



The Voice of Leasing and Automotive Rental in Europe

Leaseurope Comments on the Green Paper on Shadow Banking

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Introduction: Leasing in Europe

What is leasing?

A lease is a contract whereby a leasing company (lessor) makes an asset it owns available to another party (lessee) for a period of time in exchange for payment. Leasing is thus a very popular means of making a wide range of asset types¹ available to many different kinds of businesses.

Leasing's contribution to the European economy

In Europe, leasing is a major source of investment support for all businesses²:

- In 2010, European lessors granted new leases worth more than €224 billion and the portfolio of leased assets in their hands at the end of that year was worth over €675 billion.
- Depending on the individual country, between 20-30% of business equipment investment is supported by leasing³.
- Over 50% of all leasing to businesses in Europe is made to micro, small and medium enterprises.
- An estimated 40% of all European SMEs used leasing in 2010, which is more than any individual form of bank lending. In particular, leasing was used more than bank loans over 3 years (38%) and overdrafts (37%).

Who are European lessors?

Leasing companies can be banks, bank-owned subsidiaries, independent firms or the financing arms of manufacturing companies, which are known as captive lessors. In Europe, while a major share of the leasing industry is owned by banking groups⁴, it is important to note that leasing companies themselves are not deposit taking institutions⁵.

¹ Leased assets include cars, trucks, plant & machinery, ITC, equipment, renewable energy equipment, healthcare equipment, real estate, to name but a few.

² Sources: Leaseurope; Eurostat; "The Use of Leasing Amongst European SMEs" by Oxford Economics (Nov 2011). Please visit the [SME report page](#) on Leaseurope's website for more details on this publication.

³ Due to a lack of more detailed breakdowns of investment figures published by official European sources, we are not able to specifically calculate the penetration rate of leasing to the private sector at European level. Depending on the individual country, the figure tends to be in the range of 20% - 30% of total private sector equipment investment. We are however able to calculate that leasing companies supported more than 16% of *both* public and private sector investment taken together in 2010. The share of private sector investment is significantly more important as leasing to the public sector remains a relatively small market in Europe.

⁴ According to Leaseurope's 2010 Ranking Survey of European leasing firms, 19 of the top 20 leasing companies in Europe are bank related.

⁵ Unless they have made the decision to opt for a banking license precisely in order to be able to take deposits. However, this remains the exception.

Depending on national legislation or their shareholder structure, European leasing companies are currently subject to varying degrees of regulation. Those leasing firms who are part of bank groups will always see their leasing activities taken into account for regulatory capital and other supervisory purposes at consolidated level along with the banking group's other exposures.

Whether bank-owned, captive or independent, European leasing companies rely heavily on the banking sector to fund their operations⁶.

How leasing helps Europe's small businesses

A recent report by leading economic consultancy, Oxford Economics, has examined the extent and nature of leasing to SMEs in Europe. The report is based on a survey of just under 3,000 SMEs⁷ across 9 industrial sectors and 8 countries (Germany, France, UK, Italy, Spain, Netherlands, Poland and Sweden). Together these countries account for 83% of total EU economic output and 78% of the European leasing market.

The report finds that 16.7% of total SME investment in 2010 was supported by leasing, a figure which was expected to grow to 18.6% in 2011. For those SMEs which used leasing, it accounted for 32.4% of their total investment and users of leasing invested on average 57% more than non-users of leasing. The report also shows that smaller businesses used leasing to support a greater portion of their investment than larger firms. SMEs are thus particularly dependent on leasing and rely on it to support their growth and help them remain competitive.

When the SMEs surveyed were asked why they used leasing, a wide variety of reasons were reported as being highly valued, implying that leasing provides a large set of advantages that meet the needs of SMEs in many different circumstances. For instance, by leasing, companies can better manage their working capital by spreading payments over the life of the asset and they do not have to worry about considerations linked to ownership, such as second hand asset values or the disposal of the asset when it is no longer in use. Leasing also offers businesses the possibility to upgrade their assets to the latest, most efficient technology available, thus keeping them competitive. Moreover, it can provide a much higher degree of flexibility than purchasing assets outright as the length of a lease contract (and thus the duration of use of the asset) can be extended or shortened to coincide precisely with the user's assets needs. Leasing can also often include a set of services (such as insurance or maintenance of the leased asset), thus effectively allowing businesses to concentrate on their core-activities without having to worry about managing equipment. Last, but not least, SMEs taking part in the survey found leasing to be price competitive.

