



中国服务贸易协会商业保理专业委员会
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Session 1 Risk Analysis Report of the Factoring Industry



Foreword

- Since June 2012 when the Ministry of Commerce issued the *Notice on Relevant Work of Commercial Factoring Pilot Projects*, commercial factoring has achieved rapid growth. By the end of 2018, domestically registered factoring companies has totalled tens of thousands, and the turnover has exceeded one trillion yuan. As it is an emerging industry in our country, companies still face many problems and difficulties in operation and development, especially in risk control and legal environment. Moreover, they lack experiences that conforms to national conditions and business environment for reference.
- On March 21, 2019, Asian Factor and Shenzhen Qianhai Financial Asset Exchange, Ltd. signed a strategic cooperation agreement. The two parties will jointly assist the development of supply chain finance industry in **Shenzhen** through resource sharing and advantages complement.
- To jointly promote industrial development, under the strong support and guidance of the Commercial Factoring Professional Committee of China Association of Trade in Services, the Commercial Factoring Association of Guangdong and the Commercial Factoring Association of Shenzhen, Asian Factor and Shenzhen Qianhai Financial Asset Exchange, Ltd. jointly set up a working group to collect extensive judicial precedents of national trade financing/factoring. The series of factoring judicial precedent report has been upgraded and the risk report of factoring industry has been formed.
- Although factoring cases obtained through public channels still have data input defects due to regional differences, information disclosure differences, availability and other factors, the working group hopes to share preliminary results and trends obtained based on the above research with all sectors of society and offer valuable suggestions so as to contribute to the sustainable development of the factoring industry.



If you have any suggestions or comments, please contact the working group:
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Wang Huili: huili.wang@asiafactor.com

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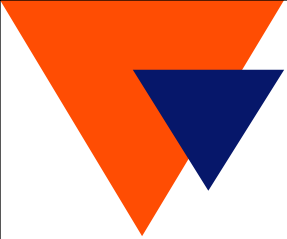
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1.Data analysis on Factoring Precedents (including bank factoring and commercial factoring)



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up to **500**

factoring legal precedents (including bank factoring and commercial factoring)

Collection of precedents

- Collected factoring precedents (including bank factoring and commercial factoring) nationwide through multiple channels since Jan 2014.
- Analyzed the precedents and summarized the imperative legal issues.

Summarization of risk items

- Extracted 1 or 2 key risk items out of each precedent.
- By authentication, it is the factor's lack of effective identification and control over key risk items that cause the disputes.

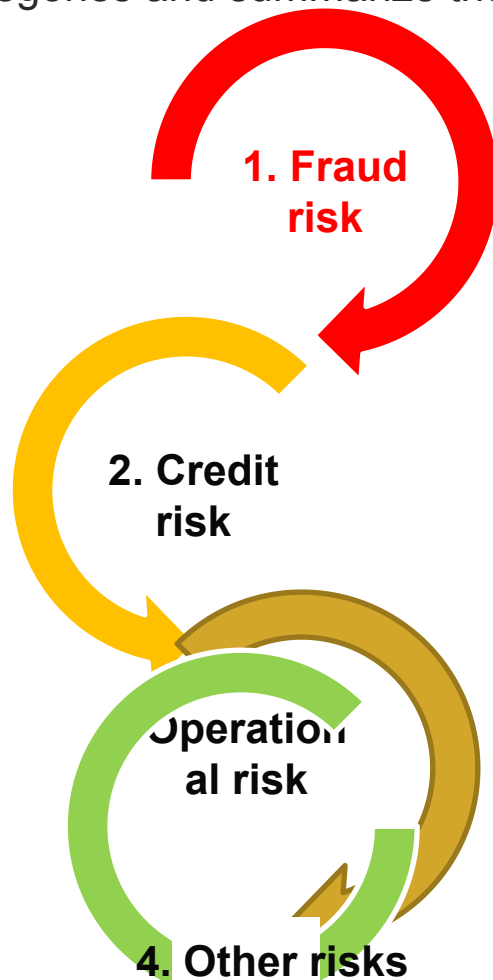
Output of the serial analytic results

- Summarized and categorized the risk items to form a complete framework.
- Generate the serial analytic results with positive significance to the risk control over factoring.

Risk Structure

Risk categories

- Basing on each factoring precedent, define risk categories and summarize the statistics:

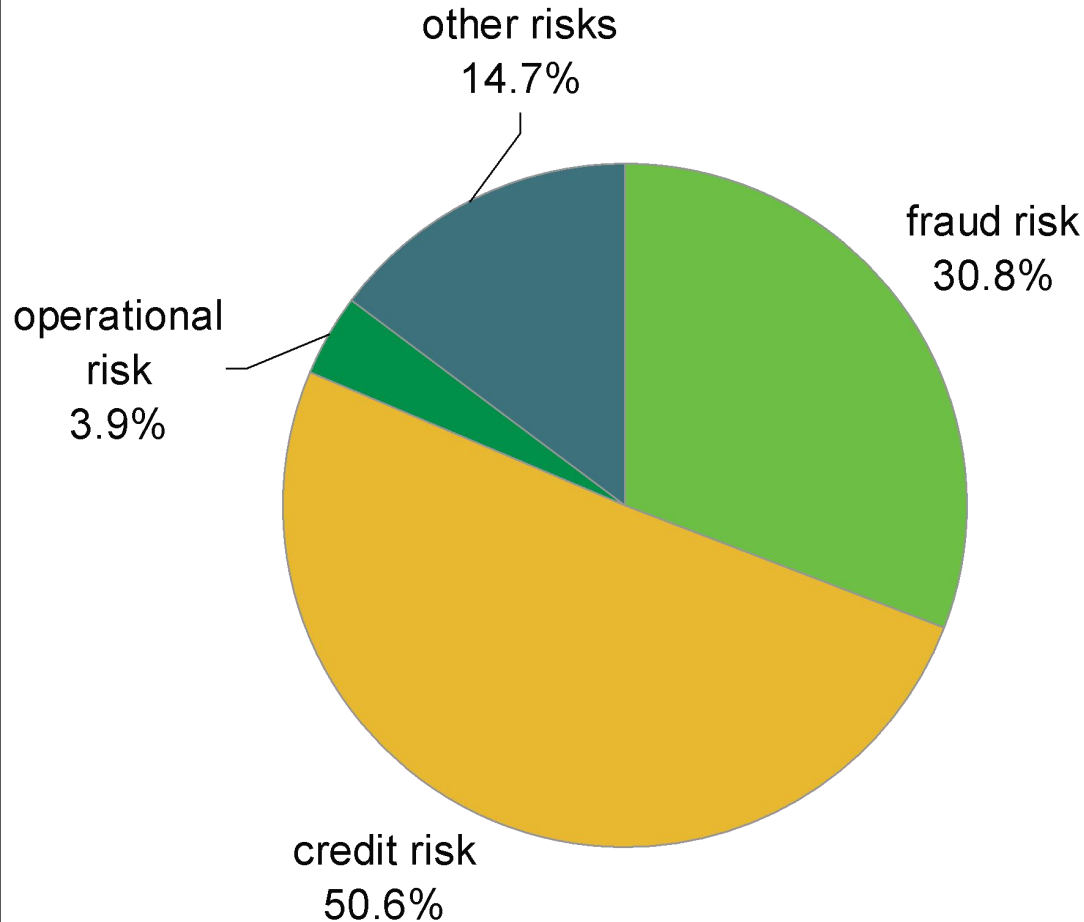


Special risk items

- Special risk items are the most important risk factors for factoring. These risk items are summarized from the factoring precedents:
 - **Fraudulent trade**
 - **Defects in AR assignments**
 - **Indirect payment**
 - **Counterfeited assignment of accounts receivable**
 - **Stop-payment order issued by the court to the overseas buyer**
 - **AR assignment prohibition clause**
 - **Jurisdiction objection**
 - **Disputes**
 - **Withholding interest in factoring financing**
 - **Absence of original copy of evidence**

Analysis on Risk Categories

Division of risk categories

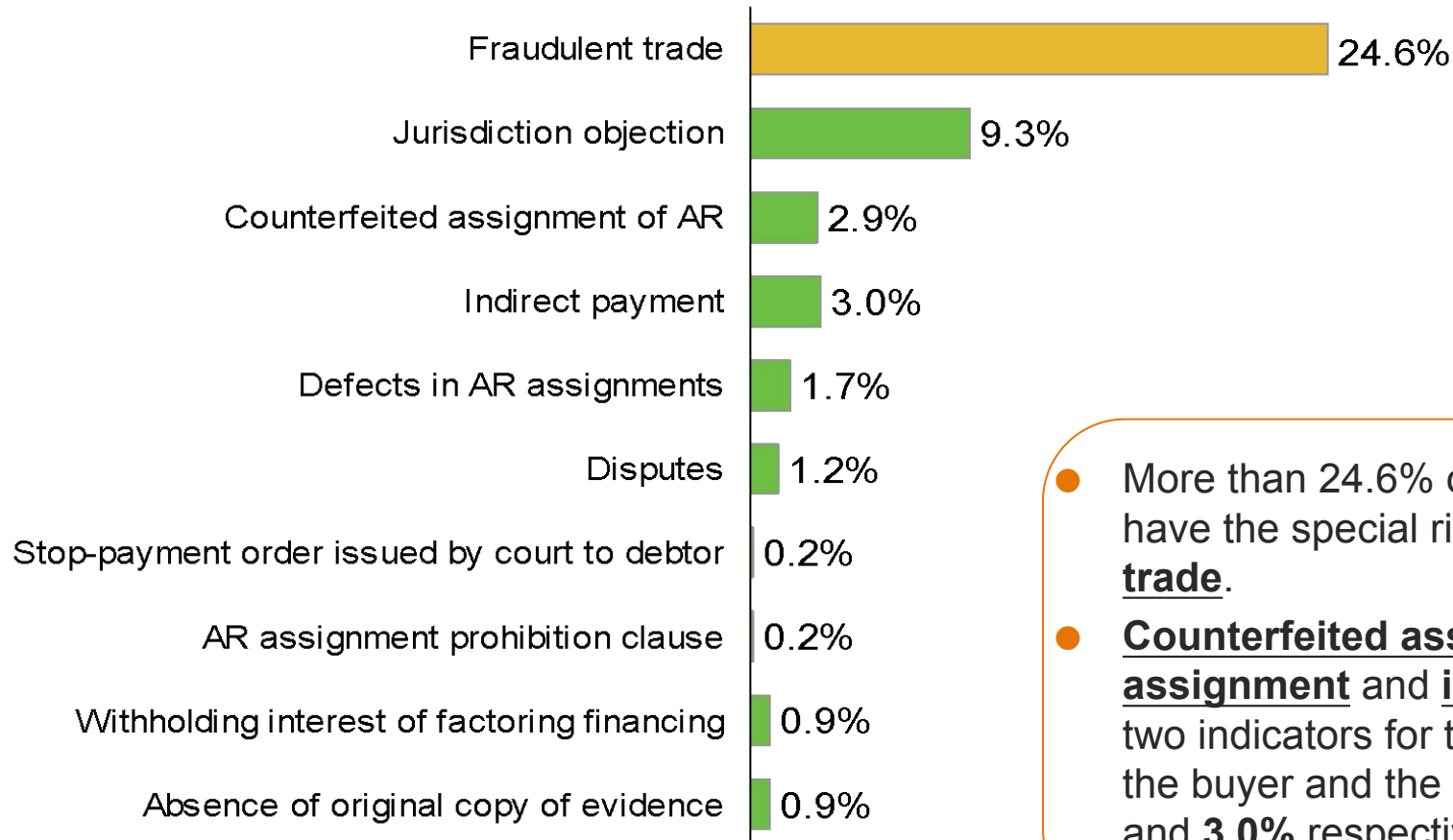


- 30.8% of the factoring cases were caused by the **fraud risk**.
- The second largest risk category is the **credit risk**. Due to the limitation of data sources, nearly 20% of the precedents' written judgments have no explanation on the specific matters in issue. Given their intuitive nature, these cases are categorized into the credit-risk precedents. **In fact, supposed the statistics are sufficient, the proportion of credit-risk precedents should be far less than 50.6%, while the fraud-risk ones may far exceed 30.8%.**



