Leaseurope

The Voice of Leasing and Automotive Rental in Europe

Brussels, 17 March 2017

Leaseurope response to the European Commission consultation paper on Capital Markets Union mid-term review 2017

Leaseurope, the voice of leasing at European level, welcomes the opportunity to respond to the European Commission consultation paper on Capital Markets Union mid-term review 2017.

Leaseurope brings together 45 member associations representing the leasing, long term and/or short term automotive rental industries in the 33 European countries in which they are present. The scope of products covered by Leaseurope members' ranges from hire purchase and finance leases to operating leases of all asset categories (automotive, equipment and real estate). It also includes the short term rental of cars, vans and trucks.

FINANCING FOR INNOVATION, START-UPS AND NON-LISTED COMPANIES

Question:

Are there additional actions that can contribute to fostering the financing for innovation, start-ups and non-listed companies? Please propose complementary policy measures, explain their advantages, and illustrate any foreseeable challenges to their implementation.

In 2015, the leasing firms represented through Leaseurope's membership helped European businesses invest in assets worth more than 315 billion EUR, reaching 755 billion EUR of outstandings at the end of the year. Leasing is used by more European SMEs than any individual category of traditional bank lending taken altogether (around 40% of all European SMEs make use of leasing, which is more than any other individual form of long-term lending). It is also extremely useful to support the public sector (e.g. leasing to schools, hospitals, etc.).

Based on the research findings of an Oxford Economics report released in 2015[1], it is shown that, relative to bank loans, which experienced significant constraints during the most recent economic crisis, leasing remained a reliable and robust form of SME finance. Oxford Economics estimates that, at the EU level, leasing was responsible for financing around €104 billion of SME investment in fixed assets in 2013 and was forecasted to account for circa €121 billion in 2014.

According to the latest ECB SAFE survey[2], leasing is a relevant source of finance for 47% of SMEs in the EU. This is in fact corroborated by the aforementioned Oxford Economics report, which found that 42.5% of SMEs used leasing in 2013 (up from 40.3% in 2010), demonstrating that leasing is an increasingly vital source of finance for many European SMEs.

[1] Oxford Economics, The Use of Leasing Amongst European SMEs, 2015;

[2] European Commission, *Survey on the Access to Finance,* 2016 Report. Available here.

Given the demonstrated importance of leasing for SMEs, we hereby call on the European Commission to work with Leaseurope to raise further the awareness of SMEs to this form of financing. This can be done by a more systematic reference to leasing as an effective alternative to bank financing in official communications. Statements made by representatives of the European Commission often leave the impression that bank loans, private placements, business angels, venture capital, crowd funding and public offerings are the only ways for SMEs to access external finance. This is not so. While we commend the European Commission for its plan to create a Capital Market Union, we strongly feel that more can and should be done to raise SMEs' awareness of leasing and its many benefits. This would be in line with the Commission's objective to help SMEs grow.

Proportionality and Various Business Models

Leaseurope welcomes the Commission's approach towards Better Regulation and its recognition of the need to make sure that legislation is proportionate and accounts for market participants' various business models.

We would also emphasise that lower risk institutions should not be burdened with the same requirements riskier institutions may face.

A Differentiated Prudential Treatment of Leasing Exposures for Credit Risk

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

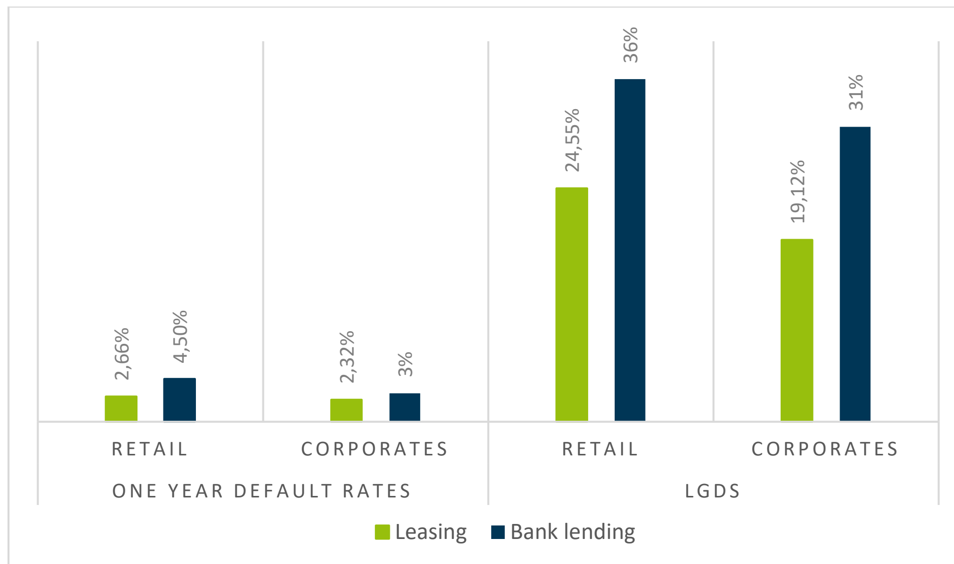
The unique feature of a lease is the lessor's ownership of the leased asset. These ownership rights provide lessors with a valuable and efficient form of in-built security which makes leasing extremely low-risk. Asset ownership represents a major advantage for lessors compared to other financial products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

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

In Europe, Deloitte undertook extensive research on our behalf which demonstrates that the leasing business model leads to significantly lower risk compared to traditional lending.[3] The graph below shows the results of the research, which was based on a portfolio of 3.3 million lease contracts in 15 European countries. The graph shows that default rates and loss given defaults (LGDs) for leasing Retail and Corporate exposures are significantly lower compared to

[3] 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 .

bank lending averages. These leasing LGD figures are for stressed conditions, average loss rate figures are even lower. European capital requirements under the Standardised Approach are also shown to be 10x higher than the real risks for SME leases within the Retail class.