⁶ In countries such as the US, lessors are able to access more diversified sources of funding than in Europe, including capital markets, securitization, etc.

⁷ The survey was conducted in July 2011 and the report published in November 2011.

Responses to the Green Paper Questions

a) Do you agree with the proposed definition of shadow banking?

b) Do you agree with the preliminary list of shadow banking entities and activities? Should more entities and/or activities be analysed? If so, which ones?

Definition of shadow banking

We consider the definition of the shadow banking system set out in the Commission's Green Paper (and which is based on that of the Financial Stability Board) to be too far-reaching. We recognise that this approach has been adopted intentionally in order to ensure that all areas (activities and entities) of relevance to the stability of the European (and global) financial system are appropriately identified and any risks they pose are adequately addressed. Nevertheless, 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 leasing activities. Given the important contribution leasing makes to the real economy, this should be avoided at all costs.

As explained above, the European leasing industry provides lease products to a wide range of European businesses. Companies use our products to be able to obtain access to the assets that are necessary to run their businesses and that allow them to remain competitive and grow. No official definition of a lease exists at European level. However, simply put, in a lease contract a lessor makes an asset it owns available to a client (referred to as a lessee) for a certain period of time in exchange for payment⁸. While there are various types of contracts that fall under this description (hire purchase, financial leases, operating leases, rental contracts are all terms used to describe different types of leases), all leases share one specific characteristic, which is that the lessor retains ownership of the leased asset throughout the contract term.

European lessors have very close ties with the banking sector. They themselves can be banks or bank-owned subsidiaries (in which case they do not take deposits). According to Leaseurope's 2010 Ranking Survey, out of the top 20 European lessors, 19 were bank-related⁹ and over 90% of total lease volumes reported in this survey were granted by bank-related leasing companies.

⁸ This definition given here is based on that of International Financial Reporting Standard "IAS17 Leases". Note that this notion encompasses rental agreements.

⁹ i.e. owned by banks or have a banking license

If viewed as being a form of financial intermediation, leasing could be considered to be covered by the broad-brush notion of shadow banking set out in the Green Paper. Alternatively, it could simply be viewed as a form of hire, i.e. the provision of a non-financial service. Indeed, a lease contract is the exchange of the use of a good for payment, rather than the trading of “money against money”. The purchase of a non-financial asset by a leasing company that is then subsequently leased to a customer marks the beginning of the real economy and the end of the chain of preceding financial transactions to fund the lessor. With the definition of shadow banking being purposely broad, our concern is that it is more likely that policymakers will come to the conclusion that (all) leasing is indeed a form of financial intermediation without due consideration of the real economic benefits of this activity or a proper assessment of whether the sector poses any real level of risk to the financial system.

Equally, as the term “leasing” covers a wide-ranging spectrum of different contract types, we would be concerned that any entity that provides some form of lease arrangement would be included under the shadow banking umbrella without due consideration of the nature of these activities and the different risks they bring about.

While we recognise that this Green Paper is to be the first in a series of more specific consultation exercises and that it forms part of a wider stream of work being conducted at international level, before considering the European leasing industry as being part of the shadow banking industry, we consider that it is essential that the Commission further elaborates its thinking on:

- 1) Which risks is it trying to identify and mitigate
- 2) Which entities/activities pose the greatest threat to financial stability and why
- 3) How these priority areas could be addressed most efficiently
- 4) What the economic impact of potential legislative (or other) measures would be

Entities and activities that form part of the shadow banking system

The Green Paper also refers to “finance companies” as being entities that are part of the shadow banking system. In the context of leasing, we do not think that this should be taken as a given. More specifically, it is unclear to us exactly what “finance companies”¹⁰ are, whether (all or some) leasing companies are intended to be included in this category and, if they are, what the justification for targeting these firms is. Even if policymakers do decide that leasing should be viewed as some form of financial intermediation, this is not a sufficient justification to extend the scope of existing regulatory requirements or indeed create new requirements to entities that lease without properly assessing 1) the systemic risks posed by leasing and 2) to what extent existing regulation already addresses these, if any.