Analysis on Special Risk Items

Analysis on special risk items

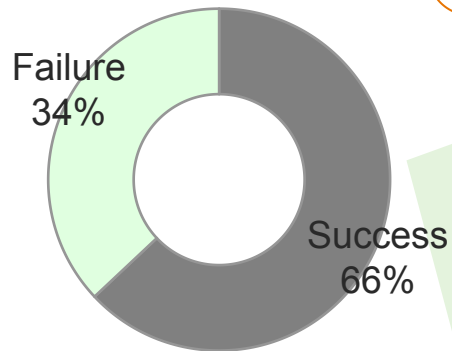


- More than 24.6% of the factoring cases have the special risk item of **Fraudulent trade**.
- **Counterfeited assignment of AR** and **indirect payment**, the two indicators for the collusion between the buyer and the seller, account for **3.0%** and **3.0%** respectively in the factoring cases.

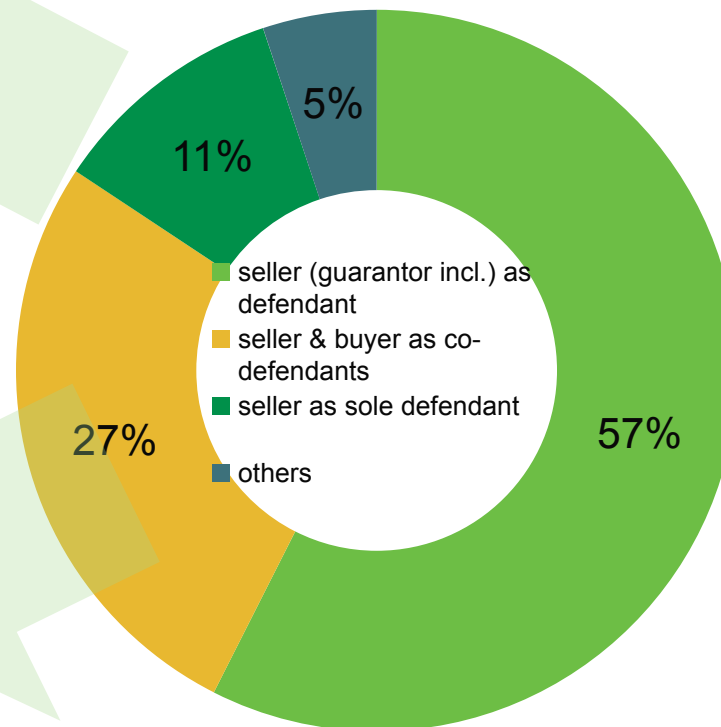
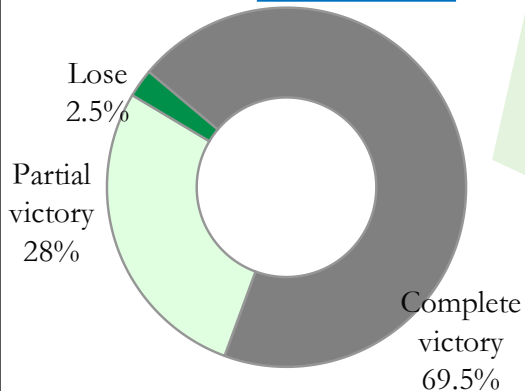
Analysis on Lawsuits

- In 57.5% of the precedents, the factor choose to sue only the seller (including the guarantor) to be responsible for the repurchase, and the success rate was as high as 97.4%.
- The success rate of cases with the buyer as the sole defendant is 66%.

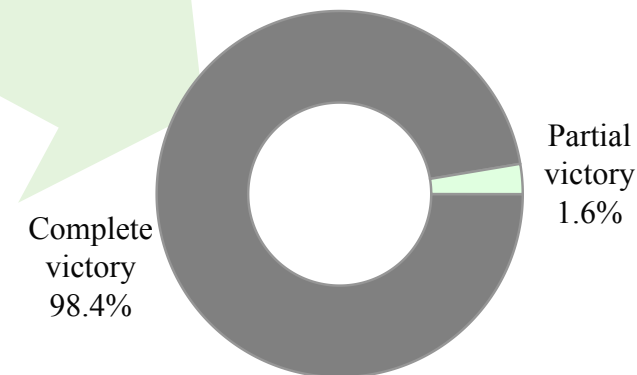
Analysis on the Defendants



The factor's success rate of cases with the buyer and the seller as co-defendants



The factor's success rate of cases with the seller (including guarantor) as the defendant

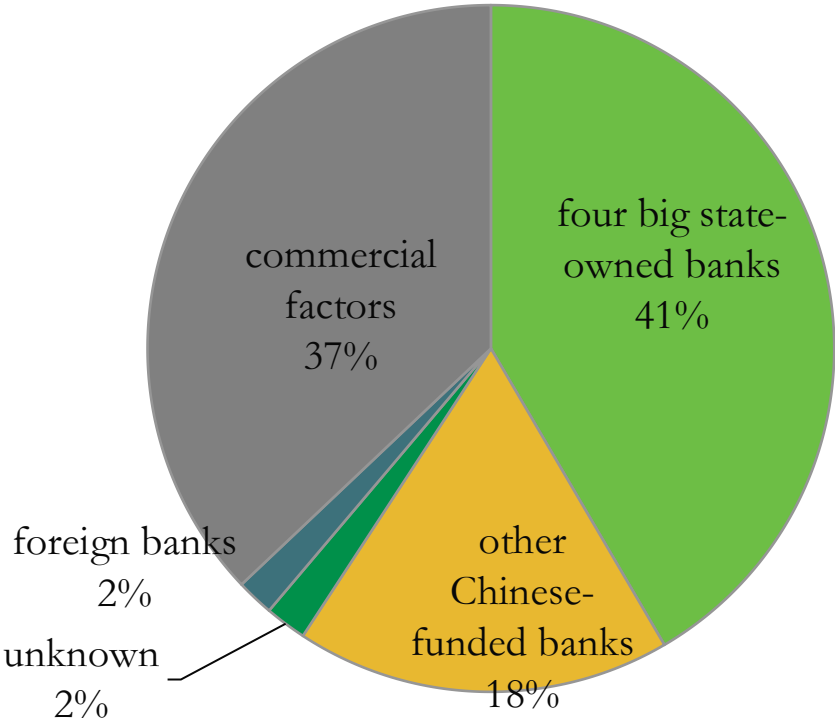


Analysis on the affected Factors

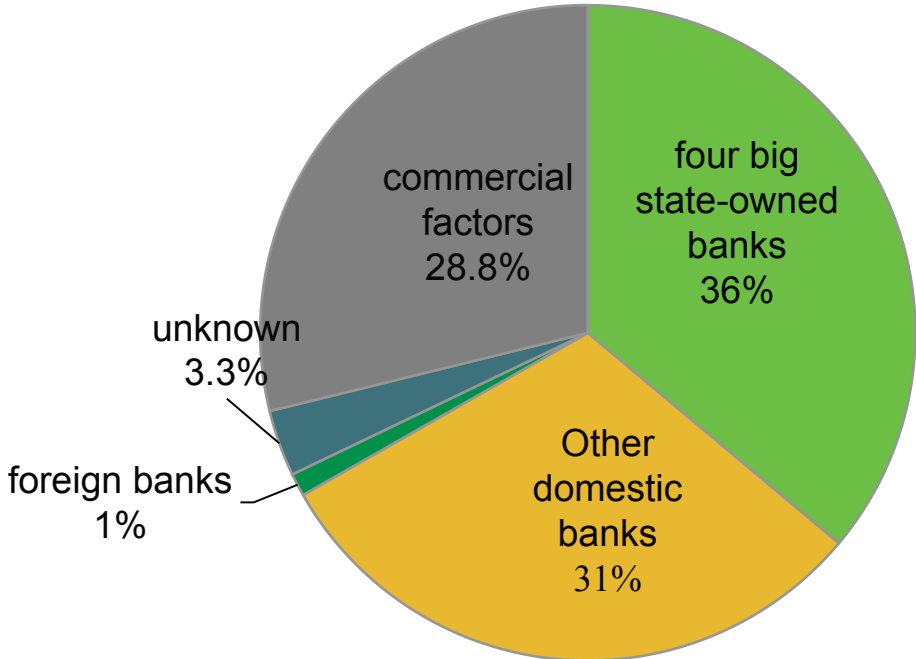


- In terms of the number of cases and the amount of money involved, the four big state-owned banks account for 41% and 36% respectively.
- The number of commercial factoring company cases and the amount involved are 37% and 28.8%. Their proportion has increased considerably.

