SPECIALISED CONSUMER CREDIT PROVIDERS IN EUROPE

The Voice of Leasing and Automotive Rental in Europe

Eurofinas/Leaseurope response to the European Commission's Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA) consultation paper on the possible impact of the CRR and CRD IV on banking financing of the economy

October 2015

About Leaseurope
Leaseurope brings together 44 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 and in 2014, total new leasing volumes worth €274.2 billion were granted by the firms represented through Leaseurope's members. More info at www.leaseurope.org.

About Eurofinas
Eurofinas is the voice of consumer credit providers in the EU. As a Federation, Eurofinas brings together associations throughout Europe that represent finance houses, universal banks, specialised banks and captive finance companies of car, and equipment manufacturers. The scope of products covered by Eurofinas members includes all forms of consumer credit products such as personal loans, linked credit, credit cards and store cards. Consumer credit facilitates access to assets and services as diverse as cars, furniture, electronic appliances, education etc. It is estimated that together Eurofinas members granted over €356.3 billion Euros worth of new loans during 2014. More info at www.eurofinas.org.

Eurofinas/Leaseurope response to the European Commission's Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA) consultation paper on the possible impact of the CRR and CRD IV on banking financing of the economy

Eurofinas and Leaseurope, the voices of consumer credit and leasing at European level, welcome the opportunity to respond to the European Commission's DG FISMA consultation paper on the possible impact of the CRR and CRD IV on banking financing of the economy.

Before answering to the specific issues posed in the consultative document, our response describes the important role that leasing and consumer credit providers play within the European economy as well as the main characteristics of these firms, the EU regulatory environment for such players and how they are positioned within the EU financial system.

The following points are of key importance for the members firms that Eurofinas and Leaseurope represent:

- Basel requirements are primarily designed for internationally active institutions. These requirements do not all fit smaller-sized institutions or specialised business models.

- In our view, smaller organisations should not be treated the same way as large systemically important financial institutions. Such smaller firms are, by their very nature, not equipped to comply with the same requirements as their larger counterparts. We believe that standards on liquidity, internal remuneration policies, materiality of default, corporate governance and large exposures should all be adjusted to match the operational constraints of specialised consumer credit, asset finance and leasing providers.

- The lack of recognition of physical collateral places specialised providers at a disadvantage compared to other market players and has a significant impact on their ability to fulfil their role of support to the real economy. We believe there is a strong case for differentiating lease finance, lending facilities secured by durable goods, loans secured on salaries and pensions.

- We believe there is strong justification for the SME supporting factor to be kept. Removing the supporting factor would have a negative effect on SMEs just when the economic conditions are improving and the first hints of relevant growth are coming up.

We remain at your disposal should you require any further information on the nature of the activities we represent or additional clarifications on the answers below (please see contact persons below).

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Eurofinas and Leaseurope are entered into the European Transparency Register of Interest Representatives with ID n° 83211441580-56 and 16013361508-12

I. The Benefits of Leasing and Consumer Credit Activities in Europe

Consumer credit and leasing are key drivers of European economic growth

In 2014, consumer credit providers that are members of Eurofinas helped support European consumption by making more than 356.3 billion EUR goods, services, home improvements and private vehicles available to individuals, reaching 861 billion EUR of outstandings at the end of the year[1]. Consumer lending is procyclical and is highly positively correlated with households' disposable income[2]. By providing access to finance to individuals and households, consumer credit supports the social and economic well-being of millions of consumers across Europe.

In 2014, the leasing firms represented through Leaseurope's membership helped European businesses invest in assets worth more than 274.2 billion EUR, reaching 730 billion EUR of outstandings at the end of the year[3]. 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. SMEs financed 18.9% of their total investment via leasing in 2013, more than any individual form of bank lending.[4] Leasing is also popular amongst large corporates[5]. It is also extremely useful to support the public sector (e.g. leasing to schools, hospitals, etc.).

The consumer credit, 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. Their economic roles are central.

Leasing and consumer credit provide sales support for manufacturers and distributors

Consumer credit and lease agreements are distributed via several channels, including through bank networks, directly from specialised firms or through the manufacturers and dealers of business equipment, vehicles and consumer goods. This latter channel is often referred to as the "vendor or point of sale channel" and is a specificity of the leasing and consumer credit industries. Point of sale activities provide a convenient one-stop-shop for clients who are seeking to purchase or obtain the use of assets and allow European manufacturers and distributors of goods to sustain and increase their sales.

Consumer credit and leasing enable smart and sustainable growth

Businesses and households' demands and needs for more energy efficient assets have increased. We believe that specialised financial services such as consumer credit and leasing can help achieving a reduction in carbon footprint and energy savings.

For example, leasing addresses one of the general barriers that inhibit the development of sustainable energy production, i.e. a lack of access to capital. In addition, leasing facilitates the financing of equipment such as wind turbines, biofuel processing plants, photovoltaic panels, long lasting battery cells and so forth, allowing Europe to produce cleaner and more sustainable energy.