¹⁰ We note that Commissioner Barnier referred to a potentially different concept of “financial bodies that are active in intermediation or other credit granting but do not accept deposits and are not regulated in the same way as banks” during the EC conference Towards a Better Regulation of Shadow Banking held in Brussels on 27 April 2012

In terms of legal entity status, the majority of leasing companies in Europe will typically either be commercial companies or financial institutions¹¹. Financial institutions are institutions which do not receive deposits or other repayable funds from the public and, in the context of leasing, engage in so-called “financial leasing”¹². However, the term financial leasing is not defined by the European legislator and is therefore left to the interpretation of Member States, resulting in a differentiated approach to the regulation of these firms throughout Europe.

As a result, the regulatory framework for leasing within the various Member States can broadly be summarised on the basis of the following two criteria:

1) Regulation depends on the shareholding structure of the leasing firm (entity approach)

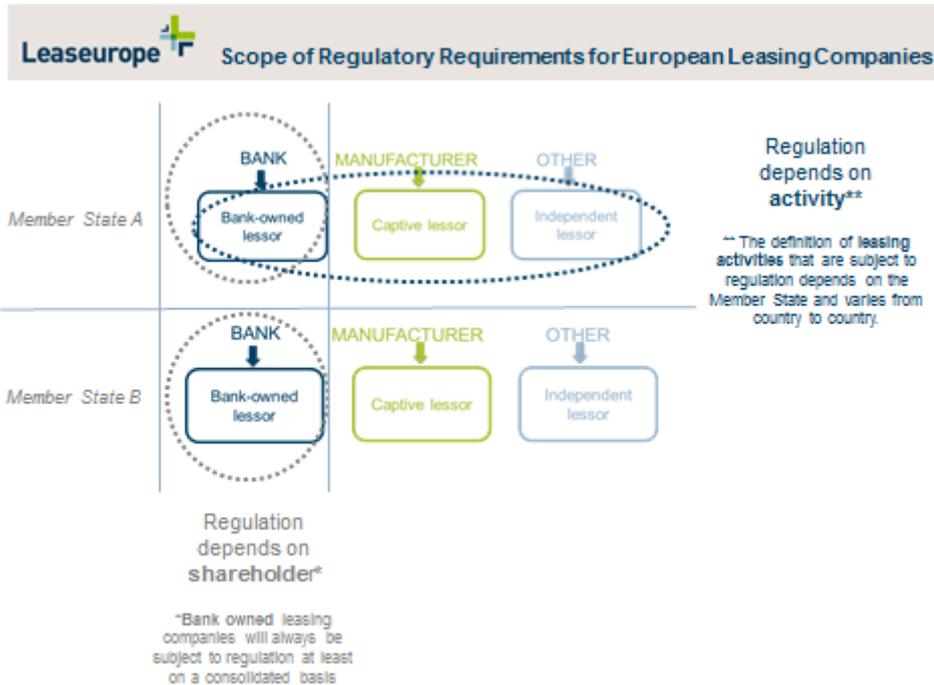
When they belong to a banking group, irrespectively of the type of leasing they carry out, leasing companies are always subject to European prudential regulation through the inclusion of their activities in the requirements that are applied to the group at consolidated level. Bank-related leasing companies in Europe, which make up the lion’s share of the European leasing business, are therefore always subject to prudential regulation. However, there is currently no similar European-level requirement for non-bank owned leasing companies such as manufacturer or independently owned lessors. Consequently, some Member States choose to regulate “leasing activities” (see point 2 below) instead of adopting an approach to regulate “entities”.

