Leaseurope

The Voice of Leasing and Automotive Rental in Europe

eurofinas

SPECIALISED CONSUMER CREDIT PROVIDERS IN EUROPE

Brussels, 29 May 2017

Leaseurope & Eurofinas response to the EBA consultation paper on its draft Regulatory Technical Standards (RTS) specifying the nature, severity and duration of an economic downturn according to which institutions shall estimate the downturn loss given default (LGD) and conversion factor (CF).

General Observations:

Eurofinas and Leaseurope, the voices of consumer credit and leasing at European level, support the work of the EBA in developing technical standards and promoting convergence of supervisory practices across Europe. We support the EBA objective of reducing unjustified variability in the internal ratings-based (IRB) approach. We see the mission of the EBA as critical and very much welcome the quality of its work as well as its constant dialogue with the industry. Nevertheless, we would like to emphasise that the EBA review of the IRB models entails significant changes for our current internal models. These changes will be time consuming and will imply significant costs for our industries. The proposed EBA date for implementing the IRB review is very challenging for our industries to meet and will pose an extra burden on ‘business as usual’ operations. Therefore, we urge the EBA to consider more adequate periods of implementation in line with the principle of proportionality.

Responses to the EBA Questions:

Q1: Do you have any concerns around the workability of the suggested approach (e.g. data availability issues)?
Q2: Do you see any significant differences between LGD and CF estimates which should be reflected in the approach used for the economic downturn identification?

We agree with the EBA that it is not easy to model downturn LGDs and CFs. We commend the EBA for its constructive proposal, in particular on the analysis of the payment recovery process in case of default. We agree with the limit that is mentioned in the credit activity.

However, we think that the proposed method suffers from its complexity and cost. It carries the risk that the efforts to implement the approach in the modelling process are burdensome for uncertain results, since the correlation between the proposed factors and the real causes of the losses is not established.

The model component approach is not easy to implement and it will not provide better quality of data than those obtained with the alternative approaches.

The modeling of the LGD and CCF parameters have different aims and are based on different starting point of observation. For instance, for some specialised credit activity, such as consumer credit, the downturn conditions are not particularly linked to external macroeconomic parameters.

Q3: Is the concept of model components sufficiently clear from the RTS? Do you have operational concerns around the proposed model components approach?

We would welcome further clarification on the definition of the approach. Though the proposed example provides some clarification, we would also suggest to have other explicit examples for credit activity.

We also notice that the proposed RTS specifies that the model components are based on historical defaults which are not risk factors (input factors for non-defaulted LGD estimation).

Q4: Do you have any concerns about the complexity around the dependency approach proposed for the identification of the nature of an economic downturn? Is it sufficiently operational?

We would appreciate if the proposed list of economic factors to be considered are more precisely defined. For instance, "default rates and credit losses from external data" seems difficult to collect, and the "tax benefits" impact appears complicated to model. The collection of external data concerning other institutions (for example default rates) is especially difficult for specialised financial services providers.

Furthermore, institutions need to find out additional economic factors: e.g. "consumer price index" for other retail.

Another concern from an operational point of view is the collection of "regional specific indexes" if it is required to be infra-national data.

To solve this issue we propose that NCAs should be responsible for the collection and delivery of the required data. If this is not the case, it will be difficult for the institutions to justify the supervisor that they cannot respect the RTS requirements.

Q5: Do you agree with the proposed approach for computing the time series of the realised model component referring to the realisation of the model component rather than to the year of default?

We agree with the proposed approach, but we would like to highlight that it would be difficult to implement this approach due to the required length of historical data.

Q6: Do you envisage any situation where a one year duration is not suitable of capturing the economic downturn at the economic factor level?

We consider that one year duration would be suitable.

Q7: Do you have any concerns about the approach proposed for the identification of the severity of an economic downturn? Is it sufficiently operational?
Q8: Do you think that more details should be included in Article 2(3) for the purposes of the evaluating whether sufficiently severe conditions are observed in the past?

