Leaseurope

The Voice of Leasing and Automotive Rental in Europe

Brussels, 12 April 2018

Leaseurope response to the European Commission consultation on the finalisation of Basel III.

Leaseurope, the voice of leasing at European level, welcomes the opportunity to comment on the European Commission consultation on the finalisation of Basel III.

GENERAL COMMENTS:

General questions:

a) What are your views on the impact of the revisions on financial stability?

b) What are your views on the impact of the revisions on the financing of the economy?

Leasing supports investment in productive and sustainable assets

We believe that leasing plays an important role in achieving sustainable growth in Europe by helping European businesses access productive and sustainable assets. Leasing allows businesses and other types of lessees to manage their working capital more effectively by spreading payments to use the asset over the contract period. Leasing also enables clients to upgrade their assets easily to the latest technologies so that they may remain competitive. It is often more affordable and quicker to obtain than other forms of finance and provides greater operational flexibility in comparison to the outright purchase of an asset.

Leasing is ideally placed to finance productive investment in a vast range of sectors and activities (including R&D and innovation, infrastructure, industrial technology, capital-intensive projects, healthcare, environmental technologies, etc.) as well as the investment of enterprises, and throughout all stages of a firm's development (from young start-ups to companies that are far along their life cycle). It is also extremely useful to support the public sector (e.g. leasing to schools, hospitals, etc.).

As Europe reduces its carbon footprint in line with the Paris Agreement on climate change, the focus on producing and using energy efficient assets has increased. Consequently, businesses demand and need more energy efficient assets. Leasing can help firms gain access to such assets. For instance, by allowing and encouraging the uptake of clean vehicle technology, the leased car fleet in Europe has become steadily less polluting over the past few years. Leasing has also contributed to the rejuvenation of European truck fleets in order to adopt necessary fuel-saving (and safety) technologies. By bringing the cleanest, newest and safest vehicles to the market, leasing companies not only rejuvenate Europe's vehicle fleet, but also ensure the assets they finance keep strong remarketing values as national and local regulators are increasing penalising usage of older vehicles.

Additionally, leasing addresses one of the general barriers that inhibits the development of sustainable energy production, i.e. a lack of access to capital. In fact, leasing already 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.

Leasing not only aids in replacing old, polluting equipment with cleaner and more energy efficient assets, it can also encourage the efficient use of scarce natural resources. The fact that lessors are the owners of the assets they lease incentivises them to ensure that resources and materials that go into asset production are of high quality. Moreover, lessors are also incentivised to ensure that production materials and the individual parts making up an asset can be re-leased, refurbished, reused or recycled. Lessors have specialised asset knowledge and sophisticated asset management capabilities to deal with the often complex asset management issues that arise with asset ownership. Thus, leasing enables a more efficient allocation of resources than when (non-specialist) businesses own assets outright.

By allowing asset use without asset ownership, the leasing instrument could enable a fundamental shift in our traditional consumption and production models. These new models of economic value creation have been referred to as "the circular economy" and are being examined seriously at European and international levels as a way forward in our environment of scarce resources.

Leasing is particularly well suited to supporting SMEs

Based on the research findings of an Oxford Economics report released in 2015 , 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 has increased in the following years.

According to the latest European Commission and European Central Bank (ECB) SAFE survey 2017[1], leasing is a relevant source of finance for 48% 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.

Leasing is an excellent financing tool to support European long-term investment. Therefore, given the demonstrated importance of leasing for supporting investment, SMEs and sustainable finance in Europe, we hereby call on the European Commission to work on a prudential regulatory framework that does not disincentivise banks from offering leasing, which is in the best interest of European business. Therefore, we propose a recognition of the low risk nature of leasing for those entities offering leasing that are subject to capital requirements.

[1] European Commission and ECB, *Survey on the Access to Finance,* 2017 Report. Available here.

