POSITION OF THE ASF ON THE THIRD CONSULTATIVE PAPER OF THE BASEL COMMITTEE

Our Association whose membership comprises all specialised French financial institutions (consumer credit, real estate credit and leasing, equipment leasing, factoring, financial garanties companies), wishes to set out its observations on the third consultative document « CP3 » of the Basel Committee concerning the draft of the New Capital Accord.

First we wish to insist on the need to produce satisfactory solutions to the concerns relating to the financing of small and medium-sized companies by specialised establishments.

The treatments envisaged do not take into account, or do so only very inadequately, the security, which these means of financing afford.

- Thus, **leasing**, the method of financing which is highly developed in certain countries, does not benefit from any specific treatment, whilst it confers on the lessor a security, which is greater than that of classical credit secured by a claim granted by a borrower on one of his assets, or on the asset which is being financed -

In fact, the lessor retains throughout the currency of the contract the ownership of the asset, which enables him not to rank after the lessee's creditors in the event of the lessee's default and to be then able to recover and sell the asset under very simple conditions and to do so more rapidly than in the case of an asset given as security by a borrower, the seizure and sale of which naturally imposes special protection procedures. We would point out that in France, as in other countries, the right of ownership of the lessor enables him to rank in front of all the lessee's creditors in being able to lay claim to the selling price of the asset and not only in front of those who have a claim to the asset as though it was a question of a credit (cf. § 485 of CP 3).

Notwithstanding this advantage, leasing, even though the consultative document specifically refers to it, is being treated as though it were a classical credit :

- Using the standard method, it is taken into account at 100% both for real estate and equipment;
- Using the IRB foundation method, it is only allocated from the relevant LGD to an asset given in guarantee by the borrower.

This situation is all the more worrying, since in many States of the EU, a lease can be financed by companies which, unlike in France, do not have the status of financial institutions and which, owing to that fact, are not subject to any prudential obligation in respect of equity, which cannot fail to increase a distortion of competition.

In these circumstances, we want to see the introduction of the following treatments, which are explained and more fully justified in the attached note (appendix I)

- using the standard method, weighting at 40% in the case of real estate leasing and at 50% in the case of equipment leasing;
- using the IRB foundation method, the application of an LGD of 30% in the case of real estate leasing and of 35% in the case of equipment leasing, without the application in either case of measures of additional collateral.

If the shortcomings of the current test are not remedied, a serious impairment of a small and medium-sized companies' financing tool would result, the said tool having proved itself, and the conditions of the operation of leasing would become more onerous or restrictive. This would be particularly damaging, since it is desired to see the development of secured financing within the banking system in both the industrialised and the emerging countries.

- Still on the subject of leasing, we wish to state that the treatment of residual value as envisaged in the IRB method (foundation and advanced - § 487 of « CP3 »), which couples residual value with a coefficient of 100%, is not suitable. In fact, by means of this 100% weighting of residual values at risk, the Basel Committee seeks to cover only the value risk. This value risk can materialise in two separate cases, namely

- the lessee defaults before the end of the contract and the equipment depreciates more rapidly than initially foreseen. In this case, it is clear that in the case of default by the lessee, the LGD already integrates that risk in the context of requirements on the subject of the LGD. Imposing a weighting at 100% of the residual value in addition to the weighting stemming from the LGD, would amount to a double weighting of the value risk in the case of default by the lessee;

or

- the lessee does not default and in that case, at the end of the contract, the residual value risk is simply a value risk, without any credit risk attached, which accordingly did not have to be weighted as a credit risk. In fact, at the end of the leasing contract, the lessor remains the owner of the asset, which appears among his fixed assets, since it has not been resold. Consequently, if it was weighted at 100% as a credit risk, the value risk would be liable to be taken into account twice.

Moreover, default by the lessee before the end of the contract and the residual value risk at the end of the contract could not eventuate simultaneously and it would be necessary not to add a weighting in PD and LGD for the flow of rental and a weighting of 100% for residual value, but to take the maximum of both.

Consequently, we advocate in the case of leasing or financial leasing, a single weighting of PD, LGD, EAD operations, regardless of the level of residual value with the following stipulations, namely

- that the EAD should, if necessary, include, apart from the updated value of the flow of contractual rentals and unpaid instalments, the amount of the residual value;

- that in the event of default by the counter-party, the LGD should, if necessary, integrate the loss of residual value and be brought back into the EAD as defined earlier »

- In a neighbouring field, it appears to us that loans secured by **physical collateral** such as a registered motor vehicle or a pledge of trade equipment must be retained in the context of the standard method, with a weighting substantially lower than the ordinary 100%.

- In commercial receivable **factoring**, which is a short-term maturity activity (less than three months), the treatment of undrawn purchase commitments in the IRB approach, must be revised, in order to remain consistent with that of the standard approach. Since corporate receivables are involved, the definition of the risk of default is inadequate. The treatment imposed for the risk of dilution excludes the taking into account of data known by the establishments, in contrast with the objectives of the IRB approach. Lastly, certain guarantees, which are specific to these operations, are not explicitly summarised. These different points are detailed in appendix II.

- On the subject of **corporate operations,** we draw the attention of the Committee to the situation in which many establishments, including specialised establishments, find themselves, to whom financing files are brought by external « agents » when they grant financing for small amounts to large « corporates ». These files are treated according to the « retail » method, with particular recourse to scores or to highly automated tools, both on the level of acceptance and on that of management (including incidents), independently of bank loans to these customers.
We want the particular situation of these establishments to be taken into account, since we anticipate that the grant of financing to corporates does not exclude them from « retail » management of these files (classification by homogeneous risk categories, not default contagion), even with the formula of calculation of the equity of the « corporations ». It would be necessary to widen point 199 in this sense.

- Using the IRB method, by reason of the principle of fair appreciation of risk which animates the reform, the taking into account by the lender of the **guarantee** must lead to the authorisation of an adjustment of the LGD of the operation to a level lower than that resulting from a direct exposure to the guarantor. An appendix (appendix III) concerning this point is attached to the present letter

- More generally, we wish to draw attention to the drawbacks which result from not distinguishing among **defaults of payment** between those, which are real defaults by the borrower and those, which are mere technical and insignificant unpaid sums, which do not indicate the real situation of the borrower. Failure to take the latter aspect into account involves the risk of applying the contagion to healthy « corporates exposures », not to speak about the undue increase in equity charges resulting from it for financial institutions. Simple technically unpaid sums are, in particular, delays linked to the drawing up of contracts, those resulting from disputes with suppliers in the case of leasing, those resulting from procedures of payment in the context of operations with governments, public companies, territorial organisations ….

- As for **« retail revolving exposures»:**

Using the advanced IRB method, it is intended to take into account, for the level of the LGD or of the EAD, the possibility of additional drawings by the borrower up to the date on which the event underlying the default is found, or thereafter. The intention of the Basel Committee, to attribute an advantage to the IRB method, would for the sake of consistency, lead to not taking into account the additional drawings on the level of the LGD or the EAD.

