The Commercial Factor

Newsletter for the Factoring Industry

Volume 5 • Number 1 • Spring 2003

International Factoring Association

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News from the IFA

The International Factoring Association website has been updated to include a shopping cart feature. Now members and non-members can purchase items online from the IFA. IFA sponsored educational events such as the annual conference and teleconference calls will be available, along with memberships and subscriptions to the association. Also in the store will be FactorHelp manuals and handbooks. Factoring A/R Audit Forms, Factoring Employee Handbooks, a Factoring Accounting Manual, a Factoring Plan Business Template, and a Factoring Operations Manual are all available on the IFA website from FactorHelp. Another item available in the store is The Law of Secured Transactions Under the Uniform Commercial Code by Barkley Clark. This is *the* authoritative treatise on UCC Article 9— and more than that, it provides practical guidance and strategies. Two of its sections dealing with Financing Executory Contracts have special importance for factors: "Freedom of Assignment" and "Account Debtor's Risk of Double Liability." Now IFA members can purchase these two sections of The Law of Secured Transactions for a special price by visiting the Store section of the IFA web site. Also available will be downloads of articles, forms and lectures. To purchase items from the IFA store, visit the website at www.factoring.org and click on Store.

As a reminder, the IFA will now be charging $200.00 per year per company for membership. Services that the IFA will continue to offer to paid members include the following:

FactorSearch - This popular service is designed to let businesses that are seeking a factoring firm to e-mail specifics regarding their business to IFA members. Only those factors that meet the search criteria will be notified. We have been averaging more than one quality lead per day through this service with quite a few deals being booked each month. The FactorSearch feature is listed on several of the major search engines under Factoring, and was recently featured in INC Magazine. FactorSearch can be accessed by Members through the IFA website.

Yahoo Discussion Group - This group allows IFA members throughout the world to communicate in an open forum. The group is open exclusively to IFA members. Members can post messages and receive responses which are e-mailed out to all group members. This has become one of the most interesting offers of the IFA, with various factor related topics being discussed each week.

IFA Web Site – www.factoring.org

IFA members have exclusive access to all areas of the IFA website.

In the **Forum section**, you can share information about several different topics with other IFA members.

· **Operational Issues** allows you to share operational ideas or post questions to other factors.

· **Credit** is designed to allow your credit manager to post or gather credit information on businesses.

· **Looking for Participants** is where you'll find Factors looking for participants on deals.

· **Looking to Buy/Sell Portfolios** lists Factors who would like to buy or sell portfolios.

The **Membership Directory** lists all IFA members and includes their company information, specialties, and links to their web sites. The database is searchable by Category, State/Province, Country, and Keyword and will allow you to search for Factors in a specific industry or area of the country.

The **Vendor Directory** lists vendors of interest to the Factoring industry, including attorneys, UCC search firms, funding sources, and many more. The Vendor area is also searchable by Category, State/Province, Country and Keyword. In addition to providing a list of qualified Vendors, you will also see **IFA Endorsed Vendors** who will offer discounts or preferred services to IFA members.

Factoring Conference - The IFA in conjunction with Distinctive Solutions hosts an annual Factoring Conference in the

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spring of each year. This is the largest conference dedicated solely to companies that offer financing through factoring. The two-day conference features an impressive array of speakers of interest to the factoring industry. IFA members will receive a conference discount for each member of their firm who attends the conference.

Conference Calls - The IFA offers educational conference calls, hosted by attorneys or companies offering services to Factors. Conference calls are held approximately 8-10 times per year. Members will receive a discount on all conference calls.

IFA Logo - Use of the IFA logo is available to Members to use on their advertisements or websites. This logo will provide credibility to your organization and lets potential clients know that you adhere to the IFA Code of Ethics.

The Commercial Factor - All IFA Members will receive our quarterly newsletter, The Commercial Factor, via e-mail. This newsletter publishes articles of interest to the Factoring industry written by attorneys and other vendors.

In order to join the IFA, you can visit our website at www.factoring.org and click on the store or call 800-563-1895 and we will fax an application to you. If your company chooses not to join the IFA, you will no longer have access to exclusive IFA features.

