**

195. We have assessed the proposed measure against the equality duty and do not consider it to have an adverse effect on any protected group. On the whole, it is expected that there will not be any impact (adverse or otherwise) on any of the protected groups under the Equalities Act.

196. Aside from this, we consider that the proposed legislation will have a positive effect on Black Minority, Ethnic (BME) and Women-led businesses.

[51] The Survey was done in July/August 2015 using respondents to the 2014 Small Business Survey that agreed to be recontacted; the research focused on firms supplying other businesses.

197. Invoice financing is typically used to release working capital to ensure a positive and healthy cash-flow. A strong cash flow is vital in enabling businesses to raise finance and invest. The nullification of bans on assignment of trade receivables will help small and medium sized businesses maintain a healthy cash flow. According to Professor Russell Griggs, (who leads the independent external review of the major banks' Appeals Process), in 2012/2013, 48% of declined finance applications over £25,000 were rejected on 'affordability' grounds[52] – the ability of a small business to service the debt from its existing cash-flow.[53] A 2013 report produced by the Department for Communities and Local Government[54] (DCLG) found that 'affordability is an area that disproportionality affects the 8% of Britain's 4.8 million small and medium sized businesses which are BME owned. The removal of bans on the assignment of trade receivables as a barrier to accessing finance will therefore appear to have the potential to benefit BME businesses disproportionately.

198. Specifically, the DCLG report found that BME businesses face the following challenges which make access to finance more difficult[55]:

- collateral shortages;
- poor credit worthiness (as assessed through credit-scoring);
- lack of formal savings; and
- poor financial track record

199. The report concluded that non-BME businesses were as a result 10% more likely to receive an overdraft or loan than BME businesses (87% vs. 77%).[56] One of the principle advantages of invoice financing is that it allows businesses lacking other collateral to use their trade receivables as security to gain access to finance. The measure to nullify bans on the assignment of trade receivables therefore has the potential to bring particular benefits for BEM businesses by allowing eligible businesses who lack collateral other than trade receivables or have poor credit ratings to access finance.

200. While evidence suggests that women-led businesses do not in general suffer a greater failure rate when seeking to access finance than their male-led businesses, there is evidence that women-led businesses are less likely to seek finance in the first place because of a desire to avoid debt and discouragement from the process of applying for external finance.[57] While invoice finance may not be right for all companies, it does change the relationship with debt and may allow

[52] Affordability relates to the ability of a business to service a debt. In a loan application a finance provider may chose not to award the finance as the company would not be able to make repayments during the course of the requested loan.

[53] http://www.betterbusinessfinance.co.uk/images/uploads/Annual_Report_Master_2013.pdf

[54] Ethnic Minority Businesses and Access to Finance, Department for Communities and Local Government, July 2013

[55] The report looked at the access to finance of BME businesses. Whilst inferences can be made related to affordability of the loans and the impact on affordability created by late payment, was must consider that the main report did not explicitly look at late payment.

[56] http://www.accaglobal.com/ie/en/member/accounting-business/bank-fairness.html

[57] Women-led businesses Analysis from the SME Finance Monitor YEQ1 2012 An independent report by BDRC Continental, 2012

a more attractive form of finance for some women-led businesses, suggesting particular benefit for this protected group.

**Small and micro business assessment**

201. The policy removes a contractual barrier to invoice financing in order to increase access to finance.

202. This policy will benefit all businesses wishing to obtain invoice financing, but particularly small and medium sized businesses as invoice financing can provide businesses with a source of finance where they might otherwise be declined a loan due to a lack of collateral. Low collateral is a problem typically faced by small and start-up businesses as they will lack significant assets such as warehouses, large stock, machinery, etc.

203. A lack of significant collateral is perhaps the most significant obstacle facing businesses needing finance. In February 2013, a report by the Durham Business School's Policy Research Group reviewing the Government's Enterprise Finance Guarantee Scheme concluded that the scheme was providing "high" additionality because it was "allowing businesses without collateral and/or a substantive track record to access loans which they would not have received otherwise". Of these two factors, a lack of collateral was the most significant. These businesses had median collateral between £50,000 and £100,000. This compared to £250,000-£500,000 for conventional borrowers.[58]

204. A nullification of bans on the assignment of trade receivables will open this form of finance to more businesses and allow the market to operate in a space that has required on-going Government intervention.

205. There may be a few cases where an invoice financer is classed as small or micro and therefore may bear the direct benefits of this policy and the familiarisation cost. However, this policy is likely to reduce the potential costs they may currently incur if they use waiver or workarounds if they come across ban on assignment clauses.

206. We considered whether it would be appropriate to still permit ban on assignment for small and micro debtors. Based on discussions with stakeholders, our understanding is that retaining a ban on assignment for small and micro debtors would be largely irrelevant as we are not aware of such debtors using these practices – they are generally terms imposed by large debtors on smaller suppliers.

207. In addition, if we did exclude small and micro debtors, it would add complexity to the policy as invoice finance firms would need to invest significant resource in working out if debtors were small or micro, and this would reduce the benefits of the policy. (The main benefits will occur to SMEs).

[58] Economic Evaluation of the Enterprise Finance Guarantee (EFG) Scheme, downloaded from https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/85761/13-600-economic-evaluation-of-the-efg-scheme.pdf (08/09/2014), p.44

208. For these reasons, use of full exemptions, partial exemptions or using extended transition periods under the better regulation framework is not appropriate for this policy.

## Annex A: Benefits from not needing workarounds and waivers

**The following benefits were included in the consultation IA, but as explained earlier they have been annexed as they are no longer included in the impact assessment calculator.**

209. Invoice financers and suppliers will also receive benefits arising from a reduction in labour costs. Due to the probability of a ban on assignment being present, financers need to carefully assess the added risk, and both financers and suppliers are required to enter into detailed discussions or negotiations to mitigate for the added risk. Savings will arise from both parties not having to expend extra resource on this activity. This annex estimates these benefits but they are not counted as direct benefits in the calculator, as some of these savings will be absorbed by invoice financers as passed on as fee reductions which are already counted in the assessment.

210. This was confirmed by the 2014 survey of ABFA members[59] where we asked "*What level of resource would be incurred by your organisation if these 'bans on assignment' were made legally invalid*?" There were 19 responses to the question. 53% (10) of respondents said that resources would be freed up.

### Reduction in labour costs due to removal of the need for workarounds

211. When there is a large probability of a ban on assignment, an invoice financer will normally seek to mitigate the risk of not receiving their payment. This is because if a debtor were to discover that their invoice has been assigned, they may refuse to pay which would cause a loss for the invoice financer. In this impact assessment, the process of risk mitigation – to avert a loss to the invoice financer - may be referred to as a "workaround".

212. In many cases, this extra risk is mitigated through the supplier providing a debenture, extra collateral or a personal guarantee to the financer. This could provide additional problems if the supplier cannot offer a debenture or they wish to use the collateral for other forms of finance. We discuss this latter problem in paragraph 149 under "Indirect Benefits".

213. When the financer and the supplier are negotiating the terms of their invoice financing deal, the presence of a ban on assignment increases the length of these negotiations. This raises the costs for both parties. The negotiations can also be ongoing; the supplier may often request additional funds to assist with cash flow needs before the financer has formally checked the invoices for issues such as whether there is a ban on assignment from the debtor. Without this formal checking, the financer has to weigh up the risk of there being a ban on assignment; this will initiate further negotiation about any measures to mitigate the financer's risks.

[59] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/383714/bis-14-1233-measure-to-nullify-ban-on-assignment-clauses-in-a-debtors-terms-of-sale-impact-assessment.pdf

214. If we were to calculate the total cost of these negotiations to invoice financers, we would estimate the time it takes as well as the wage costs of the employees involved, we would then multiply this by the number of clients that use invoice finance. This is illustrated in the formula below:

**Cost of negotiations = Duration of negotiations × Wage costs × Number of clients**

*Duration of negotiations*

215. As these negotiations are part of a broader conversation between the financer and the supplier, it is hard to estimate exactly how long they take. To get a rough idea, we have asked ABFA as well as their members.

216. Our 2014 survey of ABFA members[60] asked what level of resource is required to work around the risks to the financer. The responses were varied; one member stated that they were normal practice and so require no additional resource; others stated 3 hours, half a day; days; and another reported legal costs as high as £1,000 per workaround. So there is a broad spread of estimates.

217. ABFA also recognised the trouble with identifying the cost of these additional negotiations because of the reasons discussed above, but believe the total costs to be in the "high hundreds of pounds".

218. The approach taken when calculating the cost of a "workaround" would be that the resource employed in these negotiations are required on both sides: the supplier and the invoice financer. They will both consume the same amount of time, but the invoice financer's efforts will be split by two different employees, which we discuss further below.

219. The consultation impact assessment only counted estimated benefits on the side of the supplier.

*Wage costs*

220. During these negotiations, both the supplier and the invoice financer will need to be present. Using the duration of negotiations above (x hours) and the average earnings of the parties involved, the direct costs to the supplier and invoice financer when participating in these negotiations can be calculated.

221. Our survey, and ABFA, suggest that the employees involved in the negotiations for the supplier will be a manager. For the invoice financer, two managers are likely to be involved. A senior manager as well as a junior manager.

