

Australian Securities and Investments Commission

Answers To Questions On Notice

Parliamentary Joint Committee on Corporations and Financial Services

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**Division/Agency:** Australian Securities and Investment Commission

**Question No:** 019

**Committee Member:** Mr Andrew Wallace MP

**Question**

**QoN019-01**

**Please explain how traditional factoring works?**

Response

Factoring is where a business sells its accounts receivables (i.e. invoices) to a third party for a discount.

The steps involved are:

- when a supplier provides goods and/or services to a buyer, the supplier issues an invoice requiring payment. The payment is usually due at a future date (e.g. in 30 days), so the buyer has a debt to the supplier.
- the supplier sells this invoice/debt to the third-party at a discounted price (e.g. receiving 85 cents for each dollar that the buyer owes) in return for immediate cash. The discount is determined in accordance with the credit ratings of the parties involved and other characteristics of the invoice (e.g. length of payment).

The third-party now holds a financial asset which gives it the legal right to collect money from the buyer. The buyer is usually notified of the sale of the receivable, and the third-party collects the funds directly from the buyer at the payment date.

**QoN019-02**

**Please explain how reverse factoring or supply chain financing works?**

Response

Reverse factoring (supply chain financing) is where a buyer of the goods and services establishes a supply chain financing (**SCF**) program with a third party (the SCF provider) and arranges for its suppliers to be able to sell the accounts receivables (i.e. invoices) to the SCF provider for a discount (in return for early payment).

The key difference between 'traditional' factoring and 'reverse' factoring is who initially approaches the finance company – in traditional factoring it is the supplier, in reverse factoring it is the buyer.

The steps involved are:

- the buyer establishes a relationship with a SCF provider and extends invitations to its suppliers to join its reverse factoring program. This program typically has a maximum value of transactions that the buyer can fund at any point in time using the SCF provider.

- when a supplier provides goods and/or services to the buyer, the supplier issues an invoice requiring payment by the buyer. The payment is usually due at a future date (e.g. in 30 days), so the buyer has a debt to the supplier.
- once the buyer approves the invoice, the supplier may request early payment from the buyer's SCF provider at an agreed discounted price to the invoice. The discount is determined in accordance with the buyer's credit rating and other characteristics of the invoice (e.g. length of payment).

The SCF provider now holds a financial asset which entitles it to the legal right to collect money from the buyer.

### QoN019-03

**Why do companies hire reverse factoring supply chain financiers – what does the company gain and what risks does it take?**

#### Response

It is hard for ASIC to generalise about the commercial motivations for a buyer to enter into reverse factoring arrangements, and the benefits and risks they perceive from these arrangements.

However, based on ASIC's understanding, buyers may use reverse factoring SCF providers for one or more of the following reasons:

- managing short-term cash flows by enabling the buyer to pay for goods and services later (i.e. on longer payment terms) – as suppliers can obtain funds earlier via the SCF provider if they wish to – and being able to better align the cash outflows with the receipts from the buyer's own sales;
- depending on the buyer's credit rating and their SCF provider's cost of funds, SCF providers may be able to offer lower interest rates and fees than traditional banks and other funding sources, and
- SCF solutions may have implications for their financial reporting (see QoN019-9 below).

Engaging in reverse factoring exposes the buyer to some risks. As a source of external funding, the main risk relates to the cessation of this source of funding, particularly when the buyer is reliant on the SCF provider to fund its ongoing operations. Like the withdrawal of any other funding source (e.g. bank overdrafts) this can lead to liquidity stress and could ultimately mean the buyer is unable to operate their business.

### QoN019-04

**Please describe all relevant aspects (including factoring, reverse factoring, operating both upstream and downstream of the same customer company, securitisation and insurance) of Greensill's supply chain financing business model.**

#### Response

ASIC does not presently have full information about Greensill's business model. Greensill is a complex business enterprise involving entities in the UK, Germany, Luxembourg, Liechtenstein, US, Australia and in other jurisdictions. Most of the entities identified to date are not ASIC-regulated.