- Concerning **credit on residential real estate using the advanced IRB method (retail)**, it is provided that during the period of transition, the value of the LGD allocated to small customers exposures secured on residential real estate, cannot be less than 10%. (§ 235). This disposition, designed by the Basel authorities as a floor whose object is that of speculating in an exceptional manner on the possibility of long residential real estate price cycles, which cannot correctly be taken into account on the basis of short-term data, does not take into account reality. In fact, practical observations show that the majority of the operations in question are involved, rendering inoperative, as far as lenders are concerned, the option of using their own LGD's. It is better to remove this limitation, which, fixed in a general manner without distinguishing in accordance with situations in various countries, is not significant. If necessary, the National Authorities could, in the context of Pillar II, take into account the particularity of certain situations.

- On the subject of the conditions of application of the advanced IRB method for « corporates exposures », the requirement of 7 years' data for the use of internal LGD's and EAD's, is excessive. It would be necessary to fix a period of 5 years, as for the PD's.

Moreover, still on the subject of advanced IRB method for corporations, it would be necessary to fix a period of transition, on the model of that which is provided for the PD's in IRB foundation and for retail PD's, LGD's and EAD's (advanced IRB method).

ASSOCIATION FRANCAISE DES SOCIETES FINANCIERES

Leasing APPENDIX I - 1

Observations by the ASF concerning leasing in the third consultative document of the Basel Committee on the new Capital Accord.

- For the lessor, the operation of leasing consists in leasing an asset of which he remains the owner throughout the currency of the contract, the latter being coupled with an option to purchase, which can be exercised by the lessee at the end of the contract.

The retention of ownership of the leased asset throughout the operation confers on it a security which is not found in any other form of financing, if it is possible to speak of « financing » in the case of leasing, because of its legal nature as a lease, coupled with a promise to sell.

- This security explains why leasing is a preferred tool for companies, in particular small and medium-sized companies, since, as is mostly the case, they do not have or have only small guarantees to offer, it enables them to have available the operating assets, which they need both at the stage of their creation and at the stage of subsequent development.

Moreover, in the case of leasing, in particular for real estate, the skills of the lessor teams make it possible to provide the lessee with a specialised advisory service on the implementation of his project, which is the condition of his future operation.

- The nature of leasing is the reason why the exercise of this activity does not in most countries call for the adoption of the status of a financial institution.

For that reason, the operation is generally, on the worldwide or even a European scale, not a financial institution, subject to the requirements of equity laid down by the Basel Committee or by the authorities of the European Commission.

Now, as regards institutions established in countries which require that they should adopt the status of financial institutions, the exercise of the same activities in other countries, particularly in neighbouring ones, as is the case in the European Union, by lessors which are not subject to the regulatory constraints regarding equity, represents a serious distortion of competition, which it is necessary to correct in the context of the future agreement on equity, by taking into account the fair value of the security conferred by leasing.

- Up to the present, leasing was not appropriately taken into account in the work done at Bâle. If, in its last document, probably as a result of the actions to increase the Committee's awareness managed by several countries of the European Union, the Basel Committee has agreed to recognise the fact of the existence of leasing in connection with internal notations in paragraphs 486 and 487 under the title « Requirements for recognition of leasing», it is in order to indicate that they must be treated in the same way as exposures coupled with the same type of collaterals and to introduce stricter treatment of non-guaranteed residual value risk.

As a result, in the standard method, both equipment and real estate leasing is weighted at 100%. In IRB foundation, the applicable LGD is not different from that which can benefit to loans coupled with ordinary guarantees, namely 35% in the case of real estate leasing and 40% in the case of equipment leasing, with a requirement of a 140% additional collateral.

- It appears to us to be wrong to regard leasing as being merely similar to a loan guaranteed by an asset belonging to the borrower. It would appear necessary to recognise the application of a specific treatment to leasing using the standard method and for the LGD's using IRB foundation.

In fact, since a lender who receives an asset belonging to the borrower may rank behind creditors for secured debts, in leasing on the other hand :

1. The lessor who remains the owner of the asset throughout the currency of the contract, can, in the case of difficulties experienced by the lessee, repossess his asset without ranking behind any creditor of his customer. In this respect, the regulations concerning collective procedures honour fully the right of ownership of the lessor (1) Moreover, the right of ownership of the lessor relates to the entire selling price and allows him to rank before all creditors in respect of the said selling price and not only the lenders who have a claim on the asset, as is the case of a credit secured by the asset

(1) If the opposability of the right of ownership of the lessor is subject to publicity, which is merely intended to inform creditors and third parties about the apparent security of the lessee, the lessor never fails to do so, in order to protect his claim.

2. The procedures for the recovery of an asset whose owner is the lessor, are much more rapid and flexible than those relating to the seizure of an asset given as security by a borrower which is understood to be due to the need to provide the latter with special protection, because his right of ownership is affected.

Statistical work already carried out on this question has confirmed that it is justified to apply a specific treatment to leasing using any method founded on an approach which is appropriate to the operation and distinct from that envisaged for classical loans which are secured by an asset belonging to the borrower.

In that context, it would appear to us appropriate that the new Basel agreement should adopt

- when using the standard method:

a) a real estate lease weighting of 40%. The implementation of a weighting appreciably lower than 100% is fully justified. In this respect, on the European level, real estate leasing operations benefit, in the context of the credit rating introduced in 1991, from a specific weighting of 50% and experience has not shown that this weighting is unsuitable or dangerous. It should be noticed that the proposed weighting of 40% is higher than that applicable to credits for housing, secured by a mortgage, notwithstanding the precedence of the right of ownership over the latter. The application of the 40% weighting which is desired for real estate leasing should not be limited to a fraction of the bank loan, but should relate to its total and should not be subject to the conditions set out in the note at the bottom of page n° 21 of the consultative Document of the Committee on the subject of taking into account certain mortgages on offices or commercial premises. The treatment of leasing due to the security conferred by the right of ownership, must in fact be distinct from that given to these operations.

…/…

b) a 50% weighting of equipment leasing.

Using the standard method, small and medium-sized company borrowings do not benefit from any specificity, because of an absence of recognition of the physical collaterals, or from special treatment corresponding to a special curve, as in the matter of IRB, and hence the need to take into account, by means of weighting, the security afforded by leasing.

- when using the IRB foundation method :

a) in the case of real estate leasing, an LGD of 30%, lower than that provided for loans secured by a real estate asset for commercial use, and the non-application of measures of additional collateral;

b) in the case of equipment leasing, an LGD of 35%, lower than that provided for loans secured by a physical collateral owned by the borrower and the non-application of measures of additional collateral measures.

The LGD's, which we want to be adopted, are distinctly higher than those shown by the statistics (already supplied in the past and a copy of which is appended), which justifies the wish for the non-application of measures of additional collateral.