[60] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/383714/bis-14-1233-measure-to-nullify-ban-on-assignment-clauses-in-a-debtors-terms-of-sale-impact-assessment.pdf

222. To calculate the wage costs for the supplier and the invoice financer, the key managerial roles are as follows and relevant wage rates including an uprating[2] for non-wage cost would be applied using the latest data from the Annual Survey of Hours and Earnings (ASHE),[1].

| **Party** | **Job Title (as per ASHE)** |
|---|---|
| Supplier | Corporate managers and directors |
| Invoice financer | Financial institution managers and directors |
| Invoice financer | Financial accounts managers |

*Number of clients*

223. The number of invoice finance clients that engage in these additional negotiations would be calculated as follows and repeated for each turnover band:

**Number of clients = (Invoice discounters × Proportion who encounter BOA × Proportion who continue negotiations) × Uprate to the rest of the market**

224. Only invoice discounters engage in workarounds.

**Reduction in labour costs due to removal of the need for waivers**

225. The labour costs associated with waivers would be estimated for each financer using responses to the supplementary ABFA survey on waivers, with the wage costs uprated to account for non-wage labour costs. We would calculate the cost per client for all financers that had responded, also accounting for those that had not responded. We would do this by categorising invoice financers into either big or small, so that estimates could be imputed for financers that had not responded to the survey. Grossing up the estimates to ensure consistency with the total invoice finance market size, the total cost of time saved from waivers would be estimated as follows:

**Total cost of time saved from waivers**
**= Average cost of assessing a waiver × average number of invoices per client × number of clients**

[2] This estimate is based on Eurostat figures for employers' labour costs and non-wage costs in the UK, 2012, for the whole economy excluding agriculture and public administration.
[1] http://www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm%3A77-337425. Table 14.6a, full time employee jobs, median.

## Annex B: Underlying assumptions and methodology behind benefit calculations

**Demonstration of main impact assessment calculations:**

226. These calculations are based on privileged survey data provided to BIS, by individual ABFA members. As this data is market sensitive and cannot be disclosed, we have illustrated our method with a fictional example of Invoice Finance (IF) provided by "Microbank". This is necessary as we calculate the benefits separately for the clients of each of the 20 banks in each of 6 turnover bands, gross up the results so that they cover the whole market, and aggregate them. Therefore simply averaging the results from each of the clients would give a different and misleading result.

### 1) Discount fee

227. The discount fee is charged on amounts drawn down by the businesses accessing finance. The reduction in the discount fee on nullifying Ban on Assignment is calculated using the following equation, for each bank and turnover band, separately for suppliers with concentrated and non-concentrated sales books.

**Total amount saved from reduction in the discount fee =**
**average size of finance** *in the turnover band*
× **number of IF clients,** *in the turnover band, for each bank*
× **change in the discount charge** *for each bank*
× **weighting** *for each turnover band*
× **factor grossing up to the total annual finance provided**

228. **Average size** of funding in a turnover band is calculated using statistics published by ABFA[61].

**Table B1: Average size of funding = funds advanced / total clients**

| Turnover bands for invoice finance clients | Advanced in turnover band (£m) | Total clients in band | Average size of funding for clients within each turnover band |
|---|---|---|---|
| UP TO £1M | £1,143 | 20,533 | £56,000 |
| £1-5M | £2,900 | 14,944 | £194,000 |
| £5-10M | £1,946 | 4,039 | £482,000 |
| £10-25M | £3,048 | 2,535 | £1,202,000 |
| £25-50M | £2,277 | 1,081 | £2,106,000 |
| £50M+ | £7,989 | 789 | £10,125,000 |

Calculation results and intermediaries have been rounded to the nearest £1000.

229. The following table illustrates the average size of finance that might be advanced to concentrated and non-concentrated companies consistent with the

[61] https://www.abfa.org.uk/statistics/2015/Q2%202015/ABFA%20Statistics%20Q2%202015.pdf

assumptions made in these calculations. In our calculations the effect of concentration is taken into account later, as shown in tables B3, B4 and B5. The figures in table B2 are just illustrative at this stage and are **not** used in the calculations for B3, B4 and B5 below.

**Table B2: illustrative average finance size**

| Turnover band | Average finance size for each turnover band (concentrated) | Average finance size for each turnover band (non-concentrated) |
|---|---|---|
| UP TO £1M | £60,000 | £52,000 |
| £1-5M | £208,000 | £180,000 |
| £5-10M | £516,000 | £447,000 |
| £10-25M | £1,289,000 | £1,116,000 |
| £25-50M | £2,258,000 | £1,955,000 |
| £50M+ | £10,852,000 | £9,399,000 |

Rounded to nearest £1,000.

230. The **number of clients** and **change in the discount charge** are found for each finance provider using the BIS/ ABFA confidential survey.
All sales ledgers are defined as either concentrated or non-concentrated. The **Concentration** % shows what proportion of the clients in each turnover band are assumed to have concentrated sales ledgers (some financers start classing a sales ledger as being concentrated if a single customer makes up 15-20% of the client's outstanding invoices. Concentration falls away as firm size rises; and conversely, non-concentration increases with firm size.

231. The **weighting of each turnover band** (please see tables B3 and B4 below) reduces the benefit for larger firms and is used to show what proportion of each turnover band is affected by ban on assignment. For example, in the turnover band up to £1m, information from the consultation suggests that around 100% of clients have a BoA somewhere in the sales ledger, while in the £50m+ turnover band, only around 5% of existing clients are adversely affected by BoA. This means that even if some of these larger clients do have a contract with a BoA, it will not necessarily lead to a funding restriction from the financer.

232. The sample of finance providers covered 65% of funding, so the savings were multiplied by a factor of **1.54** (= 1 / 65%) to cover the whole market. This was then multiplied by **4** to annualise quarterly figures (fees are charged quarterly).

233. In our hypothetical example of Microbank, a very small financer with only 255 clients, clients with Ban on Assignment are charged an additional 0.5% discount fee, clients with concentration an additional 0.5% and clients with both BoA and concentration an additional 0.75%. Data which refers to this hypothetical example is highlighted in green. We have chosen the values shown below in

tables B3 and B4 to be typical of the real confidential data provided by the financers.

**Table B3: Discount fee benefit for Microbank clients without concentration**

| Turnover band | Average quantity of finance advanced for each turnover band | No. of microbank clients | Change in discount fee | % not concen-trated | Weighting | Discount fee reduction |
|---|---|---|---|---|---|---|
| | **Published data** | **Privileged data** | | **Evidence from consultation** | | **Calculation** |
| UP TO £1M | £55,666 | 100 | 0.5% | 20% | 1 | £6,000 |
| £1-5M | £194,058 | 100 | 0.5% | 60% | 0.75 | £44,000 |
| £5-10M | £481,802 | 25 | 0.5% | 80% | 0.375 | £18,000 |
| £10-25M | £1,202,367 | 15 | 0.5% | 90% | 0.1875 | £15,000 |
| £25-50M | £2,106,383 | 10 | 0.5% | 95% | 0.09375 | £9,000 |
| £50M+ | £10,125,475 | 5 | 0.5% | 99% | 0.046875 | £12,000 |
| | | | | | Sub Total | £104,000 |
| | | | | | Grossing factor | ×1.54 |
| | | | | | Annual factor | ×4 |
| | | | | | **Gross Annual Total Benefit for clients using Microbank** | **£637,000** |

Calculation results and intermediaries have been rounded to the nearest £1000, and may not sum exactly as shown.

**Table B4: Discount fee benefit for Microbank clients with concentration**

| Turnover band | Average quantity of finance advanced for each turnover band | No. of microbank clients | Change in discount fee | % concen-trated | Weighting | Discount fee reduction |
|---|---|---|---|---|---|---|
| | **Published data** | **Privileged data** | | **Evidence from consultation** | | **Calculation** |
| UP TO £1M | £55,666 | 100 | 0.25% | 80% | 1 | £11,000 |
| £1-5M | £194,058 | 100 | 0.25% | 40% | 0.75 | £15,000 |
| £5-10M | £481,802 | 25 | 0.25% | 20% | 0.375 | £2,000 |
| £10-25M | £1,202,367 | 15 | 0.25% | 10% | 0.1875 | £1,000 |
| £25-50M | £2,106,383 | 10 | 0.25% | 5% | 0.09375 | <£500 |
| £50M+ | £10,125,475 | 5 | 0.25% | 1% | 0.046875 | <£500 |
| | | | | | Sub Total | £29,000 |
| | | | | | Grossing factor | ×1.54 |
| | | | | | Annual factor | ×4 |
| | | | | | **Gross Annual Total Benefit for clients using Microbank** | **£179,000** |

Calculation results and intermediaries have been rounded to the nearest £1000, and may not sum exactly as shown.

234. The following table gives the grossed up annual **Discount Fee Reductions** based on all of the actual responses received from financers.

**Table B5: Discount fee reductions based on actual data grossed up**

| Turnover band | Benefit from reduced discount fee for clients with concentration | Benefit from reduced discount fee for clients with no concentration | Total benefit from discount fee reduction |
|---|---|---|---|

| | | | |
|---|---|---|---|
| UP TO £1M | £4.1m | £0.6m | £4.7m |
| £1-5M | £3.8m | £1.9m | £5.7m |
| £5-10M | £0.8m | £0.7m | £1.5m |
| £10-25M | £0.4m | £0.7m | £1.1m |
| £25-50M | £0.1m | £0.3m | £0.3m |
| £50M+ | £0.0m | £0.4m | £0.5m |
| Total | £9.2m | £4.5m | £13.7m |

Calculation results have been rounded to nearest £0.1m and may not sum exactly as shown.

### 2) Service charge

235. The service charge is levied on the total amount of invoices processed. The reduction in the service charge on nullifying Ban on Assignment is calculated using the following equation, for each bank and turnover band, separately for concentrated and non-concentrated finance.

**Total amount saved from reduction in the service charge =**
**average size of finance** *in the turnover band*
× **number of IF clients,** *in the turnover band, for each bank*
× **change in the service fee** *for each bank*
× **weighting** *for each turnover band*
× **Large company downward scalar** *for each turnover band*
× **factor grossing up to the total annual value of invoices assigned**

236. Calculations and data regarding **average size of finance, number of clients, concentration** % and **weighting** follows the same methodology as used in the estimate of the reduction in the discount fee.

237. In addition, we have added a **Large Company Downward Scalar (or "deflator"**) to the calculation of the service charge reduction. This scalar helps reinforce a sharp reduction in the service charge as client firm size increases. This is partly due to larger clients having a better negotiating position. For example, according to ABFA, the service fee for clients with a turnover above £100m is negligible as a proportion of turnover. The values of the downward scalar were chosen based on consultations with ABFA.

238. The funding in the sample covered 65% of total invoice finance provided, but is only 17% of the total amount of invoices assigned to ABFA members. Therefore a factor of **5.38** (= 1/17%) is used to gross up data produced in the survey to the total market value of invoices assigned to financers.