However, we make the following general observations based on information available to us:

1. Greensill obtained initial capital (both debt and equity) to set up the business and provide finance (including via traditional and reverse factoring).
2. Greensill formed relationships with buyers by offering reverse factoring arrangements and suppliers by offering factoring arrangements. In doing so, Greensill purchased receivables (invoices) from business clients around the world. A small proportion of those buyer- and supplier-clients were located in Australia. We understand the company offering this service to Australian clients was located in the UK.
3. Greensill on-sold the invoices it purchased to investors, including through a securitisation process (bundling these assets and packaging them into asset-backed notes). These asset-backed notes were sold to fund managers of collective investment schemes based in Europe, and banks. These asset-backed notes were insured against credit risk through an insurance provider.
4. We understand Greensill provided its services to corporate groups and that some of these corporate groups used Greensill's services to make payments between both upstream and downstream companies within the same company group. Key Australian borrowers from Greensill—including GFG Alliance companies and CIMIC Group—appear to have made payments between upstream and downstream related parties.

#### **QoN019-05**

**What features of Greensill's business model distinguish it from other supply chain financiers?**

#### Response

Without a comprehensive review of the SCF industry more broadly, including undertaking detailed studies of the varying business models, it is hard for ASIC to comment on the distinguishing features of Greensill's business model relative to other SCF providers. However, based on the information available to us, we understand that one distinguishing feature in Greensill's business model was the securitisation mechanism to fund their SCF activities (see answer to QoN019-4 above).

In Australia, Greensill's exposure to buyers also appears to have been quite concentrated, providing finance to a small number of larger clients, include Australian subsidiaries of GFG Alliance. However, due to a lack of data we are unable to comment on whether this is unique to SCF providers that operate reverse factoring solutions.

#### **QoN019-06**

**Would you please summarise ASIC's understanding of what has happened at Greensill and who is affected?**

#### Response

ASIC is currently reviewing the circumstances and facts surrounding the recent collapse of Greensill Capital.

Greensill Capital Pty Limited (the Australian holding company) entered administration on 9 March 2021, while its wholly-owned subsidiary, Greensill Capital (UK) Limited (the UK-based operating business of the group) entered into administration in the UK on 8 March 2021.

ASIC has been, and will continue, working closely with the administrator of the Australian holding company and international regulators. Part of the administration process is to examine what happened at Greensill and who is affected.

We understand that the parties affected by the collapse of the Greensill includes:

- employees of Greensill in Australia and globally
- equity and debt investors in Greensill Capital Pty Ltd
- Australian and global buyers and suppliers of goods and services where the relevant invoices were factored (financed) by Greensill Capital (UK) Ltd
- depositors in the German-based Greensill Bank
- investors in the securities issued by Greensill Capital (UK) Ltd and subsidiaries, including:
  - the Credit Suisse managed funds (domiciled in Luxembourg and Liechtenstein) and the wholesale/qualified/sophisticated investors who invested in these schemes, and
  - the GAM supply chain financing fund (domiciled in Luxembourg)

#### QoN019-07

- a. Which aspects of Greensill's operations are regulated by ASIC?
- b. Which aspects of Greensill's operations are regulated by other regulators?
- c. Which aspects of Greensill's operations are unregulated?
- d. What have ASIC and Treasury done in response to the recommendations made by the Small Business Ombudsman, including recommendation 7 on reviewing whether supply chain financing should be regulated?

#### Response

- a. Greensill Capital Pty Limited (the Australian parent company of the group) and its Australian subsidiaries are subject to the corporate laws of Australia, for example, the laws in relation to the responsibilities and duties of company officeholders, fundraising, financial reporting, and misleading and deceptive conduct. These laws are administered by ASIC.

On 9 March 2021, administrators were appointed to Greensill Capital Pty Limited and its subsidiaries in Australia. The primary business of Greensill Capital Pty Ltd and its subsidiaries as at this date were:

- Greensill Capital Pty Ltd: provided administration and head office support to the group but operated in only a limited capacity. We understand the company did not provide finance to customers nor does it carry loans / receivables in its balance sheet.
  - Greensill Capital Securities (Australia) Pty Limited – this entity was dormant on appointment of the administrators.
  - Greensill Capital Management Company Pty Limited – this entity was also dormant on appointment of administrators.
  - Earnd Pty Ltd – a provider of on-demand pay which allows workers to access their money as it is earned, throughout the month. The entity was sold on 30 March 2021.
- b. Beyond the laws administered by ASIC, Greensill Capital Pty Limited and its Australian subsidiaries would be subject to the usual laws applicable to Australian businesses (for example, consumer, taxation and work health & safety law).
  - c. We understand that Greensill Capital (UK) Limited, which is a wholly-owned subsidiary of Greensill Capital Pty Ltd, is the primary operating business of the group and has been responsible for the SCF arrangements and securitisation arrangements of the group. This company was the primary operating company and lender to the Australian and global clients in the SCF arrangements. This company is not licensed in Australia. (Some parts of its operations are regulated in the UK.)