2) Regulation depends on the activity of the leasing firm

In addition to the inclusion of bank-owned leasing companies into the consolidation perimeter of regulated banking group activities, some Member States choose to apply regulatory requirements (either the Capital Requirements Directive or an equivalent, tailored regime) to leasing companies at legal entity level, depending on the nature of the leasing business that the entity is involved in. Each Member State that adopts this approach will define the leasing activities that are subject to regulation in its jurisdiction in a different manner. Within the same Member State, some leasing activities may be subject to prudential requirements, and others not, depending on whether the activity is viewed locally as being financial in nature or the provision of a service. However, it would be misleading to consider that the latter operate in a totally unregulated environment when these firms are subject to relevant reporting, registration and other similar requirements.

¹¹ As already noted, credit institutions (i.e. deposit takers) can also engage in leasing activities, in which case they are of course subject to existing European prudential requirements

¹² Annex I of Directive 2006/48/EC



In our view, the approach adopted by the FSB in their workstream on “other shadow banking entities” (WS3) to firstly identify and categorise a wide range of non-bank financial institutions, identify any systemic risk they pose and then develop an appropriate and proportionate policy response is the right way to proceed. We strongly encourage the European Commission to conduct the same type of prioritisation exercise at European level and to identify specific targets requiring urgent policy action.

- c) Do you agree that shadow banking can contribute positively to the financial system? Are there other beneficial aspects from these activities that should be retained and promoted in the future?**
- d) Do you agree with the description of channels through which shadow banking activities are creating new risks or transferring them to other parts of the financial system?**
- e) Should other channels be considered through which shadow banking activities are creating new risks or transferring them to other parts of the financial system?**

Our response to this section focuses specifically on the benefits and risks that are relevant in the context of leasing.

Leasing firms are uniquely positioned to support European business investment

The Oxford Economics report “The Use of Leasing amongst European SMEs” shows that leasing is used by more European SMEs than any category of bank lending taken individually¹³. Equally, leasing is also extremely popular amongst larger corporates¹⁴. Depending on the country, leasing typically

¹³ See introduction

¹⁴ [Access to Finance of SMEs](#), ECB survey

accounts for between 20% -30% of all business equipment investment¹⁵. Eurostat's 2011 Access to Finance survey of SMEs in 20 EU countries shows that leases have very high acceptance rates and the ECB's twice yearly "Access to Finance of SMEs" survey has also clearly shown that non-bank asset-based products such as leases have become increasingly important to companies of all sizes since the onset of the financial crisis.

Indeed, as banks have reigned in on their lending capacity, businesses have had to seek alternative funding sources and means to access equipment. Leasing has been uniquely positioned to fill this gap and, depending on the circumstances, it can be the only source of investment support that is available to some companies.

Lessors are able to offer their products in situations where bank lending has been less readily available because they are the legal owners of the assets they lease. Ownership rights provide lessors with the highest form of security that exists in the event of client default. Lessors are also asset specialists, with in-depth knowledge of the assets they lease and their resale markets, making them experts in the evaluation and management of physical collateral. This is a set of skills that is not found within traditional bank lending activities and, as a result, traditional loans will tend *not* to be secured on physical assets. In the absence of asset expertise, traditional lenders will prefer non-physical collateral (such as guarantees, etc.) or property for risk mitigation purposes. To some extent, this can have a negative impact on borrowers, particularly when it comes to smaller businesses' access to finance. Requiring the owners of SMEs to post extra collateral (e.g. their private homes) or to find family members or friends willing to back them can potentially pose an additional strain on these individuals/firms. Ultimately, using traditional bank loans to finance equipment can be more costly for a borrower than taking out a lease which has built in security and can potentially place them in a more vulnerable financial situation.

Leasing provides sales support for European manufacturers

Lease agreements are distributed via many channels, including through bank networks, directly from leasing companies or through vendors and dealers of equipment.

According to the Oxford Economics report on SME leasing, the most popular means of accessing leasing is the vendor channel. This is when the customer obtains the lease at the point of sale of a manufacturer or dealer from which it wishes to obtain the use of asset. In such cases the asset manufacturer or dealer may have an arrangement with a third party/external lessor which provides the lease to the customer or it may provide the lease directly itself¹⁶. Leasing therefore provides a one-stop-shop for both the purchasing and financing of equipment, which is a clear advantage and convenience compared to loan finance which often has to be arranged through a bank separately to the asset purchase.