Leasing demonstrated low risk is not recognised by the prudential framework

Credit risk weights under prudential standards (i.e. Basel III and CRR) should reflect the real underlying risks. Failure in this could lead to otherwise healthy, beneficial lending being disincentivised in terms of capital allocation and cost of funding. 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. We also advocate for a better recognition of leasing finance as physical collateral for credit risk mitigation purposes.

Losses within the leasing activity are low because the lessor is funding a physical asset crucial to the client's core business activities. As the asset is a key working tool for the lessee, many defaulted leases regrade back to a healthy situation with zero loss. Additionally, the lessor can then sell or re-lease the asset in order to decrease any losses on the default, resulting in low loss rates.

A report prepared for Leaseurope by the University of Cologne in December 2017[2], which is based on a dataset of detailed contract-level information by twelve major European leasing companies operating across 25 countries, demonstrates that leasing is unjustifiably penalised by the current prudential regulatory framework. The research shows what would be an adequate calibration for leasing exposures compared to its real risk profile. The research is based on the current CRR rules.

Given the short deadline for this consultation we do not have an in-depth analysis of the impact of the finalisation of Basel III yet, but we estimate based on preliminary observations an increase on capital requirements for European lessors under the Advance Internal Ratings-Based (A-IRB) approach between 20% and 30 %. This is mainly due to the proposed input floors, the output floor and the impossibility to use the A-IRB for certain asset classes. Lessors using the Foundation Internal Ratings-Based (F-IRB) approach will be also impacted by the output floor as leasing is highly penalised under the Standardised Approach (SA) compared to the historically observed risk of this form of financing.

Table 1 below presents the main results of the Cologne University research calculations for the current CRR. For all three regulatory credit risk approaches, capital requirements are much higher than the unexpected losses in a simulation of a downturn. As expected, the Standardised Approach yields the highest regulatory capital requirements followed by the F-IRB approach, with the A-IRB approach leading to the lowest regulatory capital requirements[3]. However even the A-IRB approach requirements are still almost five times higher than the unexpected losses in the simulation.

The realised losses were never higher than the regulatory capital requirements in any of the simulations performed (10,000 per year). Note that the realised losses include expected as well as unexpected losses, whereas capital requirements are designed to cover only unexpected losses. In this respect, the comparison of realised losses and capital requirements is extremely conservative. This result underpins the main conclusion that current regulatory capital requirements do not account for the low risk profile of leasing exposures in an appropriate way.

2 See "Capital requirements for leasing: A proposal adjusting for low risk", University of Cologne, December 2017. Research available upon simple request

3 The results, presented in the following tables ignore any output floor.

Therefore, introducing even more conservative changes in the prudential framework will have a significant negative impact for the leasing industry.

Table 1: Comparison of regulatory capital requirements and unexpected losses split by years

	2007	2008	2009	2010	2011	Total
SA	8.17%	7.97%	8.33%	8.44%	8.50%	8.31%
F-IRB	5.34%	5.46%	5.96%	5.98%	5.95%	5.80%
A-IRB	4.19%	4.76%	5.61%	5.69%	5.36%	5.25%
Unexpected loss	1.03%	1.45%	1.29%	0.65%	0.52%	1.09%

Table 2: Regulatory capital requirements omitting the SME supporting factor

	2007	2008	2009	2010	2011	Total
SA	9.38%	9.40%	9.65%	9.73%	9.78%	9.62%
F-IRB	6.17%	6.50%	7.00%	7.01%	6.98%	6.81%
A-IRB	4.78%	5.51%	6.35%	6.37%	5.96%	5.93%
Unexpected loss	1.03%	1.45%	1.29%	0.65%	0.52%	1.09%

STANDARDISED APPROACH FOR CREDIT RISK (SA-CR):

Specific questions:

c) What are your views on the revisions? Please provide details.

d) How would the revisions impact you/your business? Please specify and provide relevant evidence.