Any questions or comments regarding this change can be directed to the IFA at info@factoring.org. We look forward to a successful future in the IFA.

www.FactorHelp.com

At last, a comprehensive operations manual for factors!

FactorHelp's Operations Manual is the only manual that gives you step-by-step details on how to operate your factoring business – from underwriting new business to portfolio monitoring to workouts – and everything in between. It's the first factoring operations manual that uses the best practices developed by industry practitioners.

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The Commercial Factor

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The International Factoring Association's (IFA) goal is to assist the Factoring community by providing information, training, purchasing power and a resource for Factors. The IFA provides a way for Commercial Factors to get together and discuss a variety of issues and concerns to the industry. Membership is open to all banks and finance companies that perform financing through the purchase of invoices or other types of accounts receivable.

The Commercial Factor invites the submission of articles of interest to the Factoring Industry. For more information on submitting articles or advertisements, please e-mail info@factoring.org, or call 800-563-1895.

To receive this newsletter via e-mail, please send e-mail to info@factoring.org and type the words "subscribe IFA" in the subject line.

To stop receiving this newsletter via e-mail, send an e-mail to info@factoring.org and type the words "unsubscribe IFA" in the subject line.

Risk-Based Portfolio Pricing

by Sung Park

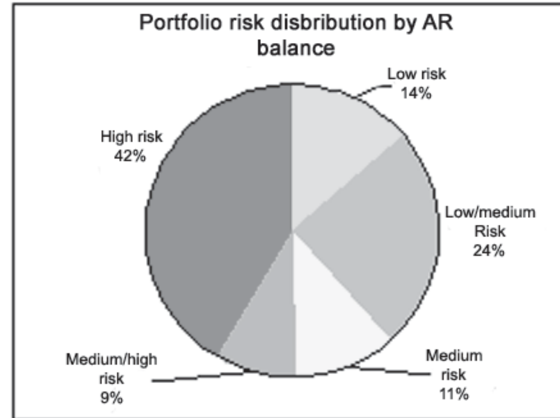
Factors are continuously challenged with accurately identifying the risk, or likelihood of payment, of the businesses within the accounts receivable portfolio. When assessing a business's risk and estimating the likelihood o payment on an outstanding balance, factors must understand the business's history and payment behavior with the creditor. However, assessing only this "internal" behavior with the creditor does not provide a complete picture of the business's payment risk. Developing an overall understanding of the risk picture requires an understanding of the relationships the business has with other external entities. For example, how many other credit relationships does the business have? What is the overall balance outstanding, and what proportion is delinquent? Does the business have judgments, liens, or UCC filings? How much is owed? Has the business filed for bankruptcy? This "external" information is also key to accurately assessing the complete risk picture of the business.

Credit bureaus such as Experian and D&B provide the detailed reports on a business that are necessary to making informed assessments. While utilizing these reports may be an effective means of conducting due diligence on a business-by-business basis, it may not be a cost-effective and efficient means of analyzing the risk of an entire portfolio of accounts. It's just not practical to pull hundreds, or thousands, of business reports. For effective portfolio risk analysis, credit bureaus also offer batch processing of the entire portfolio. The batch process involves sending a file of businesses to a credit bureau, which then processes the file in batch and appends public record, demographic and credit information on each business in the file that matched against the bureau's business database. Experian also returns a risk score for each business. The risk score predicts the likelihood of a business becoming 90 days' delinquent within a six-month window by analyzing key data elements correlated with business risk. The risk score summarizes all the risk factors into a manageable number. Consequently, applying this risk score is relevant to what factors must consider when pricing and purchasing a portfolio.

Data elements returned by Experian include:

- derogatory legal items
- legal balance
- credit relationships payment behavior
- SIC codes
- risk score