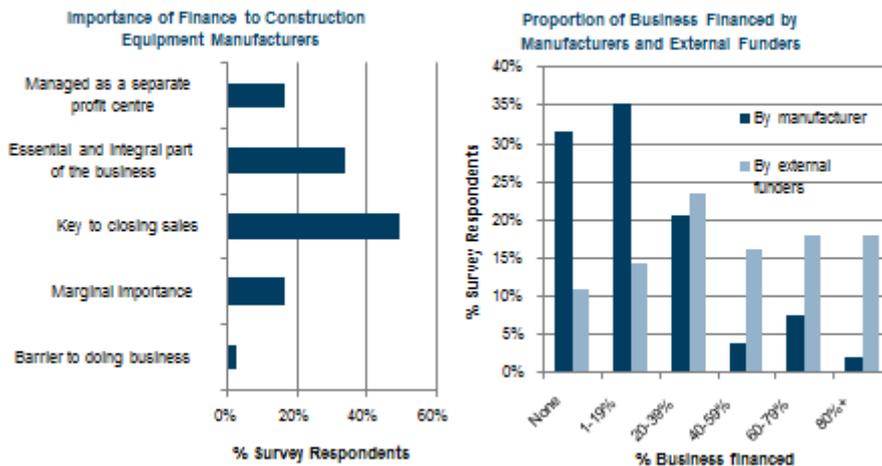
Viewed in this light, leasing provides a valuable form of support to the European automotive, manufacturing and technology industries, amongst many others. These sectors use the product as a method to sustain and increase their sales. For instance, a survey of European construction equipment manufacturers conducted in 2010 shows how valuable leasing is to this type of business

¹⁵ Leaseurope, Eurostat

¹⁶ In which case it is referred to as a captive leasing company

(see chart below). This is also true in many other sectors; for instance, a significant portion of all new cars that are sold each year for business use are leased and the situation is similar for commercial vehicles and other transportation, industrial and business equipment.

Leaseurope Illustration: The Importance of Leasing in Supporting Sales in the European Construction Equipment Sector



Source: Committee of European Construction Equipment (CECE) Business Barometer, July 2010

The risks in leasing

1) Expert and prudent collateral valuation

The specialised nature of lessors means that they have a unique understanding of asset markets (resale values, technological evolution, asset obsolescence, asset market liquidity, the ability to release assets in various geographical locations, etc.) means they are able to track the level of asset risk they are exposed to very carefully and, depending on the level of risk they are willing to take on, 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 Directive and ensures that lessors adopt a conservative approach to collateral valuation.

2) Banking regulation protects the system

As already described above, the level of involvement of the banking sector within the European leasing industry is high, both through the direct ownership of leasing firms as well as through the funding by banks of non-bank owned leasing companies, either through direct loans or other forms of finance. With European banks applying European prudential regulation, the exposures that they are able to take on in relation to such firms are limited in size by law. Consequently, the risk of contagion due to the failure of a leasing company is already largely contained.

3) Matched funding terms

Leasing activities are not funded by deposits or similar short term financing; instead lessors typically match the terms of their funding with those of their lease contracts, which vary on average between 2 to 5 years for leases of equipment. They are therefore not subject to the risk of the type of “runs” or liquidity/maturity mismatches described in the Green Paper.

4) Limited effects of lessor bankruptcy

Lastly, there are other ways of looking at the risks posed by the failure of a leasing company than just considering the consequences for its investors and funders, for example by examining the implications for the clients who using the lessor’s asset. While there are nuances in national bankruptcy legislation throughout Europe, in a normal case of a leasing company failing, the lessor’s creditors would have the right to receive rental payments from the lessee and so would simply seek to continue the lease. The lessee would therefore typically not be affected by such a situation and would be able to continue to use the asset as before.