The adoption of these dispositions would appear to be extremely important, in order to continue to make possible financing using the leasing method, which of its nature offers improved security, compared with classical secured credits, whilst making it possible to take a smaller risk attaching to them in accordance with the aim of the new regulations.

An absence of the adoption of these dispositions would entail an appreciable increase in the conditions of the leases, due to an unjustified increase of regulatory equity, which would result in certain investments and indeed the creation of certain small and medium-sized companies not eventuating or at least being subject to the application of conditions which would greatly and damagingly encumber the budgets of these companies. This would be all the more damaging, since it is desired to see the development of secured financing within the banking system in both the industrialised and in the emerging countries.

Naturally, the requests set out below and later on, also concern the operations of financial leases which can be implemented by leasing establishments alongside their leasing operations. In fact, they possess the same characteristics of security as the latter, but to the fact that the lessor retains the ownership of the asset.

Appendix

Certain other points appear to us to call for observations, in order to be able to take into account leasing under the best possible conditions enabling it to play the part, which it is expected to play on the economic level:

- Still in relation on the same concern not to limit recourse to leasing by imposing excessively stringent conditions, which would place a question mark over small and medium-sized companies' investments, which are useful to the economy, it is necessary that constraints in the matter of valuation of assets should remain reasonable. In this respect in particular, it would be necessary to be able to carry out revaluations on the basis of homogeneous pools of assets, to eliminate the requirement of physical inspection which cannot be implemented in the case of the leasing of equipment and to provide that the control of the location of the asset shall only be imposed in respect of equipment where such control makes good sense (impossible to carry out in the case of equipment which can be moved (vehicles, cranes…).

- With the same aim of not imposing unjustified constraints, the cost of which would inevitably be passed on to the lessees, it is necessary to introduce into the IRB method, revisions of LGD's and lessees notations by pools.

BANK CAPITAL ADEQUACY

ANNEXE I - 2

TREATMENT OF LEASING

Leasing can provide financing for movable (industrial, transport and agricultural plant and equipment) or real estate assets, while at the same time allowing the credit institution to retain ownership of the asset throughout the term of the operation (see appendix I-2 aconcerning the legal framework of leasing).

The latter characteristic provides the lessor, who takes the risk of undertaking the operation, with absolute security in terms of being able to recover the asset in the event of a client's default, and to resell it to cover the consequences of this default, since no creditor may take precedence over him in respect of the price of the asset (see appendix I-2 b concerning ownership of the asset and its consequences).

Leasing operations are arranged in order to ensure that, via rental payments and the option purchase price, the lessor will recover his capital in full, plus a margin sufficient to cover his own refinancing costs, the cost of risk, his overheads and his profit.

Provided the lifespan of the asset is at least equal to the term of the contract for which resale possibilities exist, and this asset is located in states whose laws allow it to be recovered within reasonable times, there is no reason why leasing operations should be costed on a 100% basis when it comes to calculating the minimum equity requirements.

Experience in France shows that using a much lower level for calculation purposes is fully justified.

- As far as real-estate leasing is concerned, a survey covering the period 1996-2000 and a sample representing between 47% and 60% of the industry's outstanding lending, shows that recovery rates following the sale of the building range from 65% to 79% (selling price compared to residual financial value plus charges) (see appendix I-2 c Weighting of real estate leasing operations in prudential ratios).

In these circumstances, a reduced weighting ratio appears fully justified. This is in fact what has been used at European Union level for the European solvency ratio since 1991, and the 50% weighting was renewed in 1998.

It is clear that leasing institutions are eager to conclude operations on suitably located assets, not just to ensure they recover their initial investment if the lessee defaults, but also, since they still own these assets, so that they can rent them out again if the client does not take up the option.

- As far as equipment leasing are concerned, experience also shows that a weighting ratio of less than 100% should be used.

In fact we find recovery rates in the resale price/outstanding finance and unpaid rents vary between 50% and 90% for categories of assets representing 87% of the fixed assets rented out (see appendix I-2 d for statistics covering five representative institutions).

Moreover, recovery and resale of the assets occur in a short period of time.

Actually, it must be stated that since the leased assets are essential to allow the lessee to run his business, he tries to give the lessor priority when it comes to making payments, to ensure he is not deprived of the asset. The incentive provided by the risk of repossession of the asset is all the stronger due to the fact that in practice, it tends to be repossessed very quickly (sometimes even within a matter of days, especially where aircraft are concerned...).

Generally speaking, for assets with a broad distribution (and an active second-hand market), the lead-time is less than one month.

As far as assets with a limited distribution (large machine tools, large items of equipment used in the printing and building industries) are concerned, this lead-time may be up to 6 months.

Under these conditions, the ASF wants the following treatment to be given :

- In standardised approac h a 40% weighting in the case of real estate leasing and 50% weighting in the case of equipment leasing (e.g. machinery and equipment) ;
- In IRB foundation, the application of an LGD of 30% in the case of real estate leasing and 35% in the case of equipment leasing, without the application, in either case, of additional collateral.

Finally, it may be seen that in several states, leasing can be also be undertaken by companies that are not registered credit institutions, and therefore may not be subject to the international solvency ratio, a situation that may have the effect of distorting competition.

Leasing is a financing method that still enjoys considerable success, both in France and abroad, because it meets the requirements of many companies (see appendix V concerning leasing in France and appendix VI concerning leasing at European and international level).

THE LEGAL FRAMEWORK OF LEASING

Leasing companies in France are credit institutions, and are usually specialised finance companies. Indeed, article L 313-1 of the French Monetary and Financial Code classifies leasing in the same category as lending operations. Consequently, it can only be exercised on a regular basis by credit institutions that come under the auspices of the supervisory authorities and are subject to the prudential constraints applicable to credit institutions.

At 31 December 2000, there were 72 institutions whose main business was equipment leasing, 83 institutions involved in real estate leasing and 16 Sofergie (*Sociétés de financement pour les économies d'énergie* - finance companies involved in energy-saving investments), i.e. 171 companies in total.

1) Definition of leasing operations

Article L 313-7 of the French Monetary and Financial Code defines equipment and real estate leasing operations.

The operations covered by this article are:

2) *"rental agreements involving capital goods or tooling plant purchased with view to such rental by companies that retain ownership of it, where these operations, however classified, allow the lessee to acquire some or all of the assets rented, in return for an agreed price that takes account, at least to some extent, of the rental payments already made on it;*

3) *Operations via which a company rents out real estate for business use, which it has either purchased or had built on its own account, where these operations, however classified, allow the lessees to acquire ownership of some or all of the assets rented, no later than the expiry date of the lease, either via a transfer pursuant to a unilateral commitment to sell, or via direct or indirect acquisition of the rights of ownership over the land on which the rented buildings have been built, or via rightful transfer of ownership of the buildings constructed on the land belonging to the said lessee."*

Three basic, interlinked elements characterising the legal nature of the leasing contract are apparent from these definitions:

- it involves a **rental agreement,** usually extending over the useful economic life of the asset,
- concerning a **equipment or real estate asset, destined for business use**
- accompanied by a **unilateral commitment to sell.**

Leasing operations are arranged with a view to ensuring that, thanks to rental payments and the price of the purchase option, the lessor will recover his capital in full, plus a sufficient margin to cover his own refinancing cost, the cost of the risk, his overheads and his profit. The purchase option price is determined in such a way that, if the client does not take up the option, its price is covered by the resale or rehire value of the asset.