239. In our hypothetical example of Microbank, clients with Ban on Assignment are charged an additional 0.25% service charge, clients with concentration an additional 0.25% and clients with both an additional 0.75%. We have chosen the values shown below in tables B6 and B7 to be typical of the real confidential data provided by the financers.

**Table B6: Service charge benefit for Microbank clients without concentration**

| Turnover band | Average quantity of finance advanced for each turnover band | No. of microbank clients | Change in service fee | % not concentrated | Weighting | Large company deflator | Service charge reduction |
|---|---|---|---|---|---|---|---|
| | **Published data** | **Privileged data** | | **Evidence from consultation** | | | **Calculation** |
| UP TO £1M | £55,666 | 100 | 0.25% | 20% | 1 | 1 | £3,000 |
| £1-5M | £194,058 | 100 | 0.25% | 60% | 0.75 | 0.7 | £15,000 |
| £5-10M | £481,802 | 25 | 0.25% | 80% | 0.375 | 0.4 | £4,000 |
| £10-25M | £1,202,367 | 15 | 0.25% | 90% | 0.1875 | 0.2 | £2,000 |
| £25-50M | £2,106,383 | 10 | 0.25% | 95% | 0.09375 | 0.01 | <£500 |
| £50M+ | £10,125,475 | 5 | 0.25% | 99% | 0.046875 | 0.01 | <£500 |
| | | | | | | Sub Total | £23,000 |
| | | | | | | Grossing factor | ×5.38 |
| | | | | | | Annual factor | ×4 |
| | | | | | | **Gross Annual Total Benefit for clients using Microbank** | **£542,000** |

Calculation results and intermediaries have been rounded to the nearest £1000, and may not sum exactly as shown.

**Table B7: Service charge benefit for Microbank clients with concentration**

| Turnover band | Average quantity of finance advanced for each turnover band | No. of microbank clients | Change in service fee | % concentrated | Weighting | Large company Deflator | Service charge reduction |
|---|---|---|---|---|---|---|---|
| | **Published data** | **Privileged data** | | **Evidence from consultation** | | | **Calculation** |
| UP TO £1M | £55,666 | 100 | 0.5% | 80% | 1 | 1 | £22,000 |
| £1-5M | £194,058 | 100 | 0.5% | 40% | 0.75 | 0.7 | £20,000 |
| £5-10M | £481,802 | 25 | 0.5% | 20% | 0.375 | 0.4 | £2,000 |
| £10-25M | £1,202,367 | 15 | 0.5% | 10% | 0.1875 | 0.2 | <£500 |
| £25-50M | £2,106,383 | 10 | 0.5% | 5% | 0.09375 | 0.01 | <£500 |
| £50M+ | £10,125,475 | 5 | 0.5% | 1% | 0.046875 | 0.01 | <£500 |
| | | | | | | Sub Total | £45,000 |
| | | | | | | Grossing factor | ×5.38 |
| | | | | | | Annual factor | ×4 |
| | | | | | | **Gross Annual Total Benefit for clients using Microbank** | **£1,042,000** |

Calculation results and intermediaries have been rounded to the nearest £1000, and may not sum exactly as shown.

240. The following table gives the grossed up annual **Service Charge reductions** for all based on all of the actual responses received from financers.

**Table B8: Service charge reductions based on actual data grossed up**

| Turnover band | Benefit from reduced service charge for clients with concentration | Benefit from reduced service charge for clients with no concentration | Total benefit from service charge |
|---|---|---|---|

| | | | reduction |
|---|---|---|---|
| UP TO £1M | £13.4m | £3.7m | £17.1m |
| £1-5M | £10.2m | £12.4m | £22.6m |
| £5-10M | £0.5m | £3.9m | £4.3m |
| £10-25M | £0.0m | £1.9m | £2.0m |
| £25-50M | £0.0m | £0.0m | £0.0m |
| £50M+ | £0.0m | £0.1m | £0.1m |
| Total | £24.1m | £22.0m | £46.1m |

Calculation results have been rounded to nearest £0.1m and may not sum exactly as shown.

### 3) Increased funding

241. Nullifying the ban on assignment will increase the amount of finance that can be offered to businesses. This is because the "prepayment percentage", the proportion of the value of an invoice that can be advanced to the client, will be increased.

242. The increase in finance on nullifying Ban on Assignment is calculated using the following equation, for each bank and turnover band, separately for concentrated and non-concentrated finance.

**Increased funding =**

**average size of finance** *in the turnover band*
× **number of IF clients,** *in the turnover band, for each bank*
× **Proportional increase in prepayment percentage** *for each bank*
× **weighting** *for each turnover band*
× **factor grossing up to the total annual finance provided**

243. The **average size of finance, number of clients, change in the discount charge, Concentration %**, **weighting** and **the factor grossing up funding to the total market size** are the same as in the discount fee.

244. For our hypothetical Microbank, we have taken that without concentration removing Ban on Assignment will increase the prepayment % from 75% to 85%. This gives a 13% increase in funding = (85%/75%) - 100%. With concentration the prepayment % increases from 70% to 80%, and funding increases by 14% (= [80%/70%] -100%).

**Table B9: Funding increase for Microbank clients without concentration**

| Turnover band | Average quantity of finance advanced for each turnover band | No. of microbank clients | Increase in funding | % not concentrated | Weighting | Increase in funding |
|---|---|---|---|---|---|---|
| | **Published data** | **Privileged data** | | **Evidence from consultation** | | **Calculation** |
| UP TO £1M | £55,666 | 100 | 13% | 20% | 1 | £148,000 |

| | | | | | | |
|---|---|---|---|---|---|---|
| £1-5M | £194,058 | 100 | 13% | 60% | 0.75 | £1,164,000 |
| £5-10M | £481,802 | 25 | 13% | 80% | 0.375 | £482,000 |
| £10-25M | £1,202,367 | 15 | 13% | 90% | 0.1875 | £406,000 |
| £25-50M | £2,106,383 | 10 | 13% | 95% | 0.09375 | £250,000 |
| £50M+ | £10,125,475 | 5 | 13% | 99% | 0.046875 | £313,000 |
| | | | | | Sub Total | £2,764,000 |
| | | | | | Grossing factor | ×1.54 |
| | | | | | | |
| | | | | | **Gross Annual Total Increase in Funding for clients using Microbank** | **£4,244,000** |

Calculation results and intermediaries have been rounded to the nearest £1000, and may not sum exactly as shown.

**Table B10: Funding increase for Microbank clients with concentration**

| **Turnover band** | **Average quantity of finance advanced for each turnover band** | **No. of microbank clients** | **Increase in funding** | **% concentrated** | **Weighting** | **Increase in funding** |
|---|---|---|---|---|---|---|
| | **Published data** | **Privileged data** | | **Evidence from consultation** | | **Calculation** |
| UP TO £1M | £55,666 | 100 | 14% | 80% | 1 | £636,000 |
| £1-5M | £194,058 | 100 | 14% | 40% | 0.75 | £832,000 |
| £5-10M | £481,802 | 25 | 14% | 20% | 0.375 | £129,000 |
| £10-25M | £1,202,367 | 15 | 14% | 10% | 0.1875 | £48,000 |
| £25-50M | £2,106,383 | 10 | 14% | 5% | 0.09375 | £14,000 |
| £50M+ | £10,125,475 | 5 | 14% | 1% | 0.046875 | £3,000 |
| | | | | | Sub Total | £1,662,724 |
| | | | | | Grossing factor | ×1.54 |
| | | | | | | |
| | | | | | **Gross Annual Total Increase in Funding for clients using Microbank** | **£2,553,000** |

Calculation results and intermediaries have been rounded to the nearest £1000, and may not sum exactly as shown.

245. In some cases, when responding to the ABFA 2015 Survey, finance providers did not provide a prepayment percentage for clients whose sales ledgers were affected by ban on assignment. This could be interpreted as meaning that they would not provide any finance to any clients with at least one case of ban on assignment. However these finance providers have large numbers of clients with a turnover lower than £5m, where BoA is particularly prevalent. Given the depth of their client base, it is not possible that no funds are provided. So, rather we assume that these financers do have clients with ban on assignment, but are stricter in how they deal with such cases, hence the stricter interpretation in responding to the survey.

246. With these institutions currently funding only very low percentages of such sales ledgers at present, this is where the scope to improve funding levels is greatest - once funding levels are equalised after contractual prohibitions on finance are removed due to BoA's nullification. Hence, this could have provided the potential for estimating some very large benefits. However, in these cases,

so as to be conservative, we did not impute very low levels of current funding. Instead, we assumed a floor in current funding levels: 70% of invoices assigned - imputing an effective prepayment percentage with ban on assignment that was no lower than those quoted by those survey respondents that also took a strict approach in cases of funding clients when there was a ban on assignment.

247. The following table gives the grossed up **Increase in Funding** based on all responses received from financers to the 2015 Survey.

**Table B11: Increase in client funding based on actual data grossed up**

| Turnover band | Increased funding for clients with concentration | Increased funding for clients with no concentration | Total increase in funding |
|---|---|---|---|
| UP TO £1M | £97m | £36m | £132m |
| £1-5M | £105m | £238m | £342m |
| £5-10M | £18m | £114m | £132m |
| £10-25M | £7m | £95m | £102m |
| £25-50M | £2m | £48m | £50m |
| £50M+ | £0m | £74m | £74m |
| Total | £229m | £603m | £833m |

Calculation results have been rounded to nearest £1m and may not sum exactly as shown.

248. As explained in the IA, paragraphs 105-115 above, the extra funding enables increased client activity and profitability. The breakdown of this is as follows:

**Table B12: Increase in client profit based on actual data grossed up**

| Turnover band | Increased profit for clients with concentration | Increased profit for clients with no concentration | Total increase in profit |
|---|---|---|---|
| UP TO £1M | £9.8m | £3.6m | £13.5m |
| £1-5M | £10.6m | £24.1m | £34.8m |
| £5-10M | £1.9m | £11.6m | £13.4m |
| £10-25M | £0.7m | £9.6m | £10.3m |
| £25-50M | £0.2m | £4.9m | £5.0m |
| £50M+ | £0.0m | £7.5m | £7.5m |
| **Total** | £23.3m | £61.3m | £84.6m |

Calculation results have been rounded to nearest £0.1m and may not sum exactly as shown.

