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The Secretariat
Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

21st March 2016

Dear Sirs,

Re: Second consultative document on Standards: Revisions to the Standardised Approach for credit risk (the Consultation)

The Rail Working Group is a Swiss not-for-profit rail and finance industry group constituted at the request of the International Institute for the Unification of Private Law (UNIDROIT). It is focused on the adoption and implementation of the Luxembourg Protocol to the Cape Town Convention on International Interests in Mobile Equipment (generally known as the Luxembourg Rail Protocol). Our group's worldwide membership comprises, directly, about 60, and indirectly, through member organisations which are part of the RWG, many hundreds, of stakeholders in the rail sector. They include banks lending in the rail sector, lessors leasing rolling stock and which are financed by banks, as well as operators receiving private sector finance through secured credit or leases ultimately financed by the banking community.

We are grateful for the opportunity to respond to the Consultation on behalf of our members and particularly appreciate your indulgence in allowing us to present our comments after the official closing date for responses.

The Luxembourg Rail Protocol will make it much easier and cheaper for the private sector to finance railway rolling stock. It sets up a new system for recognition, priorities and enforcement of creditor and lessor rights, which will be registered in an international registry based in Luxembourg, accessible to everyone over the internet 24/7. It applies to all rolling stock, broadly defined, so it covers not just conventional rail equipment but also light rail, trams, cable cars and even people movers at airports.¹

¹ For more on the Luxembourg Rail Protocol and the Rail Working Group, please see www.railworkinggroup.org



The Protocol is not yet in force but Luxembourg has ratified it as has the European Union. Germany, Italy, the United Kingdom and Switzerland have signed the Protocol and they, and many other countries around the world, are actively working on adopting the Protocol. It is expected to come into force in 2017 or 2018. The Cape Town Convention as well as the equivalent aircraft protocol, applying these principles to financing of aircraft, was adopted in 2001 and is now in force in over 60 countries.

A report prepared for the Rail Working Group by consultants Roland Berger and published in January 2016² showed that currently in Europe about 88% of all rolling stock procurement is either financed or underwritten by the state. Globally, outside of North America, the position is similar. But governments are under increasing budgetary pressures leading to underinvestment in an area which is a vital part of a sustainable development agenda. Within Europe there is a common long term commitment, now embodied in the EU 4th Railway Package³, to a liberalisation of the rail sector. The Berger report also made it clear that there is a direct correlation between liberalisation and the need for private capital. So there will be a growing need for private capital for the rail sector in Europe in the future.

Currently, across the world, there is little or no legislative or judicial support for lenders and lessors of rolling stock defining, prioritising and protecting their property rights. Unlike in aviation or shipping, there are no national title registries for rolling stock, where owners and secured parties can register their property interests. Indeed there is no global system for identifying railway equipment. When the equipment can potentially cross borders the position is even worse with the possibility of different laws applying to, and the ability of states or rival claimants to block, creditor rights.

All this means that lending margins are higher than they could be because of perceived collateral risk and, in many countries, the banking community is sometimes reluctant to finance urgently needed new procurements of rolling stock by weaker private companies, thereby restricting competition and investment.⁴

Once it comes into force, the Luxembourg Rail Protocol will facilitate banks and other financiers providing finance to support much needed new rolling stock procurement at rates reflecting the greater value of the collateral and leading to lending to operators even where their balance sheet net worth is limited. As such, it will lower the barriers to entry for operators and lead to a more competitive and dynamic rail industry worldwide.

It is against this context that we comment on the Consultation and specifically its proposals on risk weighting for object based lending.

² http://railworkinggroup.org/wp-content/uploads/docs/160122_Private%20financing%20of%20rolling%20stock_Europe.pdf

³ <http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52013DC0025&from=EN>

⁴ See for example <http://www.gprleasing.mu/news-headlines/an-african-case-for-the-luxembourg-rail-protocol>



We fully support the Committee's objective, in setting risk weighting rules, of striking a balance between simplicity and risk sensitivity. We acknowledge that the claims by special interest groups have to be examined critically but, we would argue, viewed sympathetically if they present a coherent case for differentiation based on security considerations.

The proposals set out in the Consultation in relation to object based funding⁵ are viewed by us with serious concern.

