

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

Brussels, 11 March 2016

Re: Second Consultative Document on Revisions to the Standardised Approach for credit risk

Dear Sir/Madam,

Leaseurope welcomes the opportunity to respond to this consultation. Leaseurope brings together 45 member associations representing the leasing, long term and/or short term automotive rental industries in the 33 European countries in which they are present. The scope of products covered by Leaseurope members' ranges from hire purchase and finance leases to operating leases of all asset categories (automotive, equipment and real estate). It also includes the short term rental of cars, vans and trucks. It is estimated that Leaseurope represents approximately 92% of the European leasing market. In 2014, total outstanding volume worth €729.5 billion and total new leasing volumes worth €274.2 billion were granted by the roughly 1400 firms represented through Leaseurope's members.

General comments

We very much welcome that the Committee has proposed, in this second consultative document, to reintroduce external ratings, in a non-mechanistic manner, for exposures to banks and corporates as we think that in Europe credit reports are generally reliable and credit agencies provide reports on most businesses. We also support the differentiated risk weighting of SMEs exposures.

In general we wish to ensure that any possible further changes to the calculation of regulatory capital do not result in banks restricting the provision of finance to businesses in Europe, particularly through asset finance. Lease finance is an important mechanism for funding the real economy, particularly for SMEs, and it has low default and loss given default rates. Therefore it is important that any changes to assessment of credit risk - whether for the standardised or internal ratings-based approaches - should reflect this.

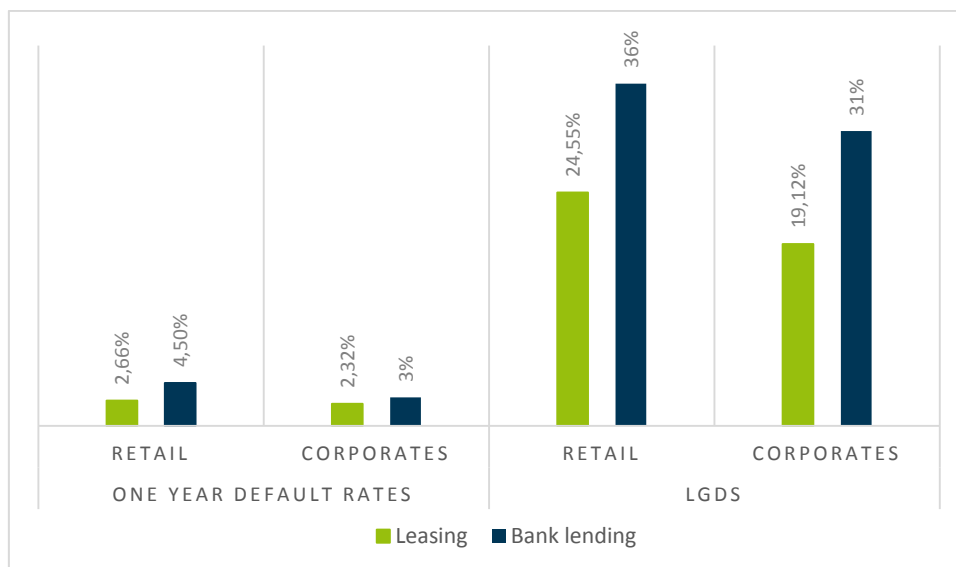
A differentiated treatment for leasing

Credit risk weightings under the proposed standard should reflect the real underlying risks, without adding undue complexity. Failure in this could lead to otherwise healthy, beneficial lending being disincentivised in terms of capital allocation and cost of funding. With this in mind, we suggest there is a strong case for differentiating lease finance (where the asset is owned by the finance company during the life of the agreement) with a specific risk weight.

The unique feature of a lease is the lessor's ownership of the leased asset. These ownership rights provide lessors with a valuable and efficient form of in-built security which makes leasing extremely low-risk. Asset ownership represents a major advantage for lessors compared to other financial products such as traditional loans, which are typically not secured on physical assets but rather with financial collateral or personal guarantees.

Default rates within the leasing activity are low because the lessor is funding a physical asset crucial to the client's core business activities. Businesses therefore prioritise lease payments because they need these assets to run their business. As the asset is a key working tool for the lessee, many defaulted leases regrade back to a healthy situation with a zero loss. Additionally, ownership of the asset makes repossession relatively fast and straightforward for the lessor (if it is necessary at all). The lessor can then sell or re-lease the asset in order to decrease any losses on the default, resulting in low loss rates. If the value of the asset exceeds the amount outstanding at default, the lessor can actually make a gain in the case of a default.