More specifically:

i. How does the revised SA-CR compare to the current approach in terms of capital requirements? Please provide an estimate, if the positive or negative difference is significant in your view, and specify the relevant revision(s).

ii. Do the revisions affect certain assets/exposure classes more than others and – if applicable – which of the provisions of the revised framework may create these effects? Please support your view with specific evidence to the extent possible.

e) Where do you expect particular implementation challenges and why? Please specify.

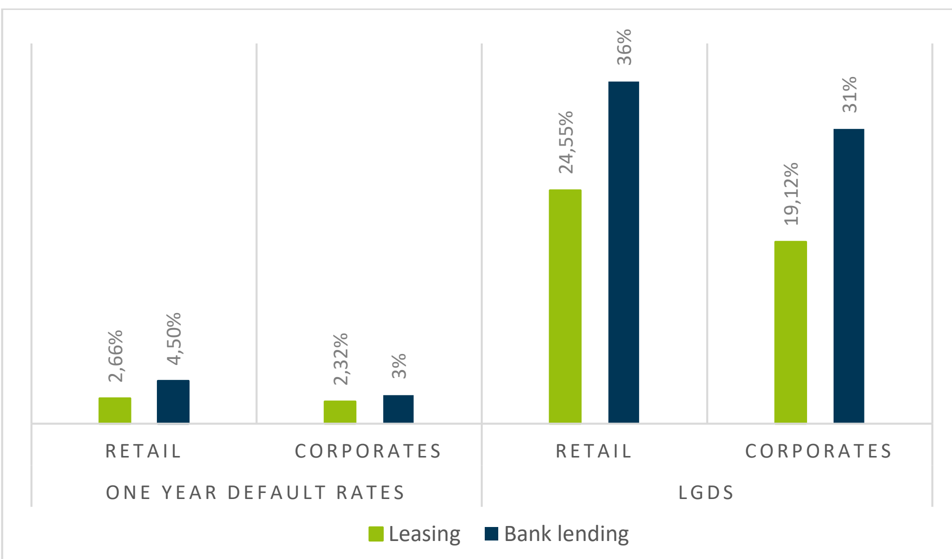
A differentiated capital treatment for leasing

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.

Loss 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.[4] 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 below shows that default rates and LGDs for leasing Retail and Corporate exposures are significantly lower compared to bank lending averages. These leasing LGD figures are for stressed conditions, average loss rate figures are even lower. European capital requirements under the SA are also shown to be 10 times 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.

[4] 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", Deloitte, October 2013. Research available upon simple request.

As far as international standards are concerned, we think that attention should be paid to the appropriate calibration of 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 losses of lease transactions have been brought to the attention of the Basel Committee on Banking Supervision (BCBS) and of the European Banking Authority (EBA) in the context of their 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.

We believe that the risk sensitivity of the prudential regulatory framework in Europe can be further increased without introducing unnecessary complexity. As the Basel Agreement does not properly reflect the real risks of leasing exposures in Europe and does not recognise physical collateral for credit risk mitigation, we share with the European Commission a proposal (table 3 below) to increase the risk sensitivity of the framework.

Leaseurope proposal

Table 3 presents leasing risk weights for the total portfolio analysed by the University of Cologne. These risk weights are sufficiently conservative in the sense that they lead to regulatory capital requirements far above unexpected and even expected losses. In addition, these risk weights ensure that on average the capital requirements under the SA are 5% above the capital requirements under the A-IRB approach.

These leasing risk weights are derived from a leasing factor calculated as a multiplier that equalises capital requirements under the SA to capital requirements under the A-IRB approach.

Based on the outcome of the research the table below shows the regulatory risk weights that would reflect the real risk of leasing:

Table 3: Adequate leasing specific risk weights under the Standardised Approach

	Leasing factor		Leasing risk weights	
	yearly average	yearly average + 5%	Retail	Corporate
Total portfolio	0.6177	0.65	49%	65%

Leaseurope calls on the European Commission to consider the above proposal (table 3), which is backed by strong evidences in Europe. This can be introduced in the CRR by adding a new category of leasing or by amending articles 122 and 123 (exposures to corporates and retail exposures).