In addition to the leasing operations defined above, credit institutions may also undertake:

- Hire-purchase agreement operations aimed at consumers. These operations are similar in nature to leases. The only difference is the beneficiary (e.g. hire-purchase agreements involve private individuals and private vehicles);

- straightforward rental agreements, i.e. those not accompanied by a purchase option for the lessee, but presenting the other characteristics of a leasing contract. The capital is then recovered via rental payments over the contract term, and via the resale price of the asset at the end of the contract, notably within the framework of the undertaking the supplier may give to take back the asset.

2) Parties involved

Three parties are involved in a leasing operation: the supplier, the lessee and the lessor.

The lessee freely chooses the asset he wishes to procure for his business activity. This item of equipment is delivered by the supplier after it has been purchased by the lessor. The latter retains ownership of it throughout the term of the operation, while the lessee retains possession of the asset in return for periodic rental payments. When the operation is complete, the lessee can either pursue the rental agreement, return the asset or acquire it, in accordance with the terms set out in the contract.

OWNERSHIP OF THE ASSET AND ITS CONSEQUENCES

In a lease or straightforward rental agreement, the guarantee provided for the lessor by **ownership** of the asset throughout the contract term, including up to the time the lease purchase option is actually taken up, is **paramount**. Indeed, the lessor enjoys a genuine right – the right of ownership over the asset financed, thus providing him with the greatest possible degree of security in his dealings with the lessee and his creditors[1]; in fact, this offers even more security than traditional sureties.

In practice, the contract is terminated by default, without the need to go to court to pronounce such termination, since a clause in the contract stipulates that it shall be rightfully terminated in the event that the lessee fails to meet his obligations, notably the obligation to pay rent. The lessor is then entitled to repossess the equipment with a view to selling it – or hiring it out again – in order to obtain payment of the balance of his debt. If an amicable agreement cannot be negotiated with the lessee concerning the return the asset, the lessor must then instigate legal proceedings involving the bringing of a claim, where equipment is concerned, or seeking expulsion where real estate is concerned, on which the judge will pronounce an emergency ruling.

Moreover it should be noted that a "penalty clause" specified in the contract obliges the lessee to pay substantial compensation if the contract has to be terminated as a result of his doing, so as to encourage him not to terminate the contract prematurely.

Where collective proceedings are instigated against the lessee – i.e. where his company is placed in administration with a view to recovery or goes into liquidation – the lessor still retains his rights:

- the lessor must be warned personally that such proceedings are to be instigated. Otherwise, he cannot be debarred from eligibility to receive rental payments predating the judgement initiating the proceedings that he would not have been able to declare in due time;

- if the administrator does not wish to proceed with the contract, the asset must be returned;

- if the administrator does wish to proceed with the contract, he must specify that he will have sufficient funds to pay the rent resulting from such a continuation;

- if rental payments are subsequently not kept up, the contract may be terminated, and the lessor may repossess the asset.

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[1] While in some cases the lessor's right of ownership can only be used in law against the hirer's creditors on condition that an announcement is made - a step always taken by the lessor in order to safeguard his rights (publication at the clerk's office of the commercial court in cases involving equipment leasing, and publication at the mortgages registry in respect of real estate rental agreements covering a period in excess of twelve years).

AN I-2 c

Weighting of real estate leasing operations in prudential ratios
50% weighting

Results of CBI survey

Total	**1996**	**1997**	**1998**	**1999**	**2000**
Number of buildings remarketed	296	332	316	559	498
Residual financial value at the time of sale (millions of francs)	1 066	1 320	1 191	2 153	1 723
Unpaid rents, charges and disbursements at the time of sale (millions of francs)	129	93	143	179	185
Selling price or basis for assessment of new contracts (millions of francs)	777	917	865	1 723	1 515
Loss/gain (millions of francs)	-418	-496	-469	-609	-392
Gross recovery rate (Selling price/residual financial value)	**73%**	**70%**	**73%**	**80%**	**88%**
Net recovery rate (Selling price/residual financial value + charges)	**65%**	**65%**	**65%**	**74%**	**79%**
Number of companies including those notinvolved in remarketing operations during the year	32 12	34 11	35 10	36 12	36 10
outstanding lending 1999 (as part of all leasing operations-- ASF)	98 065 47%	114 551 55%	114 981 55%	125 783 60%	125 783 60%
percentage of outstanding lending 1998 (as part of all leasing operations - ASF)	99 825 48%	116 750 56%	116 996 56%	125 859 60%	125 589 60%
Production 99 (as part of all leasing operations - ASF)	11 711 43%	13 542 50%	13 795 51%	17 892 66%	17 892 66%

AN I-2 d

Equipment leasing

I – Recovery rates in recent years in the case of five institutions[2]

Institution A:

Category	Recovery rate*
Aeronautical	65.24%
Coaches and buses	86.13%
Miscellaneous transport equipment	77.27%
Pleasure boats	62.49%
Industrial vehicles	73.60%
Utility vehicles	75.05%
Private cars	72.63%
Machine tools	55.99%
Building and civil engineering equipment	91.90%
Lifting equipment	56.22%
Handling equipment	80.09%
Printing machinery	53.49%

** Recovery rate on sales made over the past three years*

Institution B:

Equipment	Recovery rate*
Transport	71%
Industry	50%
Printing machinery	84%
Building and civil engineering equipment	80%
Handling	58%

** - The statistics were compiled on the basis of items written off in 1997, 1998 and 1999*
- Machine tools are included in the recovery rate for industrial equipment

Institution C:

[2] Recovery rate: ratio of selling price of the asset repossessed in the event of a dispute in relation to the total amount of outstanding finance still owed by the client (outstanding finance and unpaid rents).

Equipment	Recovery rate*
Transport	76.26%
Printing machinery	56.32%
Machine tools	44.75%

* *Average rates since 1991*

Institution D:

Equipment	Recovery rate*
Vehicles	Average rate: 83%
Civil engineering equipment	
Handling and lifting	
Waste processing and machine tools	
Offset and helio rotary printing presses	

* *Average recovery rate in respect of disputed contracts terminated in 1997, 1998 and 1999.*

Note

This institution indicated that a reconciliation was made between the amount of outstanding receivables and the second-hand value of equipment in respect of certain models of industrial vehicles built by two manufacturers (road tractor units), one manufacturer's industrial fork-lift trucks and as far as civil engineering equipment was concerned, one manufacturer's tyre-mounted and crawler-mounted mechanical shovels (see also II hereafter regarding the quoted values of second-hand assets).