Batch scoring the entire portfolio allows for factors to quickly and easily identify the overall risk of the portfolio, as well as how the risk is distributed. The graph illustrates how the proportion of the total accounts receivable (AR) balance falls into the different risk segments. In this case, the risk segments are defined by risk-score ranges. Risk distribution also can be graphed based on distribution of AR balance into different aging categories, such as current, one to 30 days delinquent, 31 to 60 days delinquent, 61 to 90 days delinquent and more than 91 days delinquent. Besides the risk score, portfolio scoring provides other ways to determine the true risk of the businesses in the portfolio. Looking only at the internal AR payment information, those businesses that are paying their balance on time may be viewed as low risk, which may or may not actually be the case. After batch scoring the portfolio, you easily can compare internal payment behavior with the business's payment behavior with other creditors. If the business is paying on time for all creditors, then the business can be considered truly low risk. If the business is paying on time internally but is severely delinquent with four of its other creditors, this business will no longer be considered low risk. In fact, it may be considered a potential high-risk business. Conversely, a business that is internally very delinquent may be a more tolerant risk if that business is paying other creditors on time because the business would be easier to collect from than those businesses that are paying all creditors very late.



Considering these elements, it is advisable for factors to score an accounts receivable portfolio prior to purchase to gain a better understanding of the overall risk. As scoring the portfolio may be mutually beneficial to both the factor and the seller, ideally, the cost would be shared.

Sung Park is an Experian Marketing Manager/Consultant.

Upcoming Teleconference Calls

John Beckstead, Esq.
from Snell & Wilmer, L.L.P.

Guarantees, Validity Indemnifications, and Conditional Guarantees

May 15, 2003 at 1:00pm PDT
$50.00
($40.00 for IFA members)

Mike Ullman, Esq.
from Ullman, Ullman & Vazquez, P.A.

Did you know that an Article 9 holder in due course issues can jeopardize a prior secured creditor's Article 9 priority in the accounts proceeds? We will be discussing what you can do about it.

June 12, 2003 at 1:00pm PDT
$50.00
($40.00 for IFA members)

Martin Fingerhut, Esq.
from Blake, Cassels & Graydon, LLP, P.A.

Cross-Border Factoring - Tips and Traps in Dealing With Canadian Receivables

July 17, 2003 at 1:00pm PDT
$50.00
($40.00 for IFA members)

Register on-line at www.factoring.org

Factoring News Flashes

Allstate Financial Inc. was forced into involuntary bankruptcy in April 2002, several months after it stopped paying interest to investors. The investors bought nine-month promissory notes from the company after being assured their investments were insured and secured. The more than $13 million in investments were to be used to buy factoring contracts. Investors are now holding out hope for getting some of their money back now that the FBI and two state agencies are investigating the company.

The Commercial Appeal (Memphis, TN), March 2, 2003

Commerce Alliance, Inc., a corporation involved in providing certain supplies to federal government agencies, entered into a purchase and sale agreement with **Four Seasons Funding Corp.** in order to fund its advance payments to third-party suppliers. Commerce claimed that since the factoring agreement imposed a 3% discount fee for every 15 days of delayed payment, it was actually a usurious loan. An Arkansas court disagreed noting that the seller retained control over billing procedures that caused it to incur the fees.

Commercial Lending Litigation News, March 7, 2003

Neither claims of an undeclared workout agreement nor attempts to impose a heightened duty of good faith on its lender allowed a debtor to shift liability for its loan default. In reversing an $11.2 million judgment in favor of the debtor, a California court repeatedly emphasized that non-traditional or high-risk lenders are not subject to a higher duty of care unless they actively participate in a borrower's enterprise. **Summit Industries of Nevada Inc.** obtained financing from factoring company **Pine Cobble** and assigned its accounts receivable to the lender. When **Pine Cobble** asked **Summit** to repay its entire obligation, **Summit** sought a loan from the **Los Angeles Community Development Bank.** The bank provided loans to borrowers that were unable to obtain funding from traditional private lenders and that located and created jobs in an impoverished area of South Central Los Angeles known as the "empowerment zone.'

Commercial Lending Litigation News, March 7, 2003

Mountain West Bank NA failed to respond to allegations that it breached a subordination agreement or prove it complied with Montana's version of Article 9. The bank made several loans to **Mine & Mill Hydraulics Inc.** in exchange for a security interest in the borrower's accounts receivable. Through a factoring agreement, **All Points Business Financing Inc.** also obtained a security interest in their receivables. The bank signed a subordination agreement with **All Points** in which it agreed to subordinate up to $700,000. The bank loaned **Mine & Mill** $75,000 two years later. **Mine & Mill** assigned the bank its contract with **Consolidated Rail Corp.** and also sold several of **Conrail's** accounts receivable to **All Points** as collateral for a loan. Montana's Supreme Court concluded the bank was liable for at least $108,000.