number



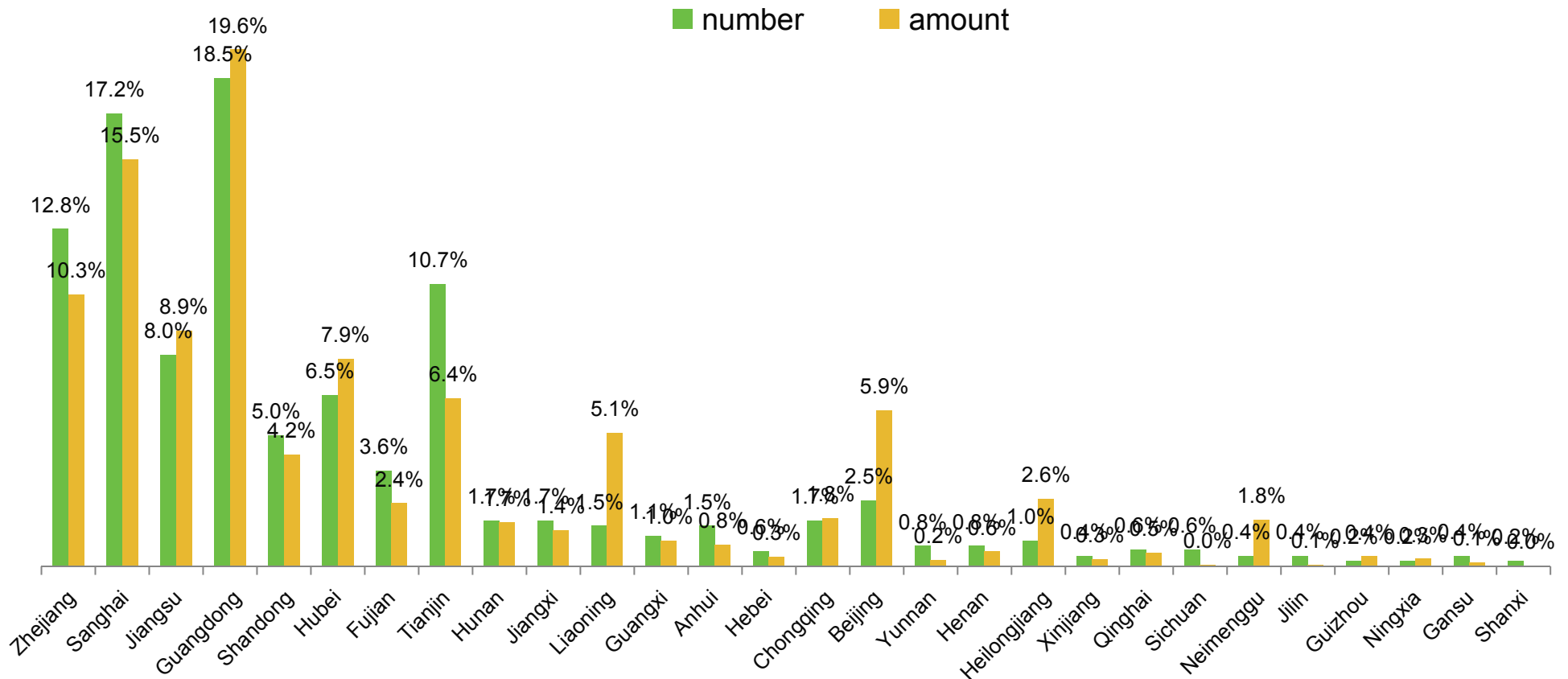
amount



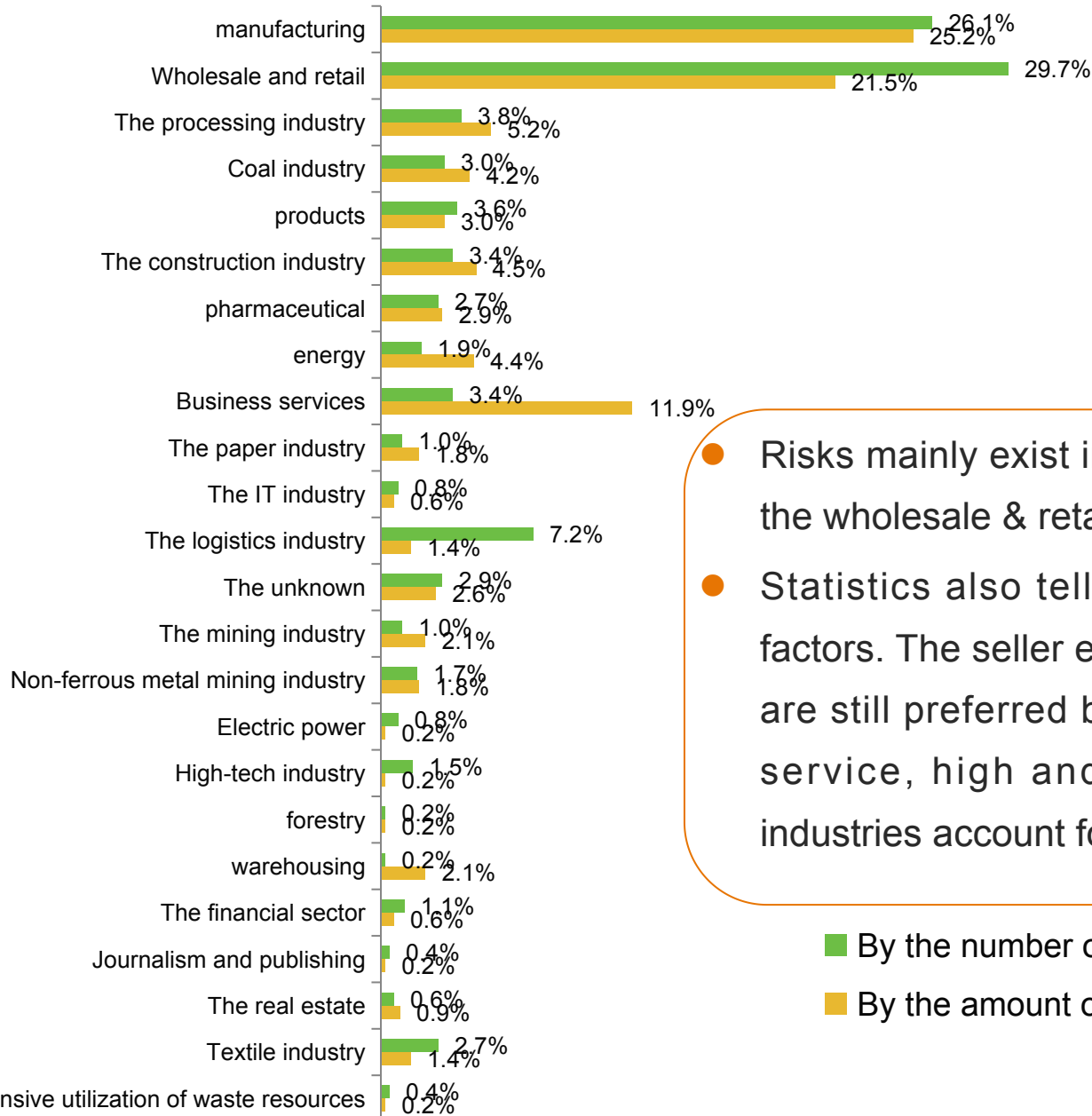
Analysis on the Dispute Arising Place



- Jiangsu, Zhejiang, Shanghai, and Guangdong encounter a higher frequency of risks in the factoring business than other regions, probably because these four regions are more active in conducting the factoring business.



Industry Analysis



- Risks mainly exist in the manufacturing industry and the wholesale & retail industry.
- Statistics also tell the major customer groups of factors. The seller enterprises of traditional industries are still preferred by factors, while the commercial service, high and new technology, and power industries account for rather small proportions.

■ By the number of cases
 ■ By the amount of the case





2. Data analysis on Legal precedents of commercial factoring



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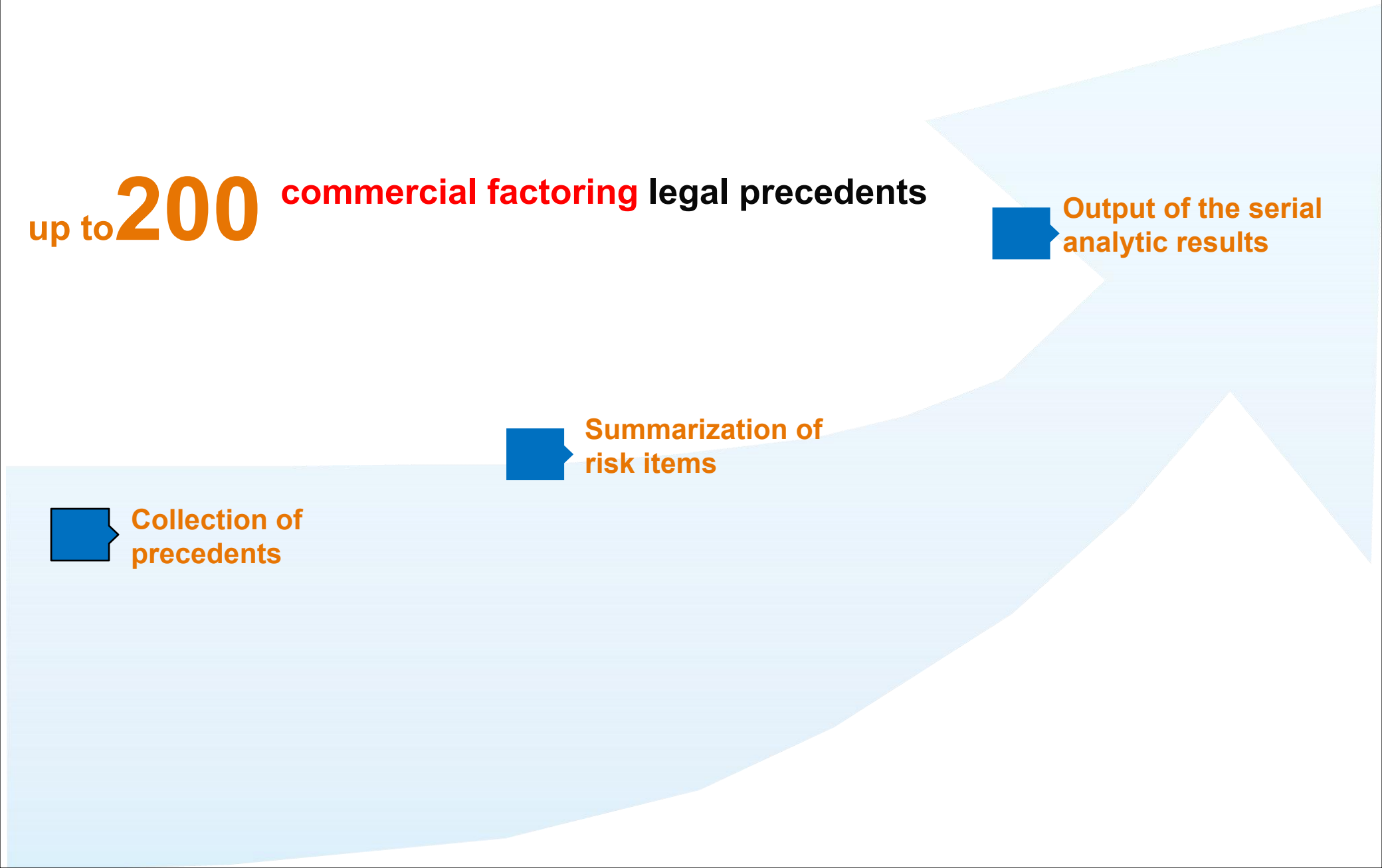
Background