Two opening remarks are made:

- the purchase price of two identical pieces of equipment, at the same time, may vary by up to 15%, depending on the purchaser's "commercial" negotiation skills,

- the amount of outstanding finance depends on the structure of the contractual repayment schedule (term, sliding scale of payments, level of residual value).

Subject to these reserves, it indicates that on average, a 6% RV is observed in respect of a conventional 4-year straight-line contract:

- the amount of outstanding finance is 20% higher than the second-hand value during the 1st year of the contract; this outstanding finance then reaches the level of the second-hand value between months 24 and 30, depending on the type of equipment in question, and thereafter the outstanding finance falls below the second-hand value.

Institution E:

	Recovery rate *
All equipment other than light utility vehicles	60% (+ or -4%)
Light utility vehicles	75% (+ or -5%)

** Including equipment with a rapid rate of depreciation, such as computer equipment – Statistics over a 5-year period (1995 to 1999)*

II - Evolution over time of standard sale values for various assets calculated by one institution, taking account of the various existing quotations (*) and experience, considered *vis-à-vis* the amount of outstanding finance

Number of months	Equipment	0/12		36	48		72	84
Standard Sale Value (1)	Nautical Aeronautical Railway	80%	70%	60%	55%	50%	45%	40%
Finance Outstanding (2)	7 years RV 1%	88%	76%	63%	48%	34%	18%	1%
Standard Sale Value (1)	Vehicles	70%	60%	50%	32%	25%	20%	14%
Finance Outstanding (2)	5 years RV 1%	83%	64%	44%	23%	1%		
Standard Sale Value (1)	Civil engineering equipment Handling and Lifting Mobile Agricultural Printing machinery Machine tools	65%	55%	50%	40%	35%	30%	25%
Finance Outstanding (2)	5 years RV 1%	83%	64%	44%	23%	1%		

It is specified that the average sale values indicated above are based on two assumptions:

1) the acquisition prices are properly negotiated
2) the options retain a market value

Category (1) assets (comprising nautical, aeronautical and railway equipment)
Equipment with a high unit price and a long useful life, of around 20 years and over, is underestimated overall in relation to the sale value curve indicated, though the term of the financing in question may exceed a period of 7 years.

Category (2) assets (comprising vehicles)
The sale value curve for coaches accommodating 50 passengers or more is very similar to category one.

Category 3 assets (comprising civil engineering, handling and lifting equipment, mobile agricultural equipment, machine tools and printing machinery).
The gradient of the sale value curve of offset rotary printing presses and large items of lifting equipment is less steep from year four onwards.

(*) See attached document for sources of quoted second-hand equipment values.
(1) Sale value expressed as a percentage of the purchase price of a brand-new
(2) Finance outstanding expressed as a percentage of initial loan approximately equal to the initial purchase price (RV 1%)

SOURCES OF QUOTED SECOND-HAND EQUIPMENT VALUES

- **L'ARGUS**

- **CNPA Conseil National des Professions de l'Automobile** ['National Automobile Industries Council']

- **SIMO Service Interprofessionnel d'Evaluation des Matériels Agricoles d'Occasion** ['Interprofessional Service for the Assessment of Second-hand Agricultural Equipment Values']

- **DLR Fédération nationale des Distributeurs Loueurs et Réparateurs de matériels de BTP et manutention** ['National Federation of Distributors, Hirers and Repairers of Building, Civil Engineering and Handling Equipment']

- **REVUE BATEAU**
  NAUT'ARGUS
  VOILES ET VOILIERS
  NEPTUNE YACHTING

- **INTERNATIONAL AIRCRAFT PRICE GUIDE**
  AIRCRAFT BLUEBOOK

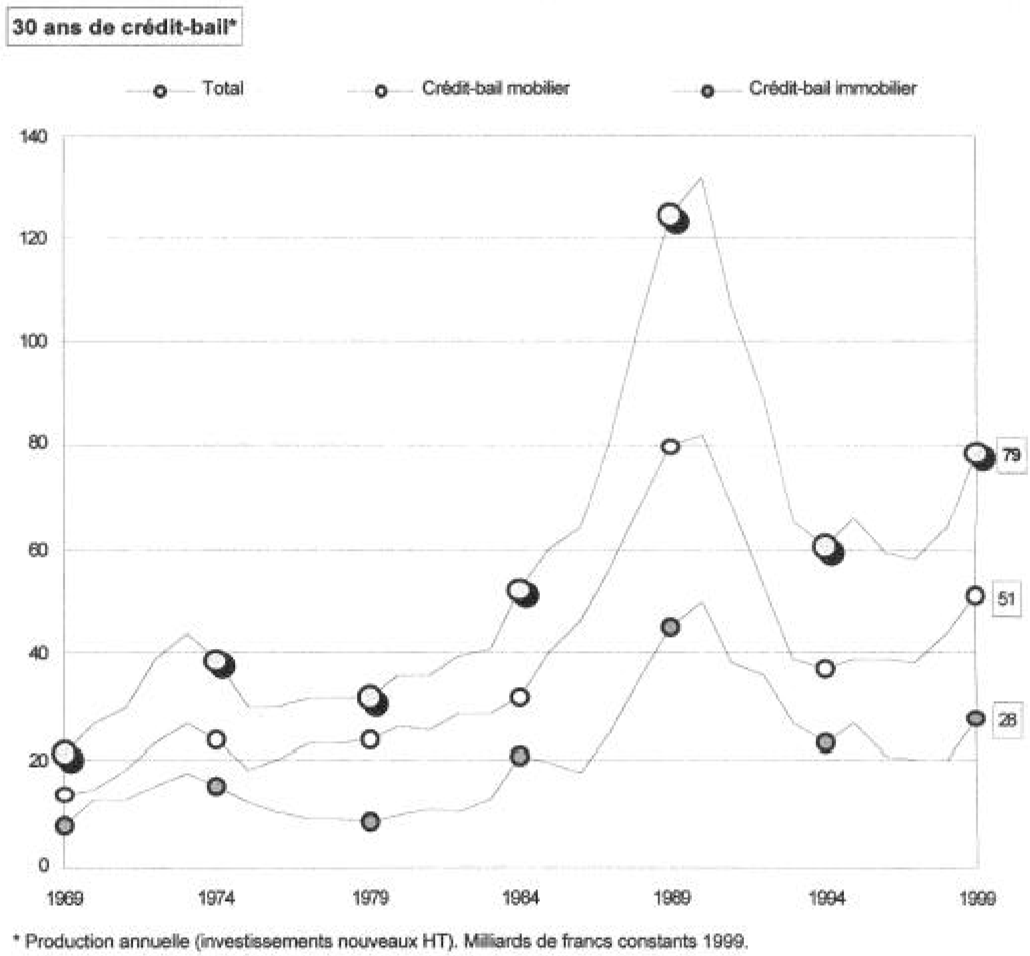
LEASING - ITEMISED DATA IN FRANCE

In France, since 1970, leasing has **financed 1,150 billion francs' worth of equipment and over 620 billion francs' worth[3] of office buildings**, thus making a valuable contribution to the investment effort of French businesses.