### 4) Increased profits to financers

249. According to ABFA, financers' additional profitability are between 1-3% of funding lent. This is summarised in the table below:

**Table B13: Increased benefit to financers**

| Operating profit margin of financers | Total additional profit for financers |
|---|---|
| **1%** | £5.3m |
| **2%** | £10.6m |

| | |
|---|---|
| **3%** | £16.0m |

Calculation results have been rounded to nearest £0.1m and may not sum exactly as shown

## Statements from major invoice financers on the impact of nullification on additional funding.

250. BIS requested further submissions from major UK invoice financers (as discussed in the IA (page 29, paragraph 107), in order to ascertain whether the estimates it had modelled on additional funding were reasonable. BIS received statements from three financers, representing almost half of the current invoice finance market (by number of clients), and these statements are printed here:

***Further question asked of invoice financers:***

**In terms of additional funding, what would be your estimate of the likely benefits to current clients of effective nullification of contractual clauses which ban the assignment of debts?**

***Statements received:***

**Submission 1)** We fully support the proposal to effectively nullify the contractual clauses which ban the assignment of debts, as it is in total alignment with our Group goals of supporting clients and helping to drive Britain's global economic growth.

In general terms, we believe that the nullification of bans on assignment may lead to fewer straight refusals of invoice discounting and factoring, and potentially a higher amount of funding available. In terms of an estimate of the benefits, based on our current client-base as a whole, we would envisage that once the proposals have had time to become embedded, we should be able to increase funding levels to our current client base by around 4%. This would equate to circa £140 million of additional funding to our existing clients.

**Statement received from: a UK high-street bank which provides invoice finance, with an estimated market share of around 20% in the UK (by number of clients).**

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**Submission 2)** In our view, bans on assignment are onerous contractual clauses that place unnecessary obstacles or even barriers in the way of smaller business accessing invoice finance. We support action to effectively nullify them and believe that it will allow an increase in the quantity of funding provided to UK SMEs by invoice finance providers.

It is difficult to provide an exact estimate, but considering the businesses we currently support, in terms of a range we estimate that effective nullification will allow us to increase funding to those clients by around 3 or 4% (once the effect of the measure has been fully established and on the basis of effective nullification). This would be equivalent to between approximately £110m and £150m in additional funding to current clients.

In addition, there are likely to be further and wider benefits in terms of making businesses for which invoice finance is not currently an option due to BOA more viable funding propositions. We are not in a position to provide an estimate of this for our organisation but expect for the industry as a whole it would certainly be tens and likely hundreds of millions of pounds of potential additional funding.

**Statement received from: a UK high-street bank which provides invoice finance, with an estimated market share of around 18-20% in the UK (by number of clients).**

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**Submission 3)** Looking at our overall client-base, we estimate that once the measures have bedded in, effective action to nullify the effect of ban on assignment clauses may allow us to increase funding advanced to our current clients by around 5% overall. This is based on a review of the most restrictive type of Ban on Assignment clauses and our estimate of their frequency within our clients' debtor books. This would be equivalent to around £25 million of additional funding to our current clients. There are also situations where there are less onerous bans on assignment present and depending on the circumstances we may provide some funding against these but we often have to seek waivers of the relevant clauses which are rarely forthcoming, and this considerably slows down the process of providing funding; we have not quantified these at present.

In addition, we estimate that effective nullification may allow us to provide £10-£15 million of funding to 70-100 additional businesses (based on our market share) to whom we cannot currently provide invoice finance.

**Statement received from: The largest non-bank provider of invoice finance in the UK, representing circa 10% of the current market (by number of clients).**

## Annex C: Definitions of the methods of invoice financing

Factoring

251. Factoring occurs when the supplier assigns their trade receivables to a third party financer and the financer takes responsibility for the supplier's sales ledger maintenance and all credit control collections (this might include issuing of statements/letters, telephone calls and commencement of legal procedures in the case of non-payment, etc.) – i.e. the third party financer assumes the position of the creditor in the relationship with the supplier's customers.

252. There are generally two forms of factoring – recourse and non-recourse factoring. Under non-recourse factoring, the third party finance provider assumes the risk of non-payment by the debtor. Under recourse factoring, the supplier retains all liability for non-payment of the invoice by debtors and so must repay advances issued by the third party financer in the event of non-payment by the debtor.

253. When factoring, the third party financer will normally inform the debtor that the trade debt has been assigned by the supplier. Therefore the assignment is a 'statutory assignment' and the financer is the financier is able to sue on the receivable in its own name, without involving the supplier, in the case of non-payment by the debtor.

Invoice Discounting

254. Invoice discounting occurs when the supplier assigns their trade receivables to a third party financer but the supplier retains responsibility for its sales ledger maintenance and all credit control collections – i.e. the third party financer acts simply as a lender and does not play a role in the relationship with the supplier's customers.

255. Under an invoice discounting arrangement, monies paid by the debtor to the supplier can be paid directly into a trust account (this was the case for 60% of respondents in our survey) so that the financer has a more secure claim and access to monies paid. The assignment is an 'equitable assignment' and the financer is unable to enforce the assigned receivable in its own name and has to join the supplier to any enforcement proceedings against the debtor. The debtor is not necessarily informed of the assignment in this instance.

Invoice Trading

256. Recently, a new product has entered the market – invoice trading. Traditional factoring and invoice discounting involves the supplier (client) paying two charges – the discount rate (eg. 20p in each £1 advanced) which is charged on what is funding is actually used by the client (supplier), and a service fee which is typically the greater of a fixed charge or percentage of the supplier's turnover. So the client (supplier) must pay for the potential assignment of their entire loan

book, as well as a discount rate on the funding actually utilised. Factoring is more expensive than invoice financing due to the loan book management services offered. Non-recourse factoring is more expensive again due to the premium charged for the conferral of liability of non-payments to the financer.

257. Invoice trading allows suppliers to pay for invoice financing on an ‘invoice by invoice’ basis instead. Suppliers will select invoices from blue chip customers against which they wish to obtain financing. The platform will then pool a number of invoices due from a particular blue chip customer to a number of different suppliers, and then sell these assigned receivables to sophisticated investors as investment products. Suppliers are thus effectively offered invoice discounting, but on an ‘invoice by invoice’ pricing model.

<u>Supply Chain Financing</u>

258. Supply chain financing is a further form of invoice financing. Typically, the customer will establish an e-invoicing platform which will allow its suppliers to obtain invoice financing from a third party finance provider against an improved invoice due from that customer. This potentially reduces costs of financing as the third party financer will provide funding on the basis of the credit worthiness of the one customer, instead of factoring in the varying credit ratings of all the customers on the supplier’s loan book.

259. By its nature, this form of financing is fully disclosed – i.e. the customer has approved the assignment of trade receivables from the platform to the third party financer.

<u>Set Off</u>

260. Debtor's right to reduce the creditor's invoice by the amount the creditor owes to the debtor.

**Annex D – Methodology and evidence collection methods:**

261. To inform policy development and ensure that our analysis was based on the most robust evidence, the following evidence collection methods were undertaken:

a. a survey of invoice financers to understand the effect of ban on assignment in the reduction of fees and labour costs,
b. a follow-up survey to understand the impact of waivers,
c. an online survey aimed at large firms for methodology,
d. an online survey distributed to Asset Based Finance Association (ABFA) members,
e. face-to-face meetings with academic researchers, invoice financers, debtors, suppliers and business representative bodies,
f. publicly available industry data,
g. international comparisons,
h. reviewing other analysis: IAs and evaluations within this area.

**A) 2015 Survey of ABFA members on economic impact of the legislation**

**Sampling approach**

262. The survey was sent ABFA who distributed to their members. ABFA have 31 UK based (including Northern Ireland) members, who were asked to complete the survey.

**Research Methodology**

263. The survey consisted of open ended questions. The survey was split into four sections asking the same questions depending on if the firm described had ban on assignment or concentration or both or neither.

264. The survey ran from the 22nd of July 2015, and responses were returned to BIS through the rest of July and August 2015.

265. We received 20 valid responses and all questions were answered.

266. A copy of the survey is found at Appendix A, below.

**B) 2015 Supplementary Survey of ABFA members on waivers**

267. A supplementary survey was sent out on the 25th of August to the same ABFA members. This survey asked solely about waivers. It contained two sections: to ask about the cost of initially assessing invoices for suitability of consideration of a waiver; and then to ask about the cost of negotiating with the debtor if the invoice had been initially considered to be suitable.

268. A copy of the survey is found at Appendix B, below.

**C) 2014 Survey of ABFA members**

**Sampling approach**

269. The survey was sent ABFA who distributed to their members. ABFA have 31 UK based (including Northern Ireland) members with another 3 Republic of Ireland members. Therefore, potentially 3 respondents from Northern Ireland could have responded to the questionnaire however we are unable to identify or filter these responses out.

**Research Methodology**

270. The survey consisted of multiple choice questions, open ended questions and ratio scale questions. The survey was split into different sections asking a number of questions on factoring, invoice discounting, the potential costs of introducing new regulations to nullify bans on assignment of trade receivables and some general questions about their organisation.

271. The survey ran for just over two weeks from the 8th August to the 26th August 2014.

272. We received 20 valid responses (10 responses were removed because the vast majority of questions were unanswered). Of the 20 valid responses, some questions were left unanswered by some respondents and not all questions were asked to all respondents.

273. The survey results are discussed in the consultation IA.

**D) BIS – BMG research**

274. In order to further develop the evidence base in the area of commercial disputes between small businesses and large businesses, BIS commissioned additional research. The consultant (BMB) resurveyed a random, representative sample of 814 respondents to the 2014 Annual Small Business Survey, who had previously consented to take place in further research. As medium businesses were over represented in the sample and single employee businesses were underrepresented, survey responses were weighted to represent the number of such businesses in the population. Analysis here uses the weighted answers.