up to **200** commercial factoring legal precedents

Collection of precedents

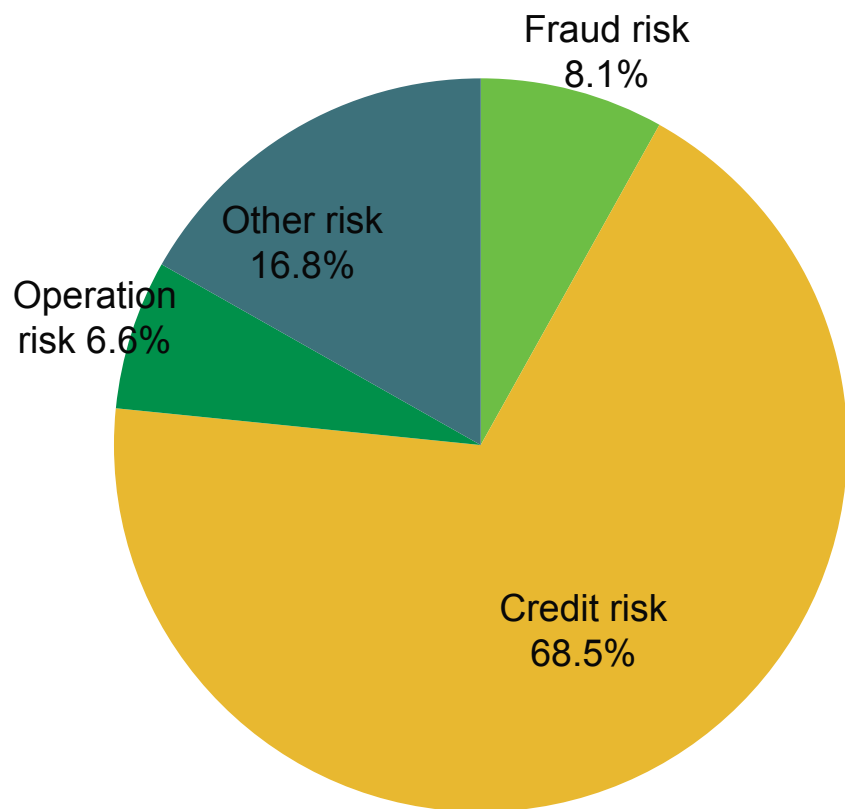
Summarization of risk items

Output of the serial analytic results



Analysis on categories of risks

Classification

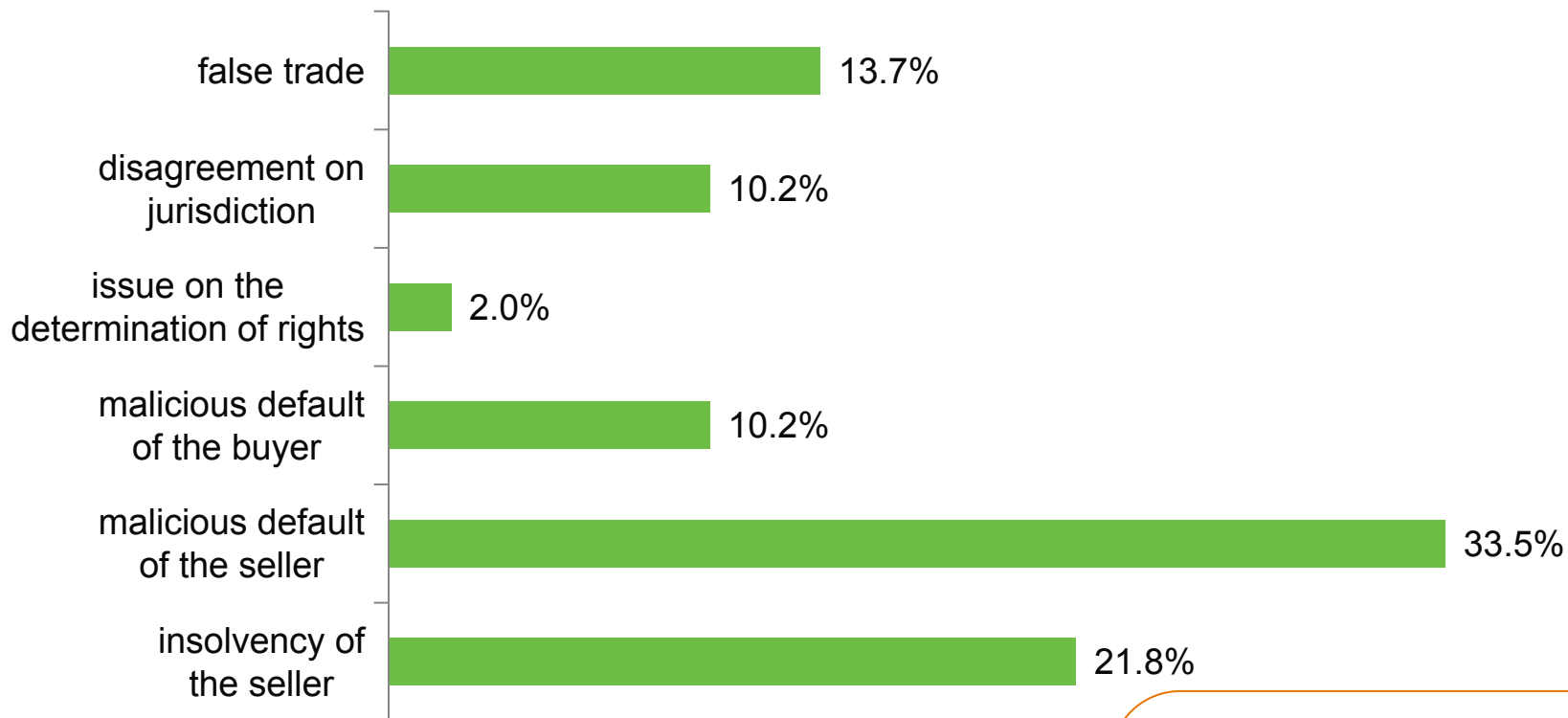


- 8.1% cases on commercial factoring are caused by **fraud risk**
- The proportion of cases on commercial factoring caused by fraud risks to all is higher than that of cases on factoring (bank factoring and commercial factoring) to all, which reflected that commercial factoring companies highly prioritize the prevention of false trade and other fraud risks and have higher capacities to prevent and control risks.



Analysis on special risks

Analysis on special risks

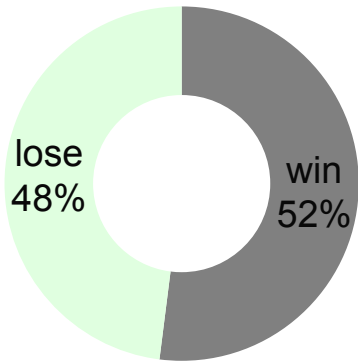


- 33.5% of cases on commercial factoring are caused by **malicious default of the seller**
- False trade contributes to 13.7% of all cases on commercial factoring, lower than that of cases on factoring (bank factoring and commercial factoring)

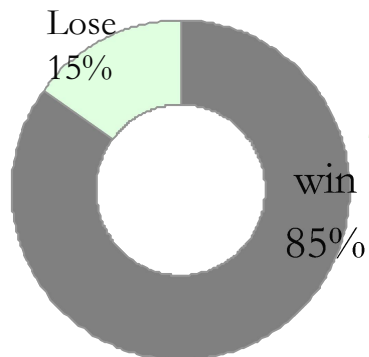
Analysis on cases

- In 69.5% of precedents, commercial factors choose to only require the seller (and guarantor) to perform the responsibility of repurchase, winning 94% of cases.
- While when the buyer is the only defendant, the chance of winning is only 52%, which is worth exploring

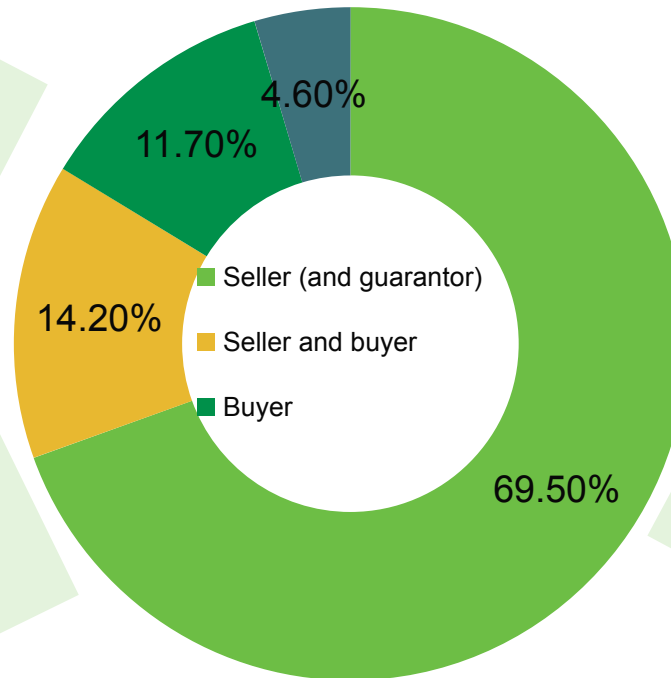
Factor's winning rate where the buyer is the only defendant



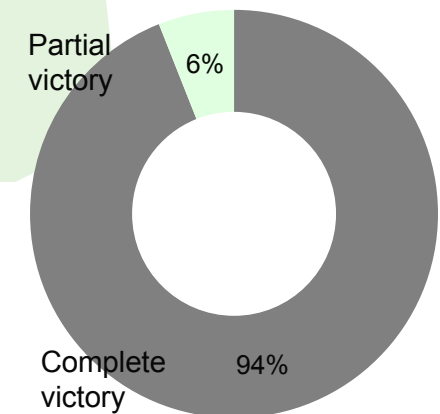
Factor's winning rate where the buyer and the seller are defendants