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[1] Eurofinas 2014 Annual Statistical Enquiry

[2] Eurofinas, *Consumer Credit, Helping European Households Finance their Tomorrow,* 2015

[3] Leaseurope 2014 Annual Statistical Enquiry

[4] Oxford Economics, *The Use of Leasing Amongst European SMEs,* 2015; Eurostat, *Access to Finance Statistics,* 2015; International Finance Corporation *Leasing in Development: Guidelines for Emerging Economies,* 2009; European Investment Fund *The importance of leasing for SME finance, 2012*; and UEAPME, *UEAPME Newsflash,* 2012

[5] European Central Bank, *Survey on the Access to Finance of Enterprises in the Euro Area, October 2014 to March 2015*

Consumer credit facilitates access to assets and services as diverse and essential as motor vehicles, white goods, brown goods, home improvements, and education. It therefore plays an integral role in the financing of the real economy.

An increased awareness of the impacts of consumption on the environment has led many households to change their habits and shift to sustainable products and services. In the consumer credit sector, many products were launched in recent years, often with the support of governmental green initiatives, to finance sustainable assets. Examples include the equipment and purchase by households of photovoltaic panels, electric vehicles or lower energy consumption heating system. Such consumer credit facilities may, under certain conditions, give rise to advantages such as a reduction of interest (interest subsidy), and/or a tax cut on interest paid by the borrower[6].

II. Characteristics of European Consumer Credit and Leasing Firms

Application of the "CRD IV package"

Leasing and consumer credit firms can either be banks, bank-owned subsidiaries, independent firms or the financing arms of manufacturing companies (known as captive companies). When they are banks or belong to a banking group, leasing and consumer credit companies are required to apply EU prudential regulation, either directly at legal entity level or through the inclusion of their activities in the requirements that are applied to the group at consolidated level. Our membership statistics show that these types of entities make up the lion's share of the European leasing and consumer credit business[7]. Also, depending on the Member State, EU prudential regulation may also be applied directly to financial institutions. For these reasons, we take a direct interest in the consultation.

Risk profile and expertise

Leasing and consumer credit entities themselves are not deposit taking institutions[8]. As these firms do not receive repayable funds from the public they do not pose a direct threat to depositors. Added to which, unlike other finance products, for loans and leases to consumers and businesses, the risk lies with the finance company rather than the consumer.

Whether bank-owned, captive or independent, European consumer credit, asset finance and leasing organisations rely heavily on the banking sector to fund their operations. The exposures that banks are able to take on in relation to consumer credit, asset finance and leasing providers are limited in size and closely monitored.

[6] See for more examples, Eurofinas webpage on green credit

[7] By way of example, according to Leaseurope's latest Ranking Survey of European leasing firms, the top 20 leasing companies in Europe are either bank related or hold a banking license

[8] Unless they have made the decision to opt for a banking license precisely in order to be able to take deposits. However, deposit taking providers remain the exception in most EU countries

The risk profile of leasing in Europe[9]

According to an extensive research carried out by Deloitte Paris in 2013, default and loss rates for leases are significantly lower than for traditional SME lending. Based on a portfolio of 3.3 million lease contracts across 15 European countries, the study shows that 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% compared to 33% for all Retail SME lending. In regard of corporate lending the study indicated that one-year defaults on leasing corporate exposures were 2.3% compared to around 3% for all corporate lending in 2010. Similarly loss rates for leasing were 11.1% compared to over 30% for all corporate lending.

Consumer credit, asset finance and leasing providers have specialist expertise, perform prudent asset and collateral valuation, maintain established re-marketing channels and have in-depth knowledge of their customers with which they manage the risks that are part of their business. It is worth stressing that the specialised nature of consumer credit firms and lessors means that they have a unique understanding of their clients and asset markets and are able to track the level of risk they are exposed to very carefully.

For instance, depending on the level of risk they are willing to take on, lessors will seek to enter into various guarantee and buyback arrangements (often with the manufacturers of goods) or purchase additional insurance for this risk. Robust and prudent risk management practices with regard to the recognition of physical collateral forms an integral part of the requirements for credit risk mitigation within the Capital Requirements Regulation (CRR) and ensures that lessors and consumer credit providers (where applicable) adopt a conservative approach to collateral valuation.

It is also worth recalling that when the client is a private individual, all providers are subject to the European Consumer Credit Directive. They are required to perform a thorough creditworthiness assessment of their customers[10]. This assessment can take into account information supplied by the borrower himself, consultation of credit bureaus / credit risk agencies, public data sources, past business records, etc.

Consumer credit standards

A high number of Eurofinas members have in recent years developed and implemented codes of good practices. These codes help promote a consistent, balanced and safe business environment where all parties' interest are taken into account. They provide flexible frameworks that come in addition to the regulatory provisions in force and contribute to the dissemination of prudent and fair lending standards.

An overview of these codes can be found in the Eurofinas brochure on national codes of conduct for consumer lending[11].

[9] See *Implicit risk weights for SME leasing in Europe*, September 2013 and *The risk profile of leasing in Europe: the role of the leased asset,* October 2013. Research available upon simple request
[10] Directive 2008/48/EC on credit agreements for consumers, OJEU L 133/66
[11] Eurofinas, *National codes of conduct for consumer lending*, 2015

III. Responses to the Consultation Questions

Capitalisation

Q1. What role has been played by the CRR and CRD IV requirements in the recapitalisation process, in terms of the timing and overall effect on the levels and quality of capital held by banks? How have market, supervisory and regulatory capitalisation demands interacted to make banks adjust the level of capital they hold to the current level? Whilst these three factors may be interlinked, is it possible to identify which has/have played the most important role?