Lender Liability News, March 20, 2003

If you have any news items you would like to include in the next issue of The Commercial Factor, please e-mail them to info@factoring.org.

Non-Factored Invoices and Other Haircuts

by Carlos Weil

Non-Factored Invoices ("NFI") are a big lure to the inexperienced factors. *"Free Funds"*…goes the rumor…*"you can play with the funds for a few days (weeks)…they are just part of your float"*…I heard when I started off in the trade.

With my eyebrows raised, I wondered…*"can it really be so sweet?"* Is it possible that this is really *"free money we can play with?"*

Lets get our terminology straight. Quite simply, a NFI (or its product after it is cashed, Non-Factored Funds "NFF") occurs when a Notified Account Debtor sends you payment for an invoice that you have not advanced on. These funds are a liability from you to the Client.

Now, my Horror Story #1: Not too long ago, we received funds from one of the Account Debtors of our Client (let's call them Tennessee). After confirming those funds cleared our bank, we forwarded those funds to Tennessee. A few days later, we get a phone call from Tennessee complaining that the funds were a short pay. We referred them to the Account Debtor (let's call them Home Improvement). Home Improvement told them that what they paid is all they were going to pay on those invoices and they should ask us for the shortfall. Tennessee was obviously quite upset when they called us (not sure whether we had kept some funds…which we hadn't).

It turns out that more than a year before all these events and unbeknownst to Tennessee, Home Improvement was an Account Debtor of another one of our Clients (let's call them Florida). Upon closing down the account of Florida (which had negative reserves), we had used NFF to help cover that shortfall. At the time, we were thrilled that we were able to walk away with all our hair (i.e. no haircut). What we didn't know, is that Home Improvement had paid Florida (through us) by mistake and could not recover their funds from them. Since in Home Improvement's computer we were the 'vendor of record', they had a note there saying that if we ever did business with them, they should debit our account for the amount of the bad payments…which is what they were doing.

Upon checking with our counsel, we concluded that even though Home Improvement probably had no right to short payment of invoices from another Client, it would be a battle too difficult to warrant the effort. So we finally took the very unexpected haircut that we deserved.

Lesson: when closing out an account, using NFF to charge back invoices is a HUGE mistake. The only one you are helping is the guarantor (to your detriment!) by getting him off the hook faster. Hold the funds until the dust settles if you wish, but do not use them to close out invoices (note that verifying with the Account Debtor is not risk free…in our case above, it took Home Improvement's Audit department a full year to alert them there was a mistake).

Do you want more? Horror Story #2…A year after we were (amicably) taken out by another lender, we are still receiving payments from some of his Account Debtors (in spite of having sent numerous de-notification letters). What would you do…what is your policy right now? The incoming lender had us remit all payments to them…so we would be liable if there were any change to those procedures. Notwithstanding, if the payment was made by mistake (wrong amount for example), the Account Debtor could sue us and prevail. Easy Solution: When being taken over by an incoming lender and asked to forward payments, get a indemnification clause from them.

The big challenge with NFI in close out situations is that the lender has very little – if any – room to charge back those invoices if there are any problems. Conversely, if the relationship with your Client is ongoing and as long as you have good diversification and turn, a limited amount of NFI might not constitute a high risk and yet give you the advantage of a small float.

Conclusion: Our experience is that NFFs are more of a risk than they are "free money". If the relationship is ongoing, we live with them….under a very close watch. If the individual invoice amounts are big, not only are the risks higher (more difficult to charge back), but it is also very likely that your Client will request them transferred to them sooner (thereby having a net negative effect to you…big risk/no benefit). If the amounts are small, it is more of a nuisance than it is a clear advantage. In the case you are closing out a Client, verifying NFI doesn't help either…as the discovery that it was indeed a mistaken payment usually comes up several months after you thought you were home free.

Tread carefully with those Non-Factored.

Carlos Weil is with Capital Solutions in Ft. Meyers, Florida. He can be reached at 941-277-5810.

