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

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March 10, 2016

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

Comments on the second consultative document on proposed
Revisions to the Standardised Approach for credit risk

Dear Sirs,

On March 26, 2015, the Canadian Finance & Leasing Association (CFLA) submitted its comments on the December 2014 proposed *Revisions to the Standardised Approach for credit risk*.

Thank you for the opportunity to comment on the second consultative document on proposed *Revisions to the Standardised Approach for credit risk* released by the Committee on December 10, 2015.

Asset-based financing in Canada

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$335 billion of vehicles and equipment in Canada, making it the largest provider of credit and capital to Canadian businesses and consumers after traditional lending. It is much larger that most Canadians realize and increasingly has become entrenched in the economy, expanding the pool of available capital and offering a competitive choice to businesses and consumers.

Banks, credit unions and other regulated financial institutions are primary funders of the asset-based financing sector in Canada. Changes to the calculation of regulatory capital that restrict the capacity of financial institutions to fund asset-based financing will simply reduce the flow of capital to consumers and businesses and threaten the competitiveness and sustainability of this part of the financial services sector.

Asset-based financing is offered by banks, credit unions, government financial institutions, manufacturer finance companies, independent finance companies and by vendors. Vendor financing is probably the most direct way for businesses and consumers to access this form of financing. That is, manufacturer finance companies, independent finance companies or banks providing financing through vendors/ dealers at the point of sale.

It is the sole mandate of the asset-based finance industry to finance the acquisition of equipment, machinery and vehicles by business and consumer customers. This industry supports a broad network of dealers, manufacturers, distributors, vendors and brokers, and their customers, in hundreds of communities throughout Canada. The auto manufacturer finance companies and banks finance dealers and their customers to acquire vehicles. Commercial fleet lessors use networks of auto dealers to acquire, maintain and dispose of fleets of vehicles for customers across Canada. Equipment financing companies have relationships with manufacturers, vendors and distributors of all sizes to provide financing to their customers to acquire machinery and equipment. Many equipment financing companies work with local independent brokers to supply financing to customers.

Asset-based finance is not the same as a classic loan. The industry complements the work of conventional lenders but stands alone as its own alternative way of financing. 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 by a line of credit. The customer doesn't actually own the equipment or vehicle; the financing company owns it until the customer buys it or returns it. The asset financed is the principal collateral for the customer's obligation to make regular payments.

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Ownership of the asset financed is intrinsic to an asset-based financing transaction and this fact is critical to the question of risk weighting.

First, ownership of the asset financed is a substantial advantage over other financing products. Conventional financings are typically not secured by physical assets rather by financial collateral and/or personal guarantees based on net worth. The direct ownership of the asset, however, provides efficient and effective security that significantly reduces the credit risk.

Second, data over the years is consistent. Customers, both consumers and businesses, using asset-based financing treat payments as a priority because the assets are core, in the case of consumers, to their lifestyle (e.g. an automobile) and, in the case of a business, critical to operations. As a result, customers will take pains to keep their regular payments current to ensure uninterrupted use of the asset.