We understand that there are a number of other foreign subsidiaries of Greensill Capital Pty Limited domiciled in the UK, Germany, Isle of Man, the US, Singapore, Malta and the Cayman Islands.

- d. This is primarily a matter for Government. Mr Warren Day, Chief Operating Officer, had a discussion with Treasury about the draft recommendations in 2020, however, no further ASIC activity arose from this verbal conversation. ASIC is unable to comment on Treasury's response to the recommendation.

#### QoN019-08

**What types of investigations or enquires is ASIC making about Greensill and its key business relationships and which laws is ASIC focussing on?**

#### Response

At present ASIC's work is focussed on understanding the events leading to the collapse of Greensill and the impact of the collapse on the Australian market, and on identifying any areas of concern where a regulatory response may be required. A number of ASIC teams are involved in this work, examining potential conflicts of interests and accounting and audit related issues, as well as the role played by third-party entities in relation to the Greensill business. ASIC is also monitoring the Australian administration process.

ASIC has also had discussion with regulators in other jurisdictions concerning Greensill regarding action that may be contemplated by them.

ASIC focuses on the [laws it administers](#), which include the *Corporations Act 2001* (Cth) and the *Australian Securities and Investments Commission Act 2001* (Cth).

#### QoN019-09

- a. **Would you please explain how supply chain financing such as Greensills is treated by the accounting and auditing standards, including in relation to debt and leverage reporting?**
- b. **Are accounting and auditing standards bodies undertaking any consideration or revising of standards in relation to supply chain financing?**
- c. **Are there any differences between how securitised and non-securitised supply chain financing are treated by accounting and auditing standards?**

#### Response

- a. Treatment of supply chain financing by accounting and auditing standards

##### *Roles of ASIC and the standard setters*

ASIC regulates compliance with the financial reporting and audit provisions of the *Corporations Act 2001* (the Act), including the accounting and auditing standards. ASIC's activities include proactive risk-based reviews of about 300 financial reports of mainly listed entities each year and reviews of other financial reports based on complaints and other intelligence. ASIC may make inquiries of entities about their reporting, seek changes in reporting and market disclosure, and may take appropriate enforcement actions.

The accounting standards and auditing standards are made by separate Government bodies, being the Australian Accounting Standards Board (AASB) and the Auditing and Assurance Standards Board (AUASB).

Accounting standards are made by the AASB and are consistent with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB). The IASB is overseen by the IFRS Foundation, which also oversees the IFRS

Interpretations Committee (the Committee). While the accounting standards do not specifically detail the treatment of SCF arrangements, the general principles and requirements of the standards apply. The Committee also issued an 'Agenda decision' on the subject and this is discussed further below.

The auditing standards do not deal with the accounting treatment for SCF arrangements. There are no specific provisions in the auditing standards concerning supply chain financing but the general principles and requirements of the standards apply.

#### *Treatment of supply chain financing*

At its meeting in December 2020, the Committee finalised an 'Agenda Decision' on the accounting treatment for SCF by buyers. While the Committee decided not to develop a formal Interpretation, the 'Agenda Decision' provides some useful guidance on applying the accounting standards without being definitive on all aspects. Unlike an Interpretation, an 'Agenda Decision' does not amend the accounting standards. The full 'Agenda Decision' can be found at <https://www.ifrs.org/news-and-events/updates/ifric-updates/december-2020/#5>. The following questions have arisen concerning the treatment for a SCF arrangement in a company's financial report:

- (i) Should the buyer's liability to the SCF provider be reflected as part of 'trade and other payables', 'other financial liabilities' or as 'debt'?
- (ii) Should the buyer's cash flow statement show payments to the SCF provider as operating cash outflows or financing cash outflows?
- (iii) Should there be disclosures about liquidity risk if SCF arrangements discontinue?
- (iv) Should there be disclosures about the nature of a SCF arrangement?

The 'Agenda Decision' and approach to these questions are discussed below.

#### *Classification of the liability*

The 'Agenda Decision' concludes that a buyer should present the liability as a part of 'trade and other payables' when those liabilities have a similar nature and function to trade payables—for example, when those liabilities are part of the working capital used in the entity's normal operating cycle.

The buyer should separately disclose the amount relating to SCF when the size, nature or timing of those liabilities makes separate presentation relevant to an understanding of the entity's financial position. Factors to consider might include:

- (i) Whether additional security is provided that would not otherwise be provided; and
- (ii) The extent to which the terms of liabilities differ from the terms of trade payables that are not part of the arrangement.