In conclusion, we do not consider that the European leasing industry poses any threat to the stability of the European financial system. On the contrary, leasing is a crucial enabler of business investment, provides a valuable, safe and price competitive alternative to traditional loans and supports the sales of the manufacturers of assets.

f) Do you agree with the need for stricter monitoring and regulation of shadow banking entities and activities?

g) Do you agree with the suggestions regarding identification and monitoring of the relevant entities and their activities? Do you think that the EU needs permanent processes for the collection and exchange of information on identification and supervisory practices between all EU supervisors, the Commission, the ECB and other central banks?

h) Do you agree with the general principles for the supervision of shadow banking set out above?

i) Do you agree with the general principles for regulatory responses set out above?

j) What measures could be envisaged to ensure international consistency in the treatment of shadow banking and avoid global regulatory arbitrage?

We do not agree that there is a need for stricter regulation in the context of leasing. A case would still have to be made.

As explained above, we consider that it is necessary to better define the scope of so-called shadowing banking activities/entities and then assess the types of risks these pose before deciding on whether increased monitoring or regulation is necessary. It also essential that the economic consequences of any changes to existing frameworks are considered before new proposals are implemented.

On a more general note, and without prejudice to our point made above that there is no need for stricter regulation in the context of leasing, we agree with the general principles for supervision and regulatory response that are set out in the Green paper. In particular, any new measures should be tailored and proportionate to the activities they intend to cover. The need for such measures should always first be demonstrated however.

k) What are your views on the current measures already taken at the EU level to deal with shadow banking issues?

The EU has already taken an important number of steps to deal with some of the issues related to so-called shadow banking. In particular, we consider that the various revisions of the Capital Requirements Directive, including the EU implementation of Basel 3, will make a significant contribution to safeguarding the financial system, both directly (e.g. through stricter capital requirements related to securitisation) as well as indirectly (e.g. through the application of the current and revised prudential requirements at the consolidated level of banking groups, where subsidiaries of banks like leasing companies are included in the prudential consolidation scope, or through higher risk weights for exposures to unregulated financial institutions).

l) Do you agree with the analysis of the issues currently covered by the five key areas where the Commission is further investigating options?

m) Are there additional issues that should be covered? If so, which ones?

n) What modifications to the current EU regulatory framework, if any, would be necessary properly to address the risks and issues outlined above?

We would not agree with any proposal to extend the scope of existing banking regulation to cover leasing firms.

In fact, when it was issued, we strongly welcomed the recognition in the Commission's CRD 4 proposal that this set of requirements should only be applied to credit institutions as defined at European level¹⁷, as this is in line with the intended scope of application of the Basel 3 requirements.

The main objectives of the CRD 4/Basel 3 requirements are to ensure the stability of the financial system and depositor protection. They are therefore aimed at the category of institutions which pose systemic risk and put depositors at risk. By their very nature, non-deposit taking institutions such as leasing companies do not pose these risks to the European financial system. Indiscriminately applying the new Basel/EU liquidity and leverage requirements to non-deposit taking leasing firms at legal entity level would likely have a significant impact on these firm's ability to continue to conduct their business and would have a counter-productive impact on the real economy.

¹⁷i.e. as defined in Directive 2006/48/EC

We therefore urge the Commission to ensure that Member States do not extend the scope of the liquidity and leverage requirements to leasing firms directly during the process of transposition of the CRD 4. Equally, we do not think that it would be suitable for the Commission itself to put forward such a proposal (as suggested in section 7.1 of the Green Paper) as these rules are designed for large, international (deposit taking) banks and address risks that do not exist within leasing firms.

With respect to the work being carried out by the FSB on other shadow banking entities, we support the identification of priority areas as a first step and fail to see how leasing firms can be considered to be in the same league as structured investment vehicles or credit hedge funds. The leasing business is a simple business that is positioned at the very start of the intermediation chain, if indeed it is considered to a form of financial intermediation at all.

We recognise that no “official” statistics on leasing are readily available at European level. However, as the Federation representing the European leasing industry, we collect a wide range of descriptive market data from our member associations and as such have the only set of comparable information on European leasing activities that is available. We are of course happy to provide this information to the Commission or other relevant bodies at international level to aid in their understanding of European leasing activities.