Leaseurope

The Voice of Leasing and Automotive Rental in Europe

eurofinas

SPECIALISED CONSUMER CREDIT PROVIDERS IN EUROPE

Leaseurope & Eurofinas Joint Response to the European Commission Call for Evidence on the EU Regulatory Framework for Financial Services

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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.

Leaseurope & Eurofinas executive summary to the European Commission Call for Evidence on the EU Regulatory Framework for Financial Services

Eurofinas and Leaseurope, the voices of consumer credit and leasing at European level, welcome the opportunity to respond to the European Commission Call for Evidence on the EU Regulatory Framework for Financial Services.

Before answering to the specific issues of the call for evidence, we highlight below the benefits for the real economy of Leasing and Consumer Credit Activities in Europe.

Consumer credit and leasing are key drivers of European economic growth

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[1]. 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[2]. Leasing is also very popular amongst large corporates[3]. It is also extremely useful to support the public sector (e.g. leasing to schools, hospitals, etc.).

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[4]. Consumer lending is procyclical and is highly positively correlated with households' disposable income[5]. By providing access to finance to individuals and households, consumer credit supports the social and economic well-being of millions of consumers across Europe.

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.

[1] Leaseurope 2014 Annual Statistical Enquiry
[2] 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
[3] European Central Bank, Survey on the Access to Finance of Enterprises in the Euro Area, October 2014 to March 2015
[4] Eurofinas 2014 Annual Statistical Enquiry
[5] Eurofinas, Consumer Credit, Helping European Households Finance their Tomorrow, 2015

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.

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

- The financial services industry shoulders a significant cost as a result of increasing regulation. Regulation is costly for 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.

CDR IV Package:

- As a general observation, we believe that increased capital requirements have 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.

- Basel III requirements and, to some extent, CRR and CRD IV at European level, 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 and this should be recognised in the European framework. 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 capital, 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.

- 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 financial services providers (SFSPs) 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, and loans secured on salaries and pensions.** This should be done by **introducing a specific risk weigh category that reflects the reality of our specialised business model and low risk profile.**

Accounting:

- The new lease accounting standard (IFRS 16) published by the International Accounting Standards Board will require banks with (current) operating leases to report these as 'Right of Use (ROU) assets on their balance sheets. In reality no new assets or liabilities have been created, the ROU asset is merely a new way of reporting existing contracts based on a different theoretical accounting model. It is important therefore that the regulatory treatment of these leased assets does not change, in order to avoid banks having to raise extra capital for no real reason.

Consumer Protection:

- We support the European Commission's objective to ensure that consumers enjoy transparent, complete and comparable pre-contractual and contractual information across Europe. Experience shows however that the implementation of recent standards lead to a major increase of contractual material to customers. Information overload should be avoided at all cost.

We remain at your disposal should you require any further information on the nature of the activities we represent or additional clarifications on our response to the European Commission Call for Evidence on the EU Regulatory Framework for Financial Services (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

1) Unnecessary regulatory constraints on financing: the Commission launched a consultation in July on the impact of the Capital Requirements Regulation on bank financing of the economy. In addition to the feedback provided to that consultation, please identify undue obstacles to the ability of the wider financial sector to finance the economy, with a particular focus on SME financing, long-term innovation and infrastructure projects and climate finance. Where possible, please provide quantitative estimates to support your assessment.

Regulation concerned
Basel 3 rules, CRR/CRD4

Summary
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. In this context, scoring processes and access to objective data are essential.

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 (CCD). They are required to perform a thorough creditworthiness assessment of their customers[6]. 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.

Evidence
According to an extensive research[7] 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.

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

[6] Directive 2008/48/EC on credit agreements for consumers, OJEU L 133/66
[7] 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

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[8].

Proposition

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.

Given the demonstrated importance of leasing for European SMEs as well as the demonstrated low risk profile of leasing in Europe, we call on the European Commission to promote a **better recognition of physical collateral** other than real estate as far as leasing transactions are concerned. **The "one size fits all" risk weights currently being applied fall short from properly reflecting the low risk profile of leasing.**

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[9].