275. The survey asked questions about:

- the incidence of unfair practices they had experienced,
- how many of them had led to a dispute and if this dispute had been resolved,
- their opinion on the need for a dispute resolution service,
- their experience of invoice financing.

**E) Online survey aimed at large firms**

### Sampling approach

276. The pilot survey was sent to 14 organisations known to BIS in the course of work on prompt payment. The sample for the final survey was compiled using the FAME company database (as it can be used to identify large companies using the Company Act 2006 definition) and BIS connect (an online tool that stores information about the Department's stakeholders and their contact details). In addition we also asked the Chartered Institute of Purchasing and Supply (CIPS) and the Association of Corporate Treasurers (ACT) to distribute the link to their networks using their Linked-in profile.

### Research Methodology

277. The survey mostly consisted of multiple choice questions but also included some interval scale questions and a limited amount of open ended questions.

278. The survey mostly asked questions on the prompt payment report policy however it did contain a couple of questions regarding Ban on assignments. This is because, from early discussions it seemed ban on assignment were not widely known about.

279. Before launching the full survey, BIS conducted a pilot. This allowed us to test people's understanding of the language used and to test the overall flow of the questionnaire and to make the necessary changes were needed before sending out the survey to the wider sample. As a result of the pilot we modified one question which respondents had found difficult to interpret. This meant that for this particular question we were unable to merge the results from the pilot and the final survey results. Other minor changes were made such as an addition of a comment box which did not invalidate responses made in the pilot.

280. The pilot survey ran from the 10$^{th}$ July to 4$^{th}$ August 2014 and the final survey ran for around two weeks; from the 28$^{th}$ July 2014 to 12$^{th}$ August 2014.

281. We received 35 valid responses (29 responses were removed because the majority of questions were unanswered), 7 were from the pilot and the remaining 28 responses were from the final survey. Of the 35 valid responses, some questions were left unanswered, not all questions were asked to all respondents and as mentioned before one question changed significantly between the pilot and final survey, hence pilot responses for that question was invalid.

282. The survey results are discussed in the consultation IA.

## E) Face-to-face meetings

283. BIS held face-to face meetings during the consultation with a variety of large debtor customers as well as various organisations representing large debtors. The attendees at these meetings are listed below.

| | | |
|---|---|---|
| Aggregate Industries | EEF | National Grid |
| Alliance Boots | Elasto UK Ltd | National Specialist Contractors' Council |
| Amey | Federation of Master Builders | Pennine Telecom |
| ASDA | Ford Retail | Prospero Accounting Limited |
| Avnet Technology | Grant Thornton | Query Management Ltd |
| Balfour | Hachette | Renewable Planet |
| Boots | Handelsbanken | SMMT |
| British Property Federation | Home Builders Federation | Specialist Engineering Contractors' Group |
| British Retail Consortium | I-com | Tesco |
| Carillion plc | Ingram Micro | Travis Perkins |
| Civil Engineering Contractors Association | John Lewis Partnership | UK Contractors Group |
| Construction Industry Council | Kingfisher plc | UK Manufacturing Accelerator |
| Construction Products Association | M&S | Veolia Environmental Services |
| Coop | Metrostress | Wallwork Heat Treatment Ltd |

BIS also pro-actively consulted with senior representatives at various debtors including Fujitsu, Skanska, John Lewis, Bam Nuttall. BIS also received written submissions from debtor groups including SMMT, BESA and Hardyman and Co Ltd.

## F) Publicly available data

284. The main source of publicly available data on the invoice finance industry is from the Asset-Backed Finance Association (ABFA). ABFA members account for over 95% of the UK industry by market share. On the other hand, some ABFA members fund firms in the Republic of Ireland and do not separate out this element of their business. This accounts for less than 5% of the published ABFA data, and so these two factors cancel each other out.

## G) International Comparisons

285. International evidence on the impact of nullifying ban on assignment type clauses is extremely limited. We engaged and researched ban on assignment type policies in several countries including the US, Canada, Australia, Germany and France. However, in terms of any impact evaluations, there is only a general policy review of securities legislation, from Australia, published in February 2015[62] which mentions ban on assignment type issues in passing. The report contains no assessment of costs and benefits, although a couple of passing allusions to legislation relating to invoice finance can be gleaned, such as:
    - invoice finance is an "important feature of our financial system, so that it may cause "significant disruption" if transfers of accounts were not covered by the Act" (page 59 of the Australian evaluation);
    - another response to the review discusses that a lack of "priority" for invoice financers is making it difficult for them to accept receivables as collateral for finance, (page 341).

## H) Other analysis (Impact Assessments and evaluations)

286. We reviewed the Final Impact Assessment for banning exclusivity clauses in zero hour contracts, July 2014, IA number BISLMD002 to learn from methodology used to assess the policy and to identify lessons learnt.

287. HM Treasury recently did an IA on the policy of "Referrals"[63] where a bank, on rejecting an application for finance, must inform the applicant of other possible finance providers. The bank Referrals policy is different to the one of nullifying BoA and so has limited read-across to this IA. The bank Referrals policy does <u>not</u> over-write any legal barrier. It makes the information clearer. Applicants were always free to approach other lenders for finance after an initial refusal. By contrast, BoA will be releasing finance and activity that is currently held back by contractual restriction.

288. An analysis that is potentially more relevant to nullifying BoA is the evaluation of the Enterprise Finance Guarantee[64]. Although EFG is a spending programme whilst this IA deals with nullifying a regulation, there is an important similarity in terms of the rationale for intervention. Here, we have a contractual restriction on the use of invoices that invalidates their use as collateral. Nullifying BoA means that invoices can be used as collateral, enabling suppliers to access finance. In the case of the rationale for the EFG, EFG borrowers also have no collateral – until the Government provides a guarantee, unlocking finance for these SMEs.

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[62] http://www.ag.gov.au/Consultations/Documents/PPSReview/ReviewofthePersonalPropertySecuritiesAct2009FinalReport.pdf

[63] http://www.parliament.uk/documents/impact-assessments/IA14-20D.pdf

[64] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/85761/13-600-economic-evaluation-of-the-efg-scheme.pdf

**Annex E: History of the proposal, international precedents and technical aspects of the proposed legislation.**

289. There can be legitimate reasons for businesses (debtors) to seek to ban the assignment of invoices (“trade receivables”). These include exercise of a right to set off and retention of commercial confidentiality. The law will continue to protect the position of debtors even once bans on assignment of invoices have been nullified.

**Set-off**

290. Set off allows a debtor to consolidate invoices from multiple transactions, including debts the supplier owes to the debtor, into a single invoice. Any sums that could be set-off between the supplier and the debtor, prior to receipt of notice of assignment of a subsequent invoice, can still be set-off against the invoice financier as the subsequent assignee. The law on set-off is quite clear that a debtor cannot be put in a worse position by an assignment than when it only had a relationship with its supplier as his creditor.

**Commercial Confidentiality**

291. The proposals are not expected to affect commercial confidentiality. Our consultation stage IA consulted on including exemptions to the prohibition on the grounds of commercial confidentiality. The legislation is being drafted so that debtors cannot use commercial confidentiality as a reason to avoid having their bans on assignment from being nullified. The legislation will do this by nullifying confidentiality clauses to the extent that they (currently) frustrate assignment. We understood from pre-consultation stage discussions with large businesses, that commercial confidentiality can be important to some debtors who may wish to remain anonymous in a transaction. The disclosure of the debtor to the invoice financer compromises that confidentiality. We have since consulted on this issue and spoken with large businesses, legal experts and invoice finance organisations via a series of round tables. As a result of the consultation, we think that there are grounds to include a proportionate exemption for commercial confidentiality. The evidence for and against inclusion is outlined in further detail in the Summary of Responses. In brief, those opposed said that: they had concerns that debtors would use this exemption disingenuously to prevent assignment, it would maintain the culture of waivers and workarounds to nullification clauses and that banks already offer this sort of confidentiality without significant breaches of trust. From our round table discussions with large businesses, we did not receive any significant concerns related to breaches of commercial confidentiality due to assignment.

292. However, debtors will continue to have the ability to seek recourse from a supplier if the debtor's details are passed onto any other party. The evidence gathered from stakeholder meetings and the consultation has lead us to believe that damages arising from commercial confidentiality are exceptionally rare and that our approach therefore appropriately weighs up the need to protect debtors in the event of an assignment with the financial benefits for businesses.

**Supply Chain Finance**

293. Our consultation IA also proposed to offer debtors an exemption for supply chain financing, where they offer their suppliers an exclusivity clause. Originally, in our pre-consultation talks with large debtors, we were told that it would be uneconomical to omit an exclusivity clause. However, from our consultation, we received no evidence to support the earlier assessment. Further detail can be found in the summary of responses document.

**Retrospective nullification**

294. During the consultation phase of IA, invoice financers told us that the regulations would not apply to contracts that preceded the commencement date. We received legal advice that a contract that was agreed before the commencement date but renewed after the commencement date would still be permitted to contain a ban on assignment clause. Similarly, if a master contract was agreed before commencement, linked contracts agreed after the commencement would be permitted to contain ban on assignment clauses. This is because our regulations are not permitted to be applied retrospectively.

295. We have asked invoice financers to provide us with evidence on the scale of this problem. Financers are in a good position to do this because they do this all the time as part of the due diligence carried out during the application process. We asked them what the average age of a contract was with ban on assignment clauses in them and secondly, if they had any indication of the number of contracts which were linked contracts or renewed contracts.

**Limiting the scope of companies which could benefit from assignment**

296. We were also asked to consider limiting the scope of the nullification to SME creditors by a law society. They requested an exemption in the regulations so that large companies could agree to ban assignment of invoices provided they were not contracting with small businesses. However, there was very little appetite among large businesses to include ban on assignment clauses in their contracts. We are also aware of creating unintended consequences. It might create a disincentive for large companies to enter contractual relationships with smaller suppliers, though we judge the risk to be low. More importantly, it would certainly slow down the provision of credit, and potentially make this more expensive, compared with the situation where the ban applied to all companies, as invoice financers would need to confirm a company's SME status before being able to agree to provide credit. Finally, we are not aware of any

international precedents for limiting the ban by company size, making it difficult to assess the outcome. For these reasons, the policy should apply to all businesses, regardless of size.