We consider the proposed methodology is clear enough. Nevertheless, we wish to express our concerns on the availability of some statistical data, in particular for a 20 year historical period.

Q10: Do you have any concern around the proposed approach about the identification of the final downturn scenario?

We understand the EBA approach to consider the worst level in a period of 20 years for each economic factor. However, we think that the fact that some economic factors may not be correlated may pose a fundamental problem as these factors do not react to the same causes and may reach their worst level at different time of the period. This could entail difficulties for determining a consistent final downturn scenario based on economic factors. We would therefore welcome more clarity and some examples on this issue.

Q13: Do you think the draft GLs should describe in more detail the downturn adjustment methodology?

We think that the definition of the elements listed in this RTS and the proposed methodology to estimate LGDs and CFs provided in the proposed Guidelines on PDs and LGDs are linked. Therefore, we would recommend that the key elements of the Guidelines should be included in the RTS as this would meet the objective of reducing the variability of the models.

Q14: Do you think simpler alternative approaches for downturn adjustment should be considered in the spirit of proportionality?

We consider that the Model Component approach could entail for some specialised activities non-coherent results and may raise implementation issues in terms of complexity (access to data) and cost. We would therefore suggest to allow specific business models and/or risk profiles using a simpler alternative approach in the cases where it is not possible/justified to use the Model Component approach.

For some activities, the economic downturn is not always the key parameter of a downturn LGD. For instance, considering credit activities, the evolution of the legal background and external elements other than strictly economic may have a major impact on the LGD estimation. It would not be effective to impose the use of the complex and costly Model component approach to these institutions as it is predictable that it will not lead to relevant results for credit risk analysis.

We do not consider that the “Reference value” approach would be more efficient, as it is based on the same methodology. Therefore, we would support the ability to use the “Supervisory add-on” approach as the proposed updated rates are not practical. They correspond more to severe stress tests than to a regular credit risk analysis modelling. The application of such a level of updated rates would significantly reduce the risk sensitivity of the models.

Q15: What is your view on the alternative approaches? Please provide your rationale.

We would support the possibility to use the “Supervisory add-on” approach, in line with the principle of proportionality. Nevertheless, we highlight that this approach relies on a balanced calibration of the add-on by the supervisors in order to guarantee that it is determined considering the specificities of the business models. Otherwise, it would hamper the risk sensitivity of the internal models.

Q16: Which approach are you currently using for estimating downturn LGDs?

Some specialised financial services institutions currently perform an approach that is close to the supervisory add-on approach.

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About us

The membership of our two Federations covers institutions specialised in one or more of the following activities:

- Lending to consumers, for instance via personal loans, credit cards or lease/hire purchase agreements
- Leasing to businesses of all asset types, including machinery and industrial equipment, ICT and others assets
- Motor finance, granted to individuals or businesses, either in the form of loans or leases

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. The types of institutions represented by the Federations include specialised banks, bank-owned subsidiaries, the financing arms of manufacturers as well as other, independently-owned institutions.

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[1]. Leasing is used by more European SMEs than any individual category of traditional bank lending taken altogether (around 40% of all European SMEs make us of leasing which is more than any other individual form of lending)[2] and is also extremely popular amongst larger corporates[3]. It is also extremely useful to support the public sector (e.g. leasing to schools, hospitals, etc.).

In 2015, consumer credit providers that are members of **Eurofinas helped support European consumption by making more than 423 billion EUR goods, services, home improvements and private vehicles available to individuals**, reaching 981 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.

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

[1] Leaseurope 2015 Annual Statistical Enquiry

[2] Oxford Economics, *The Use of Leasing Amongst European SMEs,* 2015; Eurostat, *Access to Finance Statistics,* 2011; 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 Small and Medium-Sized Enterprises in the Euro Area* , April 2013

[4] Eurofinas 2015 Annual Statistical Enquiry

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