Stop The Bleeding

by Dr. Ron

There once was a factor named Drew
Who thought once filed was through
Along came account debtor
Who filed one better
Drew's lien became second thereto.

That's right folks, this is another iconoclastic blast from the drafters of the uniform commercial code that you have come to love…most of the time. And you all thought you could file, then search, and except for federal tax liens, put the file away. You bunch of sillies. Try this on for size.

You book a new client, you search and file and even search again to make certain that your filing is the first and only filing on Accounts. Being a prudent receivable lender or factor, as the case may be, you search regularly for federal tax liens or in the alternative you do the IRS form 8821 thing. Little did you know, after you booked the business your client entered into a contract with one of its Account Debtors that, among other things, gave the Account Debtor a security interest in all of your client's Accounts to secure any money your client might owe the Account Debtor. How, you may ask, could the client wind up owing the Account Debtor money? The worst that could happen, you theorize, is that the Account Debtor offsets against the existing Account that you purchased. That is bad enough. But what if the amount of the offset exceeds the amount of the Account? What if the client had some of the Account Debtor's property in its possession and your client damaged it? Or what if the client failed to deliver product on time, or produced a part that ultimately damaged the Account Debtor's equipment and caused the Account Debtor damages far in excess of the amount the Account Debtor owed your client? You are in big trouble, that's what.

The District Court of the Northern District of Ohio held (and was upheld later on appeal) that a ***prior*** perfected lien in Accounts is ***inferior*** to a ***subsequently filed*** and perfected lien if it arises from a contract between your client and one of its account debtors provided, however, that the monies owed to the account debtor from the client is characterized as a "recoupment" rather than a "setoff", a distinction beyond the scope of this column and one which would be argued in court. Which is the last place any of us wish to be.

So what do we do? First and foremost, understand the nature of what your client does for a living and take the time to understand the type of relationships between your clients and their account debtors. Oh yes, I almost forgot, also run a UCC search daily on all your clients to be certain no Account Debtor has filed. May I suggest you use Dr. Ron's newly formed search company? I've decided to get out of the factoring business and put my efforts towards a business where I can make some real money and sleep at night too.

Wanna do business in Wisconsin anyone? I thought most lenders knew about this wonderful piece of legislation, but we recently received an application from a prospect that had offices in Wisconsin. In the course of our normal due diligence call to the existing lender, we discovered that the lender was not aware of the Labor Lien Law in Wisconsin. Allow me to enlighten those of you that have no idea what I'm talking about.

If your client has 50 or more employees working in Wisconsin and that client were to go out of business, up to 60 days worth of unpaid wages will prime your lien. What constitutes unpaid wages? Clearly unpaid payroll, but what about accrued vacation pay and/or other benefits? Of course, if you are a Wisconsin banking institution, you are exempt. You would think that since this effectively precludes non-Wisconsin bank and non-bank lenders from lending to Wisconsin companies, that the state would reconsider this unfair law, which will ultimately work against its citizens. But so far, they are not budging. Ah, politics.

As if these problems were not enough, there's this factor I know from Nantucket…

To contact Ron Winicour, a/k/a Dr. Ron, or to request copies of documentation, past articles, etc., please send an e-mail to: dr.ron@gibraltarfinancial.com. In the alternative, mail your request to Dr. Ron at Gibraltar Financial Corporation, 60 Revere Drive, Suite 840, Northbrook, IL 60062.

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Uploading Client Files

by Joseph R. Caplan

Until recently, it was difficult to get data files from clients. However, with the growth of small accounting packages, large hard drives and common file formats, the ability to get data has improved and the techniques to massage that data are better than ever. Factors have been limited in their ability to upload files due to a lack of knowledge, lack of resources, client resistance, and some software limitations. Things have changed and it is now easier than ever to get client data.

Have you ever turned down a deal due to the sheer volume of invoices or size of the initial aging that needed to be entered? Converting the files into usable data can solve these detail-oriented issues.

Other benefits are obvious: Reduced staffing, improved client response times, and accuracy are all improved. In some cases, software analysis will help you to pre-screen customers or set limits before imports take place. The ability to convert an aging to invoices that can be uploaded is going to help you win the deal and possibly save the day for an entity.