In simplified form, it is possible to distinguish five phases in the evolution of leasing, and probably the beginning of a sixth, since the law of 24 July 1966 came into force:

- an initial period of **growth** in the product, lasting until 1973 (up 21% per annum on average, in volume terms);
- a **levelling out** between 1974 and 1983, corresponding to a period of consolidation, in which favourable years alternated with more frugal years (as a result of the two successive oil crises) with an overall growth rate over the period close to zero (a 0.3% fall, including a 1.6% rise for equipment leases and a 2.8% fall for real estate leases);
- a **very strong expansion** between 1984 and 1990 (up 23% per annum on average), a year that marked a peak of 113 billion francs' worth of production – a figure never since reached again;
- a **sharp fall** between 1991 and 1994, covering both equipment and real estate leases (down 18% per annum on average): at 57 billion francs, 1994 production represented only half of that of 1991;
- a **hesitant rise** from 1995 to 1997, which was particularly pronounced in equipment leasing (up 1.1% per annum on average);
- a **clear resumption** for equipment leases in 1998 and 1999 (up 15% per annum on average), which was accompanied in 1999 by real estate leases (up 40%): over the past two years, the average growth rate overall is close to 17% per annum.

[3] constant 1999 francs.

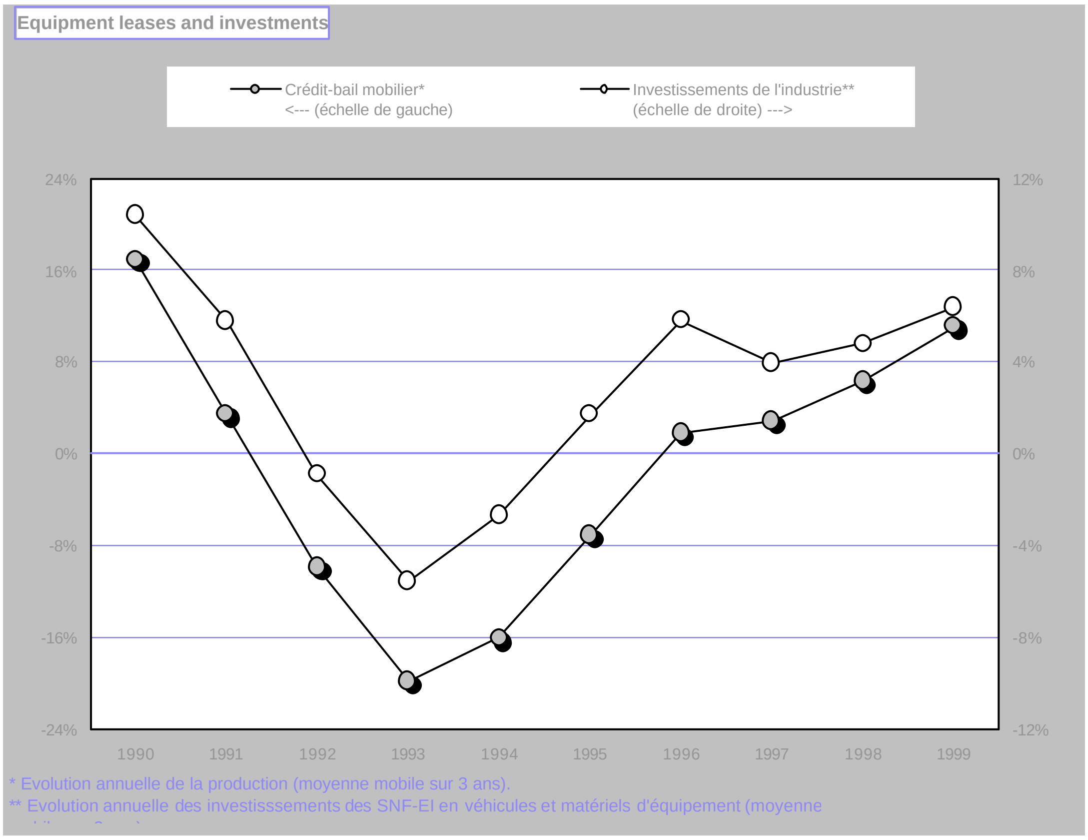


<u>Text of chart</u>:

30 years of leasing
Total
Equipment leases
Real estate leases

Annual production (new investments excluding tax). Constant billions of 1999 francs.

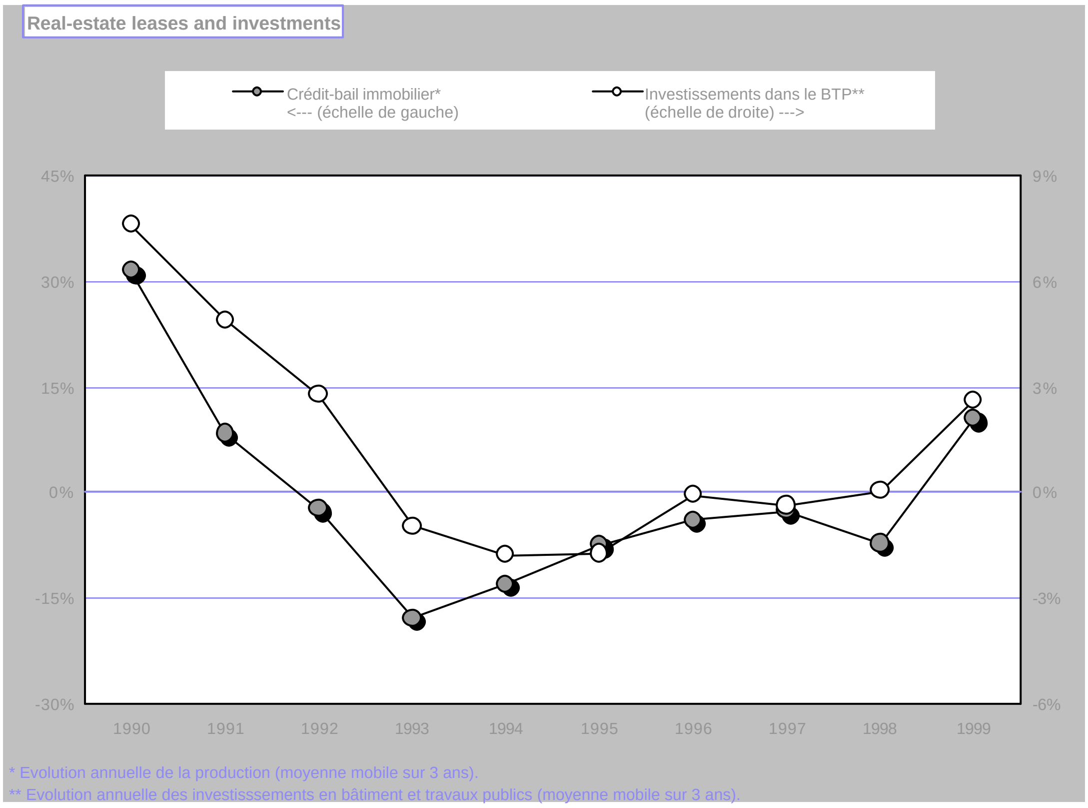
It can be seen **that the evolution of real estate leasing, over the medium term, almost perfectly replicates that of equipment leasing**, despite the multiplicity of external factors that may affect the very different markets that equipment and real estate leases are aimed at. Overall, these two financing methods are closely correlated with the evolution of productive investments (see graphs on next page).



