Canadian Finance & Leasing Association
Association canadienne de financement et de location

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March 26, 2015

Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel, Switzerland

Comments on Proposed Revisions to the Standardised Approach for Credit Risk: Basel Committee on Banking Supervision consultative document

Dear Sirs,

Thank you for the opportunity to comment on proposed *Revisions to the Standardised Approach for Credit Risk* as put forward in the consultative document released by the Committee on December 22, 2014.

The Canadian Finance and Leasing Association (CFLA) represents companies active in the asset-based financing, equipment and vehicle leasing industry in Canada. This industry finances over C$300 billion of consumer vehicles, commercial equipment and vehicles. Members range from large multinationals to national and regional domestic companies crossing the financial services spectrum from manufacturers' finance companies and independent leasing companies, to banks, insurance companies and suppliers to the industry.

As its name suggests, asset-based finance is the financing of a specific asset: a vehicle or piece of equipment, commonly by way of a lease, loan, conditional sales contract, or line of credit. The asset is generally the principal collateral for the customer's obligation to make regular payments.

Our starting point is the principle that credit risk weighting should reflect the real underlying credit risk. Based on that principle, the industry feels strongly that any revisions to the standardized approach for credit risk must reflect the unique and positive historical credit quality of our members' business lines. Furthermore, it is recommended that any revisions must reflect the need for our industry to receive weighting treatment tailored to real industry risk factors. As the data presented below indicates, the commercial equipment and vehicle finance industry considerably out performs general and corporate business lending. Leasing and loans with equipment and vehicles as collateral can be identified as subcategories that perform in a distinct and predictable pattern that is substantially better than the performance of general business lending.

A failure to address the unique performance of the commercial equipment and vehicle finance industry as a subcategory will have the unintended consequence of increasing the marginal cost of capital by an incorrect risk assignment and a consequent mis-allocation of capital.

Small and medium sized enterprises (SME) in Canada (< 50 Employees) represent 95% of all Canadian firms and about one quarter of Canada's gross domestic product. Any increase to the marginal cost of capital for commercial equipment and vehicle finance operations will reduce the amount of capital made available to SME and therefore lower the performance of the domestic economy in Canada. As the CFLA has pointed out in previous studies, the commercial equipment and vehicle finance industry plays an important role in the Canadian economy and each dollar of financing provided to SME contributes significantly to the Canadian economy. In 2013, 32% ($34 Billion) of all machinery and equipment and commercial vehicle acquisition was financed by the firms described above. As the table below demonstrates, the economic impact of the financing activity goes beyond the $34 Billion increase in spending.

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Economic Impact of a $34 Billion Increase in Public & Private Sector Machinery and Equipment Investment Spending

	First Year	Long-run Average
Investment Shock	34.3	0.0
GDP Impact	14.2	8.9
Consumption Impact	3.7	8.0
Investment Impact	36.3	9.5
Government Revenue Impact	4.3	0.7
Employment Impact (thousand)	100.3	27.8

Source: C4SE Provincial Economic Modelling System

The CFLA wishes to draw the attention of the Committee to the particular credit performance of commercial equipment and vehicle finance transactions in comparison to corporate and general business lending in Canada. It is clear from the data provided below that incurred losses of our industry are significantly lower than losses incurred by corporate and general business lending

Default Rates - Small and Medium Sized Businesses versus Corporations			
	U.S. SME Debt[1]	**Canada SME Debt[3]**	**Non-Investment Grade Corporate Bonds[5]**
2014 Default Rate	1.4%	2.0%	2.2%
2013 Default Rate	1.4%	1.5%	1.7%
5 Year Avg. Annual Historical Default Rate	2.2%	2.0%	2.5%
Peak Default Rate Last 10 Years	6.2%	4.6%	14.6%
1 Year Probability of Default	1.5%[2]	2.2%[4]	2.8%
Sources:			
1. PayNet Historical Default Rates on U.S. business borrowers with total credit exposure less than $2.5mm.			
2. AbsolutePD on U.S. business borrowers with total credit exposure less than $2.5mm.			
3. PayNet Historical Default Rates on Canadian business borrowers.			
4. Absolute PD on Canadian business borrowers with total credit exposure less than $2.5mm.			
5. January 2015 Monthly Default Report, U.S. Speculative Grade Bond Default Rates, Moody's Investor Service			

Definition of “Default”:
The borrower is considered to be in Default with all relationships if any lender reports the borrower being in Bankruptcy
The borrower is considered to be in Default with the subject lender if any contract with the subject lender is in one of the following statuses:

- Legal
- Repossession
- Loss > $5,000 and > 5% of Total Relationship Outstanding

The borrower is considered to be in Default with the subject lender if :
- The borrower is 91 or more days past due (or if the borrower has multiple open contracts with the lender, then the outstanding-balance-weighted average of those contracts is 91 or more days past due; or the majority, by outstanding balance, of the borrower’s contracts are 91 or more days past due AND the outstanding-balance-weighted average is 61 or more days past due)

Definition of “Relationship”:
Each borrower-lender combination is viewed as a Relationship

One transaction with a lender cannot be in Default while other contracts with that same lender are not; all or none of the lender’s contracts with that borrower are in Default
- A borrower could default with one lender (one Relationship), but not with other lenders

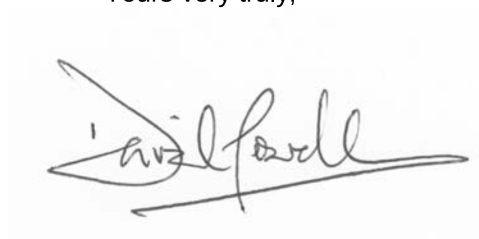
Conclusion

Again, we return to first principles: credit risk weighting should reflect the real underlying credit risk.

The Canadian data plainly supports the need to have a lower risk rating for asset-based commercial equipment and vehicle finance exposures in the standardized approach under discussion. A failure to address the unique positive performance of the asset-based commercial equipment and vehicle finance sub category will likely reduce the flow of capital to SME and threaten the competitiveness and sustainability of this part of the financial services sector. Our industry is a proven contributor to Canadian economy and a catalyst for growth of the gross domestic product. Revisions to the standardize approach to credit risk need to give tailored weighting treatment to our industry.

Should you have any questions, please do not hesitate to contact the undersigned.

Yours very truly,



David Powell
President & Chief Executive Officer

<u>Attachment</u>
List of Members of the Canadian Finance & Leasing Association

<u>Copy</u>
Members of the Canadian Finance & Leasing Association