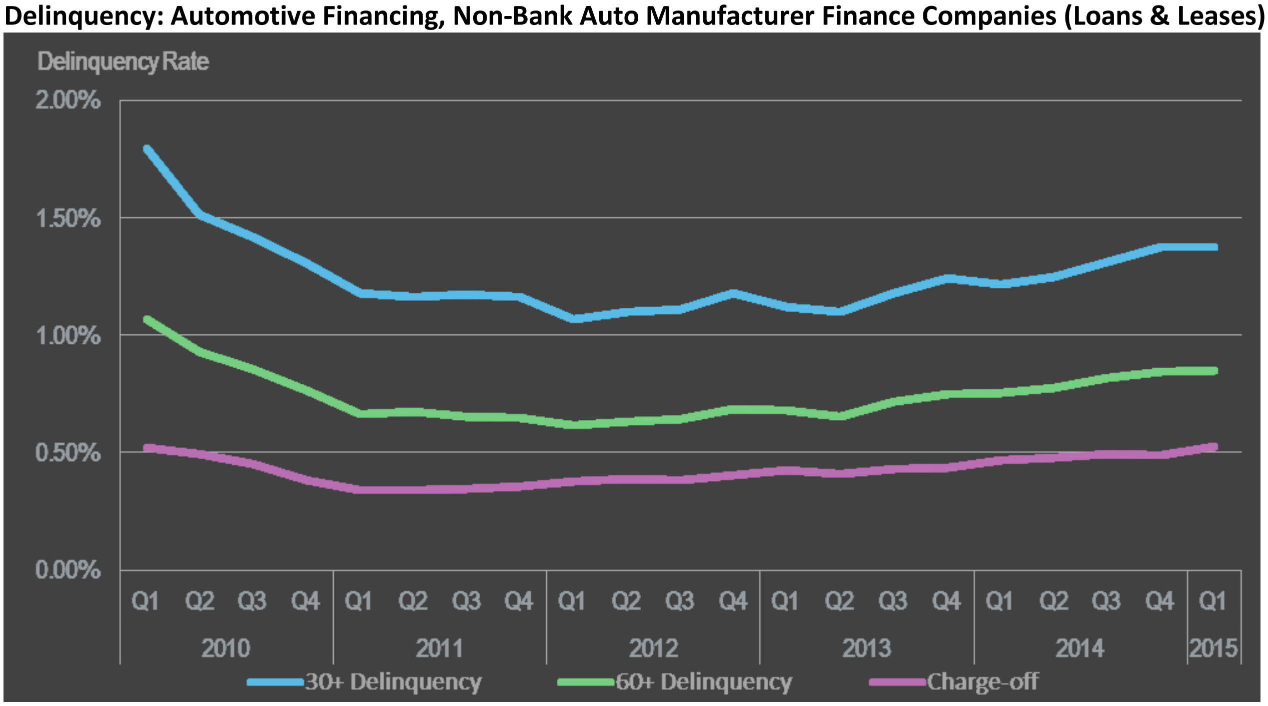
Third, since its very beginnings, those active in asset-based finance have become experts in different equipment and vehicles and how they will be used. The finance company must understand the asset and its value at every stage of its useful life. From receipt of the customer's application to the asset's return or repossession, the finance company must know what the asset is worth and how it is used. This is crucial to safeguard its position. In the case of a lease, finance companies must accurately forecast the value of the asset in the event they get it back several years later. Consequently, unlike other sectors of financing, the asset-based financing company is in the best position to minimize its losses through optimizing the repurposing or remarketing of its assets.

Superior performance of asset-based finance assets

As the data presented below indicates, the vehicle and equipment finance industry considerably outperforms consumer 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.

Consumer asset-based financing experience

Delinquency: Automotive Financing, Non-Bank Auto Manufacturer Finance Companies (Loans & Leases)



Source Automotive Financing Trends, Q1 2015, prepared by Equifax Analytical Services

Delinquency: Automotive Financing, Financial Institution Installment Loans

Source Automotive Financing Trends, Q1 2015, prepared by Equifax Analytical Services

Commercial asset-based financing experience

As the data presented below indicates in summary, commercial customer losses incurred by the asset-based finance industry are significantly lower than losses incurred by corporate and general business lending.

Default Rates - Small and Medium Sized Businesses			
	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 or 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).

General Comments

As with our submission of March 26, 2015, 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 indicates, the asset-based 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 asset-based 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.

Canadian Light Vehicle Retail Finance Market. On the consumer side (principally the financing of vehicles), of the 4,287,000 light vehicle retail sales in 2014 (new and used), over 85% of the units sold, or valued at C$77.9 Billion, obtained asset-based financing.

SME Financing. According to the latest available government statistics, small and medium-sized enterprises (SME) in Canada (< 500 Employees) represent 95% of all Canadian firms. SME account for 90% of total private sector employment and 91% of all new jobs in the private sector. Furthermore, SME account for 39% of Canada's Gross Domestic Product (GDP), while 25% of GDP is generated by the public sector and 36% by large businesses.

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 national economy. In 2013, 44% (C$34 Billion)[1] of all machinery and equipment and commercial vehicle acquisition was financed asset-based financing. As the table below demonstrates, the economic impact of the financing activity goes beyond the $34 Billion increase in spending.

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

Any increase in the marginal cost of capital for the asset-based finance sector will reduce the amount of capital made available to consumer and business customers and therefore lower the performance of the domestic economy in Canada.

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[1] The CFLA March 26, 2015 letter indicated that "in 2013, 32% (C$34 Billion) of all machiney and equipment and commercial vehicle acquisition was financed by the" commercial equipment and finance industry. Subsequent to that letter, later in 2015 revised public and private capital and repair expenditures data was released by the Canadian government.