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

We also advocate for the recognition of leasing 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 invite the European Commission to promote a better recognition of physical collateral (other than real estate) as far as leasing transactions are concerned.

Real estate exposure class

We have some concerns below regarding the risk weight treatment of real estate leasing:

- In general, the increasing use of the “loan to value” parameter in the revised framework is detrimental to leasing compared to classical banking loans, since banking loans granting processes require usually a higher initial self-financing part than leasing. Then leasing is penalized by the new LTV parameters, whereas it usually presents a lower risk profile - due the direct ownership of the asset by the lender – than usual loans.

- Most real estate assets financed through leasing are buildings dedicated to corporates own activities: factories, workshops, sales spaces, offices, etc. They do not generate revenues in the sense of the Basel Agreement: they are not considered as property generating cash flows. Strictly applying the new Basel III classification, the RWA of those exposures – treated as “user estate” - would result in a significant raise in required capital for real estate lessors.

- For instance, some credit institutions specialised in real estate leasing estimate RWA would increase by 16 bp due to new parameters regarding corporates real estate financing treatment. This should increase the price of financing by 18 bp for corporates.

INTERNAL RATINGS-BASED (IRB) APPROACHES FOR CREDIT RISK:

Specific questions:

What are your views on the revisions? Please provide details.

b) How would the revisions impact you/your business? Please specify and provide relevant evidence.

More specifically:

i. How do the revised IRB approaches compare to the current approaches in terms of capital requirements? Please provide an estimate, if the positive or negative difference is significant in your view, and specify the relevant revision(s).

ii. Do the revisions affect certain assets/exposure classes more than others and – if applicable – which of the provisions of the revised framework may create these effects? Please support your view with specific evidence to the extent possible.

c) Where do you expect particular implementation challenges and why? Please specify.

We are deeply concerned that the changes proposed in the Basel Agreement will raise the required levels of bank capital, which have already seen substantial increases through previous Basel agreements.

Our experience in Europe is that credit risk models have proven to be reliable and supervisory authorities have invested years of hard work and careful consideration into controlling and validating them. Constraints on the use of the A-IRB to some types of exposures, and the introduction of parameter floors, would lead to less risk sensitivity, not increased comparability. Conceptually, referring to measures and practices under the SA as a benchmark for internal modelling under the IRB Approaches does not contain a clear rationale.

We suggest that the Basel Agreement should be reconsidered in Europe in the context of decreasing heterogeneity unrelated to risk, rather than limiting the use of internal models and raising capital requirements. The European Banking Authority work on internal model parameters - where the definition of default has been identified as a major source of variability - is a good example of attempting to improve comparability while maintaining risk sensitivity.

Lease finance is an important low risk mechanism for funding the real economy, particularly for SMEs. We therefore urge the European Commission to ensure that any further changes to the calculation of regulatory capital do not result in lenders restricting the provision of finance, particularly through asset finance.

IRB (A-IRB) approach removed for certain asset classes

We are concerned by the BCBS decision to remove the A-IRB approach for exposures to large and mid-sized corporates, and exposures to banks and other financial institutions.

We question the BCBS views that exposures to banks, other financial institutions and large corporates are best regulated under the F-IRB approach, as there is significant market analysis on them for ratings purposes and low numbers of defaults present difficulties in modelling concerning leasing. Any difficulties experienced in modelling should rather be addressed with clear guidelines and institutions working closely with their supervising authority. We think that for lease assets do not apply the idea that LGDs to large corporates on secured recoveries do not follow observed estimates in the SME market. For instance, if a lessor has to liquidate a truck leased to a large corporate and sell it on the market, the proceeds will be the same as if it is owned by an SME. Different observed LGDs between SMEs and larger corporates are mainly caused by the unsecured part via the cure or no-loss rate or unsecured recovery. Leasing companies under A-IRB are by definition very well equipped to estimate these for large companies, banks and financial institutions.