The Process

- Obtain a file of exported data from the accounting system
- Parse (split) columns to get data into distinct columns
- Sort / Collate or Export into Custom Program that can manipulate the data
- Perform Mathematical Analysis against limits or check for accuracy
- Upload into factoring software

The largest problem with ordinary parsing software like Monarch or Data Import is that the parsing is done, but the file format will not feed into the factoring software's required format. Custom solutions are possible and one is now available for the new version of Factor SQL.

The Tools

Until recently, the tools have centered on parsing software that split data into columns and custom applications that would manipulate the parsed data. Unfortunately, the parsing tools can hit a wall with busy reports and unusual date formats. Sometimes, your clients will produce report formats that can't be converted and you will need to resort to manual entries. As a final limitation, many of the parsing tools handle only fixed length (text report) files and other formats such as Excel files or delimited files wont work. The right tool set is needed to handle these common problems.

Data is everywhere . . .

Specific purpose tools have emerged and some of them can work with products like Distinctive Solutions Factor SQL for the task of uploading files. The newest version of Factor SQL supports direct uploads from AssetReader and the conversion to the correct columns and formats is done in AssetReader automatically.

The number one tool is the human mind. Some training is needed to review the data format, client systems and even know how to move the data from their system to yours. This knowledge is invaluable and is a key ingredient in finding a solution to read-in data. Clients themselves range from computer astute to computer shy and it often takes a bit of pushing to get data because they have never done it before. However, many lenders have implemented requirements for data files and many customers actually enjoy the paper-free approach.

Most of the post Year 2000 software packages have export facilities built into the software. Programs like Quick Books have an Excel export button right on the preview screen, while other programs have export features on the Print menus. The emergence of both the accounting software and data parsing tools has created a favorable environment for data uploading.

Strategy and Implementation

The following strategy is recommended:

1. Gather the skills needed to talk to your clients or outsource these skills as needed.
2. Purchase the correct software to facilitate the uploads
3. Be prepared for some failures, but press the issue with your clients.
4. Implement policies and requirements to make this part of your agreements.
5. Stop getting paper and start getting e-mail files from clients.
6. Start uploading and start saving time.

Data is everywhere and your client's have much of this in their systems. With the right combination of software systems, it is now easier than ever to upload agings, invoices and cash records into factoring software.

Joseph R. Caplan is managing Director of FinSoft, LLC a software provider that produces the AssetReader and AssetWriter programs used in ABL and provides data conversion services. Mr. Caplan is also the owner and instructor for Clear Choice Seminars, Inc., offering advanced courses in ABL and Data downloading techniques. He has been downloading data for approximately 17 years.

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To order, visit www.factoring.org or call 800-563-1895.

Banks and Factoring? What Can They Be Thinking?

by David Rains

In the past ten years, numerous banks have gotten in and out of the factoring industry in one form or another. With the advent of several companies that sold "their concept of factoring" to banks, the industry has changed dramatically. Rates have been driven down to half of what they were twenty years ago and yet, in many cases, the risk has risen.

Banks have primarily concentrated on balance sheets and cash flow. They look at the credit history of the client company to determine if they can reasonably expect the client to service the debt so that their money will return to them with an interest percentage that is connected to prime or LIBOR. As collateral goes, they are most comfortable with a hard asset such as real estate or machinery and equipment. This is their mindset; it is what they have been taught to do.

Then, you have the factoring company. This is an entirely different mindset. They want to know the history and character of the principals of the client they are factoring, but their primary focus is the quality of the commercial accounts receivable. Their credit criteria are the strength and concentration of the account debtors, the opportunity for dilution and several other considerations which are necessary to consider every day, on every piece of business. They understand that the reason they are being used is because a company's balance sheet does not meet the criteria of a bank's credit culture. They know and understand the risk involved and further understand that monitoring is the key to successfully getting their money returned to them.

Banks have been sold a false concept . . .