Q2. If you consider that capital levels go significantly beyond what is necessary in light of the level of risk incurred and posed by banking activities in certain areas, please specify those areas and back up your view with specific evidence.

Basel requirements are primarily designed for internationally active institutions. These requirements do not all fit smaller-sized institutions or specialised business models. As explained above, consumer credit providers, asset financiers and lessors across Europe encompass a diversity of organisations of different legal nature and with various operational characteristics. All share a very high degree of specialisation and have a very limited mix of business activities compared to traditional mainstream banking organisations.

To achieve the right balance between a sound prudential framework and an efficient financing of the economy, the scope of the regulation should be adjusted in line with the proportionality principle. In particular, we would strongly advocate for a better recognition of physical collateral. The lack of recognition of physical collateral places specialised providers at a disadvantage compared to other market players and has a significant impact on their ability to fulfil their role of support to the real economy.

Given that the unique feature of a lease is the lessor's ownership of the leased asset, we believe there is **a strong case for differentiating lease finance** (where the asset is owned by the finance company during the life of the agreement) from other retail and corporate exposures. These ownership rights provide lessors with a valuable and efficient form of in-built security which makes leasing extremely low-risk.

As explained above, leasing shows a lower risk profile than other retail SME and corporate lending. Therefore, we believe the European Commission should promote the awareness of the leasing as an important financial instrument and its advantages for clients and investors. A Leaseurope leaflet has been developed to explain how SMEs and corporates can manage their working capital more efficiently as well as upgrade their assets to the latest technologies for example to increase their performance or to reach a more environmentally-friendly standards .

The extent to which a **lending facility is secured by durable goods** can be a strong factor for a differentiated treatment from other retail exposures. For example, motor finance (loan and lease) could be treated as a specific subcategory in the retail portfolio. Against this backdrop, we would recommend to introduce a lower risk weight for exposures to motor finance (for example a 50% risk weight). Information on the performance of motor finance activities is publicly available and can be collected from rating agencies' pre-sales reports on asset-backed securities auto loans[12].

[12] See for example recent pre-sale reports for RCI Banque by DBRS and Standard & Poors

We would also advocate for a specific favorable treatment for **loans secured on salaries and pensions**. Such lending facilities currently exist in Italy. They are strictly regulated and provide a valuable set of guarantees such as the direct assignment of one-fifth of the pensions or the salary to cover the payment of the loan instalments, mandatory insurance policies as well as restriction on the availability of retirement indemnities and the possible foreclosure of salaries/pensions[13]. A recent industry survey confirms that default and loss rates for such a product are significantly low[14]. For example, the probability of default (PD) within 12 months is 3.0%, the effective loss rate (weighted-average LGD rate) is 5.8% and the expected loss (EL) is 0.16%.

The EBA recently published a consultation paper on the conditions for National Competent Authorities (NCAs) to raise the levels of risk weight and the levels of LGD floors for exposure secured by mortgage. NCAs have the ability to raise the risk weight levels up to 150%, which would have a major impact on the financing of the economy. In its response, Leaseurope underlined the importance of transparence and communication between NCAs and credit institutions in the decision process to raise risk weights and LGD floors for these types of exposures[15].

We also believe that the specific features of specialised business models should be taken into account for other types of regulatory prudential standards such as liquidity and leverage requirements .

Q3. What role have the additional capital requirements and buffers exceeding the harmonised requirements set out in the CRR played in the capitalisation process? Are such additional micro- and macro prudential capital requirements and buffers commensurate to the level of risk incurred and posed by banks? Please back up your view with specific evidence.

The changes and raise in capital requirements had a major impact on lending processes. The overall capacity of credit institutions to lend has been structurally modified. The level of Return on Equity (ROE) is directly linked to the cost of capital, and pricing, in a competitive background, cannot be fully used as an adjustment parameter. Capital requirements have taken a larger place in the lending decision process. Some types of financing, especially long term financing, which require more capital allocation due to the new standards, have been clearly disadvantaged.

The importance of specialised financial services providers in the financing of the real economy is growing. It is therefore essential that the proportionality principle applies to specialised business models and that the most fragile counterparts benefit from a specific treatment. Against this background, the continuation of the SME supporting factor introduced in the CRR is of major importance.

We understand that the new general requirement of 2.5% capital buffer is to be phased in from 2016 to 2019. We are strongly concerned by the introduction of this additional buffer and its impact on the financing to the real economy. We believe that the additional buffer should apply in a proportionate manner and take into account the capital efficiency of the various lending business models (for example, asset-based finance).

[13] *Cessione del quinto dello stipendo/pensione* as regulated by the Presidential Decrees 180/50, 895/50 under supervision/instruction of the Ministry of Economy and Finance and the Bank of Italy

[14] Survey by the Italian Banking Association (ABI). Participating financial institutions (11) provided over 80% of the product in 2013

[15] Leaseurope, *Response to the EBA consultation paper on RTS on conditions for capital requirements for mortgage exposures*, October 2015

Corporate lending

Q4. Have increased capital requirements influenced the overall capacity of banks to lend? Which factors, including demand-side factors, regulatory changes and other supply-side factors (such as the volatility of interbank and capital markets), contributed most significantly to the change in the volume of loans? How do you think bank lending would have developed had regulatory changes to capital requirements not been introduced?