In addition, large corporates could see a significant impact on their financing if exposures to these entities are moved to the F-IRB. Increases in funding costs for firms that have a large footprint in multiple economies could have unintended negative side effects.

We would urge the Commission not to exclude in Europe certain exposures from using the A-IRB based on assumptions regarding their ratings status. Otherwise, specialised subsidiaries and smaller leasing companies would be discriminated against, which is not in line with the principle of regulatory proportionality.

“Input” floors for bank-estimated IRB parameters

The Basel Agreement proposes applying floors to PDs, LGDs and the credit conversion factors (CCFs) used to determine Exposure at Default (EAD) for off-balance sheet items. We challenge the need for parameters floors in principle as these types of limits on internal modelling under the IRB approaches only serve to artificially raising capital requirements, rather than encouraging comparability. We therefore urge the Commission to reconsider the introduction of any floors in Europe.

However, if floors are to be introduced they should take into account the risk profiles of various different business models and should not unduly penalise low risk forms of lending such as leasing. Failure in this could lead to otherwise healthy, beneficial lending being disincentivised in terms of capital allocation and cost of funding.

LGD floors for corporate and retail under A-IRB

The level of over-collateralisation required for an exposure to be considered secured could be problematic for leasing companies. As a result, some leasing exposures could be classified as unsecured and be subject to an even higher LGD floor of 25% for corporates and 30% for retail, despite the fact that this is an asset based form of lending. The LGD floor for A-IRB do not take into account the strong expertise leasing companies have in assessing the risk in the asset based finance, where the financed amount is related to the estimated value of an asset during its economic lifetime.

In addition, for those lessors specialised in operational leasing of vehicles, corporate and retail exposures are all unsecured as the residual value of the leased vehicle is not considered collateral under the CRR. This means that the effect of the LGD floors will be even bigger for this type of leasing companies.

This issue could be solved by introducing a separate floor - both for secured and unsecured retail and corporate exposures - of 15% for leasing exposures, which have a completely different risk profile and business model compared to bank lending secured by physical collateral. As the objective in introducing the floors is to eliminate low value outliers, and not to prejudice entire low risk forms of lending, this recommendation would make the regulation in Europe better fit for purpose.

The effect of the floors, if not adjusted is shown in the example below, where the introduction of a floor overestimates the actual risk profile with 30%:

Assuming the following LGD model and parameters

$$LGD = \frac{(1-\text{no loss rate})*(EAD-(\text{secured recovery}+\text{unsecured recovery}))}{EAD} + \text{costs}$$

- No-loss rate 50% (includes cured cases and (early) full repayments)

For the litigated cases:

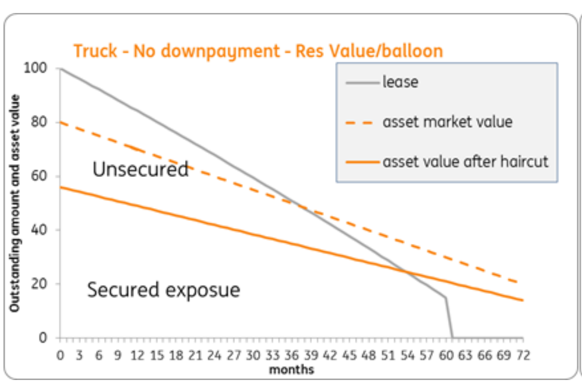
- Unsecured recovery rate 25% (includes all proceeds repaid by lessee or receiver after default). Unsecured part of outstanding is the remaining part of the outstanding amount during the lease, minus the secured exposure. The 25% recovery rate is applied to the unsecured part only.