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[10]. A recent industry survey confirms that default and loss rates for such a product are significantly low[11]. 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%.

3) Investor and consumer protection: please specify whether, and to what extent, the regulatory framework has had any major positive or negative impacts on investor and consumer protection and confidence.

Regulation concerned

Consumer Credit, Mortgage Credit and Insurance Distribution Directives

Summary

EU consumer protection standards are primarily focused on precontractual information: the Consumer Credit Directive (CCD), the Mortgage Credit Directive (MCD) and, more recently, the Insurance Distribution Directive (IDD) set out detailed and standardised information requirements which we believe creates information overload for both clients and providers.

[8] Eurofinas, National codes of conduct for consumer lending, 2015

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

[10] 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

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

Evidence
For example, with the implementation of the CCD, it is not uncommon that a consumer credit agreement is 30 or 40 pages long. If the consumer also takes out an insurance, the information requirements of the IDD will also apply, resulting in an even longer document, with duplication of information. The same applies for home loans.

Proposition
Preventing information overload, and the administrative burden it causes for providers, should be one of the main objectives of the European legislator, in order to achieve a simple, clear and adapted information for the consumer.

4) Proportionality / preserving diversity in the EU financial sector: are EU rules adequately suited to the diversity of financial institutions in the EU? Are these rules adapted to the emergence of new business models and the participation of non-financial actors in the market place? Is further adaptation needed and justified from a risk perspective? If so, which, and how?

Regulation concerned
Basel 3 rules, CRR/CRD4

Summary
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.

The “CRD IV package” have 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.

Basel 3 rules at international level and, to some extent, CRR and CRDIV at European level, have mostly been designed for large international banks. Yet, Basel 3 and CRR/CRD4 principles apply to all credit institutions in EU whatever their size and business model. They apply to only a few large American banks, creating a competitive distortion between USA and EU. From this perspective, we share your view that specific business models of specialized credit institutions that are lower risk institutions should not be burdened with the same requirements bigger and riskier institutions face.

Evidence
As a general observation, we believe that increased capital requirements have 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.

Proposition
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.

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 financial services 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.

Regulation concerned
CRR / CRD 4

Summary
A "one size fits all" application of CRR/CRD4 affects specialised institutions that collect few or no deposit and present low risk profiles. We underline the importance of the proportionality principle that consists in adapting the rules to specific business models.

A good illustration of the application of the principle of proportionality is the Liquidity Coverage Ratio (LCR). The Delegated Act on the liquidity coverage requirements for credit institutions adapts the liquidity requirements to specific business lines such as leasing, factoring, motor finance and consumer credit activities.

Evidence
The application of the Liquidity Coverage Ratio, without the adaptations of the cap on inflows allowed for leasing, factoring and consumer credit, would have dramatically increased the cost of lending for those activities, with an immediate impact on the financing of the economy.

Proposition
European rules should respect the principle of proportionality, in particular to the diversity in size and scale of operations and to the range of activities of institutions.

Capital requirements should be proportionate to the risks addressed[12] and liquidity and leverage ratios should take into account business models and activities.

The Commission should ensure that delegated and implementing acts, regulatory technical standards and implementing technical standards are consistent with the principle of proportionality. The EBA should therefore ensure that all regulatory and implementing technical standards are drafted in the same way.

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.

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[12] *Credit risk should maintain different levels of risk-sensitivity and allow different degrees of sophistication.*

Regulation concerned
CRR / CRD 4
Summary
CRD IV remuneration requirements that apply to all institutions, regardless of their size, level of significance, business models, use of variable remuneration, activities or products.

Evidence
The CRD IV currently does not allow for a proportionate application of its remuneration principles. This has been confirmed by the EBA in its recent opinion, in which it recommends the EU institutions to make legislative amendments to the Directive. We support this proposal.

Proposition
Exemptions must be introduced in the CRD for small and non-complex institutions and for staff that receives only a small amount of variable remuneration, for example by way of legislative amendments.