Q5. Are the effects of increased capital requirements, such as they are, generally temporary and transitional or have structural changes been seen? Has the requirement to hold higher levels of capital increased the cost of funding banks? Has the per-unit cost of bank capital decreased as banks have become less risky?

Q6. Have increased capital requirements affected the market for some categories of assets more than others? If so, which ones and how? Which of the provisions contained in the CRR, apart from those establishing capital ratios, are likely to have created the effects experienced by specific markets and/or exposures?

Q7. Do you think the phase-out of the transitional provisions under CRR could have an incremental impact on future lending decisions? If so, please explain how.

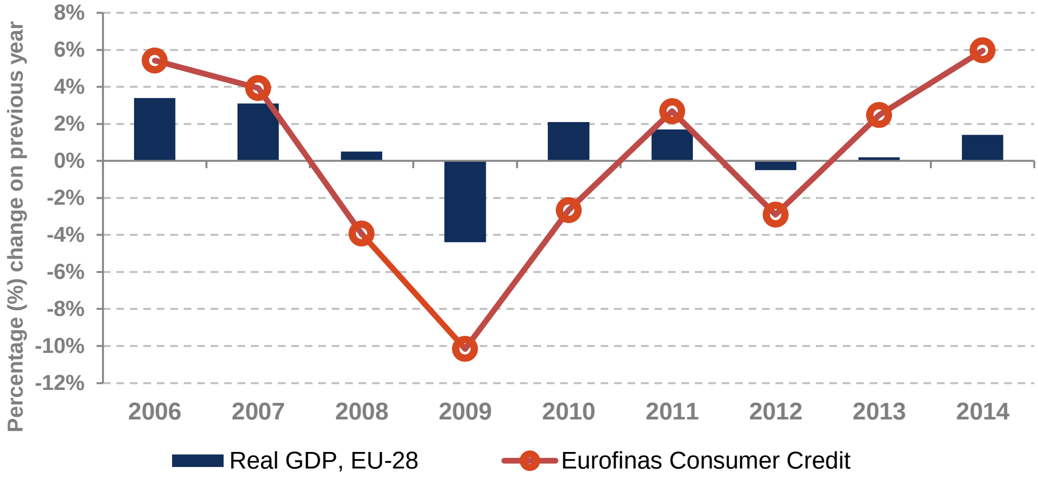
As a general observation, we believe that increased capital requirements influenced the overall capacity of credit institutions to lend. We think this is not specific to corporate lending and also affected the financing of households.

The financial services industry in general shoulders a significant cost as a result of increasing regulation. Regulation is costly for general business and can sometimes project disproportionate constraints for employees. Leasing, asset finance and consumer credit entities are particularly affected by this burden as regulation impacts these type of firms, not only through general banking regulation, but also through other legislation (consumer protection, anti-money laundering, insurance distribution, data protection, asset related regulation, etc.). They are also particularly affected because of their relative smaller size and specialised business models.

Evolution in new consumer credit lending is influenced by key economic indicators such as employment, disposable income, savings and consumer confidence. During the recent economic downturn, new lending declined significantly due to worsening macroeconomic conditions, weak consumer demand and a tightening of credit standards. The situation varied across Europe, with some markets experiencing downturns of up to -25%. We think the anticipation of major regulatory capital and liquidity standards necessarily impacted the risk appetite, strategic outlook and finance availability of consumer credit providers.

When analysing the impact of the “CRD IV package”, it is therefore important to take into account all relevant factors such as the economic situation and the wider financial services regulatory framework.

Consumer credit vs. real GDP (annual growth rate)

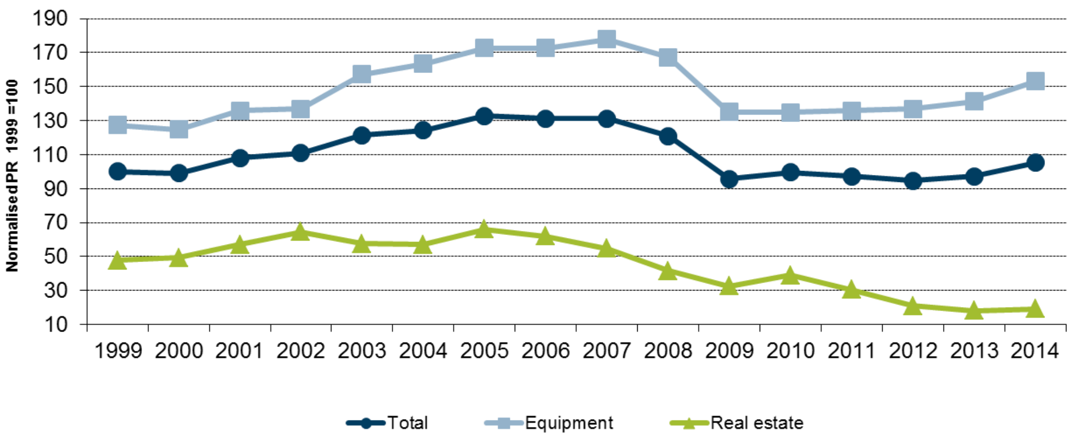


Source: Eurofinas Annual Surveys, Eurostat

An uncertain economic environment and low confidence implies that European businesses are reluctant to invest, and indeed, European gross fixed capital formation levels fell significantly in 2009 and have yet to recover. European leasing volumes appear to have followed the trend of European investment levels, however, it is often difficult to separate out whether the performance of the past few years has mostly been demand or supply side driven.