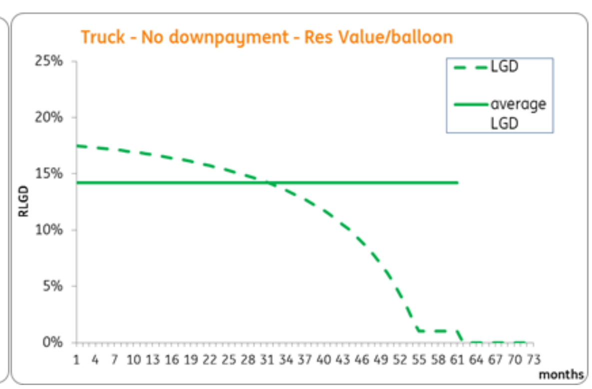
- Secured exposure is minimum of the actual outstanding amount and estimated market value of the asset during lease, after haircut. This amount is usually (at least) recovered in a liquidation process.

- Haircut on asset market value 30%, where asset market value depreciates on average from 80% of the initial value to 0 in 8 years. (e.g. a truck). At t = day 1, the market value is 80% of the investment value or purchase price of the asset. After 4 years, the asset has a value of 40% of the initial value. After application of the 30% haircut, the secured exposure at day 1 is (1-30%)*80% = 56%. After 4 years the secured value is capped at (1-30%)*40% = 28% of the initial investment/lease amount. (no down payment)

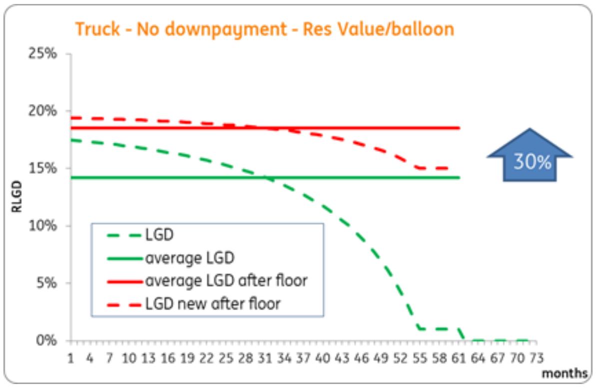
- Costs 1% of EAD

Assuming a lease of 5 years (starting at 100, equal to the investment in the leased asset), no down payment and a residual value/balloon of 15%. Based on the model estimates, LGD diminishes over time from 17.4% to a minimum level of 1% at the end. During the transaction LGD without the floors results in an estimated exposure weighted average of almost 14.2% on average, as shown below:





If we now introduce the floors, the secured exposure, during the lease is represented by the area below the orange line, being the estimated market value during the lease, after haircut. This part obtains a minimum LGD of 15%. The rest is unsecured and gets a minimum LGD of 25%. This increases the exposure weighted average LGD with 30% from 14.2% to 18.5%.



The LGD floor under A-IRB and the prescribed F-IRB parameters for large corporates will have a significant negative impact on a low risk form of financing, which is critical for promoting sustainable growth in Europe. Given the relevance of leasing for SMEs and the expertise within leasing on estimating the risk on asset based finance, the LGD floor do not consider the expertise of leasing companies following the A-IRB. Also for large companies, the increase of assigned risk weights under the F-IRB approach will have a substantial impact (it could double or even triple, due to the prescribed LGD of 25% for secured and 40% for the unsecured part).

F-IRB LGDs values

While we welcome the Basel Agreement proposal to decrease the F-IRB LGD value for "other physical collateral" to 25%, we believe that, if haircuts are also adjusted (see our proposal below), a 20% value would better reflect the reality of lease exposures. If haircuts are not adjusted a 15% LGD for leasing exposures is more appropriate.

Haircuts

We have significant concerns regarding the decision to increase the haircut applied to "other physical collateral" from 28.6% to 40%. As mentioned previously, leasing firms are asset specialists who utilise physical assets for a large portion of their recoveries, 80% on average (refer to Deloitte research). We believe that a 40% haircut for leasing exposures would be far too conservative, particularly when applied to leases nearing the end of their maturity. We suggest that a haircut for leasing exposures be introduced at a 20% level.