Analysis of defendant



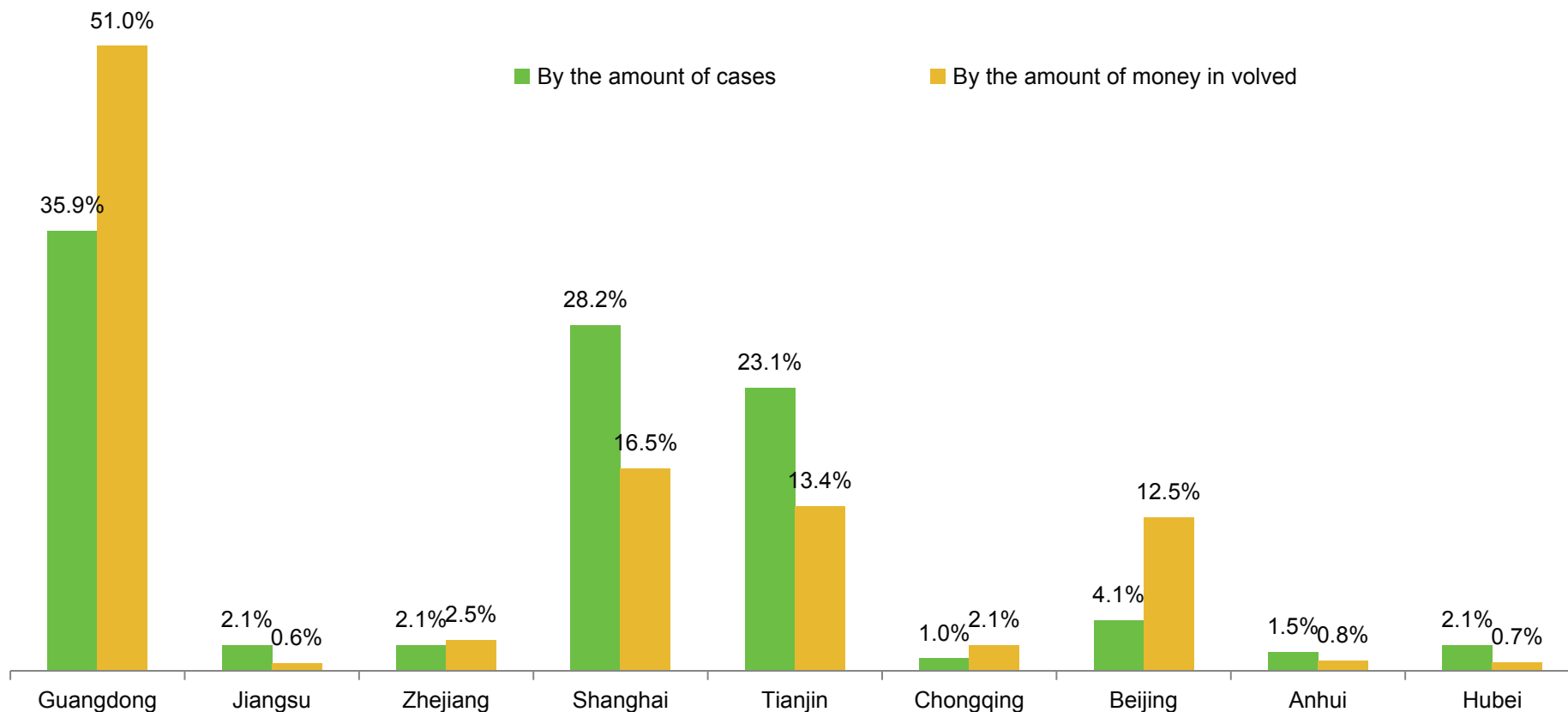
Factor's winning rate where the seller (and guarantor) are defendants



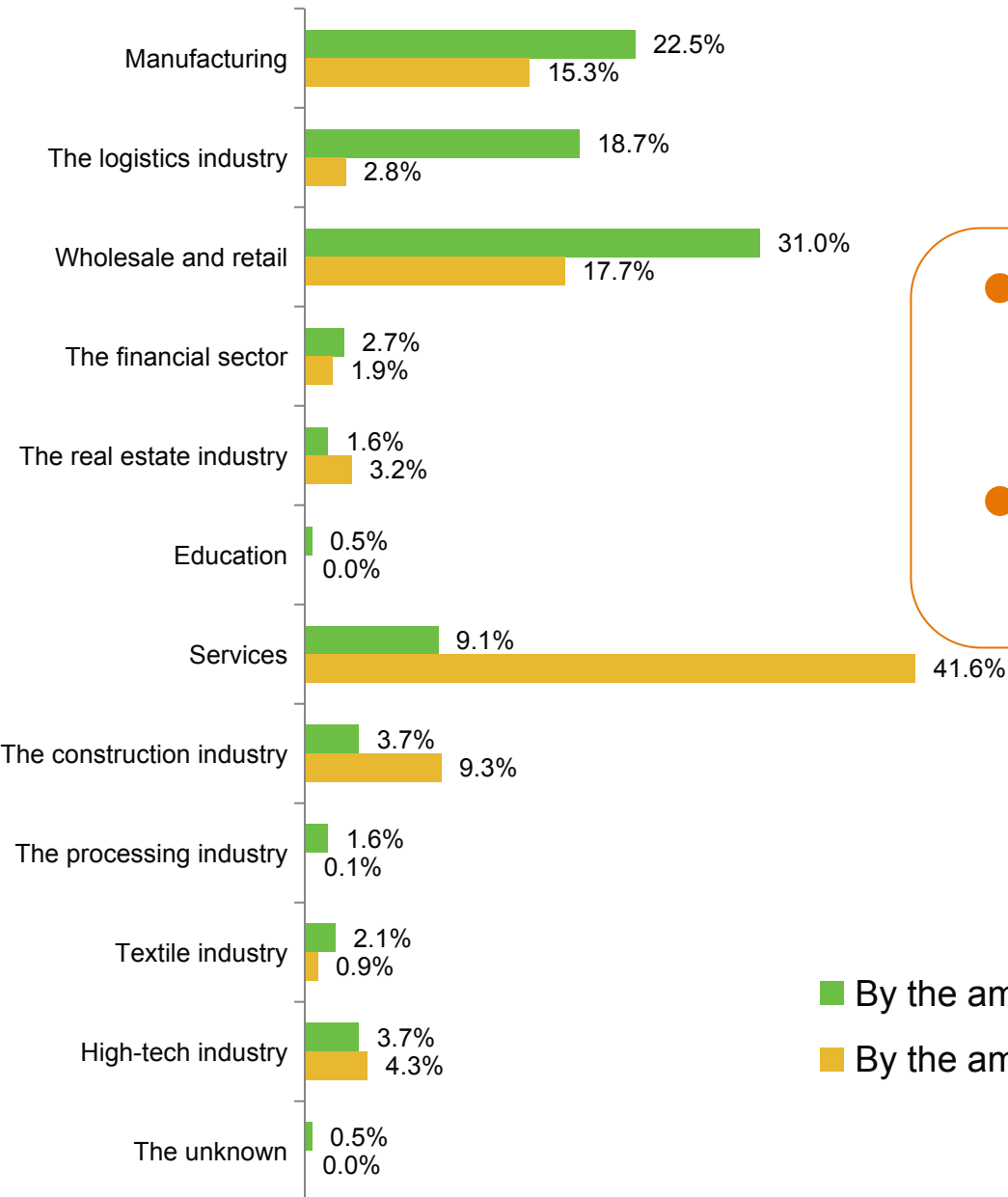
Analysis on places where disputes arise



- Disputes on commercial factoring frequently occur in Guangdong, Beijing, Shanghai, Tianjin etc.
- Beijing has fewer cases, but has the largest amount of money involved.



Analysis by industry



- The diversity of cases on commercial factoring reflects the flexibility and inclusiveness of the market.
- Wholesale and retail (trade) accounts for the largest number of cases.



■ By the amount of cases
■ By the amount of money involved

Study on Closed Commercial Factoring Precedents (1)

(2015)
Yue Yi
Chang
Zhong Zhi
Yi Zi
No.00056

Because of the default in the third party's debt, the seller was sued and subjected to compulsory execution. When the court judicially froze the seller's accounts receivable that had been assigned to the factor, the factor raised an objection to execution. Though the factor in this case conducted an undisclosed factoring, the court regarded that the notice to the debtor was not the essential element for the validity of the agreement on the creditor's right assignment; and the court also regarded that a failure to perform the obligation to notify would not invalidate the aforesaid agreement. Therefore, the factor had legally obtained the creditor's right. The court thus sentenced to support the factor's objection to execution.

The factor claimed that the buyer should fulfill the accounts payable. The buyer defended that the seller did not actually deliver the goods and that the accounts receivable did not exist. The seller acknowledged the fact of non-delivery of the goods. Nevertheless, from the perspective of the court, both parties, in spite of their recognition of the authenticity of the *XXX Purchase and Sale Contract* and confirmation of the stamps' authenticity in the *Testimonial of Goods' Right Assignment*, *Testimonial of Goods' Receiving Acknowledgement*, and *Confirmation of the Notice on Accounts Receivable Assignment*, the seller and the buyer could neither give any reasonable explanation on the successive stampings, nor provide related evidence to overturn the written evidence above. Therefore, the court believes that the statements from the seller and the buyer were insufficient to overturn the fact that the accounts receivable were real as evidenced in the written form, and hence adjudicates that the buyer should be responsible for the payment.

(2015)
Er Zhong
Bao Min
Chu Zi
No. 29

Commercial Factoring Case Study (2)



- In this case, the factor's individual liquidation was cancelled due to the bankruptcy process of the buyer. The factoring company was forced to participate in the bankruptcy liquidation and faced the risk of not being able to receive full compensation. From this case, it can be seen that it is particularly important for factoring company to promptly and efficiently collect and seize opportunities for risk disposal in the event of a credit risk on the buyer.

(2016)
Su 02
C.FR.
No.37**

- In this case, the factoring company entered into a factoring contract with the seller to establish a factoring legal relationship. On the basis of the factoring financing requested by the seller and the buyer's confirmation of the debt, the factoring firm has successively recovered the corresponding accounts from the buyer. Shortly afterwards, the buyer suffered a serious loss due to business and became insolvent. The buyer went into bankruptcy proceedings and the bankruptcy administrator took over the bankruptcy liquidation work.
- When reviewing the assets, the bankruptcy administrator considers that the buyer's repayment action on the factoring company occurred within six months prior to adjudicating the bankruptcy acceptance and submitted the bankruptcy revocation right to the court, requesting the factoring company to return the payment received.
- The court held that, according to Article 32 of the Bankruptcy Law, "If the debtor has such circumstance stipulated in the first paragraph of Article 2 of this Law as within six months before the people's court accepting an application for bankruptcy, the individual creditor has been paid. The administrator has the right to request the people's court to revoke it. The buyer's repayment to the factoring company within six months before the bankruptcy application is subject to individual repayment. This repayment shall be revoked according to law and the factoring company shall return the repayment to the buyer.