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

We believe that the risk sensitivity of the credit risk framework can be further increased without introducing unnecessary complexity.

As far as international standards are concerned, we agree that attention should be paid to the appropriate calibration of SME lending capital requirements and to the need for implementing international standards in a way that makes sense for Europe's diverse financial landscape.

The above-mentioned Deloitte findings on PDs and LGDs of lease transactions have been brought to the attention of the Basel Committee on Banking Supervision and of the European Banking Authority in the context of their ongoing/future work on, respectively, the review of the Standardised Approach for Credit Risk and the future of the IRB approach. We have also shared the findings with the European Commission in our response to the consultations on the Possible Impact of the CRR and CRD IV on Banking Financing of the Economy and the Call for Evidence on the EU Regulatory Framework for Financial Services.

While the Basel Committee admittedly needs evidence from other regions of the world before considering suggesting any changes, we consider that the European Union can, and should, take the lead on this issue of better recognition of physical collateral other than real estate as far as leasing transactions are concerned. A proper calibration of the risk weights applied to leases would provide the right incentives and result in European SMEs investing more, to the benefit of the European economy. This should be the priority.

Credit Risk Mitigation (CRM): Exposures secured by durable goods should be recognised as collateral

We strongly advocate for the recognition of exposures secured by durable goods (e.g. equipment leases and motor finance) as physical collateral for credit risk mitigation purposes because the assets on which the lending is secured exist in liquid markets with transparent and publicly available pricing and can be realised quickly.

Given the demonstrated importance of leasing for European SMEs as well as the demonstrated relatively 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.

STRENGTHENING BANKING CAPACITY TO SUPPORT THE WIDER ECONOMY

Key trends and challenges: Securitisation

The ability of specialised financial services providers (SFSPs) to support job creation and sustainable growth relies on their ability to raise sufficient capital for lending at the lowest possible cost. For a growing number of providers, including bank-owned, independent firms and captives (provide financing to customers buying the parent company's product), this relies on their ability to use securitisation.

The extent to which securitisation is used varies significantly among our members, in large part due to the diminishing amount of investors. This is why we support the European Union's commitment to stimulate securitisation as part of its commendable Capital Markets Union Action Plan.

We appreciate the Commission´s political approach to focus on the development of simple, transparent and standardised (STS) securitisation to build a sustainable EU market for securitisation. However, we are worried that these political aims will not be met by the draft for an STS framework as proposed by the Commission. We are particularly concerned that the proposal may lead to the exclusion of a wide range of well-established securitisations from the definition of STS. With the Trilogues process underway, the need for sound provisions and compromises to stablish the STS framework is critical.

In comparison to the US, the volume of EU investors is very low. This therefore underscores the need for a more ambitious approach to the proposed new framework. For example, the proposal does not address the barriers to entry for new investors. It is critical that investor obligations are kept to an absolute minimum so as not to discourage them. In this regard we very much welcomed the final text on Money Markets Funds which allows this important investor base to continue investing in real economy ABS and ABCP.

However, we are concerned with the proposed capital requirements for banks. Capital Increases will be imposed on European securitisations which have a proven record of rating stability and low defaults. If the proposed capital calibrations for STS are not revised, damaging and unintended consequences will arise for the European economy directly and indirectly. We therefore urge policymakers to consider the need to revisit these calibrations in the Trilogues or through a review mandate shortly after the STS framework is adopted.

We also encourage European policy-makers to engage with both European and international investors to find out what measures would persuade them to invest in the EU market.

We support efforts to promote securitisation in Europe and the work of the European Commission to ensure that the draft regulations avoid any unintentional consequences. However, as previously mentioned some requirements seem to make it very difficult - if not impossible - for investors to deal with originators, sponsors and conduits, other than possibly those already well-established in the market.

As non-complying securitisation will receive less favourable regulatory treatment (e.g. risk weights) this could represent a serious restriction on the use of securitisation by SFSPs. To avoid this unfortunate situation, Leaseurope together with our sister federation Eurofinas have already shared separately with the Commission, the Council and the Parliament the provisions that would impede our companies obtaining the STS label. We will continue working with EU policy-makers to ensure securitisation remains not only possible but attractive for both issuers and investors.

Contact Persons:

Rafael Alarcón Abeti
Policy Adviser
Leaseurope
+32 2 778 05 69
r.alarconabeti@leaseurope.org

Hayley McEwen
Senior Adviser
Leaseurope
+32 2 778 05 71
h.mcewen@leaseurope.org

Leaseurope is entered into the European Transparency Register of Interest Representatives with ID n° 16013361508-12