**Territorial Extent**

297. We discussed territorial extent of the regulations with consultees and decided to apply the regulations to two parties conducting business where at least one of the parties carries on business within the UK. Two parties can agree to use UK contractual law, even if they are based outside of the UK's jurisdiction. We decided that businesses should be allowed to continue to do so. We do not intend to prohibit restrictions on assignment in international contracts where there is no UK businesses to protect.

**International Comparisons and Precedents**

298. There is international precedent for nullifying the ban on assignments. In May 1988, UNIDROIT (L'Institut International pour L'unification du Droit Privé) adopted a Convention on International Factoring, which stated that "the assignment of a receivable by the supplier to the factor shall be effective notwithstanding any agreement between the supplier and the debtor prohibiting such assignment" (Article 6, 1). In 2001, UNCITRAL (the United Nations Commission on International Trade Law) adopted the Convention on the Assignment of Receivables in International Trade which states that "an assignment of a receivable is effective notwithstanding any agreement between the initial or any subsequent assignor and the debtor or any subsequent assignee limiting in any way the assignor's right to assign its receivables" (Article 9, 1).

299. Other advanced economies have introduced legislation to nullify bans on the assignment of trade receivables directly, or have created a legislative framework for the registration of property securities that effectively allows for the assignment of trade receivables irrespective of contractual bans to that effect. These include the US, Australia and Canada,

300. Under the US Uniform Commercial Code (Article 9-406), ban on assignments clauses and the requirement for the debtor's consent for assignment is invalidated. However, the debtor should receive notification that the payment has been assigned to a financer.

301. In Australia, the Personal Property Securities Act 2009 nullifies ban on assignment clauses. There is also a provision to allow the debtor to sue for damages that could be incurred by the assignment between the financer and the supplier.

302. In Canada each state has adopted a Personal Property Security Act. The Ontario version of the Act nullifies a ban on assignment and contains a provision which entitles the debtor to compensation if an assignment causes damages to it.

## Previous attempts to tackle the problem in the UK

303. On 31 August 2005 the Law Commission published a set of recommendations (LAW COM No 296) on reforming the registration of company security interests. This included a recommendation to 'override' bans on the assignment of trade receivables. The report stated that "in a contract between a company and a third party creating a receivable payable to the company, a term that purports to prohibit or restrict assignment of the account should be of no effect against a third-party assignee" (LAW COM No 296, 2005, Para 6.73, p.155).

304. In 2008, both the Scottish and UK Governments changed their policies to recommend against the use of bans on the assignment of receivables by public sector authorities. On 16 June 2008, the Office of Government Commerce (Efficiency and Reform Group, Cabinet Office) issued a Procurement Policy Note instructing recipients "to permit explicitly, the assignation of debts arising under a contract". As with all OGC model terms, this change in policy was aimed at Contract Authorities in Central Civil Government, with Contracting Authorities in the Wider Public Sector encouraged to adopt the OGC model contractual terms. However, from discussions with invoice financers and surveys we have carried out it is apparent that bans on assignment of trade receivables have continued to be used in UK business contracts, including in public sector supply chains.

305. In April 2013, the Companies Act 2006 (Amendment of Part 25) Regulations 2013 came into force. The Regulations amended the Companies Act 2006 relating to company security interests. However, the Regulations only implemented some of the Law Commission's recommendations. Due to this partial implementation some recommendations, including the recommendation to make ineffective contractual bans on assignment, were not implemented at this time.

306. In December 2013, the Department for Business, Innovation & Skills published a Discussion Paper entitled 'Building a Responsible Payment Culture'. The Discussion Paper asked "would removing contractual barriers to selling invoices (e.g. as a result of a ban on assignment) be helpful to small and medium sized businesses by increasing their access to services such as factoring and invoice finance?"; about half of the respondents agreed that removing ban on assignment clauses would be helpful.[65] The majority of respondents who disagreed suggested that the cost of waivers and workarounds would dissuade small businesses from accessing invoice financing; however, we anticipate that the nullification will make access to finance easier.

307. In May 2014, the Department for Business Innovation & Skills published a response to the 'Building a Responsible Payment Culture' Discussion Paper. The Government Response stated the intention "to introduce legislation to tackle contractual barriers such as bans on assignment when Parliamentary time permits".

[65] 19 respondents responded that it would be helpful, 12 that it would not and 6 responses were inconclusive

308. In March 2015, The Government passed the Small Business, Enterprise and Employment Act. This Act includes two clauses relating to the nullification of bans on the assignment of trade receivables. The first clause provides an enabling power for the Secretary of State to introduce regulations to nullify bans on the assignment of trade receivables, and the second introduces an exemption for financial services and products. Essentially the regulations will not apply to any contract for financial services and this is broadly defined to cover just about any financial services product, but there is a lengthy indicative list of financial services in section 2 of the Small Business Enterprise and Employment Act.

309. Over the summer of 2014, we undertook a programme of informal consultations with businesses, financers and legal experts. We conducted a non-representative survey aimed at large firms as well as a separate survey of invoice financers who were members of Asset Based Finance Association (ABFA). We also received consultation responses on the content of the regulations and cost benefit analysis.

310. The consultation Nullification of Ban on Invoice Assignment Clauses set out our initial views on what should be in the secondary legislation. The proposal we tested proposed to nullify the term outright with some exemptions. Our consultation asked whether we should limit this proposal to business to business contracts and exclude financial services. We received 20 responses to the consultation, coming mainly from business representative bodies, invoice financers and law practitioners. We also had some responses from large businesses in the retail and construction industry.

## Annex F: Actual case studies where invoice financing is funding business growth and where BoA is preventing access to invoice finance.

**I Below are a selection of real companies where BoA is not an issue and consequently, financers have been able to provide finance. *(Sources: press releases, ABFA).***

### 1) Caroline Packaging

Caroline Packaging, a wholesale disposable tableware supplier, is projected to hit £5m turnover in the next two years following an invoice facility from Secure Trust Bank Commercial Finance, which will help roll out its products across the UK and expand into European markets.

The Bristol-based company is family-owned, supplying an extensive range of disposable tableware including cutlery, napkins, plates and cups to trade and wholesale customers across the UK. Working with a number of UK and European-based manufacturers and currently employing 25 staff, Caroline supplies to Bestway as well as all the major supermarkets.

The funding from Secure Trust Bank Commercial Finance will facilitate the company's future development and expansion plans. The deal was introduced by Kerry Kimitri, who joins Caroline Packaging as director, alongside his role as senior partner at Grosvenor Park Advisory Partners. Kerry has helped the business increase stability through the implementation of a new structure, and is now looking to progress its long-term growth plan.

### 2) Caledonian Recycling

Caledonian Recycling, a specialist waste management contractor, has secured a £2m funding package from Secure Trust Bank as it aims to expand the business.

The Livingston-based firm specialises in providing inert material recycling, breaking down materials such as stone, rubble and demolition waste and forming new material to be sold to clients. The firm supplies its products for use in new building sites and temporary road surfaces. Founded 16 months ago, the company employs 12 staff and is aiming to achieve sales of £3.6m in the next 12 months.

The funding package from Secure Trust Bank comprised of a £1m invoice finance facility in addition to a £1m asset finance loan.

As the industry is renowned for its lengthy lead times between payments, sometimes taking 90 days, the invoice discounting will be used to support cash flow for the business. The asset-finance loan will allow the business to purchase additional equipment as it expands the business.

The company is now aiming to increase its market share in the crushing contracting sector, as its recycled material is cheaper than the fresh-quarried material typically used in the industry. It is also looking to expand its specialist plant hire business to large-scale excavators, supplying both machinery and operators to these companies.

## 3) Ripmax

With recently secured exclusive distribution rights to supply Futaba radio control products across Europe, and growing interest from old and young enthusiasts, Ripmax Limited is set to double its turnover over the next 18 months. To keep up with demand and deliver on its growth ambitions in new markets, this dynamic UK SME sought much needed finance to help with its cashflow. With imports coming from Japan, China and the Far East, the business has had to manage its cashflow carefully.

Nick explains: "as we have grown our business we have had to become more creative with our cashflow. On the one side, when importing goods, we often find ourselves paying for them before they arrive in the UK. On the other side, when selling our products to retailers, it often takes up to 60 days to receive payment. This leaves a gap in our working capital."

Working with Bibby Financial Services and Park Capital, Ripmax has secured £4 million of funding made up of invoice discounting and trade finance to help close the business's cashflow gap. Nick added: "Ripmax has been on a real growth journey in the last couple of years following its acquisition of Amerang in 2013. We have recently secured exclusive European distribution rights for Futaba radio control products which are going to grow the business considerably. This deal will significantly grow our revenues in the European market."

## 4) Turtle Wax

The iconic brand started its European business in the 1950s followed by establishing a UK based company in 1966. It now sells Turtle Wax products, including Perfect Finish and Essentials, within the UK and abroad. In October 2014 it relocated its EMEA headquarters to Bootle, Liverpool. To help facilitate its ambitious growth plans, Turtle Wax turned to business funder Bibby Financial Services who agreed to provide a £6 million funding facility.

The agreement was structured by BFS' Corporate team, which was formed in October 2012 to develop larger transactions. Since this time, the team has structured more than 300 deals, providing available funds of over £275 million.

Mark Brickhill, EMEA President for Turtle Wax said: "We have ambitious plans to grow throughout the EMEA region and required a finance partner that not only understood the history and seasonality of our business, but that could also support our expansion plans for the future.

## 5) Hogs Back Brewery

The working capital facilities provided by our Invoice Finance team have given Hogs Back Brewery the capacity to win newbusiness with larger customers. In addition, they have supported the development of the Hogstar English Lager, Hazy Hog Cider and Hopping Hop India Pale Ale (IPA) and their sale in pubs and supermarkets across the region. Without this source of finance, Hogs Back would not have been able to expand in these areas. Hogs Back boasts an annual turnover of £3.5 million and is set to increase this as it extends and markets its new product lines.