One way of looking at this issue is to compare new leasing volumes to business equipment investment, a measure we refer to as “leasing penetration”. After remaining stable in 2007 and 2008, we observe a decrease in leasing penetration in 2009 and little change thereafter, with a slight recovery last year. All else being equal, if total European business equipment investment decreases due to a lack of confidence and demand, we would not expect to see a decrease in leasing penetration rates, particularly if there is an incentive for banks to invest in leasing given its low capital absorbency.

Evolution of leasing penetration in Europe



Lease penetration is the share of total investment (excluding residential real estate) financed by leasing calculated as new leasing volumes / gross fixed capital formation for the 19 associations reporting from ’99-’14
Source: Leaseurope, Eurostat and AMECO (GFCF)

So why have we seen a decrease in European leasing penetration? Our analysis of the situation is that, in spite of its low risk nature, leasing activities have nevertheless been negatively impacted by banking group's reactions to the ongoing implementation of Basel 3 in Europe. Basel 3 incentivises deleveraging, but is deleveraging always positive?

There is, however 'good' deleveraging (that leads to increased capital levels, better pricing for risk, a reduction in riskier assets, etc.), but also 'bad' deleveraging. Bad deleveraging can impact the availability of long-term financing for the real economy[16]. Once a financial institution has done all it can to improve its financial situation on the liability side, it has to look to the asset side and seek to reduce (risk-weighted) assets.

Although the low risk character of leased exposures is reflected in lower risk weighted assets for credit institutions, it seems that some European banking groups have chosen to privilege other businesses instead, resulting in the divestment of various leasing activities over the past few years. In cases where banks have chosen to retain leasing activities, some bank-owned leasing companies have not always been allocated sufficient funding by banking parents to be able to finance new business opportunities. As a result, there is undoubtedly a level of demand from the real economy that is not being addressed. Leasing supports SME investment, which contributes to the real economic growth in Europe.

The counterintuitive and unexpected result of Basel 3 implementation in Europe appears to be that the absolute focus on de-leveraging has led to banks forgoing activities that are beneficial for the real economy.

Lending to SMEs

Q8. To what extent has this provision been effective in supporting lending to SMEs? Could you provide any evidence, preferably quantitative, of the change in lending to SMEs due to the introduction of the supporting factor as from 2014?

The capital supporting factor for SMEs was one of the main claims during the legislative process of the CRR; finally this was achieved through Art. 501 of the CRR, which introduces a capital reduction factor of 0.7619 to SME exposures fulfilling certain eligibility criteria. However, the volume of new lending to SMEs in the euro area has declined by around 40% since 2008. This decrease is due to the double effect of lower demand, in addition to stricter conditions on the supply side.

Between 2003 and 2008, monthly new lending to non-financial corporations on loans up to and including EUR 1 million (a proxy for SME lending) in the euro area increased and peaked at about EUR 95 billion in mid-2008. Since then, consistent declines are observed up until 2012, at which point new lending appears to have stabilised at approximately EUR 54 billion (mean monthly lending for 2013/2014). As a share of GDP, new lending was steady at about 11% pre-2008, but then declined consistently up until 2014 to less than 7%.

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 small businesses in Europe, particularly through leases. Leasing is an important SME financer with low default and loss rates, as shown by our

[16] The World Bank, Policy Research Working Paper 6338, *European Bank Deleveraging and Global Credit Conditions: Implications of a multi-year process on long-term finance and beyond*, E. Feyen and I. Gonzalez del Mazo

various research reports. Especially in light of current regulatory measures aimed at supporting SME finance, such as the discussion on long-term financing and the proposed Capital Markets Union, increasing capital requirements for SME lending would seem counter-productive.

The EBA mentions in its discussion paper that approximately €10.5 billion in capital had been saved by those banks reporting to the EBA in 2014 due to the SME supporting factor[17]. When compared to total European Investment Bank and European Investment Fund SME lending schemes' contribution of €22 billion in 2014, it is clear that the SME supporting factor is an important tool in promoting SME access to finance in Europe.

In our opinion, there has not been enough time since the introduction of the SME supporting factor (less than 2 years) to gauge if there has been a real impact on SME lending. However, we do have evidence that SMEs' use of leasing has increased. A recently released Oxford Economics report on leasing to SMEs, conducted on behalf of Leaseurope, shows that an estimated €121 billion in SME leasing was done in 2014, compared to €104 billion in 2013, a growth of 16%[18]. This rise was not echoed in total leasing figures, where growth from 2013 to 2014 was 9%[19]. Micro SMEs in particular seem to be accessing leasing more than in previous years, with 19.6% of their investment being financed by leasing in 2014 compared to 15.4% in 2013. While we can show that leasing to SMEs has grown more than for large firms between 2013 and 2014, it is impossible for us to attribute this to the introduction of the SME supporting factor. However, we also have no evidence as to why this would not have an impact, as it encourages parent banks and investors to support businesses with a large number of SME clients, such as leasing, while incentivising these firms to increase their SME portfolios. The Oxford Economics research highlights the vital and increasingly important role leasing has to play in financing European SMEs, therefore it will be important that this form of finance is not restricted going forward.