Commercial Factoring Case Study (3)



- **Although this case didn't involve factoring business, it is still significant to discuss some legal issues concerning the receivable accounts as a security object.**

- **In the case of disputes over financial loan contracts among Xuzhou Branch of China Minsheng Banking Co., Ltd., Anhui Coal Transportation and Marketing Co., Ltd. and Jiangsu Surun Energy Group Co., Ltd., Xuzhou Branch of China Minsheng Banking Co., Ltd. the Pledgee, Xuzhou Branch of China Minsheng Banking Co., Ltd., lodged a direct appeal for "Anhui Coal Transportation and Marketing Co., Ltd. to repay 30 million yuan of borrowings and corresponding interest within the scope of pledges receivable from Surun Company."**
- **The judgment of first instance was: "Xuzhou Branch of Minsheng Bank has the right to be given priority to repay from the Anhui Coal Company's receivable accounts of xxx Yuan pledged by Surun Company. Anhui Coal Company performs the above-mentioned payment obligations to Xuzhou Branch of Minsheng Bank within the scope of XX Yuan. Jiangsu High Court upheld the judgment in the second instance.**
- **In this case, the pledgee appealed to the sub-debtor to pay the pledged amount directly to the pledgee, which was supported by courts' first and second instance. This shows that some courts in the judicial practice have recognized that the pledgee can directly appeal to the subordinate debtor for payment.**

(2013)
Xu C. FT
No.27*

Commercial Factoring Case Study (4)



- From this case, it can be seen that in the factoring business based on real trade, bills of exchange as one of the payment methods are more secure in specific situations than transfer (cash) payment methods for factoring firms.

(2015)
C. 2nd F.R
No.13*

- In this case, the seller applied for factoring financing to the factoring company based on the factoring legal relationship established with the factoring company and transferred the buyer's commercial draft for payables after endorsement to the factoring company. After the expiry of the bill of exchange, the buyer refused to redeem the goods due to disputes in the payment and the incorrect writing of the facet elements. Factoring company appealed to the court for payment.
- The court held that the buyer had no objection to the authenticity of the bill of exchange and that the error on the bill of exchange was not a necessary record specified in Article 9 of "Negotiable Instruments Law of the People's Republic of China", so the bill should be a valid bill. At the same time, the court held that instrument is circulating securities and it has the abstraction principle. Except a direct defense between the parties due to the invalid original reasons, the other through the endorsement of the goodwill of the parties to the bill circulation is the right holder of the bill, the rights on the bill can be exercised to the debtor. Its effectiveness in principle is not affected by the effectiveness of the cause relationship. And thus the court judged that the buyer should bear the responsibility of redemption.

Commercial Factoring Case Study (5)



- Factoring company bears the burden of proving the authenticity and validity of debts when it claims payment from the buyer. This case reveals the importance of pledging the original trade documents when factoring the financing business.

- In this case, the factoring company provided corresponding financing to the seller based on the assignment of the seller's receivables, but the buyer did not pay the corresponding payment after the receivables were expired. The factoring company sued the buyer to the court without the support of the court at the first instance. The factoring company filed an appeal.
- The court of second instance held that in the lawsuit, the buyer objected to the authenticity of the creditor's right of the receivables, and held that the seller failed to fulfill the delivery obligation. After the invoice was issued, it was set invalid on its own. The payment terms have not yet been fulfilled. At the same time, the court held that the factor advocating the authenticity of the creditor's rights is the precondition for the buyer to fulfill its obligations, and the "*Product Purchase and Sales Contracts*", "*Outbound Warehouse Receipts*", and "*Material Receipts*" submitted by the factoring company to the court are all copies. There are also doubts that are not consistent with the common sense. The buyer also didn't not recognize this, thus it cannot achieve the degree of demonstrating the true existence of the creditor's right.
- The court of second instance held that the buyer is not responsible for the payment and decided to dismiss the appeal in accordance with the law and uphold the original judgment.

(2016)
Lu 14
C.FR.
No.28* *



3. Analysis on Credit Insurance Precedents



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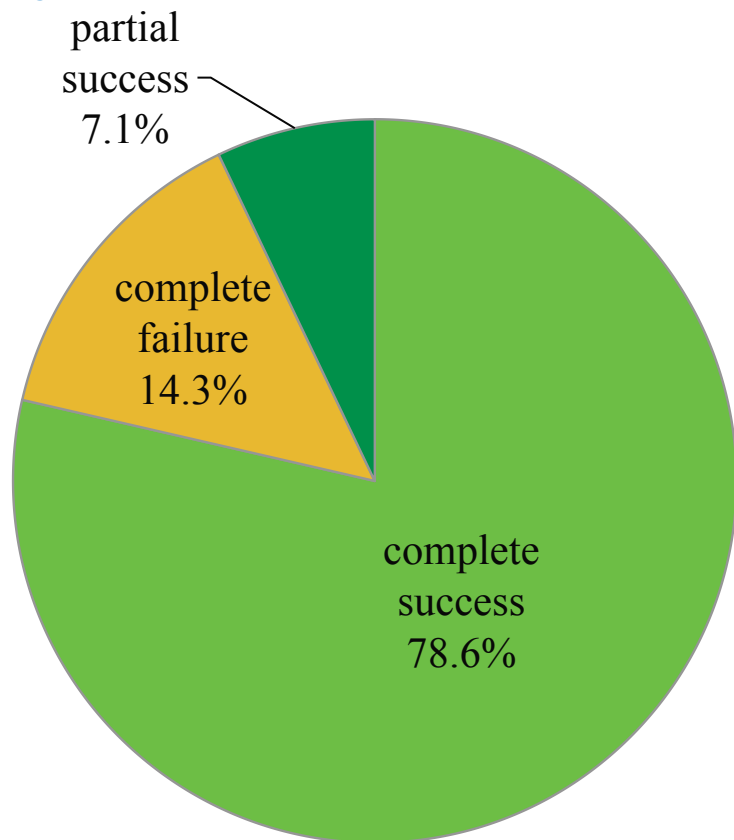
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Data Analysis on Credit Insurance Precedents

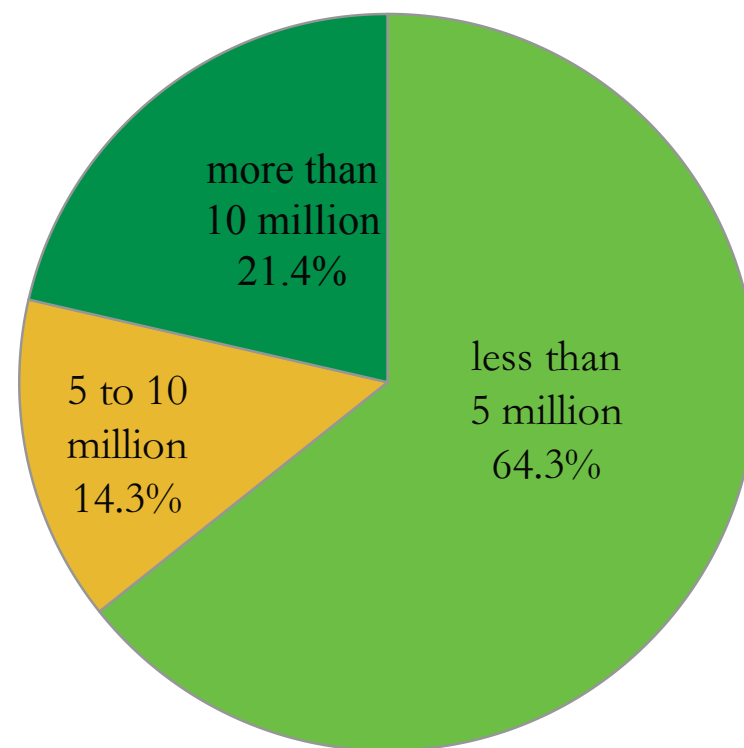


- In the credit insurance precedents, the rate of complete success of the insurant (usually the seller) reaches 78.6%.
- The proportion of cases involving less than RMB 5 million stood at 64.3%.

By success rate of the insurant



By amount (RMB)

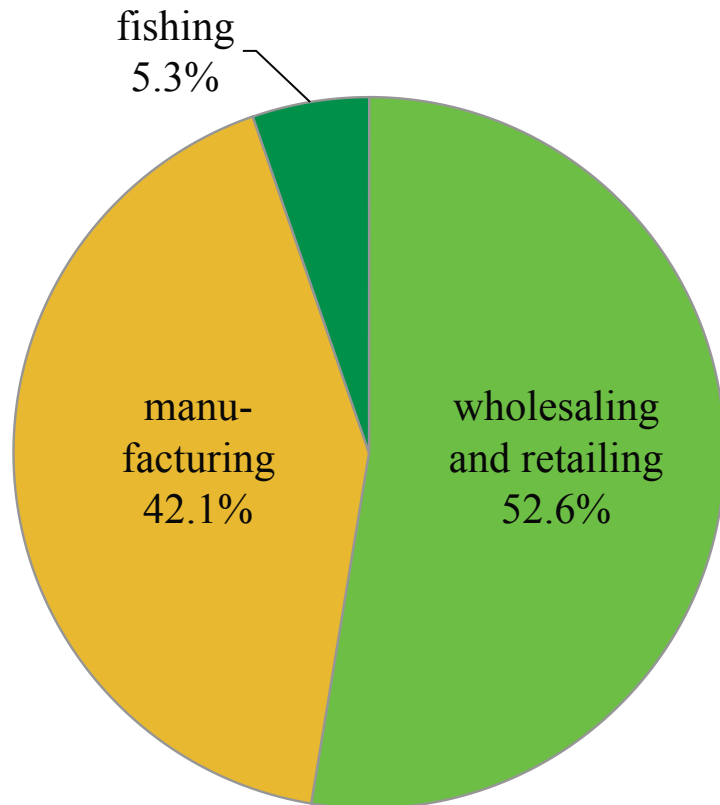


Industrial Analysis on Credit Insurance Precedents

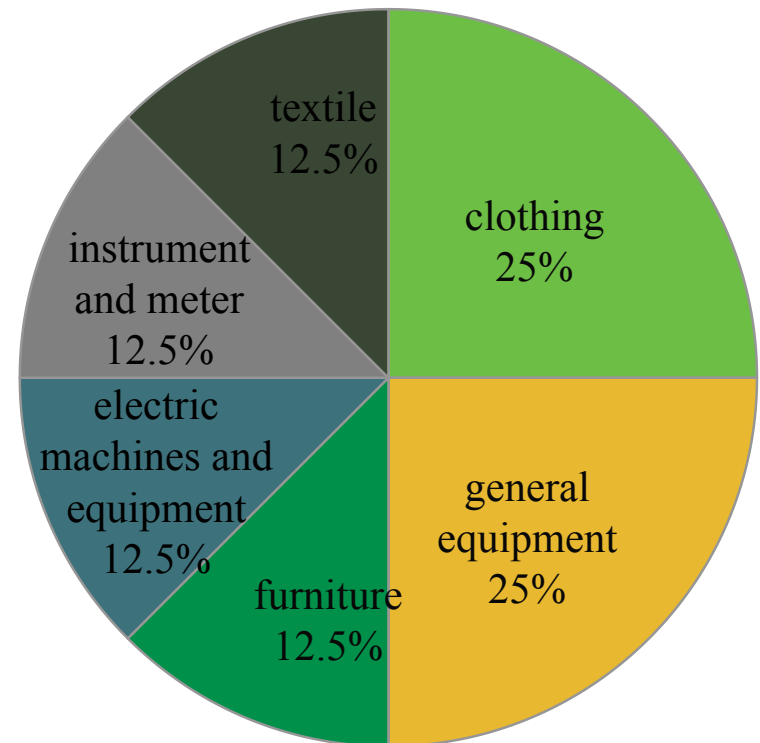


- In terms of the number of cases, credit insurance disputes mainly occur in the manufacturing and wholesale & retail industries with a proportion of 42.1% and 52.6% respectively.
- The clothing and the general equipment manufacturing industries have the largest proportion in the manufacturing industry.

