BOSNIA & HERZEGOVINA

Bosnia and Herzegovina's Factoring Market: Trick or Treat?

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Bosnia and Herzegovina (BiH) consists of two distinct administrative entities – the Federation of BiH (FBiH) and Republika Srpska (RS) – and the special administrative unit Brcko District of BiH (BD). In accordance with the constitutional division of competences, factoring activities – a type of debtor finance in which a business sells its accounts receivable (*i.e.*, invoices) to a third party (called a factor) at a discount – fall under the competence of individual parts, resulting in several sets of legislation but two regulators: the Federal Banking Agency (FBA) in FBiH and the Banking Agency in Republika Srpska (BARS), with BD able to choose either of the two.

Currently, factoring represents a regulated financial and non-deposit activity in FBiH, and it is subject to the supervision of the FBA, pursuant to the Factoring Act adopted in 2015. In RS, however, this activity remains unregulated and falls within the sphere of general contract law, although new legislation is expected and is likely to be very similar to the legislation in FBIH.

Although factoring in FBiH is in its infancy, it has been recognized as a new financing instrument, especially efficient for liquidity management. Combined with the Financial Dealings Act in FBiH that was adopted in 2016 and its capital adequacy requirements focusing on liquidity and pertaining restrictions if the liquidity is impaired, factoring is becoming more popular.

Current Regulatory Framework in Brief

In FBiH, factoring represents a regulated financial activity that can only be pursued within the framework set up by the Factoring Act and relevant FBA bylaws, and can only be performed by regulated entities, *i.e.*, licensed factoring companies and banks. The market is regulated by the FBA. Both recourse and non-recourse factoring are recognized. While cross-border factoring is also recognized, it is not possible for foreign factors to operate directly on the local market, and in order for a foreign factor to be involved, a two-factor system needs to be implemented involving a local factor.

In RS and BD, factoring transactions are implemented based on general contract law provisions regulated under the Obligations Act. Factoring agreements are not recognized by this Act, but are primarily based on the provisions governing assignment of receivables (*i.e.*, "cession"). Furthermore, as the Banking Act of RS expressly permit banks to perform factoring activities, the BARS has regulatory authority over them.

The Market

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Based on a FBA report on the banking sector, as of March 31, 2018, factoring was pursued by four banks and the one factoring company that had been established at the beginning of 2018 (but was still not active transaction-wise), with the total nominal value of the factoring portfolio at approximately EUR 10 million. In the first quarter of 2018, there were 72 active factoring agreements, representing an increase of 35.8% over the same period in 2017. Although the majority of factoring transactions remain recourse factoring (55.4% in the first quarter of 2018), that represents a significant increase of non-recourse factoring from 2017, when recourse was over 97%.

In terms of market players, all active factoring transactions were implemented by four banks active in BiH. As mentioned above, factoring can also be pursued by licensed factoring companies, and currently there is only one such company in FBiH. Prior to the adoption of the factoring regulations, there were a number of companies offering factoring services and operating under the general contract law frame. Consequently, the probable reason for the small number of factoring companies today is the regulatory requirements – particularly capital requirements – and the time required to meet them. Therefore, it is likely that the number of factoring companies will increase in the future, especially since the legislation has been largely tested since its initial adoption.

In line with the conclusions in the FBA report, it is reasonable to expect the need for short-term financing and receivables management to significantly increase, particularly considering the liquidity requirements and restrictions imposed by the financial dealings regulations. Accordingly, an increase in factoring activities is expected in the forthcoming period as a reliable and efficient instrument for liquidity management and maintenance.

A particular selling point for the market is the limited number of players with an evident need for active cross-border factoring services providers. Coupled with the expected factoring legislation in RS, the outlook for the BiH factoring market looks positive. It will likely represent an attractive opportunity for investors, which – combined with a prognosis of intensified factoring deals – is likely to make this area in BiH an interesting box of treats.

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