1. The "one size fits all" approach allocating a risk weighting of 120% to all credits in this category is, in relation to financing of railway equipment, unfair and unreflective of the true risks. It is unfair since it makes no allowance for the (stability of the) industry sector, depreciation or age of the asset (rolling stock finance tends not to exceed a term of 14 years, and is often shorter, where new assets usually have a useful life of at least 30 years), cyclical exposures, political risk or ability to recover and remarket collateral. Moreover, the proposals give the financing banks no ability to factor in regulatory support for the equipment financed. For example, passenger rolling stock financing in markets such as the UK and Germany are underpinned by regulatory frameworks providing support for the stability of cash flow throughout the financing term. As a result the passenger rolling stock market is viewed as a stable market for lenders and equity investors with appetite for long term stable cash flows. At 120% it is unreflective of the real risks, where current bank provisions in the rail sector are well below this level, and there is no evidence of any systemic failures to account properly for risk in the rail finance sector.
2. It is surely illogical that both unsecured corporate debt and types of project finance should have a lower risk rating, although clearly riskier, compared to secured rail finance, and perverse because unsecured corporate debt may even be made available to the same borrower and rolling stock finance is sometimes part of a transport infrastructure project. In the case of the rail sector, the result will surely be to move banks away from secured lending, urgently needed for good public policy reasons, into riskier unsecured corporate or project finance because their capital costs are lower.
3. We see no reason to allocate a special lower and differentiated risk weighting system to real estate finance⁶ and not to rolling stock finance, where the rail sector has historically been less cyclical and volatile in relation to asset values and cash flows. We do not understand why, in relation to real estate finance, latitude is given to credit providers to take into account the length of the financing term, the LTV, the type and enforceability of security, the way the security is structured and not in relation to rolling stock finance even though the rail sector is characterized by solid long term assets generating steady income, directly or indirectly, from a large cross section of the travelling or logistics community.
4. We would also argue that financiers of rolling stock should be able to take into account the extent and development of the local and international legal environment supporting creditor rights.

⁵ At paragraphs 38 – 41 of the Consultation

⁶ At paragraphs 50 - 60 of the Consultation



5. The proposals give no incentive to improve the security position of the banks through either more prudent loan and security structures. Specifically the Luxembourg Rail Protocol will create a significant additional layer of security for lending banks, making a real difference to the security profile of a transaction. But why should financiers press for, and governments adopt, such an instrument if it makes no difference to the capital allocation and therefore the funding rate? In fact the current proposals may severely restrict future private sector funding for the rail industry where the credit is not state guaranteed even compared to the minimal amount of private sector debt available currently. For example we know that in Europe alone, the private sector will need to raise about €400 mio. per annum alone for the next three years just to finance new freight wagon procurements. We see a real risk with the proposals that they will make credit more difficult to obtain for private wagon owners, and then more expensive even if it is available, just at a time when governments are working hard to encourage a shift to rail for freight from other forms of transport and to create a more open market and a level playing field between state and private operators. The proposals will therefore exacerbate the current problems, not solve them.
6. We would argue that, rather than creating a negative dynamic for banks to move away from lending in prudent, socially and environmentally responsible areas, the proposals should be re-evaluated to incentivise both the private and public sector to create more secure conditions for object based financing which, we would hope, would also be the long term objective of the Committee. In addition, there should be latitude for banks to reassess collateral they hold for loans, and the consequent risk weighting based on the certainty of the cash flow servicing the debt, and the ease of repossession and remarketing to cover the outstanding debt on debtor/lessee default or insolvency.
7. We further submit that there should not only be a preferential analysis of secured debt compared to unsecured debt, but then be a differentiated treatment of collateral provided to secure loans where there is an international treaty network facilitating easier realisation of the collateral. Specifically, in the Sector understanding on Export Credits for Civil Aircraft of 31st August 2011, various key Export Credit Agencies and the OECD have understood and recognised that, in relation to aircraft finance with the benefit of the protections from the Cape Town Convention, the risk premium applicable should be correspondingly be reduced. We expect similar treatment in respect of rolling stock finance once the Luxembourg Rail Protocol comes into force. Quite correctly, where international instruments genuinely reduce credit risk, they may be taken into account. We urge the Committee to take the same, methodical, approach.

In summary, we would respectfully suggest that, in its commendable quest for simplicity, the Committee has moved too far away from allowing banks to make reasoned risk assessments in relation to specific long term assets and to calibrate the risk weighting of their loan books based on such assessments. A “one size fits all” approach to all object based financing, regardless of asset type and actual risks, and then a 120% risk weighting where current bank provisions in the rail sector are well below this level, is unsupportable and not reflective of reality. It must be illogical that unsecured corporate debt and project finance in the operational phase is seen as being less risky than secured asset finance, which may even be made available to the same borrower.



The proposals are also inconsistent as the Committee has recognised the value and nuances of secured financing for one long term asset class (real estate) and yet does not do so in relation to others (such as rolling stock, or for that matter, aircraft or ships). At the very least, banks should be given the ability to treat secured corporate financing in the same way as unsecured corporate finance and preferably the regime proposed for assessment of risk in relation to real estate should also be applied to other long term asset classes such as railway rolling stock. They should also be permitted to take into account in their risk assessments the benefit of international instruments designed to create more security for their collateral.

The current proposals will create serious damage to the rail sector across the world. They will make private sector finance of rolling stock more difficult in the future, and sometimes impossible, at a time when policy makers worldwide recognise that private sector banks, lessors and other financiers have a critical role going forward in underwriting the expansion of the railways, in turn delivering important social, environmental, developmental and economic advantages as well as new business opportunities, new investment, new jobs and a new affordable vision for sustainable transportation in the 21st Century. We strongly urge the Committee to revise its approach in relation to railway rolling stock, to allow lenders to match sensibly the risk weighting to actual risks and to adopt a system which encourages them, and governments, to minimise those risks.

We are at your disposal should you require further information or assistance in relation to this matter.

Yours truly,

A handwritten signature in blue ink, appearing to read "Howard Rosen". The signature is fluid and cursive.

Howard Rosen
Chairman
Rail Working Group