In Europe, Deloitte undertook extensive research on our behalf (which we have shared with the Committee) which demonstrates that the leasing business model leads to significantly lower risk compared to traditional lending. The graph below shows the results of the research, which was based on a portfolio of 3.3 million lease contracts in 15 European countries. The graph shows that default rates and loss given defaults (LGDs) for leasing Retail and Corporate exposures are significantly lower compared to bank lending averages. These leasing LGD figures are for stressed conditions, average loss rate figures are even lower. European capital requirements under the Standardised Approach are also shown to be 10x higher than the real risks for SME leases within the Retail class.



This result is consistent with data for other equipment finance markets, for example in the US and Canada, confirming that businesses across any jurisdictions will prioritise paying for equipment finance because they need these assets to continue to run their businesses.

We believe that the risk sensitivity of the proposal can be further increased without introducing unnecessary complexity. As the current proposal does not reflect properly the real risks of leasing exposures and does not recognise physical collateral for credit risk mitigation, we propose various ways to increase the risk sensitivity of the framework.

We regret that the TFSA did not propose any specific treatment for this type of lending, and we disagree with the notion that it would introduce undue complexity. For the purpose of this consultation, which is quite advanced in the process, we propose differentiated risk weights within an existing exposure class e.g. a specific “secured lending” or “leasing” risk weight within the Retail/Corporate classes. This could be achieved in one or two additional lines, as is done with SME exposures, with the inclusion of a workable definition.

Ultimately, we strongly 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. Leaseurope is currently investigating an appropriate risk weight calibration and would be happy to provide our assistance in establishing an effective treatment.

Alternatively, the appropriate recognition of physical collateral within the Credit Risk Mitigation (CRM) framework of the Standardised Approach could achieve a similar outcome.

Specific comments on the various exposure classes

Section 1: Proposed revisions to the Standardised Approach for credit risk

1.1.1 Exposures to banks

We support that exposures to securities firms and other financial institutions will be treated as exposures to banks provided that these firms are subject to prudential standards and a level of supervision equivalent to those applied to banks. We welcome this as it is important that non-bank financial intermediaries (such as many leasing companies in Europe) are not automatically classified as ‘corporates’ for credit risk assessment purposes, as that would unnecessarily restrict this important alternative channel of SME finance.

However we are concerned with the definition in Annex 1 – Section 5 paragraph 30 as the Committee restricts its definition of financial institutions to those with capital and liquidity requirements. Many non-bank financial institutions in Europe are subject to prudential supervision but not necessarily to capital and/or liquidity requirements as they are non-deposit-taking. We would urge the Committee to select a single and consistent definition of ‘financial institution’ that reflects the fact that many such bodies in Europe will not take deposits from the public. A suitable definition could be “financial institutions authorised and supervised by the competent authorities and subject to relevant prudential and supervisory requirements”.

1.1.2 Exposures to corporates

Firstly, as already discussed in this position, the risk sensitivity for corporate exposures would be increased by taking into account the low-risk nature of leasing transactions. Based on the aforementioned Deloitte research, one-year defaults on leasing corporate exposures were 2.3% compared to 3% for all corporate lending in 2010. Similarly, the average loss rate for leasing was 11.1%, with a stressed LGD of 19.1%, compared to 31% for all Retail SME lending.

Secondly, we welcome the Committee's proposed treatment for Corporate SME exposures but suggest that a 75% risk weight would reflect better the reality of the market.

1.4 Retail portfolio

Firstly, we welcome that the Committee recognises that "the only risk driver that had the potential of enhancing the risk sensitive of the exposure class was the extent to which an exposure is secured by durable goods". However we regret that no specific treatment is proposed. As for corporate exposures, the risk sensitivity for retail exposures would be increased by taking into account the low-risk nature of leasing transactions. Based on the aforementioned Deloitte research, one-year defaults on leasing retail SME exposures were 2.7% compared to 4.5% for all Retail SME lending in 2010. Similarly, loss rates for leasing were 19.6%, with a stressed LGD of 24.6%, compared to 36% for all Retail SME lending.

Secondly, we agree that exposures to SMEs complying with paragraph 46 of Annex 1 will be treated as regulatory retail exposures. However the definition of a granularity criteria where no aggregate exposure to any single counterparty can exceed 0.2% of the overall regulatory retail portfolio is too restrictive, particularly for smaller institutions. For example, in Europe the Capital Requirements Regulation (CRR) Article 123b states that "the exposure shall be one of a significant number of exposures with similar characteristics such that the risks associated with such lending are substantially reduced".

