

Brussels, 22 February 2022

## **Leaseurope feedback on the European Commission proposal for the CRR III**

Leaseurope welcomes the Proposal of the European Commission to implement the finalisation of Basel III in Europe. Most of the issues regarding the implementation of the Basel standards are a consequence of choices made at international level, which make a tailored implementation of Basel taking into account the specificities of Europe's financial system more difficult.

Leaseurope acknowledges the Commission's efforts to reduce the expected impact of reforms on the EU credit institutions and to mitigate the impact of these reforms on the financing of the real economy, however further adjustments are necessary.

In Europe, over 80% of total leasing volumes are provided by leasing companies regulated under the CRR directly, or indirectly through parent company's consolidated reporting. For this reason, it is critical to support lessors' financing of business investment by **recognising the low risk profile of leasing** within the CRR through the inclusion of **a new category for movable (e.g. automotive, equipment or machinery) leasing**.

Currently, under the **Standardised Approach**, the risk weight implicitly reflects both Probability of Default (PD) and Loss Given Default (LGD) risk parameters. For Unrated Corporates, which is an important part of the leasing portfolio, the risk weight is 100%. For Retail Exposures, the risk weight is 75%. This means that **currently the Standardised Approach treats leasing in the same manner as an unsecured loan**. By doing so, **the impact that lease collateral has on risk, paired with the strong understanding of the leased assets and its secondary markets by lessors, is completely overlooked**. Currently, only those lessors using the Standardised Approach are penalised by this treatment. **With the introduction of the output floor in the Basel III finalisation agreement, the prudential framework will also significantly penalise lessors following the IRB Approaches as their capital requirements will be benchmarked to the Standardised Approach levels**. According to the University of Cologne, this is **in the case of leasing up to 8 times higher than the unexpected losses incurred during the years of the financial crisis**.

## **Leaseurope comments on the European commission proposal**

We welcome the Commission's efforts to mitigate the impact of the Basel agreement following on from the introduction of input floors for the risk parameters and the output floor which significantly reduces the benefits of using internal models, thereby making the regulation less risk sensitive.

**Leaseurope welcomes the European Commission's recognition of the high level of expertise and risk management developed by institutions in the EU in the area of leasing.**

**Leaseurope supports the transitional arrangements for leasing exposures as a credit risk mitigation (CRM) technique.** We also support the introduction of a provision mandating the EBA to prepare a report on the appropriate calibrations of risk parameters associated with leasing exposures under the IRB Approach, and in particular on the *LGDs* and Haircuts provided for in Article 230.

This notwithstanding, **these measures fall short of recognising leasing as a specialised financial product with a risk profile that differs considerably from other banking products.** Indeed, leasing companies adopt solid origination and monitoring processes in order to assess the credit risk profile of lessees, leased assets and suppliers. In addition, leasing exposures are characterised by a number of issues that contribute to their low risk profile; chief among these, is the instrumental role leased assets play in enabling lessees to engage in economic activities, thereby incentivising the lessee to continue making payments throughout the contract duration. It is also important to note that leasing companies retain the asset's legal ownership by over the life of the contract which allows for an efficient and effective repossession process of the asset in case of the lessee's default.

Leasing companies' decision to apply either the Standard or IRB approach has no bearing on overall credit risk processes as the service offered remains the same low-risk form of financing with the same defining characteristics, and should thus be regulated accordingly. In support of this, it shall be also underlined that the leased asset represents the main risk mitigation of the leasing operation, according to an asset-based approach; hence, the controls and practices for credit process of the leased assets are the same regardless the prudential rules adopted and type of asset (real estate or non-real estate). For these reasons, **we call on legislators to extend the EBA report in article 495 c) to the treatment of movable leasing under the standardised approach**, as there is no reasonable justification for not adequately addressing this issue.

Moreover, the new calibration of the loan splitting approach for exposures secured by commercial property entails a higher required capital in comparison to the current

prudential treatment. This penalises low risk products such as leasing, in which several robust controls are put in place by the leasing companies in the evaluation and management of the risks arising from the financing activity. By way of example, the obligation to stipulate insurance contracts on the immovable property, the maintenance of the legal ownership of the immovable property by the lessor throughout the life of the contract, as well as the instrumentality of the asset to the lessee's business activity are important aspects that contribute to the low risk profile of leasing exposures.

The European Commission's Proposal, if implemented as is, will also significantly increase the capital required when providing real estate leases for the construction of commercial "own use" purposes. Whilst we recognise the increased risk profile of (construction) finance of Income Producing Real Estate (IPRE), this is not the case with funding end-user real estate which does not bear market risk. With IPREs the leasing asset is used by the lessee to carry out its business activity and not for speculative purposes, and the lessor retains the legal ownership of the asset during the life of the contract, having the rights to execute on-site inspections. As such, it should consequently not bear a higher risk weight than a clean corporate construction loan. Therefore, we call on the legislators **to implement the Basel acquisition, development and construction (ADC) standards for IPRE only**. In addition, we consider that pre-lease real estate leasing contracts should be clearly excluded from article 126 dispositions concerning ADC exposures, due to the absence of the risk of "unsold" since the lessee provides the lender with an already existing irrevocable obligation of a third party to buy the property. if not addressed, the increase in the capital required when providing real estate leases for commercial purposes to corporates would be disproportionate.

Finally, we are concerned that the **risk weights for providing financing to regulated and supervised leasing companies will increase significantly** as a result of the new regulation. We therefore request **to implement the Basel standards in such a way that the financing of those companies is less affected**.

Taking into consideration all of the before mentioned points, Leaseurope, the European association of leasing industry, consider that the Commission's proposals on leasing exposures should at the very least remain unchanged, with scope for making further improvements.

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## About us

Leaseurope brings together 46 member associations representing the leasing, long term and/or short term automotive rental industries in the 32 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, machinery, ICT and real estate). It also includes the short term rental of cars, vans and trucks. It is estimated that Leaseurope represents over 90% of the European leasing market.

Asset finance and leasing markets have developed to respond to business investment and consumption needs as well as to accompany the development of local industrial production and distribution. The types of institutions represented by the Federation include specialised banks, bank-owned subsidiaries, the financing arms of manufacturers as well as other, independently-owned institutions.

In 2020, the leasing firms represented through **Leaseurope's membership helped European businesses and other customers invest in assets that is estimated worth more than 352 billion EUR, reaching about 715 billion EUR** of outstandings at the end of the year<sup>1</sup>. Leasing is used by more European SMEs than any individual category of traditional bank lending taken altogether (around 43% of all European SMEs make use of leasing which is more than any other individual form of lending)<sup>2</sup> and is also popular amongst larger corporates<sup>3</sup>. Leasing is also useful to support the public sector (e.g. leasing to schools, hospitals, etc.).

**Leaseurope is entered into the European Transparency Register of Interest Representatives with ID n° 430010622057-05**

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<sup>1</sup> Leaseurope 2019 Annual Statistical Enquiry.

<sup>2</sup> Oxford Economics, *The Use of Leasing Amongst European SMEs*, 2015; European Investment Fund, *The importance of leasing for SME finance*, 2012

<sup>3</sup> European Commission, *Survey on the Access to Finance of Enterprises-Apr. – Oct. 2019*