<u>Text of chart</u>:

Equipment leases and investments
Equipment leases (left-hand scale) Industrial investments (right-hand scale)

*Annual evolution of production (moving average over a 3-year period)
** Annual evolution of SNF-EI investments in vehicles, plant and equipment.



<u>Text of chart</u>:

Real estate leases and investments
Real estate leases (left-hand scale) Investments in building and civil engineering (right-hand scale)

*Annual evolution of production (moving average over a 3-year period)

** Annual evolution of investments in building and civil engineering (moving average over a 3-year period)

LEASING - ITEMISED DATA AT EUROPEAN AND INTERNATIONAL LEVEL

Leasing is practised in many countries, using an identical basic principle, i.e. that the lessor retains ownership of the asset. In several states, leasing can be also be undertaken by companies that are not registered credit institutions, and therefore may not be subject to the international solvency ratio.

1. LE CREDIT-BAIL EN EUROPE EN 1998	**Engagements nouveaux de l'année** (millions €)			**Immobilisations nettes en fin d'année** (millions €)		
Classement des pays 1. selon leur appartenance ou non à l'Union européenne 2. selon le montant décroissant des immobilisations nettes en fin d'année.	TOTAL	Crédit-bail mobilier et opérations assimilées (1)	Crédit-bail immobilier	TOTAL	Crédit-bail mobilier et opérations assimilées (1)	Crédit-bail immobilier
PAYS DE L'UNION EUROPENNE (2)	**127 067**	**108 670**	**18 397**	**312 363**	**213 918**	**98 445**
ROYAUME-UNI	**31 293**	31 003	290	**89 033**	86 140	2 893
ALLEMAGNE	**32 653**	27 219	5 434	**81 251**	45 704	35 547
FRANCE	**18 525**	15 463	3 062	**59 965**	25 597	34 368
ITALIE	**17 163**	11 590	5 573	**27 269**	17 727	9 542
ESPAGNE	**6 402**	5 552	850	**11 955**	9 084	2 871
AUTRICHE	**3 541**	2 500	1 041	**11 225**	4 717	6 508
SUEDE	**4 324**	3 757	567	**9 014**	6 504	2 510
PAYS BAS	**3 379**	2 959	420	**7 622**	5 672	1 950
IRLANDE	**2 047**	2 047	0	**5 640**	5 640	0
PORTUGAL	**2 593**	1 995	598	**4 173**	2 653	1 520
DANEMARK	**1 777**	1 584	193	**3 700**	3 255	445
FINLANDE	**620**	560	60	**1 185**	894	291
LUXEMBOURG	**195**	195	0	**331**	331	0
BELGIQUE (3)	**2 555**	2 246	309	n. d.	n. d.	n. d.
PAYS HORS UNION EUROPENNE (4)	**10 082**	**9 489**	**593**	**16 429**	**15 026**	**1 403**
SUISSE	**3 050**	2 935	115	**5 724**	4 863	861
REPUBLIQUE TCHEQUE	**2 037**	1 906	131	**3 865**	3 684	181
NORVEGE	**1 546**	1 524	22	**2 579**	2 495	84
POLOGNE	**1 648**	1 405	243	**2 123**	1 895	228
HONGRIE	**882**	852	30	**1 089**	1 089	0
SLOVAQUIE	**466**	466	0	**604**	603	1
ESTONIE	**213**	187	26	**445**	397	48
SLOVENIE (3)	**240**	214	26	n. d.	n. d.	n. d.
TOTAL	**137 149**	**118 159**	**18 990**	**328 792**	**228 944**	**99 848**

Source : LEASEUROPE.

(1) Y compris opérations de location avec option d'achat réalisées avec des particuliers et opérations de location financière.

(2) GRECE : données non disponibles.

(3) Données non disponibles en termes d'immobilisations nettes.

(4) Pays membres de LEASEUROPE.

2. LE CREDIT-BAIL (1) DANS LE MONDE EN 1997	Engagements nouveaux de l'année (milliards de dollars US)	% du total
AMERIQUE DU NORD	**189,2**	**45,9%**
Dont ETATS-UNIS	179,8	43,6%
EUROPE	**115,2**	**27,9%**
Dont ALLEMAGNE	31,9	7,7%
Dont ROYAUME-UNI	20,8	5,0%
Dont FRANCE	18,1	4,4%
Dont ITALIE	10,3	2,5%
ASIE	**80,2**	**19,4%**
Dont JAPON	60,1	14,6%
AMERIQUE DU SUD	**15,9**	**3,9%**
Dont BRESIL	12,2	3,0%
AUTRES ZONES	**12,1**	**2,9%**
AUSTRALIE et NOUVELLE-ZELANDE	6,9	1,7%
AFRIQUE	5,2	1,3%
TOTAL	**412,6**	**100,0%**

Source : WORLD LEASING YEAR BOOK 1999.
(1) Opérations sur biens mobiliers et immobiliers.

Text of chart 1:

Column 1

1. LEASING IN EUROPE IN 1998
Countries are classified according to:
1. whether or not they belong to the European Union
2. decreasing order of the amount of their net fixed asset values at the year-end

EUROPEAN UNION COUNTRIES (2)
UNITED KINGDOM
GERMANY
FRANCE
ITALY
SPAIN
AUSTRIA
SWEDEN
NETHERLANDS
IRELAND
PORTUGAL
DENMARK
FINLAND
LUXEMBOURG
BELGIUM (3)
NON-EUROPEAN UNION COUNTRIES (4)
SWITZERLAND
CZECH REPUBLIC
NORWAY
POLAND
HUNGARY
SLOVAKIA
ESTONIA
SLOVENIA (3)

Source: LEASEUROPE

(1) Including rental operations with a purchase option conducted with private individuals and operating lease operators
(2) GREECE: data not available
(3) Data not available in terms of net fixed assets
(4) LEASEUROPE member countries

Column 2

New lending concluded during the year (million €)
TOTAL
Equipment leases and similar operations (1)
Real estate leases

Column 3

Net fixed assets at the year-end (million €)
TOTAL
Equipment leases and similar operations (1)
Real estate leases