Leaseurope Submission

We have had an opportunity to review the submission of Leaseurope to the Committee on the second consultative document. As it reflects much of the situation found in Canada, CFLA endorses the views put forward by Leaseurope. In particular, CFLA wishes to underline its agreement with the position presented on page 3 of the Leaseurope submission:

> "Ultimately, we believe that there is a demonstrated case for differentiated risk weights calibrated as a distinct exposure class e.g. a new "secured lending" or "leasing" exposure class. This option will make the regulation more risk sensitive."

Like Leaseurope, CFLA would be willing to provide assistance in establishing an effective treatment.

Conclusion

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

The Canadian data, and that provided by Leaseurope, clearly and consistently supports the need to have a lower risk rating for asset-based finance exposures in the standardized approach under discussion.

Changes to the calculation of regulatory capital that fail to address the unique positive performance of the asset-based finance sub-category, consequently restricting the capacity of financial institutions to fund asset-based financing, will simply reduce the flow of capital to consumers and businesses 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 national GDP. 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

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

The Members of CFLA ♦ Les membres de l'ACFL
as of December 31, 2015

Accord Financial, Equipment Finance
Accurate Leasing Ltd.
ADD Capital Corp.
Addison Leasing of Canada Ltd
ADESA Canada
Admiralty Leasing Inc.
Advant Leasing Limited
Aird & Berlis LLP, Barristers & Solicitors
ALLWEST INSURANCE SERVICES LTD.
Alta Canada
Arbutus Leasing Group
ARI Financial Services Inc.
Arundel Capital Corporation
ATB Financial
Atticus Financial Group
Auctus Auto Group
AutoVin Canada Corp.
Axiom Leasing Inc.
BAL Global Finance Canada Corporation
Bank of Montreal
Banque Laurentienne -
BDO Canada LLP
Bennett Jones LLP
Bennington Financial Services Corp.
Blake, Cassels & Graydon LLP
Blaney McMurtry LLP
Blue Chip Leasing Corporation
BlueShore Financial
BMW Group Financial Services Canada,
a Division of BMW Canada Inc.
Bodkin Leasing Corporation
Bruce Auto Group
CAG Vancouver
Calidon Financial Services Inc.
Canadian Automotive Fleet Magazine
Canadian Equipment Finance & Leasing Inc.
Capmor Financial Services Corp.
Carbon Capital Corporation
Cardel Leasing Limited
Cars on Credit .ca Inc.
Cars4u.com
Casitron Ltd.
Cassels Brock & Blackwell LLP
Catalyst Finance Partners Inc.
Caterpillar Financial Services Ltd.
Central Technology Services
CHP Consulting Ltd.
CIBC Wholesale Banking
Cisco Systems Capital Canada Co.
CIT Financial Ltd.
CLE Canadian Leasing Enterprise - Crédit-Bail Clé
CLI Leasing Corporation
Coast Capital Equipment Finance LTD
Concentra Financial, Commercial Leasing Services
Connect Lease Corporation
Constellation Financing Systems
Corpfinance International Limited
Credicor Financial Corp.
Crelogix Credit Group Inc.
CSI Leasing Canada Ltd.
CTL Corp
Cullen Diesel Power Ltd.
D&D Leasing
D+H Ltd.
D.L.C Leasing Inc.
DLL Financial Services Canada Inc.
Dealertrack Technologies
Deloitte & Touche LLP
DLA Piper (Canada) LLP
DRIVING FORCE INC.
DSM Leasing Ltd.
Dynamic Capital Equipment Finance Inc
EASYLEASE CORP.