Unnecessary regulatory burdens

5) Excessive compliance costs and complexity: in response to some of the practices seen in the run-up to the crisis, EU rules have necessarily become more prescriptive. This will help to ensure that firms are held to account, but it can also increase costs and complexity, and weaken a sense of individual responsibility. Please identify and justify such burdens that, in your view, do not meet the objectives set out above efficiently and effectively. Please provide quantitative estimates to support your assessment and distinguish between direct and indirect impacts, and between one-off and recurring costs. Please identify areas where they could be simplified, to achieve more efficiently the intended regulatory objective.

Regulation concerned
Basel 3 rules, CRR/CRD4 - Risk models to determine RWA

Summary
There remain important concerns about the future developments of the regulation. The regulation framework is not stabilized yet, especially as regards to the current Basel Committee works on the revision of the standardised approach and the current EBA works on the IRB approach.

Evidence
This lack of stability of the regulation framework results in a very complex environment for European institutions, and the compatibility of these mentioned Basel Committee and EBA works with the RTS and ITS issued or to be issued according to the CRR schedule is of main importance. Capital allocation resulting from new risk drivers, or new definitions of main parameters such as “default”, “Probability of default” and “Loss given default”, could be strongly affected. It could result in activities arbitration within banking groups detrimental to some specialised financing activities such as leasing or factoring.

Proposition
Concerning those two projects, a risk sensitive approach needs to be preserved at the European level. Especially, current IRB models that are adapted to specific business models should be preserved. These IRB models are very useful for credit institutions as a tool monitor and control their risks.

Regulation concerned
IFRS

Summary

The new lease accounting standard (IFRS 16) published by the International Accounting Standards Board will require banks with (current) operating leases to report these as 'Right of Use (ROU) assets on their balance sheets. In reality no new assets or liabilities have been created, the ROU asset is merely a new way of reporting existing contracts based on a different theoretical accounting model. **It is important therefore that the regulatory treatment of these leased assets does not change, in order to avoid banks having to raise extra capital for no real reason.**

7) Contractual documentation: standardised documentation is often necessary to ensure that market participants are subject to the same set of rules throughout the EU in order to facilitate the cross-border provision of services and ensure free movement of capital. When rules change, clients and counterparties are often faced with new contractual documentation. This may add costs and might not always provide greater customer/ investor protection. Please identify specific situations where contractual or regulatory documents need to be updated with unnecessary frequency or are required to contain information that does not adequately meet the objectives above. Please indicate where digitalisation and digital standards could help to simplify and make contractual documentation less costly, and, if applicable, identify any obstacles to this happening.

Regulation concerned

Directive 2014/17/EU on credit agreements for consumers relating to residential immovable property (Mortgage Credit Directive) of 4 February 2014

Summary

The Directive includes a standardised information sheet (ESIS) which purpose is to give consumers a position to compare different loan offers (article 14 and Annex II). ESIS (standardised information sheet) is a very complex and unclear document.

Evidence

The ESIS contains a significant number of provisions which makes the document complex and unclear for the consumer (when all the relevant information is filled out in ESIS, ESIS will constitute more than 10 pages). In comparison it should be noticed that the Consumer Credit Directive (CCD) also includes a standardised information sheet (SECCI). However, to our experience, SECCI only comprises approximately 5 pages when it is filled out.

Moreover, some of the information in ESIS seems to be of little value and in some cases even potentially misleading. An example of this is the calculation of an illustrative example on the Annual Percentage Rate of Charge (APRC), according to ESIS part B, section 4(2). Where there is no cap, the example shall illustrate the APRC at the highest borrowing rate in at least the last 20 years, or the longest period for which such data is available. We think this is of limited value for the consumer but implies considerable costs for institutions to implement the new standard, i.e. costs the development of the calculation and the storing of data.

Proposition

Considering that the review of the Directive by the European Commission will first occur by 21 March 2019, it may be appropriate to adapt this provision via the Delegated Act on ESIS provided for in article 14(9) following a proper impact assessment taking into account the implementation difficulties within Member States.