#### *Statement of Cash Flows*

The 'Agenda Decision' notes that a company's classification of the liabilities may help in determining the classification of the related cash flows. If the buyer treats the liability as a 'trade or other payable' the cash outflows to settle the liability should be treated as operating cash flows. If the company treats the liability as borrowings, the cash outflows should be treated as financing activities cash flows.

Accounting standards require a company to provide 'disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes'. Such disclosure is required for SCF liabilities if the cash flows were, or future cash flows will be, classified as cash flows from financing activities.

Separate disclosure is required of any non-cash transactions in the notes to the financial statements with all relevant information about the financing activity.

### *Liquidity risk disclosures*

Accounting standards require companies to make disclosures in the notes to the financial statements about the nature and extent of risks arising from financial instruments to which the entity is exposed, including liquidity risk. The 'Agenda Decision' notes that liquidity risks related to SCF might include:

- (i) The buyer having concentrated a portion of its liabilities with one financier rather than a diverse group of suppliers. The buyer may also obtain other sources of funding from the SCF provider. If the entity were to encounter any difficulty in meeting its obligations, such a concentration would increase the risk that the company might have to pay a significant amount, at one time, to one counterparty; and
- (ii) The buyer may have become reliant on extended payment terms or suppliers may have become accustomed to, or reliant on, earlier payment under the arrangement. If the financing became unavailable, the buyer's ability to settle liabilities when they are due may be affected, particularly if the buyer were already in financial distress.

Accounting standards require disclosure of: how exposures to risks from financial instruments, including liquidity risk, arise; the entity's objectives, policies and processes for managing the risk; summary quantitative data about the entity's exposure to liquidity risk at the end of the reporting period (including further information if this data is unrepresentative of the company's exposure to liquidity risk during the period); and concentrations of risk.

### *Other disclosures*

The 'Agenda Decision' noted that a company is required by accounting standards to:

- (i) Disclose judgements on significant accounting treatments that have the most significant effect on the amounts recognised in the financial statements.
- (ii) Provide information about the arrangements in its financial report where relevant to an understanding of any of the financial statements.

### b. Revisions of accounting and auditing standards

The 'Agenda Decision' indicated that the IASB will consider at a future Board meeting whether to undertake any standard-setting in this area. Although the IASB has not publicly specified the Board meeting, the matter is likely to be discussed at a meeting before the end of 2021.

We are not aware of any indication that the international or domestic auditing standard setters will amend the auditing standards to specifically deal with audit procedures for SCF or provide guidance for auditors.

### c. Securitised and non-securitised supply chain financing

Non-securitised financial assets and any related funding liabilities remain on the statement of financial position of a company. All related cash flows, income and expenses are also recognised by the company.

Securitisation arrangements generally involve a company placing financial assets into a vehicle which is financed by third parties. The financing may also come in whole or part from the company.

The following requirements of accounting standards are relevant to the treatment of arrangements for the securitisation of financial assets:

- (i) A company continues to recognise a financial asset unless:
  - A. It transfers the contractual rights to receive the cash flows of the financial asset and either:

- I It transfers substantially all the risks and rewards of ownership of the financial asset, in which case it recognises separately as assets or liabilities any rights and obligations created or retained;
- II It neither transfers nor retains substantially all the risks and rewards of ownership of the financial asset, and:
  - It has not retained control, in which case it recognises separately as assets or liabilities any rights and obligations created or retained; or
  - It has retained control, in which case it continues to recognise the financial asset to the extent of its continuing involvement in the financial asset; or
- B. It retains the contractual rights to receive the cash flows of the financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients in the arrangement and:
  - I The company has no obligation to pay amounts to the eventual recipients unless it collects equivalent amounts from the original asset;
  - II The company is prohibited by the transfer contract from selling or pledging the original asset other than as security to the eventual recipients for the obligation to pay them cash flows; and
  - III The company has an obligation to remit any cash flows it collects on behalf of the eventual recipients without material delay and without reinvesting monies in the meantime unless any interest earned is passed to the eventual recipients.
- (ii) Even if the financial asset is derecognised or never recognised, the company must consolidate the securitisation vehicle where the company has:
  - A. Power over the vehicle, being existing rights that give the company the current ability to direct activities of the vehicle that significantly affect the company's returns;
  - B. Exposure, or rights, to variable returns from its involvement with the vehicle; and
  - C. The ability to use its power over the vehicle to affect the amount of the vehicle's returns.