Hogs Back Brewery owner, Rupert Thompson said: "The growth of the local brewing sector is creating some exciting sales opportunities for us. An increasing number of consumers are looking for

locally sourced beers and for brands that offer something different. Hogs Back ticks both those boxes.
The facilities have helped with new product development and sales, and the brewery is forecasting an increase in its £3.5 million turnover as a direct result of new lines.

## 6) Uist Asco, harvester of organic seaweed

Uist Asco has grown steadily, becoming the second largest employer in the area and is a completely green business.

As their larger customers pay at 60 days – but they have to pay their bills at 30 days – they had a pressing requirement for additional working capital. Working Capital Partners MD Perry Burns personally visited the factory in the Outer Hebrides (a trip of several days' duration) and quickly approved the funding that the company so desperately required.
The facility was signed and funded within a week, allowing the company to start factoring invoices from their larger customers and receiving the funds within 48 hours.
Although the company had managed to raise money for the equipment required to dry the seaweed, no one was willing to finance the ongoing working capital requirements.
The local enterprise agency had been promising money for over four years but no funds had been forthcoming and their bank would not help either.

The funding has enabled Uist Asco to pay their bills quicker, to invest and to grow steadily. They now have plans for additional machinery, all of which will help the business expand in the coming years.

## 7) Lion Creative

Lion Creative has agreed a refinance deal with our Invoice Finance and banking teams to help its growth strategy after securing significant new contract wins. This includes the launch of a new children's bathroom range from Ella's Kitchen's owner called Paddy's Bathroom. The funding deal includes loan and working capital facilities to also support day to day cash flow management. The business has grown organically over the last 35 years which is a great achievement in this competitive industry. With the funding from our banking and Invoice Finance teams, Lion Creative is now well placed to expand the team and has announced plans to recruit two new roles.

Paul Rice, Invoice Finance said: "Lion Studios has an impressive client base and are enjoying strong growth in a sector which can be challenging. The working capital facility works well alongside the loan to provide funds to support day to day cash flow needs and the agency's expansion strategy."

**II Below are a selection of real company case studies where BoA has recently caused serious issues, leading to financers being unable to provide finance. Due to the sensitive nature of these cases, names have been deleted. *(Source: Invoice financers/ABFA).***

## Packaging material provider

- Potential invoice finance client: A new start business - provides packaging materials to a leading building and timber merchant.
- Sector: Building and construction.
- Region (finance client): Yorkshire and Humber.

**Summary:**

- The Directors of the potential client have been working for another business and are looking to set up on their own.
- The business plan is good – however there is minimal credit worthiness in the Directors/Principals. They have no other assets that can be secured against.
- The leading building and timber merchant is their only debtor at the current time. The debts are the only assets.
- The merchant has a ban on assignment in place as part of its general terms and conditions.
- The start-up is tiny; the debtor is in the FTSE 100.
- It is highly unlikely that the debtor will agree to provide a waiver; regardless, the view of the Directors is that to request one would put the contract in jeopardy.

**Outcome:** The debtor in question was not willing to provide a waiver and the invoice financer was not able to provide a facility to the prospective client. The prospect had also been turned down by their bank and their current situation is unknown but the invoice financer is doubtful that they were able to secure mainstream funding from anyone with the debtor's approach to ban on assignment.

## Specialist 'forensic' clean-up business based in the South East.

- An ABFA Member has a small client providing specialist clean-up services to police forces, local authorities, infrastructure firms and such like. They clean up when people commit suicide in front of trains, when people die unexpectedly at home and aren't discovered for a period of time, crime scenes and so on. Unpleasant work but it has to be done. (To clarify, the work involves clean-up post forensic investigation, so they are not privy to sensitive information which might justify elements of confidentiality).

- Their police force and local authority clients are generally okay but approximately 50% of the debtor book (by value) is with a large infrastructure, construction and support services firm. This large debtor firm strictly enforces bans on assignment in their contracts. Given that half the client's revenue (approximately £200,000 p/a) is tied up with this debtor, combined with the fact that the debtor is a notoriously slow payer anyway, puts the cash flow of the client business under severe pressure. The size of the client and the composition of the debtor book is such that it is not possible to offer a confidential facility.

- Our Member funds the untainted portion of the debtor book but this is not sufficient to allow the business to develop in the way that it could, as there is (unfortunately) apparently a lot of opportunity in these areas! So instead the client's turnover has been static for 3 years, they might be forced to offer away equity if they are going to get the funding that would allow them to take the next step, whereas a factoring facility would allow them to grow organically. This is a clear example of BOA holding a client back.

- The debtor business is a signatory of the Prompt Payment Code and is an outsourced service provider to the public sector and so benefits from the improvements to public sector payment practices but does not cascade those benefits down the supply chain to its second and third tier (and below) suppliers.

### Specialist recruitment firm supplying temporary labour into the rail industry based in the Midlands.

- An ABFA member is supporting this small new start business. The prime debtor, a leading international infrastructure group based in the UK, represents 61% of the overall ledger. The debtor strictly enforces ban on assignment clauses with no willingness to negotiate or mitigate the impacts.

- The funding requirement for the business was immediate and the eventual composition of the debtor book was not clear when the Member took the client on. Given the client's pressing cash-flow requirements (paying the wages of temporary workers), the Member has sought to support the business and manage the situation by restricting funding advanced against the prime debtor. It is only able to fund against the debtor at 30% however; given the composition of the debtor book this constitutes a restriction of potential funding of around 40% (probably around £150,000 of funding that cannot be provided). However, this situation is not sustainable for the either the invoice finance client or the financer. The situation is developing at the current time but the Member is not likely to be able to continue to support the client and it is not clear from where the client would be able to access alternative funding.

### Prospective client business supplying fashion product to the retail industry, based in London.

- An ABFA Member is seeking to support this business, which has a turnover in the region of £10m p/a. The Member is offering a disclosed facility. The prospective client has around 400 customers/debtors but there are issues with concentration and, in particular, ban on assignment is a feature of the contract with their second largest customer, representing around 20% of turnover. A waiver of the BOA is required and at the time of writing it was not hopeful that this would be granted. The Member would thus struggle to provide funding against sales to that debtor. This may mean that the overall funding package available would be insufficient.
- The Member estimates that effective nullification of ban on assignment clauses would unlock around £300,000 funding p/a for this prospect.

### Former client supplying fish to the retail industry, based in Hull.

- An ABFA Member provided a disclosed factoring facility to this client business which has a turnover in the region of £20m p/a. Their largest customer – a large retailer – constituted 70% of the business's turnover and enforced a ban on assignment with no waivers provided. The Member sought to support the business and manage the risk by restricting advances against the whole debtor book and capping the funding provided against the BOA debtor.
- The Member estimates that effective nullification of BOA clauses would have unlocked around £400,000 additional funding for the client.

# IA Appendix A: 2015 survey of ABFA members – sample form

**NULLIFYING BANS ON ASSIGNMENT CLAUSES**

**SURVEY OF ABFA MEMBERS TO INFORM GOVERNMENT IMPACT ASSESSMENT**

**The Department for Business, Innovation and Skills (BIS) has requested that the ABFA survey Members in order to provide information to inform the Government's Impact Assessment on regulations nullifying bans on assignment (BOA)** under the Small Business, Enterprise and Employment Act 2015**.**

**In order to do this, we request Members' help in assessing the current impact (or otherwise) of BOA in a series of scenarios.**

In consultation with BIS, we have constructed some questions in order to gain an insight into the current funding environment under existing BOA and debtor concentration constraints.

The ABFA understands that BIS will use the information provided to estimate or indicate the potential benefits to UK SMEs (and hence to the UK economy) of effectively addressing the issue of BOA through the proposed regulations. In recognition of the impact on your time, we believe this is the most efficient way to help BIS with its evidence on the benefits of the proposals.

**Please could we receive your responses by no later than Monday 3 August 2015.**

BIS will treat all responses as confidential. We have requested a few basic supplementary details about your business at the end, but there is no obligation to answer this final section. Many thanks for your time!

**EXPLANATORY NOTES**

- The following questions are designed to explore the impact (or not) of BOA in four different hypothetical scenarios.
- It is suggested that the impact will be ultimately reflected in the:
    - **Availability of funding** – primarily through the prepayment percentage and debtor/concentration restriction; and
    - **Costs of funding** – through the Service Charge and (albeit less likely) through the Discount Charge.
- It is recognised that these are highly hypothetical and simplistic examples and that the responses will, necessarily, be generalisations. This is necessary to attempt to isolate the impact of BOA as much as possible from other considerations.
- So the only variables that should be taken into account in responding to the questions below are the:
    - **Concentration within the sales ledger**; and
    - **Extent to which BOA is present within the ledger**.
- In addition, it is recognised that not all Members would provide finance to a business with just £1 million turnover. Again, this is a hypothetical exercise and the results of it will be extrapolated – please answer on the basis that the client business is within your funding range.
- **Note the survey does not request details of the actual rates that Members charge – only an estimate of the variation from what they would be in Scenario 1 (the 'perfect scenario').**
- **So if a rate would be 'BOE BASE RATE + 2.5%' for Scenario 1, but 'BOE BASE RATE + 3.5%' for Scenario 4 the response would be '+ 1.0%'.**
- **Members' responses will not be shared with other Members.**

---

**ABOUT THE CLIENT**

- The business's annual turnover is £1 million per annum.
- The business manufactures and supplies widgets to customer businesses of a range of sizes.
- The business will have around 30 live debtors at any one time.
- The goods are highly 'invoice finance-able'.
- The business requires a whole turnover invoice finance arrangement.
- The prevailing economic conditions are average, the prospects for the client business are average.
- The contracts the business has with its customers are unencumbered by any other onerous contractual terms such as Retention of Title, Sale or Return, Pay When Paid.

- The prospect's typical debtor book has no other negative characteristics.
- The financier has been provided with perfect information regarding which contracts have BOA.