Text of chart 2:

Column 1

2. LEASING WORLDWIDE IN 1997
NORTH AMERICA
of which the USA
EUROPE
of which GERMANY
of which the UNITED KINGDOM
of which FRANCE
of which ITALY
ASIA
of which JAPAN
SOUTH AMERICA
of which BRAZIL
OTHER ZONES
AUSTRALIA and NEW ZEALAND
AFRICA
TOTAL

Source: WORLD LEASING YEAR BOOK 1999
(1) Operations on movable and real estate assets

Column 2
New lending concluded during the year (billion US dollars)

Column 3

% of total

APPENDIX II

FACTORING

CP 3 elicits the following observations by factoring companies:

Maturity

The maturity adopted for the calculation of the allocation of equity of factoring operations, must be three months and not one month, as stated by CP 3. In this sense, we stress

- that such maturity corresponds to the economic reality of these operations; factoring falls into the context of inter-company credit, which becomes effectively due on average at three months
- that there are regulatory texts, which set due payment periods of three months in those sectors, in which factors take charge of corporate receivables. These texts, which may be applicable to specific fields of activity (for example the field of fresh produce) or which have a more general range of applicability (directive on due payment periods), have a direct impact on factoring operations.
- that the purchase facilities of factors are rescindable at three months (cf. below)

We therefore suggest that factoring operations relate to exposure at less than three months laid down in § 292.

Stipulations concerning the application of the notion of « purchase facility » (§§ 335 and 336)

If the standard method provides that the commitments with an original maturity up to one year receive a credit conversion factor of 20% (cf. § 56), in the context of internal ratings methods, the text provides for an amount up to 75% of undrawn purchase commitments (cf. § 335). This is a distortion of treatment to the detriment of the IRB method, which does not appear to us to meet the intentions put forward by the prudential authorities for promoting the development of IRB models.

Moreover, since the subject is factoring, one has seen (cf above) that the real maturity of this type of operation is three months and not one year.

We therefore desire that the system laid down in IRB should be competitive with that laid down in the standard method, for example, by the calculation of a specific EAD for these exposures.

Problem arising from the definition of the risk of default

The definition given to default, which is analysed as a sum unpaid for longer than 90 days, does not appear to us to be suitable for operations of factoring. In these operations, the true default is not the result of the existence of late payment, but of the start of a procedure of collection against the debtor (case of contracts without recourse), and against the seller (case of contracts with recourse), the lateness being in practice due to technical reasons.

We want the definition of default to be modified in this sense for operations of factoring, in order to approach more closely the prudential and economic reality.

…/…

Dilution

Definition of the risk of dilution (§ 338)

Factors make a distinction between 4 types of dilution:

- The ordinary dilution which can occur during the life of the agreement (credit notes, ordinary disputes) ;
- The default-related dilution which stays unnoticed until default occurs (non-payment of instalments, subcontractor's direct recovery, netting generating payments by compensation of receivables) ;
- Fraud (anticipated invoices, multiple assignment, forgery, invoices on counterfeit or fraudulent goods, embezzlement);
- For undisclosed agreements only: «commingling » (direct payments that will not reach the factor in case of seller's default between the notification of obligors and the time when they actually forward their payments to the factor).

Definition of PD's and LGD's (§ 338)

For the calculation of the risk of dilution, the CP3 (§ 338) adopts the function relating to corporate exposures with the following parameters, namely, PD corresponding to the estimated EL and LGD of 100%.

As said above, the practice of establishments causes them to assume and manage very varied dilution factors[1]. They are generally able to distinguish between PD and LGD components of dilution risk and want the text to authorise them to do so in IRB in the context of pillar II.

The taking into account of guarantees (§ 339 ii)

Apart from the manager's guarantee, the risk of dilution is covered by mechanisms of reserve funds or restricted funding, which make it possible to absorb the « first loss » on dilution (the sum of these guarantees is fixed for every contract in accordance with risk analysis prior to signature).

The taking into account of these sums does not appear to be set out clearly in CP3, this concerning the treatment of the risk of dilution. The sums must nevertheless be regarded as deposits – or assimilated -, which enable the risk to be covered. Besides, they are registered in accounts specified by supervisors.

Since it is a question of their being taken into account in the calculation of the EL, these sums must be either taken into account on the level of the LGD (net LGD of the sums concerned), or subtracted directly from the EL, if not from equity, in strict compliance with the spirit of the Basel text.

[1] Resulting from different methods of transfer (factoring, whether managed or otherwise, notified or otherwise, with or without recourse). The factor having the possibility to transfer the amount of the dilution, even in the case of a contract without recourse, the materialisation of this risk implies in all cases a default of the seller.

APPENDIX III

GUARANTEES

Treatment of guarantees deposited with the lender

Paragraph 442 of CP 3 envisages two options for taking into account, in the IRB method, guarantees deposited with lender:

- *treatment by adjustment of the factor of « probability of default » (PD) of the operation*: the lender takes into account the PD of the guarantor in his calculation of shareholders' equity;

- *treatment by adjustment of « loss given default » (LGD) of the operation*: the lender integrates into his calculation of allocation of equity the contribution of the guarantee to the LGD of the operation. This device must make it concretely possible for the lender to take into account the reduction of risk attached to the guarantee, whilst retaining in a single portfolio exposures of the same nature (loans on residential real estate, other retail exposures, exposure on small and medium-sized companies…).

This second method, which appears to have been validated following replies given by the Bâle Committee on the occasion of QIS 3, appeared to us to be impaired by the wording of the first sentence of paragraph 444, which prohibits the lender from attributing to an exposure coupled with a guarantee, an estimate of the probability of default or loss given default, which would render the adjusted weighting lower than that of a comparable direct exposure to the guarantor.

If this restriction were confirmed, it would appear to us to be unjustified.

The second proposed method is, in fact, the result of a fair analysis of the risk of operations which it would need to take into account ; in practice, the existence of a guarantee does not directly affect either the probability of default of the debtor, or the nature of the credit, but, on the other hand, it does fully influence the final loss in the event of default. To take into account the effects of a guarantee, it is accordingly logical to preserve, as does the envisaged device, the PD of the debtor, as well as the initial classification of the credit and to integrate the benefit of the guarantee in question into the LGD of the operation.

Now, in applying this method, some establishments will be able to obtain an adjusted weighting lower than that of a comparable direct exposure to the guarantor, in cases where the quality of the debtors and the small amount of losses given defaults will be combined in guaranteed operations (these two elements being measured by internal ratings generated by systems complying with conditions laid down by the texts).

In these cases, the removal of this more favourable weighting would appear inconsistent and unjustified, in view of the principle of fair appreciation of risk which inspires this reform, especially in the IRB approaches.

Consequently, we suggest the elimination of the first sentence of paragraph 444 or, at the very least, its modification, so as not to restrict the application of the method of taking into account the guarantees by means of adjustment of the LGD.