Capital requirement depends on the type of exposure and thus is definitely a main factor to determine credit allocations. The SME supporting factor is with no doubt an incentive to grant financing to SMEs. Abandoning the SME supporting factor would significantly increase capital requirements. The analysis of one institution shows that this increase would be around 33%. Furthermore, the lending rates to firms currently subject to the supporting factor would rise. Assumptions refer to as much as 6.5 to 25 basis points.

We believe there is strong justification for the supporting factor to be kept. Removing the supporting factor would have a negative effect on SMEs just when the economic conditions are improving and the first hints of relevant growth are coming up. We consider that more time should be given to have a better grasp of what the effects of the supporting factor are in the SME lending provision. In any case, the supporting factor is highly unlikely to have any negative impact, but plenty of positive effects. The figures above show that SME lending needs to be supported with all available efforts. Indeed, we should take into account that SMEs recovery has been partial and fragile and should be supported where possible[20].

[17] EBA, *Discussion paper and call for evidence on SMEs and the SME Supporting Factor*, July 2015

[18] See Oxford Economics, *The Use of Leasing Amongst European SMEs*, 2015. Research available upon simple request

[19] See Leaseurope 2014 Annual Statistical Enquiry

[20] For more information see Leaseurope, *Response to discussion paper and call for evidence on SMEs and the SME Supporting Factor*, September 2015

Q9. What specific difficulties do banks face when lending to SMEs, compared to when lending to larger corporates? Are these related to the CRR? How could the CRR and other prudential regulations contribute to addressing some of these difficulties in other ways than by adjusting rules for SMEs, or do they need to be resolved by some other means? If so, what other means would be adequate?

There is no doubt that SMEs are an important source of employment and growth for the EU economy. We believe that when the European Commission is setting policies, a main consideration is to ensure that SMEs have adequate access to finance. It is known that SMEs are particularly exposed to credit constraints, due to factors intrinsic to their size and structure. Therefore, they are generally more dependent on bank lending than are larger non-financial companies. Moreover, the asymmetry of information that exists between SMEs, as borrowers, and potential lenders is particularly acute, and limits their ability to switch sources of funding quickly.

According to the latest ECB SAFE survey[21], leasing is a relevant source of finance for 44% of SMEs in the euro area. This is corroborated by the before-mentioned Oxford Economics research on the importance of leasing for European SMEs. According to this study[22], 42.5% of SMEs used leasing in 2013 (up from 40.3% in 2010) and asset finance in 2014 accounts for circa 19% of total SME investment, demonstrating that this type of financing is an increasingly vital source of finance for many European SMEs. Relative to bank loans, which experienced significant constraints during the most recent economic crisis, leasing remained a reliable and robust form of SME finance.
We therefore advocate for the European Commission to promote alternative sources of financing. Given the demonstrated importance of leasing for SMEs, European and national initiatives that rise SMEs' awareness of leasing would undoubtedly help in ensuring that European SMEs can invest and expand in the future.

Q13. Should the provisions contained in the CRR allow for more differentiation in how they are applied to banks of different sizes or with different risk-profiles? How can they do this without compromising the objective of achieving financial stability and creating a level playing field within the single banking market? Are there any provisions that could potentially be applied with greater differentiation? If so, what are these provisions? Provided application on a differentiated basis is desirable, what considerations could be relevant to make such a differentiated application? Are any concrete changes desirable in this context? If so, what are these changes and the associated costs and benefits?

We agree that it is important to analyse the effect that the "CRD IV package" may have on banks' ability to finance the economy. We think that the starting point of a more stable and efficient banking system is to ensure that regulatory standards are suitable for all the institutions affected. The "CRD IV package" applies to all credit institutions. In this respect, it is important that the text takes into account the different business models, level of risk-taking, type of products and the level of systemic relevance of all the institutions it covers.

In our view, smaller organisations should not be treated the same way as large systemically important financial institutions. Such smaller firms are, by their very nature, not equipped to comply with the same requirements as their larger counterparts. These institutions commonly do not have any complex business strategy, technical or human resources at their disposal to fulfill complex prudential requirements. It is also important that the above points are taken into account when setting transitional periods of time for requirements to apply.

[21]ECB, Survey on the Access to Finance of Enterprises in the Euro Area, October 2014 to March 2015
[22] Oxford Economics, *The Use of Leasing Amongst European SMEs,* 2015

Liquidity Coverage Ratio (LCR)

On 10 October 2014, the European Commission released its Delegated Act on the liquidity coverage requirements for credit institutions. The text adapts the liquidity requirements to specific business lines such as leasing, factoring, motor finance and consumer credit activities.

For the purpose of calculating the Liquidity Coverage Ratio (LCR), credit institutions shall limit the recognition of liquidity inflows to 75% of total liquidity outflows. Subject to the prior approval of their competent authority, specialised credit institutions may be exempted from this cap on inflows when their main activities are leasing and factoring. Specialised institutions may be subject to a cap on inflows of 90% when their main activities are motor finance and consumer credit (as defined in the Consumer Credit Directive).