Element Financial Corporation
Element Fleet Management Inc.
EMKAY Canada Fleet Services Corporation
Equifax Canada
Equirex Leasing Corp.
Essex Capital Leasing Corp.
Essex Lease Financial Corporation
Eugene E. Macchi Personal Law Corporation
Excel Leasing Inc.
Execucor Financial Limited
Finloc 2000 Inc.
First Access Funding Corp.
First Capital Leasing Ltd.
First Union Rail Corporation
First West Leasing Ltd.
Fiserv Inc. (Lending Solutions)
Ford Credit Canada Ltd.
Foss National Leasing
FPC Leasing Corporation o/a Financial Pacific Leasing
Fuyo General Lease(Canada) Inc.
GC Leasing Ontario Inc.
GE Capital
General Motors Financial of Canada Ltd.
Geolin
Gold Key Sales and Lease LTD.
Gowling Lafleur Henderson LLP/s.r.l.
Great American Insurance Company
GreatAmerica Financial Services, Inc.
Greenback Leasing Corp.
HarbourEdge Commercial Finance Corporation
Harrison Pensa
Hav-A-Kar Auto Group
Hitachi Capital Canada Corp.
Honda Canada Finance Inc.
HUB International HKMB Limited
Humberview Group Leasing Inc.
Hyundai Capital Canada
IBM Global Financing, a division of IBM Canada Ltd.
IndCom Leasing Inc.
Infinity Leasing Inc.
Jim Pattison Lease
Jim Peplinski Leasing Inc.
John Deere Financial Inc.
Jones Brown Inc.
Kempenfelt Capital Inc.
Key Equipment Finance Canada Ltd.
Kronis, Rotsztain, Margles, Cappel LLP
Kropschot Financial Services, a member of The Alta Group.
Lapointe Rosenstien Marchand Melançon S.E.N.C.R.L/L.L.P
Lavery, de Billy S.E.N.C.R.L. Avocats
Lease Insurance International
Lease Link Canada Corp.
Lease Plus Financial - 7964927 Canada Inc.
LeaseDirect Canada Corporation
LeaseFund International Inc.
Leasepath
Leasepath.com
LeaseTeam, Inc.
Leman Group Advisory Services
Liftcapital Corporation
Linedata Lending & Leasing
Lionhart Capital Ltd.
LMG Finance Inc
M+I Equipment Finance Co.
Macquarie Equipment Finance (Canada) Ltd.
MapelLease Financial Services Ltd.
Maxium Financial Services Inc.
McCarthy Tétrault LLP
McLean & Kerr LLP
McMillan LLP
Medi-One Financial
Mercedes-Benz Financial Services Canada Corporation
Miller Thomson LLP
Minden Gross LLP
Minerva Holdings Ltd.
Money in Motion Inc.
National Leasing
Newfound Capital Corp.
Newroads Automotive Group Ltd o/a New Roads National Leasing
Nisco National Leasing
Nissan Canada Finance
Norand Capital Ltd. o/a UMA "Your Financial Partner"
Northstar Acceptance Corporation
Northstar Leasing Corporation
Norton Rose Fulbright Canada LLP
O'Regan's National Leasing
Odessa Technologies Inc.
Oracle Financing Division

Orchid Leasing Corporation
Osler, Hoskin & Harcourt LLP
Pacific & Western Bank of Canada
Paige-Ruane Inc.
Patron West Equip Finance
PayNet Inc.
PDP Group, Inc.
Peel Financial Inc.
Pfaff Leasing
Platinum Asset Services
PNC Equipment Finance
Polaris Leasing Ltd.
Porsche Financial Services Canada
Portfolio Financial Servicing Company/PFSC Canada Inc.
PPSA Canada Inc.
Precision Paralegal Services
Prime Capital Consulting and Forest Leasing (2008) Inc.
QUESTOR FINANCIAL CORP.
RBC Equipment Finance Group
RCAP Leasing Inc.
Rifco National Auto Finance
Ritchie Bros. Financial Services Ltd.
Roderick H. McCloy Law Corp/
Shapiro Hankinson & Knutson Law Corp.
Roynat Lease Finance
Ryzn Enterprise Systems Inc.
Savoie Joubert, g.p.
SCI Lease Corp.
Scotiabank Leasing Group
Securcor Corporation
Securefact
Services Financiers Leblanc
SIT Strategic Information Technology Ltd.
Skelter Imports Inc. DBA Exxel Truck & Equipment Sales
Somerville National Leasing & Rentals Ltd.
Spartan Services Inc./Securcor
Stonebridge Lease Financing Corporation
Summerside Financial Corp
Summit-Northlake Canadian Leasing Corp.
Sun Life Financial
TAO Asset Management
TD Equipment Finance Canada Inc.
TFG Financial Corporation
TIP Capital
Torys LLP
Toyota Financial Services Canada Inc.
TPine Leasing Capital Corporation
Trademark Capital Finance Corporation
Trans Lease Canada
Transcourt Inc.
TransUnion of Canada
Trend Financial
Tricor Lease & Finance Corporation
Tycor Systems Ltd.
Upper Canada Leasing
VantageOne Leasing Inc.
Vista Credit Corp
VIVA Financial Corp
Volvo Financial Services
VW Credit Canada Inc.
Wells Fargo Equipment Finance Company
Weslease Income Growth Fund LP (Weslease)
Westana Staff Leasing Fund Ltd
Wheels Leasing Canada Ltd.
Wilson Vukelich LLP
WS Leasing Ltd.
Yellowhead Equipment Finance Ltd.