OPERATIONAL RISK FRAMEWORK

Specific questions: **a) What are your views on the revisions? Please provide details.** **b) How would the revisions impact you/your business? Please specify and provide relevant evidence.** **More specifically:**

i. Which approach for the calculation of the operational risk requirement do you use at the moment?

ii. How does the new approach compare to your current approach in terms of capital requirements? Please provide an estimate, if the positive or negative difference is significant in your view, and specify the relevant revision(s).

c) Where do you expect particular implementation challenges and why? Please specify.

We do not oppose the Basel Agreement to replace the current framework with a more solid and comparable regulation.

Leaseurope welcomes Basel's proposal on how to determine the business indicator (BI). We think, it fixes current inconsistencies within the framework.

By netting leasing income and expenses – including depreciation, a level playing field is created, irrespective of national accounting standards, when determining the interest component of the BI. This is also determined with the structure of the "Definition of Business Indicator Components (BIC)" in the Annex.

The combination of leasing and credit in one category provides more consistency to the operational risk framework. Indeed, capital requirements should properly reflect the underlying risks. Failing to do so, disincentives appropriate capital allocations and create distortions in the financial system.

The Basel Agreement fixes this issue by providing an equal treatment for leasing and credit. We welcome this approach as when it comes to operational risks leasing and credit face similar risks and the rules governing the associated risk management process are similar.

As explained before in our response to the questions on credit risk, leasing is a low-risk form of financing and this should be recognised within the prudential regulatory framework.

We expect particular implementation challenges on the following:

- Calculating gross income on operational risk for operational leasing is a problem today. In financial leasing the basis for calculations are net income (gross income minus expenses, including depreciations), the basis for operational leasing is gross income (without deducting depreciations). This is because depreciations on operational leasing is booked as an operational cost (please refer to the IFRS regulations).

- It might also be a challenge to separate operational losses from credit loss 10 years back.

OUTPUT FLOOR

Questions:

a) What are your views on the revisions? Please provide details.

b) How would the revisions impact you/your business? Please specify and provide relevant evidence.

A number of leasing companies have invested significant amounts of money and effort over the past years to implement internal models. This is because as explained before leasing is highly penalised under the SA approach. The proposed floor based on the SA calculations will be very punitive for lessors unless the SA calibrations are adjusted to reflect the real risks of leasing exposures.

If business lines (such as leasing)within a bank have to apply the output floor at business line level, the capital advantage of all the investments in the A-IRB approach will be minimal. If the output floor is to be determined at consolidated level, the level playing field across banks and business lines may be missed, as banks across Europe may have different activities and range of counterparties for which prescribed risk weight techniques are not similar.

Therefore, we believe that the 72.5% output floor on the IRB approach based on the SA approach may have a distorting effect depending on the business line type. For example, banks with portfolios that absorb more capital under the new rules (e.g. residential real estate) may be forced to reduce financing of other activities. As a result, the proposed floor does not provide a level playing field.

If Leaseurope's proposals in this response, both for standard and internal approaches, are not taken into account by the European Commission, leasing will be significantly hit by the new framework as the current LGD levels are very low compared to traditional unsecured lending products. We are happy to follow up with the Commission on our proposals and to provide further evidences you may require.

Contact Person:

Rafael Alarcón Abeti
Senior Policy Adviser
Prudential & Capital Markets
Leaseurope
+3227780569
r.alarconabeti@leaseurope.org

About us

Leaseurope brings together 46 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, machinery, ICT and real estate). It also includes the short term rental of cars, vans and trucks. It is estimated that Leaseurope represents approximately 94% of the European leasing market.

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

In 2016, the leasing firms represented through **Leaseurope's membership helped European businesses invest in assets worth more than 334 billion EUR**, reaching 779 billion EUR of outstandings at the end of the year[5]. 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)[6] and is also extremely popular amongst larger corporates[7]. It is also extremely useful to support the public sector (e.g. leasing to schools, hospitals, etc.).

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

[5] Leaseurope 2016 Annual Statistical Enquiry
[6] 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
[7] European Central Bank, *Survey on the Access to Finance of Small and Medium-Sized Enterprises in the Euro Area* , April 2013