ELFA
Equipping Business for Success

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Bank for International Settlements
Centralbahnplatz 2 and Aeschenplatz 1
CH-4002, Basel, Switzerland

Dear Sir/Madam:

The Equipment Leasing and Finance Association (ELFA) provides this response to the Bank for International Settlements (BIS) ***Revisions to the Standardized Approach for Credit Risk - Consultative Document,*** dated December 2014.. The ELFA is the trade association representing over 600 financial services companies and manufacturers in the $903 billion U.S. equipment finance sector. ELFA members are the driving force behind the growth in the commercial equipment leasing and finance market and contribute to capital formation in the U.S. and abroad. Overall, business investment in equipment and software accounts for 8.0 percent of the GDP; the commercial equipment finance sector contributes about 4.5 percent to the GDP. For more information, please visit http://www.elfaonline.org

This response is based on empirical evidence of historical default rates of various segments of corporate lending, which is assigned a 100% risk weighting under Basel III. Many types of borrowers use commercial and industrial lending for credit – municipalities, large corporations, middle market companies and small and medium sized businesses (SME). Credit forms include various types of lending facilities. Large corporations use public or private bonds or bank loans. Municipalities use general obligation or revenue bonds. Small and medium sized businesses use term loans or revolving lines of credit. BIS has assigned a 100% risk weight to corporate lending in aggregate, which is made up of these varied borrowers and credit facilities. An analysis shows the credit quality differs materially enough by borrower and facility types to warrant risk weights that vary according to the underlying credit characteristics of the borrower and facility. BIS must allow each sub-segment to receive risk weightings appropriate to its accurate credit risk as shown in past default performance and probabilities of default.

ELFA represents 450 commercial lenders to U.S. businesses to help finance their growth. Equipment finance not only contributes to businesses' success, but to U.S. economic growth, manufacturing and jobs. Seventy-two percent of U.S. companies use some form of financing when acquiring equipment, including loans, leases and lines of credit (excluding credit cards). Each year, American businesses, nonprofits and government agencies invest $1.454 trillion in plant, equipment and software annually. Some 62%, or $903 billion, is financed through loans, leases and lines of credit. America's equipment finance companies are the source of such financing, providing access to capital. Equipment finance companies also finance the export of U.S. manufactured products abroad. ELFA members provide financing to all sectors of the corporate credit market.

Historical default rates show the varied credit risk of borrowers. For example, SMEs show default rates 12% up to 58% ***lower*** than U.S. non-investment grade corporate bonds. U.S. Corporate Bank Loans exhibit a default rate nearly double SMEs in the recession at 12.0% versus 6.2%, respectively. Municipal bonds, which receive a 20% risk weight from BIS, show default rates far lower than non-investment grade bonds and bank loans. U.S. investment grade corporate bonds stand as the lowest defaulting borrowers at only 0.3%. Variance between large corporations, middle market companies and medium and small businesses varies by orders of magnitude of 200% in some cases. Each of these assets deserves risk weights appropriately informed by actual and probability of default rates as opposed to general corporate lending risk weight of 100%. BIS's goal to strengthen the regulatory capital standard can be better achieved by reflecting the actual and specific risk nature of borrowers.

Default Rates by Borrower Type

	U.S. SME Debt[1]	U.S. Investment Grade Corporate Bonds[5]	U.S. Bank Corporate Loans[5]	U.S. Non-Investment Grade Corporate Bonds[5]
2014 Default Rate	1.4%	0.0%	0.9%	2.2%
2013 Default Rate	1.4%	0.0%	2.4%	1.7%
2009 Default Rate	6.2%	0.3%	12.0%	14.6%
6 Year Avg. Annual Historical Default Rate	2.9%	0.1%	3.6%	2.5%

Sources:

1. PayNet Historical Default Rates on U.S. business borrowers with total credit exposure less than $2.5mm.
5. Default Report, Moody's Investors Service

Credit performance varies greatly by facility type. Loss given default is much different depending on type of collateral. For example, essential use equipment presents very low credit loss, whereas general purpose equipment, such as furniture and fixtures, offers much higher loss given defaults. Loss given default can vary depending on the type of recession. In the 2000 Internet bubble, technology-based collateral values fell much faster than construction equipment. Owner occupied real estate showed far higher losses in default in 2009 than in other economic contractions.

Private U.S. businesses comprise approximately 50% of U.S. gross domestic product. They consist of about 7 million employer firms and another 20 million sole proprietorships. These private small and medium sized businesses account for most new job growth and they generate more patents per capita than large corporations. Commercial and Industrial lending, which are made to small and medium sized businesses, totals approximately $1.6 trillion according to the Federal Deposit Insurance Corp. Quarterly Banking Profile. Credit is one primary source of growth capital for private companies accounting for about 20% of their capital structure based on debt outstanding divided by gross production.

Pooling large corporations, municipals and SME's into "one size fits all" corporate loans with a 100% risk weighting skews the cost of capital for lending operations at U.S. banks. In some cases, lending operations heavy into non-investment grade bonds will receive favorable capital treatment. Other lending operations heavy into SME lending will subsidize the cost of capital for higher risk lending units within the same bank. For example, SME lending of loans secured by equipment would have paid a higher than warranted interest cost in 2013 to fund their lending operations and this higher capital cost increases the cost of credit to an SME borrower. One example shows higher capital costs translate into an extra $64,000 interest costs for a $1 million loan (10.8% interest cost) over three years.

The proposed Revisions to the Standardized Approach for Credit Risk seek to strengthen the existing regulatory capital standard in several ways. Quantitative analysis of default rates show risk weightings should not be a "one size fits all" for corporate lending. Application of a 100% risk weighting to each segment of corporate lending means some segments are penalized and others gain a capital cost advantage at different points in the economic cycle. This "one size fits all" approach distorts the lending markets by unfairly raising costs for SMEs and lowering costs for higher risk non-investment grade corporates or larger syndicated bank loans. Distortions in the lending market that flow through to business borrowers can have a negative impact on economic growth by restricting access to credit at times when it should be easier to obtain.

We respectfully request that BIS add a mechanism that allows risk weightings to be appropriate to each type of corporate lending. The assignment of risk weightings must be determined by the recent actual and probabilities of default specific to SME, investment grade, bank loan and non-investment grade credits. This mechanism can be easily accomplished through an allocation of the 100% corporate risk based on the lending unit's borrower and facility type and the associated defaults rates specific to those loans.

We appreciate the opportunity to provide our views on this most important matter and are available to provide additional input as necessary.

Sincerely,

William G. Sutton, CAE
President and CEO