In both cases, institutions should exhibit a low liquidity risk profile i.e. the timing of inflows matches the timing of outflows and the institutions are not significantly financed by retail deposits. Their main activities (i.e. leasing/factoring or consumer credit/motor finance) should represent more than 80% of their total balance sheet. Exemptions may be applied at both individual and consolidated levels.

We strongly support the introduction of a specific standard which takes into account the specificities of our business models and activities. We believe such differentiation should also apply for the calculation of the Net Stable Funding Ratio (NSFR) for which the European Commission is expected to release concrete proposals.

Large exposures to shadow banking entities[23]

Article 395 CRR requires the European Banking Authority to issue guidelines to set limits to exposures to shadow banking entities which carry out banking activities outside a regulated framework. In developing the guidelines, the EBA shall consider whether the introduction of such limits would have a detrimental impact on the risk profile of institutions, on the provision of credit to the economy or the stability and orderly functioning of financial markets.

The EBA's current proposed definition of shadow banking entities is too wide as it includes finance companies, market intermediaries, investment funds, asset managers, etc. Though we appreciate the EBA's intention to conduct an exhaustive identification of all financial activities currently not subject to EU prudential and supervisory requirements, the various entities and activities encompassed have very little in common. We are concerned that the general nature of this definition could lead to the stigmatisation and possible decline of the provision of essential services by non-deposit taking entities, such as consumer credit, asset finance and leasing. We think that given the important contribution these activities make to the real economy, this should be avoided.

The current definition would essentially lead to the introduction of a specific "shadow banking risk" disconnected from the risk profile of the various activities concerned. We consider it critical that the European authorities bear in mind the fundamental differences between the various types of suggested shadow banking activities and entities. We strongly believe that Article 395 CRR allows the EBA to introduce further granularity and proportionality in the definition of shadow banking. This would be consistent with the work undertaken at international level by the Financial Stability Board (FSB). We refer here, in particular, to the FSB's proposed high-level framework for identifying "non-bank non-insurer global systemically important financial institutions".

[23] Eurofinas & Leaseurope, *Response to the EBA consultation paper on limits on exposures to shadow banking entities*, June 2015

International standard-setters have been developing detailed sector-specific indicators and we call on the European authorities to introduce at least such differentiation in their work. We would also advocate for product level differentiation as being the most relevant for the definition of the scope.

Remuneration policies[24]

The European Banking Authority (EBA) is currently working on guidelines for sound remuneration policies in the European financial sector. These guidelines directly stem from the "CRD 4 package". Once adopted, they will have to be e implemented by competent authorities into the national frameworks of EU Member States.

We support the work of the EBA in promoting sound remuneration policies and agree that remuneration policies of credit institutions must be consistent with and promote sound and effective risk management. However, it is important that, in the process of achieving such framework, no issues with regard to legal certainty will or can arise. In this respect, we believe that the guidelines at hand do not provide sufficient clarity with regard to their scope of application. Further clarification should therefore be provided.

Application of the principle of proportionality is extremely important. Smaller organisations should not be treated the same way as large systemically important financial institutions. Firms that are only involved in low-risk activities, such as consumer credit, asset finance and leasing transactions, should also not be subject to the same rules as institutions involved in investment type of activities that, due to their very nature, can impact the sector in its entirety. We understand that the European Commission recently provided an opinion on article 92(2) CRD according to which all remuneration requirements have to be applied to each institution[25].

We disagree with this reading of the text. We would also like to point out that some national supervisors already opted for the neutralisation of certain requirements. For example, in Germany, the provisions in points (l), (m) and (n) of article 94(1) CRD, namely the deferral of variable remuneration, its pay-out in instruments and malus are not applied to small and non-complex institutions under the threshold of 15 billion EUR total balance sheet. This is also the case in France where institutions or groups under the threshold of 10 billion EUR total balance sheet benefit under strict conditions from adjustments from the CRD4 remuneration requirements,

Against this background, we believe that the requirements for variable remuneration regarding material risk-takers should be neutralised for small institutions, as well as for institutions with only small amounts of variable remuneration. We believe that the general framework ensures that the remuneration is in line with the risk profile, values and the strategy of the company. Further requirements would prove disproportionate and excessively burdensome for consumer credit, asset finance and leasing providers especially given the low risk nature of their activities.

Remuneration policies cannot exclusively be addressed from the perspective of corporate governance, and risk-taking. It should also be recognised as a key component of firms' recruitment packages and attractiveness for prospective staff. It is important that, as a result of these new standards, smaller entities are not placed at a disadvantage in the labour market thereby affecting their ability to compete with larger operators.

[24] Eurofinas & Leaseurope, *Response to the EBA consultation paper on draft guidelines on sound remuneration policies*, June 2015

[25] See European Commission, *letter to the European Banking Authority on Article 92(2) CRD*, 23 February 2015

Future of the Internal Rating Based Approach for Credit Risk

On 4 March 2015, the European Banking Authority released a Discussion Paper on the future of the Internal Rating Based (IRB) Approach. To ensure convergence of current implementation of the IRB approach, action is required through regulatory review, supervisory consistency and increased transparency. The position of the EBA is to improve the models and ensure that institutions are provided with sufficient time and resources to adjust their current practices.