Industrial broad category



specific industries of manufacturing



Should the Debtor Be Sued First in the Settlement of Insurance Claim?



- In credit insurance, when a transactional dispute arises, the general insurance clause requires that the seller (insurant) should first sue the buyer and then claim against the insurer.
- However, in the precedents below, the court believes that unless the insurer can submit sufficient evidence to prove the existence of dispute, the seller (insurant) is entitled to directly claim against to the insurer.

Guangdong

(2015) Yue Gao Fa Min Er Shen Zi No. 546

Fujian

(2015) Rong Min Zhong Zi No. 2053

Guangdong

(2014) Sui Zhong Fa Jin Min Zhong Zi No. 460

Are the Credit Insurance Exemption Clauses Widely Recognized?

Can the insurer claim a liability exemption at the excuse that the seller does not invoice and declare the transaction in time?

Can the insurer claim a liability exemption at the excuse that the seller does not submit the *Letter of Notice on Possible Damages* in time



Can the insurer claim a liability exemption at the excuse that the seller continues to supply goods while the buyer defaults in payment?

Can the insurer claim a liability exemption as the seller does not comply with the contract to claim its right against the guarantor first?

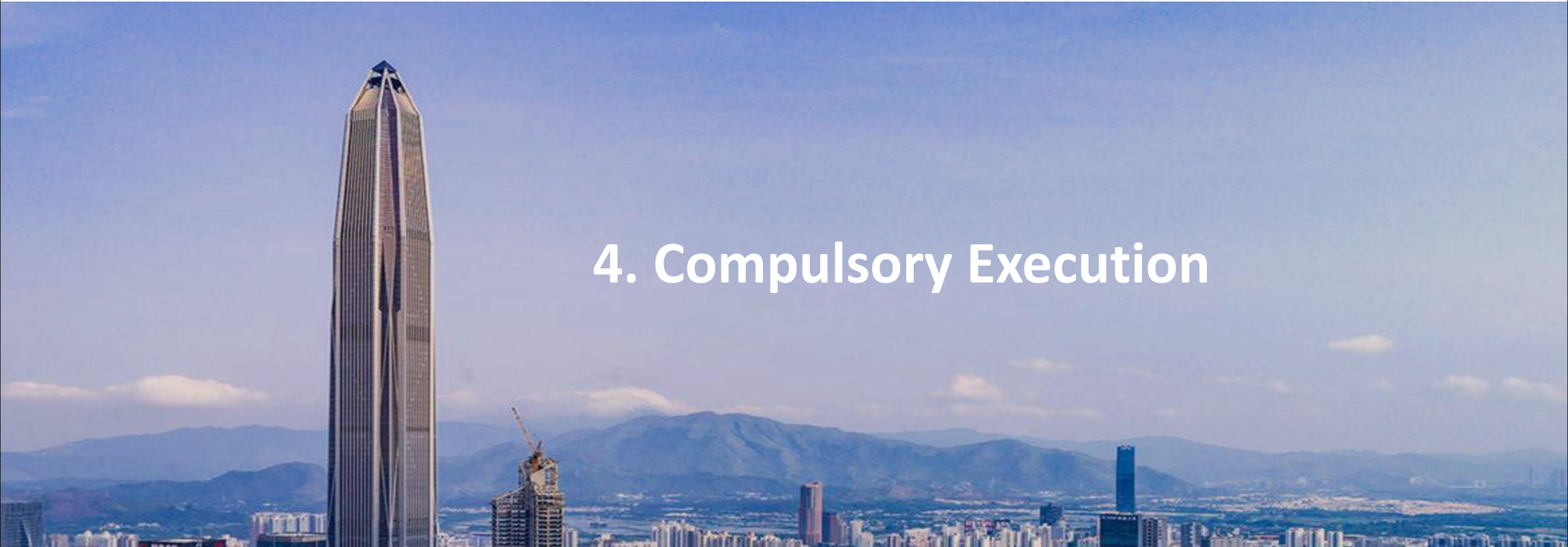
Can the insurer claim a liability exemption as the seller directly initiate the prosecution without first claiming against the insurer?

- The court's denial of the exemptions leads to a pro-insurant environment.
- While the insurer's disclaimer should be based on scientific data models, it should also rationally protect the right to claim of the insurant. In that case, the rationality of the disclaimer need further testing in judicial practices.



**(2015)
Rong Min
Zhong Zi
No. 2053**

- The credit insurance contract has clear definitions on the scope of settlement of claims and the liability exemptions under specific circumstances.
- However, when a dispute occurs, usually both parties, especially the insurant, tend to challenge the exemptions. In this precedent, the court denied all the following exemptions commonly seen in an insurance contract.



4. Compulsory Execution



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Introduction to Compulsory Execution

- Concept: the compulsory execution means that the notary public office notarizes the document evidencing creditor's rights and grants it with the compulsory execution effect. When the creditor's rights are overdue and not repaid in full, based on the compulsory execution notarization issued by the notary public office, the creditor (including mortgagee / pledgee) can directly apply for an execution of the people's court without filing an action.
- Legal basis:

Laws & Regulations

- Article 238, *Civil Procedure Law of the People's Republic of China*
- Article 37, *Notarization Law of the People's Republic of China*

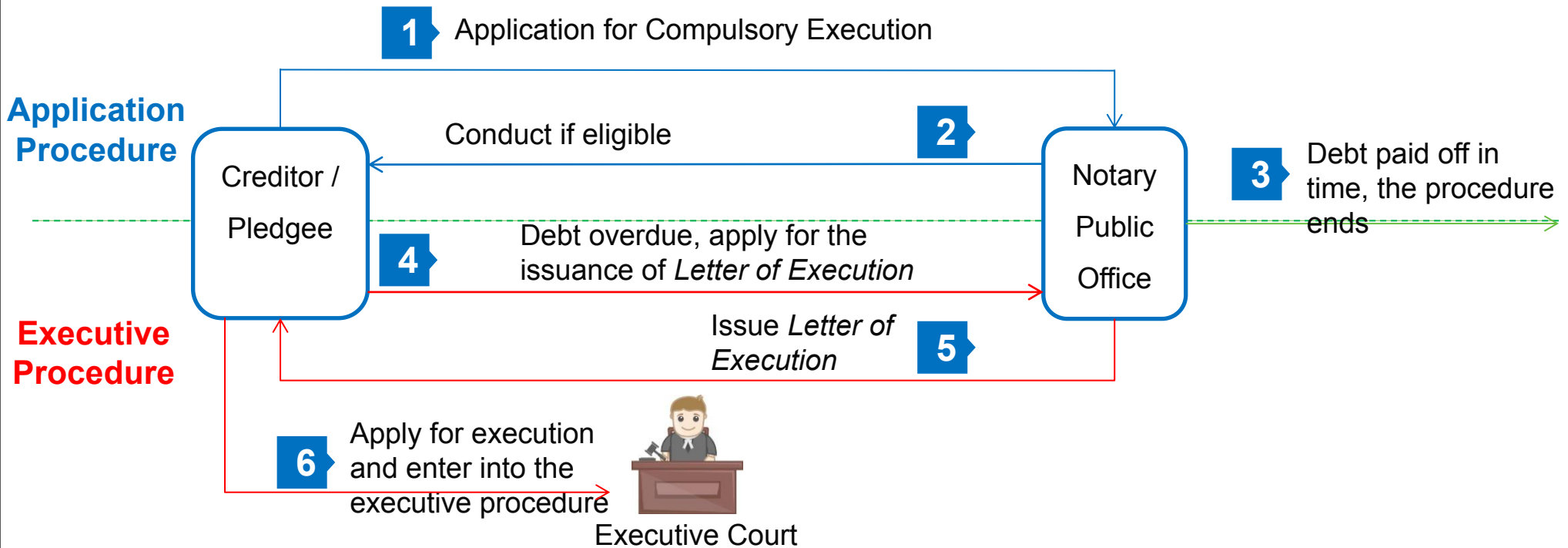
Ministerial Rules

- Article 238, *Joint Notice on Issues of Executing Documents Evidencing Creditor's rights with Compulsory Execution Effect Granted by the Notary Public Office*, the Supreme People's Court and the Ministry of Justice
- Article 39 and Article 55, *Notarial Procedure Rules*

Judicial Interpretation

- *The Supreme People's Court's Rules on Issues of the People's Court's Execution (Trial)* (Judicial Interpretation [1998] No. 15)
- *The Supreme People's Court's Reply on Whether the People's Court Should Accept a Party's Lawsuit on Dispute over the Content of Notarized Document Evidencing Creditor's Rights with Compulsory Execution Effect* (Judicial Interpretation[2008] No. 17)
- *The Supreme People's Court's Reply on the Request of the People's High Court of Shandong Province* 【(2014) Zhi Ta Zi No. 36】
- *The Supreme People's Court's Rules on Issues of the People's Court's Hearing Cases of Objection to Execution and Review on Execution* (December 29, 2014)

Procedure for Conducting Compulsory Execution



- Requirements**
- The document evidencing creditor's rights contains payment of money, goods, and negotiable securities.
 - The credit-debt relationship is clear, and the creditor and the debtor have no doubt about the content of payment in the document evidencing creditor's rights.
 - The document evidencing creditor's rights clearly states the debtor's promise that when he / she does not perform the obligation or performs the obligation incompletely, the debtor is willing to accept the compulsory execution in accordance with the law.
 - The notarization should be applied for to the prescribed notary public office.
 - The materials are complete.

This procedural information is offered by Shenzhen Qianhai Notary Public Office.