So, how do these two cultures reconcile their different mindsets? Banks have been sold a false concept (and many have paid a high price for the learning experience) by companies that promise them the high return on their money without fully explaining their risk, nor giving them the proper training and tools to properly carry out the daily duties and responsibilities of the factoring company. These companies have very derisively been called "factor in a box" by the factoring companies that know the truth and the high risk that is involved. Banks have been sold on this false concept of "Just use this software and you too can be getting 24%-36% APR on your money, just like those factoring companies are getting.". Just use our software and training program and we will generate business for you and then our software and systems will protect you. Then the banks happily put a teller, or an up and coming junior bank officer in charge of the portfolio. Three months, six months, or a year later a deal goes south and the bank wonders what happened. The high returns have evaporated in the loss and they have a bad taste for the factoring industry.

In order for a factoring entity to survive and be successful, it must have three elements; #1 is capital, #2 is a method of sourcing companies for their product and most importantly, #3 is a proven method of getting their money back along with a reasonable fee for their efforts. Fail in the first area and you will prevent growth as having money available is the product, fail in the second area and your product (your money) sits on the shelf and you realize no gain, *but fail in the third area and your company is doomed.* .

For a bank to be successful in the factoring industry, they have to change their mindset and understand these basic principals. They already have the first element, capital and they have it at a much cheaper rate than most factoring companies. They usually have leverage on assets of 12.5 to 1 and their cost of funds is much cheaper. The second element is, in most cases, right in their bank. They have a built in referral system which allows them to draw on their customer base to loan money when the commercial lending arm is just not able to justify the lending of money based on balance sheets. The third element is what gets them in trouble. Portfolio monitoring is critical and it is not an easy task. So much of the daily decision making process of advance rates, when or should you loan on an invoice is based on experience in the industry. Collateral must be monitored on a daily basis. The very reason that the balance sheet does not justify loaning money is why the monitoring is so critical. It requires a conscious effort on the part of the back room operation on a daily basis to ensure that the invoices are correct and valid; the debtors are properly notified and are of sufficient credit strength to justify an advance. Someone who does not have experience in the industry is going to lose money. There are just too many snares and traps which can and will trip you up, take your money and take it fast. Factoring is not rocket science but it does take experience and the education process can cost more than 8 years at Harvard Business School. Even the most experienced people will occasionally take a hit in their portfolio but the entire concept is to lessen the risk. The banks that understand this vital third element of success in the factoring industry have flourished, while the ones that have bought into the false theory of a software monitoring package and little or no controls have taken massive hits.

Another point that banks should take into consideration is the rate on return. The very fact of having bank rate funds is a very lucrative position to hold in commercial finance. The inherent costs of the backroom must be taken into account, but also the concept of "Risk versus Return". So often, with the strong competition that the industry is experiencing, rates are lowered and lowered significantly. Sometimes in the heat of competition for a deal, rates are dropped even further until it is way past the concept of "risk vs return". This industry sells a product and if you do not realize the return on the product, the industry as a whole suffers. Banks in the industry or entering the industry would do well to keep in mind that comparing the normal rate of return on a commercial loan to a factoring proposal is not the proper way to set your rates. Take all of the other costs in consideration of properly monitoring the loan and the risk of the proposal. Take advantage of the competitive edge that having the high leverage and the low cost of funds allows but cutting rates to the point of not being able to hold the proper amount in loan loss reserves is damaging to the industry as a whole and certainly will come back to haunt the institution that practices wholesale rate cutting.

So, as in most industries, the key to success in factoring is experience and following good solid industry practices. If banks can change their paradigm of thought, they can be successful, however if they buy the concept that has been sold by these "factor in a box" companies, they will continue to suffer losses and do damage to the factoring industry.

Dave Rains is one of the nation's foremost recruiting professionals. With over 27 years of sales/recruiting experience and an honors graduate of SHSU, he has earned a reputation as an expert in the placement of Business Development and Operations professionals in Commercial Finance. Throughout his career, Dave has been recognized as a top performer within the MRI family of over 1,000 offices. He has been awarded 16 national and regional awards including "Southwest Account Executive of the Year – 2001". He consistently ranks in the "Top 10 in the Nation" of the vast MRI family of over 5000 recruiters.

Legal Factors

by John A. Beckstead, Esq.

UCC Financing Statements:
Are You Getting It Right? (Part 1)

I am pleased to accept Bert Goldberg's invitation to write a regular column for each issue of *The Commercial Factor*. I welcome your input and feedback, especially ideas for future columns you would like to see. Please contact me at the e-mail address below with your comments and ideas.