---

**ABOUT THE SCENARIOS**

| | |
|---|---|
| **Scenario 1:** | No BOA present and no individual debtor more than 20% of the sales ledger (i.e. no problem with concentration).<br>**[No BOA/good spread]** |
| **Scenario 2:** | No BOA present but significant concentration – say 50% - within the sales ledger.<br>**[No BOA/significant concentration]** |
| **Scenario 3:** | BOA is present and no individual debtor more than 20% of the sales ledger (i.e. no problem with concentration but BOA is present on the whole ledger).<br>**[BOA/good spread]** |
| **Scenario 4:** | BOA is present and there is significant concentration – say 50% - within the sales ledger (BOA is present on the whole ledger).<br>**[BOA/significant concentration]** |

*Please refer to Page 2 for the basic details about the client and the scenarios.*

**SCENARIO 1 – NO BOA & GOOD SPREAD OF DEBTORS (I.E. NO PROBLEM OF CONCENTRATION)**

**Q1**

It is assumed that an invoice financier would be able to provide invoice finance to this business. On that basis, please provide an approximate indication of the following:

| | % |
|---|---|
| **Prepayment percentage:** | |
| **Debtor / Concentration Restriction:** | |

---

**SCENARIO 2 – NO BOA & SIGNIFICANT CONCENTRATION OF DEBTORS**

**Q2a**

Would you be able to provide invoice finance to this business?......................................................

*If **no**, please go to Scenario 3*

**Q2b**

If **Yes**, please provide an approximate indication of the following:

| | % |
|---|---|
| **Prepayment percentage:** | |
| **Debtor / Concentration Restriction:** | |
| **Variation in Service Charge** *(relative to Scenario 1 – see explanatory notes on Page 1)***:** | |
| **Variation in Discount Charge** *(relative to Scenario 1 – see explanatory notes on Page 1)***:** | |

**Q2c**

In addition:

i) Would you require additional security if you were to increase the prepayment or concentration percentage?.......................................................................................... (if **Yes**, please specify)……………………………………………………………………………………………….

ii) Would there be an additional charge if the prepayment or debtor/concentration percentage were increased?.......................................................................................... (if **Yes**, please provide an indication)………………………………………………………………………………

**Q2d**

In the normal course of your business, would there be any other steps that you would take in this situation, in particular any that would directly or indirectly affect the availability or costs of funding to the client business?

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……………………………………………………………………………………………………………………………………*(please use as much space as necessary)*

**SCENARIO 3 – BOA PRESENT & GOOD SPREAD OF DEBTORS (I.E. NO PROBLEM OF CONCENTRATION)**

**Q3a**

Would you be able to provide invoice finance to this business?...............................................

*If **no**, please go to Scenario 4*

**Q3b**

If **Yes**, please provide an approximate indication of the following:

| | % |
|---|---|
| **Prepayment percentage:** | |
| **Debtor / Concentration Restriction:** | |
| **Variation in Service Charge** *(relative to Scenario 1 – see explanatory notes on Page 1)***:** | |
| **Variation in Discount Charge** *(relative to Scenario 1 – see explanatory notes on Page 1)***:** | |

**Q3c**

In addition:

i) Would you require additional security if you were to increase the prepayment or concentration percentage?......................................................................................... (if **Yes**, please specify)……………………………………………………………………………………………….

ii) Would there be an additional charge if the prepayment or debtor/concentration percentage were increased?.........................................................................................

(if **Yes**, please provide an indication)……………………………………………………………………………

**Q3d**

In the normal course of your business, would there be any other steps that you would take in this situation, in particular any that would directly or indirectly affect the availability or costs of funding to the client business?

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*(please use as much space as necessary)*

**SCENARIO 4 - BOA PRESENT & SIGNIFICANT CONCENTRATION OF DEBTORS (BOA PRESENT ON WHOLE LEDGER)**

**Q4a**

Would you be able to provide invoice finance to this business?................................................

*If **no**, please go to Question 5 below.*

**Q4b**

If **Yes**, please provide an approximate indication of the following:

| | % |
|---|---|
| **Prepayment percentage:** | |
| **Debtor / Concentration Restriction:** | |
| **Variation in Service Charge** *(relative to Scenario 1 – see explanatory notes on Page 1)*: | |
| **Variation in Discount Charge** *(relative to Scenario 1 – see explanatory notes on Page 1)*: | |

**Q4c**

In addition:

i) Would you require additional security if you were to increase the prepayment or concentration percentage?........................................................................................... (if **Yes**, please specify)…………………………………………………………………………………………….

ii) Would there be an additional charge if the prepayment or debtor/concentration percentage were increased?.....................................................................................

(if **Yes**, please provide an indication)……………………………………………………………………………………

**Q4d**

In the normal course of your business, would there be any other steps that you would take in this situation, in particular any that would directly or indirectly affect the availability or costs of funding to the client business?

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*(please use as much space as necessary)*

**OTHER QUESTIONS**

**Q5**

Please provide any additional comments you may have on the impact of BOA and how it can be demonstrated:

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**Q6**
**Name of Member:**

**Q7**
**Name of person responding to survey:**

**Q8**
**Email/telephone contacts:**

**Q9**
**Total number of clients to whom invoice finance is provided by Member:**

**…………………………….**

**Q10**

**Approximate numbers of invoice finance clients in the following turnover brackets:**

| | |
|---|---|
| **0-£1m:** | |
| **£1m - £5m:** | |
| **£5m - £10m:** | |
| **£10m – 25m:** | |
| **£25m - £50m:** | |
| **£50m +:** | |

# IA Appendix B: 2015 supplementary survey of ABFA members on waivers – sample form

NULLIFYING BANS ON ASSIGNMENT CLAUSES

SURVEY OF ABFA MEMBERS TO INFORM GOVERNMENT IMPACT ASSESSMENT

SUPPLEMENTARY QUESTIONS REGARDING WAIVERS

The Department for Business, Innovation and Skills (BIS) has requested additional information on the costs involved in Members and/or their clients seeking waivers to ban on assignment clauses.

We should be grateful for responses to the following supplementary questions.

Q1

*Assessing a prospective new clients' debtor book for BOA and considering whether requesting waivers is worthwhile,*

*Do you consider obtaining waivers where BOA is prevalent on a client ledger?* **Y**/*N.*

*If No please give your reasons why*

***………Nb we only consider on our factoring facilities.***

***……………………………………………………………………………………………………………………………………
…..***

If yes please provide:

Q1a

An estimate of the length of time involved in such an initial assessment of the potential need to request a waiver from the debtor

**Need is established quickly and easily upon review of debtor terms as part of our initial review or survey. If there is BOA then a waiver ( or acknowledgement of our involvement from debtor)  will be required. As such there is minimal time used to assess for the need.**

……………………………………………………………………………………………………………………………………….

……………………………………………………………………………………………………………………………………………….

Q1b

The job titles of all the people involved in the initial waiver assessment and the ratio of time allocated if there is more than one person involved. *[This is so that a notional cost can be applied. It is not necessary to provide BIS with details of hourly rates of pay as BIS can obtain generic data on pay rates of different occupations using ONS data]*.

…………………………………………………………………………………………………………………………………………………**We have set wording for our waiver, so a template is used. Minimal time and cost for issuing, as the BDM controls this aspect.**

…………………………………………………………………………………………………………………………………………….

Q1c An estimate of the total number of opportunities to obtain waivers you initially assess as against the total number of debtors you would assess in a Quarter. If you don't know the total numbers, please would you provide us with an approx. proportion of initial waiver assessments, per quarter.

……**No records held but as a guide in H1 of 2015, from a sample of 234 customers, 10 had BOA of which 8 were mitigated by either a waiver or debtor acknowledgement. Of the2**

**that did not provide a waiver, 1 decided against factoring altogether and the other non notified that debt**.

……………………………………………………………………………………………………………………………………………
……….

**Q2**

***Where the client or prospect's debtor book has already been assessed for BOA including any initial assessment of whether it is worthwhile to request a waiver (Q1). In Q2, BIS is seeking to understand the costs involved in requesting a waiver, (i.e. the costs following the decision to go ahead with the request).***

***Please provide:***

Q2a

An estimate of the length of time associated in preparing and negotiating the waiver request on average for a typical debtor.

……**Waiver is a standard template so minimal time and cost involved.**

**Any delay would be in getting the debtor to sign and return the waiver.. As a rule the bigger the debtor the longer the wait.**

……………………………………………………………………………………………………………………………………………
……….

……………………………………………………………………………………………………………………………………………
…………….

Q2b

The job titles of all the people involved in the waivers request and negotiation and the ratio of time allocated if there is more than one person involved. *[This is so that a notional cost can be applied. It is not necessary to provide BIS with details of hourly rates of pay as BIS can obtain generic data on pay rates of different occupations using ONS data]*.

…………………………………………………………………………………………………………………………………………
…………………**as per above, BDM is the main person involved in the process.**

……………………………………………………………………………………………………………………………………………
……….

Q2c

An estimate of the total number of waivers you would request as against the total number of debtors you would assess in a Quarter (regardless of whether the debtor agrees to the request or not). If you don't know the total numbers, please could you provide us with the approx. proportion of debtors who are approached for a waiver, per quarter.

…………………………………………………………………………………………………………………………………………
……………. ……**see Q1c**

…………………………………………………………………………………………………………………………………………
……….

Q2d

The success rate in obtaining waivers as a percentage of requests made to debtors

…………………………………………………………………………………………………………………………………………
…………….

Q3

Do you have any additional comments to make on the costs of assessing, calculating, negotiating and granting of waivers on debtor invoices with ban on assignment?

…………………………………………………………………………………………………………………………………………
……………….
…………………………………………………………………………………………………………………………………………
…………

……**On existing customer where a new debtor includes BOA, the onus of sorting the waivers generally falls onto the customer. We will provide a waiver but won't be able to fund until a waiver is sorted. As such minimal impact on us but does impact on additional work for customer and also delay for customer in accessing new funds.**

…………………………………………………………………………………………………………………………………………
……….