The EBA recognises that there is a certain overlap with the work currently conducted at international level. However, the Authority believes that at least five years will be needed before the adoption of new Basel Committee standards and its future transposition in the EU regulatory framework. This time window should be used to significantly improve the comparability of internal models.

Though we appreciate that the IRB approach is principally used by larger scale institutions, smaller entities can also be concerned by this work. For example, this can be the case when several smaller organisations mutualise risk assessment functions or when specialised subsidiary firms apply the IRB approach as part of a group policy. This can be the case of specialised consumer credit and leasing firms.

It is therefore critical to ensure that the outcome of this work is indeed consistent with firms' technical abilities and resources. For example, work at entity level should be restricted to what is necessary i.e. to those functions for which subsidiaries may have a margin of discretion. Flexibility should also be provided to competent authorities in their supervisory assessment functions. National supervisors should be able to set a lighter supervisory/reporting framework for smaller and simpler financial institutions (for instance monoline product bank subsidiaries).

We draw your attention to the following elements which are of particular importance for the specialised financial services industry:

Corporate governance[26]

The CRR specifies several control levels in the development of the rating systems and the application of the IRB approach. Supervisory rules should be in place to control the roles and required level of independence of the credit risk control unit, validation function and internal audit.

We think that a requirement of independence for the validation functions is ill-suited for specialised subsidiary entities. Validation functions are typically piloted by mother companies. Requiring that independent validation functions be implemented at subsidiary entity level would be, for many companies, a major shift in the application of the IRB approach. It is worth stressing that the costs involved in the implementation of completely independent validation and credit risk control units that are appropriately staffed and trained would be disproportionate for smaller entities.

The assessment of the adequacy of the level of independence should therefore be based on the proportionality principle.

[26] Eurofinas & Leaseurope, *Response to the EBA consultation paper on the requirements to use the IRB approach*, March 2015

Default[27]

The European Banking Authority is currently working on Regulatory Technical Standards (RTS) on the materiality threshold for credit obligations past due and Guidelines on the application of the definition of default. Both are developed in accordance with Article 178 CRR and aim at providing quantitative and qualitative warnings of default.

Concerning quantitative indications, we see the EBA original proposal to introduce an absolute ceiling or threshold of 200 EUR for retail exposures and 500 EUR for all other exposures as extremely conservative. We do not think that this proposal would sufficiently take into account the diversity of credit obligations and, in particular the specific features of leasing and consumer finance. We also think that default should be recognised after both absolute and relative thresholds are breached. This will ensure that there is no artificial increase in the number of defaults due to IT failures or misunderstandings with clients.

Qualitative indications are also key such as, for example, specifications to the concept of technical default, the definition of return to non-defaulted status and the ability to extend to 180 days the past due criteria for real estate exposures. We think there should be a degree of flexibility built in the standards to ensure that the operational characteristics of leasing and consumer credit firms are taken into account.

Q14. Which areas of the CRR could be simplified without compromising the Regulation's objective of ensuring prudence, legal certainty and a level playing field? Are there areas that could be simplified, but only for specific types of bank or business models? Would it be useful to consider an approach where banks that are capitalised well above minimum requirements or that are less exposed to certain risks could be subject to simplified obligations? What would be the risks with such an approach?

Q15. What additional measures could be taken in the area of prudential regulation to further promote integration and enhance a level playing field? Can you indicate specific examples and evidence of discretions that affect the cost and availability of bank lending?

The "CRD IV package" brought important new administrative and human resources burden for institutions. In this context, the respect of the proportionality principle is also of major importance in order to ensure a level playing field between competitors, since smaller institutions suffer a proportionally higher burden.

The Basel Committee is reviewing the standardised approach for credit risk. We support the objective of the review to ensure that the standardised approach is appropriately calibrated to reflect the riskiness of credit exposures. We are however concerned by the potential detrimental impact certain recommendations could have on specialised credit institutions. The proposed new risk weights will imply an important increase in capital requirements. Recalibration and fine-tuning of the standards are therefore needed to avoid a disproportionate impact on firms and ensure consistency with the review's objectives. For example, the proposal that institutions should apply a risk weight of 300% to exposures to an obligor that has not provided its revenue and leverage data could be highly detrimental to the financing of many small businesses.

In general, we are concerned that the transition to the proposed methodology would increase capital requirements of standardised banks for most credit exposures, widening the gap between standardised and IRB institutions, raising serious competition issues for smaller or challenging banks.

[27] Eurofinas & Leaseurope, *Response to the EBA consultation paper on credit obligation past due*, February 2015

We would also strongly advocate for **a** better recognition of physical collateral in the BCBS's review of the standardised approach for credit risk. The lack of recognition of physical collateral places specialised providers at a disadvantage compared to other market players and has a significant impact on their ability to fulfil their role of support to the real economy[28].

The lack of regulatory stability leads to a very complex environment for specialised entities.

[28] Eurofinas, *Response to the BCBS consultation on revisions to the standardised approach for credit risk*, March 2015 and Leaseurope, *Response to the BCBS consultation on revisions to the standardised approach for credit risk,* March 2015