The consolidated financial statements of the company would include the assets, liabilities, revenues and expenses of the vehicle on a line-by-line basis, after eliminating the effect of transactions between the entities.

In applying these requirements, it is necessary to consider all of the relevant facts and circumstances of any particular case.

The auditing standards do not deal with the accounting treatment for securitisation arrangements. There are no specific provisions in the auditing standards concerning securitisation arrangements but the general principles and requirements of the standards apply.

#### **QoN019-10**

**How does Australia's corporations and financial services regulation of supply chain financing compare to other relevant jurisdictions?**

#### Response

Australian companies providing SCF are subject to the ordinary corporations laws, including the requirement to keep financial records and financial reporting obligations



(depending on the size of the company), and the duties owed by company officeholders. However, as providing SCF in Australia does not require an AFS licence<sup>1</sup>, and is not a credit activity requiring an Australian credit licence, the financial services and consumer credit regulations will generally not be applicable.

It is difficult to provide a comprehensive comparison with the applicable laws and regulations in overseas jurisdictions. However, based on available public information, we understand there is no specific regulatory regime for SCF in jurisdictions such as the UK, US and New Zealand, with limited if any licensing requirements. In Singapore, some operators of factoring platforms may require a capital markets services licence under the Securities and Future Act (CAP.289)<sup>2</sup>.

Funding of the SCF, both in Australia and other relevant jurisdictions, will be regulated under the applicable laws for the relevant type of funding, e.g. credit, securities, securitisation, collective investment vehicle and/or banking laws.

#### QoN019-11

How common are operations like Greensill in Australia and overseas:

- a. In general
- b. In relation to the securitisation and insurance of supply chain finance?
- c. Operating both upstream and downstream of the same customer company?

#### Response

In response to this question, ASIC notes that it does not have specific data, nor does it have power to collect specific data, nor know of any specific data sources regarding the number, or scale, of operators like Greensill in Australia and overseas. Consequently ASIC is unable to comment on how common operations like Greensill in Australia and overseas are in any substantive manner.

Companies often use various financing avenues to manage their cash flows. They can use: cash on hand buffers, overdrafts, credit cards, working capital facilities (e.g. revolving credit), trade credit finance, term debt and issuing debt securities (including invoice securitisation conducted by the companies), or using the services of a SCF provider.

- a. According to the Australian Small Business and Family Enterprise Ombudsman, we are aware a total of 9 SCF providers (including Greensill) were consulted in conducting their Review in relation to SCF in Australia in 2020. In addition, it is ASIC's understanding that more broadly the market for business operations funding

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<sup>1</sup> ASIC provides relief in ASIC Corporations (Factoring Arrangements) Instrument 2017/794 from licensing, disclosure and hawking obligations in relation to factoring arrangements that may technically be derivatives under the Corporations Act, on the basis that we consider these obligations were not intended to apply to factoring arrangements.

<sup>2</sup> <https://www.mas.gov.sg/-/media/MAS/Regulations-and-Financial-Stability/Regulations-Guidance-and-Licensing/Securities-Futures-and-Fund-Management/Regulations-Guidance-and-Licensing/FAQs/FAQs-on-SFLCBR-29-September-17.pdf?la=en&hash=F6045B5213D5C40BCB9B1480013D308F704F1104>

through types of debt instruments is dominated by bank lenders (based on our analysis of ABS data of the liabilities of non-financial corporations<sup>3</sup>).

Globally, we note that in 2019, McKinsey reported that factoring models ('buyer-led solutions') were roughly only 7% of the total estimated transactions facilitated by trade finance solutions globally (around US\$7.3 trillion in turnover in the year).<sup>4</sup>

- b. We do not have the data and are not presently aware of other non-bank SCF providers in Australia that fund their operations through securitisation.

We do not have data regarding the extent to which insurance is used by other non-bank providers of SCF to insure their exposures.

- c. We are aware that some corporate groups that utilised the services of Greensill used the SCF for payments between both upstream and downstream entities within the same customer company. However, we do not have data or information regarding the extent to which any other non-bank supply chain financiers in Australia also allow this practice.

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<sup>3</sup> See ABS Australian National Accounts: Finance and Wealth (December 2020, released March 2021): <https://www.abs.gov.au/statistics/economy/national-accounts/australian-national-accounts-finance-and-wealth/latest-release>.

<sup>4</sup>

<https://www.mckinsey.com/~media/mckinsey/industries/financial%20services/our%20insights/accelerating%20winds%20of%20change%20in%20global%20payments/chapter-3-supply-chain-finance-a-case-of-convergent-evolution.pdf>