In raising our children, we teach them to do their best and to try hard but we don't expect perfection. The Uniform Commercial Code is not as forgiving. When it comes to priority of security interests, perfection is required.

Revised Article 9 became effective in most states on July 1, 2001 and is now in effect in all fifty states. Revised Article 9 dramatically changed the rules for perfection of security interests, impacting both searches and filings. The tests for determining what constitutes an ineffective filing have been tightened – meaning that errors can more often be fatal. Review your procedures and policies against this summary to double check your knowledge and understanding.

Methods of Perfection

There are three primary ways in which a security interest may be perfected: filing, control and possession. Which method is used depends on the type of collateral.

Filing of a Financing Statement is sufficient for accounts, inventory, general intangibles, equipment and goods (unless subject to a certificate of title), electronic chattel paper, and commercial tort claims. A filing is not sufficient for money, letter of credit rights, stock certificates, securities accounts, and deposit accounts with financial institutions. (A security interest in some of these items can be perfected by filing a Financing Statement but it is subject to being primed by another creditor who perfects by possession or control.)

Always remember that even a true sale of accounts is subject to Article 9 and the purchaser's interest must be perfected.

Form of Financing Statement

Description of Collateral. A general description (i.e., "all the debtor's assets") is sufficient for a financing statement (but not a security agreement) in most cases. If your client will allow it, this is the simplest procedure. Exceptions requiring more detailed descriptions include securities accounts and investment property.

Debtor's Name: The Financing Statement must provide the debtor's legal name and the name of the secured party. Using the correct, full name of the debtor is very important under Revised Article 9. The new test for whether a name is seriously misleading is whether a search, using the logic of the computer system of the state agency where the filing is made, done under the correct name, would reveal the incorrect filing. If not, the incorrect filing is ineffective. Under many state computer systems, slight variations in the name can be defective.

Revised Article 9 also clarifies other name issues: It is not necessary to list a trade name or DBA or to list the names of partners or members of the debtor. Failure to indicate the representative capacity of the secured party (such as trustee or agent) does not affect the validity of the filing. Multiple debtors and multiple secured parties may be listed on a single Financing Statement.

Tips:

1. Organizational documents should be obtained to determine the debtor's correct legal name; good standing certificates are not sufficient for determining the correct name and spelling.
2. Trade names and DBA's are not effective.
3. For trusts, use the name set forth in the trust documents.
4. For individuals, use full, complete names, such as "Robert William Smith" rather than "Bob Smith". It is recommended that verification of the name, such as a driver's license or social security card, be checked and photocopied.

New Form: Revised Article 9 includes sample forms of Financing Statements that must be accepted by every filing office in the country. There are now only two forms, the UCC Financing Statement and the UCC Financing Statement Amendment (with an Addendum for each available for lengthy descriptions).

Authorization: There are no longer any signatures on the Financing Statement. Revised Article 9 only requires that the debtor *authorize* the secured party to file the Financing Statement. Authorization is automatic if a security agreement covers the collateral.

Where to File

The biggest change in Revised Article 9 concerns where to file Financing Statements. Rather than having different rules depending upon the type and location of collateral, all Financing Statements are now filed only in the jurisdiction in which the debtor is located. Dual filings (state and local) have been eliminated except in the case of real estate fixtures.

Determining where the debtor is located:

Registered Organizations are organizations that are required to register with a state, such as a corporation, limited liability company, or limited partnership. Debtors that are "registered organizations" are located in the state under whose law the debtor is organized.

Non-registered Organizations are organizations that are not registered, such as general partnerships and joint ventures. This type of debtor is located at either (i) its place of business if it has only one or (ii) its chief executive office if it has more than one place of business.

Individual Debtors: Individual debtors are located in the state in which his/her principal residence is located. Sole proprietorships are considered individuals when determining where to file financing statements.

Tip: If it is not clear which is the proper jurisdiction, file in each jurisdiction that might be considered to be the debtor's place of business or residence.

In the next issue, Part 2: Searches, impact of certain post-filing events (name change, merger, etc.), termination statements, and the ever confusing transition rules.

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