Lastly, we support the treatment of SMEs exposures which fall under "other retail exposures" as corporate SMEs exposures.

1.5 Real estate exposure class

We consider that commercial real estate exposures are unfairly penalised (articles 58 and 60) in the new proposal, with a higher risk weight of 60% compared to the current 50% when LTV is < 60%.

Leasing specificities – leasing is secured through ownership of the assets and presents a lower risk profile as illustrated above - are not sufficiently taken into account in the proposal. As far as leasing is concerned, the risk weighting formula based on comparison of a fixed coefficient and the counterparty's risk weighting (as introduced in Appendix 1 table 11) especially lacks risk sensitivity. Therefore, we would recommend extending the LTV bucketing principle proposed in Appendix 1 - table 9 to real estate leasing in order to improve the risk profile accuracy.

When LTV is higher than 60%, the corresponding risk weight in Table 12 is at least 100%, which corresponds to the risk weight for defaulted residential real estate exposures (as per article 78) and other assets (cf. article 80). Therefore, the second consultative document creates a situation where a secured exposure receives a higher risk weight than an unsecured exposure.

In addition, currently a 50% risk weighting is applied to commercial real estate exposures not exceeding 50% of the market value of the asset, and the risk weighting of the counterparty is applied to the residual part of the exposure. According to paragraph 58, the risk weights described in table 11 are to be applied to the entire exposure, without any possibility of splitting between the part of the exposure not exceeding 60% LTV and the remaining exposure. This new rule would have a significant impact in terms of RWAs of commercial real estate exposures (including leasing).

We recommend keeping the current rule allowing a split risk weighting between the part of exposure not exceeding LTV buckets and the remaining part of the exposure. This, in order to avoid disproportion in risk weights if compared with the ones that would result by adopting the IRB approach.

1.7 Off-balance sheet exposures

We would like to point out that while CCFs for unconditionally cancellable retail commitments are defined in Annex 1 - Section 11 paragraph 69 with a CCF of 10-20%, unconditionally cancellable commercial commitments seem to fall under point 66 with a CCF of 50-75%. Under the current framework, these exposures have a CCF of 0%, therefore the new treatment would be a dramatic increase. We would propose having a specific category for unconditional cancellable commercial commitments (like for retail commitments) with a CCF of 0%, therefore retaining the current treatment.

1.8 Defaulted exposures

We disagree with the proposed treatment of defaulted exposures, where risk weights would not be linked to the level of specific provisions.

This new treatment would discriminate against those banks which have a more conservative approach in provisioning.

As an example, according to the current rules:

- Bank “A”, who, with €100 of defaulted exposure, provides €20 of specific provision, calculates a RWA of €80 (100% of the net exposure),
- Bank “B”, providing only €10 of specific provision for the same exposure amount, calculates a RWA of €135 (150% of the net exposure).

According to the new rules proposed in the current consultative paper:

- RWA calculated by Bank “B” would remained unchanged,
- Bank “A” would see its RWA growing from €80 to €120 (150% of net exposure).

This effect would be a disincentive for banks to utilise higher levels of provisions.

From a methodological point of view there is also a relationship between the RW and provisions. In the current IRB approach framework, sections 328-330, “The capital requirement (K) for a defaulted exposure is equal to the greater of zero and the difference between its LGD and the bank’s best estimate of expected loss...” where the best estimate of expected loss is an approximation of the impairment provisions (if not, any positive difference would be deducted to CET1). This definition provides a strong incentive to include stressed macroeconomic conditions on impairment calculations in order to minimise unexpected losses.

For this reason, and in order to incentive more prudential provisions for those firms using the Standardised Approach, we ask you to maintain the current treatment of past due (“defaulted”) exposures.

Section 2: Proposed revisions to the credit risk mitigation framework for exposures risk-weighted under the Standardised Approach

We draw your attention to the fact that the current framework does not recognise physical collateral for credit risk mitigation, despite this being a valuable form of collateral.

I remain at your disposal, should you be interested in discussing any specific issue. Alternatively feel free to contact my colleagues Rafael Alarcón Abeti (r.alarconabeti@leaseurope.org – tel: +32 2 778 05 69) and Hayley McEwen (h.mcewen@leaseurope.org - tel: + 32 2 778 05 71).

Yours sincerely



Leon Dhaene
Director General