Advantages of Factoring with Compulsory Execution



- Compared with common litigation procedures, the compulsory executive procedure can skip the first instance and the second instance trials and directly enter into the final executive procedure.

efficient and convenient

Conducting the compulsory execution notarization means that the debtor gives up his / her right of action and defense. In that case, the compulsory executive procedure can skip the first and the second instance trials and directly enter into the executive procedure, which saves the time cost and makes the claim on the creditor's rights efficient and convenient.

economical at litigation cost

The compulsory executive procedure saves the litigation cost of the first and the second instance trials and thus saves the cost in safeguarding the rights and interests to some extent.

direct preservation of properties

A direct entrance into the executive procedure can directly preserve and execute the debtor's properties. While saving the cost in preserving the properties, the compulsory executive procedure exempts the factor from providing the equivalent guaranty of litigation / pre-litigation preservation as involved in common litigation procedures.

Limitations of Factoring with Compulsory Execution



- As the factoring business is different from the traditional bank loan and private lending, there are also limitations on the factoring business with compulsory execution notarization.

Limitations on the buyer's applicability

- The debtor's consent and cooperation throughout the process is the prerequisite for conducting the compulsory execution notarization.
- Given the contractual relationship directly established by the factor with the seller, the seller is also a borrower. It is not difficult to gain the seller's cooperation in conducting the notarization.
- However, as for the buyer who is not in a direct contractual relationship with the factor and has a comparatively advantageous position, more often than not, it is difficult to persuade the buyer to give up the right of action and cooperate in the notarization.

Effects of the absence of the buyer's applicability

- For the factoring business, the primary repayment source is the buyer's repayment, and the second is the seller's repurchase. It is more important for factoring to ensure the buyer's repayment.
- The limitations on the buyer's applicability will definitely lead to the applicability of the project that relies on the buyer's repayment or that has a weak repurchase capability of the seller.
- The absence of the buyer's applicability leads to the dilemma where the recourse against the buyer can only follow the common litigation procedure. Consequently, the recourses against the buyer and the seller are not in the same judicial stage. The influence of such an imbalance on the factor claiming its right of recourse needs further testing in judicial practices.

Interpretation on Precedents of Compulsory Execution



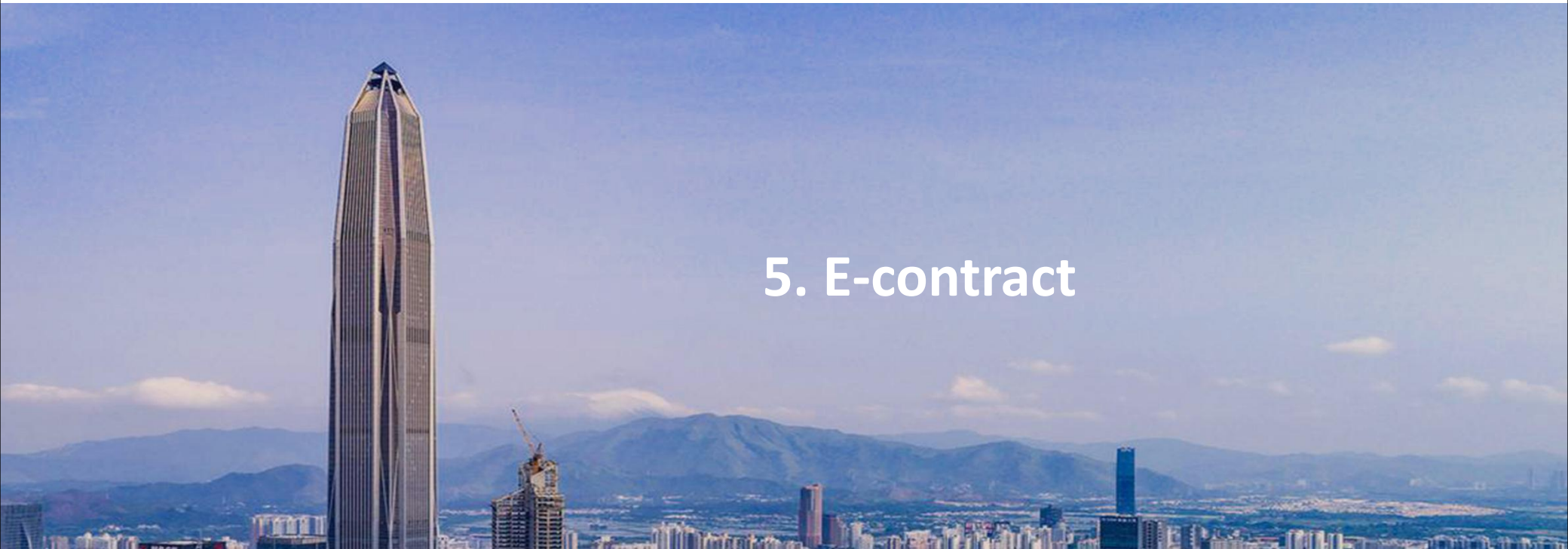
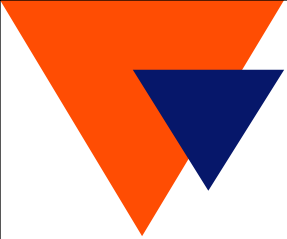
- In the following two precedents, the factor applied for the compulsory execution notarization to the notary public office. As the debtor failed to perform the repayment obligation when the debt was due, the factor requested the notary public office to issue the *Letter of Execution* by which it directly applied for the compulsory execution of the court. In accordance with the law, the court accepted the factor's application.
- Though the debtor in the precedents temporarily had no executable property and the executive procedure was not satisfying, the compulsory execution notarization completed the mission of ensuring that the factor was exempted from litigation and trial procedures and directly entered into the executive stage.

Beijing Precedent

- (2015) Da Zhi Zi No. 2452

Liaoning Precedent

- (2015) Fu Zhi Yi Zi No. 00086



5. E-contract



中国服务贸易协会商业保理专业委员会
Commercial Factoring Expertise Committee of CATIS



广东省商业保理协会
GUANGDONG FACTORS ASSOCIATION



深圳市商业保理协会
SHENZHEN FACTORS ASSOCIATION

前海交易所

专业 让生活更简单



亚洲保理
ASIAFACTOR

Current situations of physical contracts

- High cost



....



Printing + storage + time + labor + logistics +

- Features of the factoring business will require frequent contracting for commercial factors, and physical contract will bring high cost, which is a burden for commercial factoring operators.
- Physical copies maybe lost or destroyed easily, bringing risks to record management



Advantages of e-contract



- E-contract enables on-line and efficient signing of contracts
- E-contract lowers the operation cost for commercial factors, and is the trend for those companies to gain competitiveness with Internet plus.



The efficient and convenient methods lower costs



The contracts are easy to check and manage



It's easy to keep, making records safer



The signing process is simplified, making customers more satisfied



Legal basis

- Legal basis

Electronic Signature Law

- **Article 13** If an electronic signature concurrently meets the following conditions, it shall be deemed as a reliable electronic signature:
 - (1) When the creation data of the electronic signature are used for electronic signature, it exclusively belongs to an electronic signatory;
 - (2) when the signature is entered, its creation data are controlled only by the electronic signatory;
 - (3) ...
- **Article 14:** A reliable electronic signature shall **have equal legal force** with handwritten signature or the seal.

Contract Law

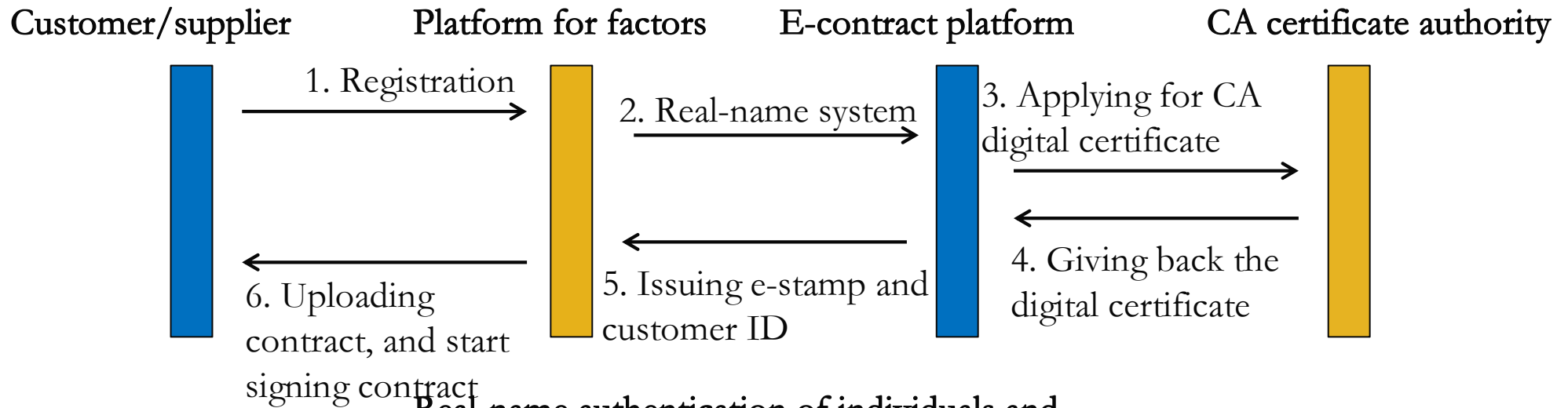
- **Article 10** Forms of Contract; Writing Requirement A contract may be made in a writing, in an oral conversation, as well as in any other form.
- **Article 11** Definition of Writing A writing means a memorandum of contract, letter or **electronic message** (including telegram, telex, facsimile, electronic data exchange and electronic mail), etc. which is capable of expressing its contents in a tangible form.



- *Electronic Signature Law* and *Contract Law* provide legal basis for e-contract to have equal legal force with physical contracts.

Process

- Processes



Real-name authentication of individuals and enterprise, signing contracts on the e-platform

Process

- After the real-name authentication, CA digital certificates are gained through the e-platform and the customer ID and e-stamp will be provided.
- Factors upload contracts to the e-platform, and the contract will be sent to the customer/supplier after it is signed by the factor.
- The customer/supplier signs the contract, which will be saved in a third-party platform.

The data are provided by fadada.com

Legal precedents



- In the two precedents, the courts recognized the legal force of the e-contracts and ruled that the signatory shall perform its obligations under the contract. In the case in Jiangsu Province, the defendant questioned the legal force of the contract, but according to the Verification Report on National Standard E-contract presented by the platform and related laws and regulations, the legal force of the contract was recognized by the court.
- Though the legal precedents of e-contract are few now, according to legal basis like the *Electronic Signature Law*, the legal force will be recognized by the court to a large extent where the **real-name authentication is strictly controlled**, and requirements of “reliable electronic signature” in Article 14 of the *Electronic Signature Law* are met.

Legal precedent in Zhejiang Province

- (2016) Zhe 0102 minchu No. 2027

Legal precedent in Jiangsu Province

- (2015) Gushangchuzi No. 2605