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European Federation of Leasing Company Associations

Fédération Européenne des Associations des Etablissements de Crédit-bail

Europäische Vereinigung der Verbände von Leasing-Gesellschaften

Patrick Pearson

Head of Unit

Directorate of Banking & Financial Conglomerates
DG Internal Market & Services,
EU Commission

Brussels, 19 September, 2007

Dear Patrick,

I would like to thank you for the invitation to take part in the Commission's informal stakeholder meeting to discuss possible amendments to the CRD.

As requested, Leaseurope would like to submit the amendments attached to this document for discussion at the meeting. The points raised in these amendments are of specific concern to the European leasing industry and include the treatment of leasing under the Standardised Approach and the required level of collateralisation under the IRBF Approach.

Currently, no definition of lease exposures is provided in the Standardised Approach and a Leaseurope survey of national implementations reveals that local authorities treat leasing very differently from country to country under this approach. Consequently, we suggest that the definitions provided in the Advanced Approaches be transposed into the Standardised Approach to ensure consistent and coherent treatment across Europe.

Another crucial issue for leasing, of which the Commission is already aware, relates to the so-called overcollateralisation level that is required for an institution to be able to recognise certain levels of LGDs under the IRBF Approach. We understand that the Commission has in the past suggested that this provision could be reviewed in light of industry experience. We can confirm that the provision is unduly burdensome, not only for leasing, where the lessor maintains the ownership of the leased asset throughout the contract, but also for other forms of lending secured by physical collateral and that, were it to be maintained, the likely upshot would be that leases (or secured loans) to counterparts such as SMEs who typically borrow the entire purchase price of an asset would become more expensive.

It should be pointed out that the above issues are not the only points where the leasing industry would like to see improvement. Indeed, in reaction to your request for technical difficulties and other issues arising upon implementation of the CRD, our members have also highlighted the treatment of guaranteed residual values as an area of concern. We will aim to come back to you on this issue in the near future with a suggested amendment.

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Lastly, I would like to mention that the CRD TG has already provided clarification on two major leasing issues in its answers to questions 24 and 190 of the FAQ website. We would welcome that these issues be included in the set of amendments the Commission will table based on the CRD TG's work to date. The answer to question 190 is of particular importance as it gives clarity as to how the "1/t requirement" for unguaranteed residual values should be interpreted. Again, this is an area of the Directive that has been subject to multiple local interpretations and clarity is essential to ensure a level playing field for European leasing firms.

Leaseurope will be represented at the stakeholder meeting of the 26th by Jacqueline Mills, Adviser to the Federation. Jacqueline can be reached directly at j.mills@leaseurope.org or +32 2 778 05 66 for any further details you may required on the above issues.

Yours sincerely,

Tanguy van de Werve
LEASEUROPE DIRECTOR GENERAL

Copy to:

- Jérôme Deslandes
- Adina Apetroi
- Giuseppe Siani

About Leaseurope

Leaseurope, the European Federation of Leasing Company Associations, is composed of 48 Member Associations in 34 countries. It represents as an umbrella body the European leasing and automotive rental industries. In 2006, its leasing members accounted for 92% of the European leasing market. In April 2006, the Federation integrated short and long term car and truck renters into its membership base. It now represents around 8 500 companies across Europe employing over 200 000 people. During the course of 2006, the companies represented via Leaseurope financed 297,5 billion euros of new investments in vehicles, equipment and real estate.



I. CONSISTENT TREATMENT FOR LEASING UNDER ALL APPROACHES

Amendment 1 Annex VI, part 1, § 90a (new)

The risk weighted exposure amounts shall be calculated according to the formula:

**Risk-weighted exposure amount =
100% * exposure value except for when the exposure is a residual value in which case it should be calculated as follows::**

$1/t * 100% * \text{exposure value}$ where t is the nearest whole number of years of the remaining lease term.

Justification

This proposed amendment aims at having consistent definitions and treatments of residual value exposures under the Standardised and IRB approaches. Consequently, we suggest that the treatment for unguaranteed residual values as given in the IRB approaches (see Annex VII, part 1, § 27) be extended to the Standardised Approach.

As a reminder, the underlying philosophy behind the IRB approach treatment of unguaranteed residual values is given below.

If a lessee is in default before the end of the lease contract term, the risk-weight to cover credit takes into account this event. In the other case of a lessee not being in default, the residual value of the leased asset is exclusively subject to market risk and, even then, this risk is only realised at the end of the contract.

Consequently, we suggest that the credit institution should take into account a portion of the residual value risk each year over the lease contract term.

In its answer to question 190 on its FAQ website, the CRD TG has provided clarification as to how the ‘1/t requirement’ for the IRB approach should be interpreted. As a result, we suggest that this treatment be transposed into the Standardised approach accordingly.



Amendment 2
Annex VI, part 1, § 90b (new)

‘Minimum lease payments’ are the payments over the lease term that the lessee is or can be required to make and any bargain option (i.e. option the exercise of which is reasonably certain). Any guaranteed residual value fulfilling the set of conditions in Annex VIII, Part 1, points 26 to 28 regarding the eligibility of protection providers as well as the minimum requirements for recognising other types of guarantees provided in Annex VIII, Part 2, points 14 to 19 should also be included in the minimum lease payments.

Justification

The Standardised Approach currently does not define a lease exposure. Therefore, we suggest that a definition consistent with that given in the advanced approaches be included in the Standardised Approach.



II. COLLATERALISATION LEVELS UNDER THE IRBF APPROACH

Annex VIII, Part 3, § 73 sets out applicable effective LGDs and required collateralisation levels for secured parts of exposures under the IRBF approach. The required levels of collateralisation (i.e. the value of the collateral to the exposure value ratio) in order to be able to apply these LGDs for the secured portion of exposures are all above 100%.

One should bear in mind that the lessor retains ownership of the asset throughout the lease contract. This specificity implies that lease finance benefits from higher levels of protection than equivalent loans. Indeed, whereas a secured lender ranks after preferential creditors in the event of the lessee's default, the lessor is able to recover and sell the asset under very simple conditions and to do so more rapidly than in the case of an asset given as security by a borrower. By law, the right of ownership of the leased asset enables the lessor to rank above all the lessee's creditors in being able to lay claim to the selling price of the asset.

Consequently, the overcollateralisation requirement is an unnecessary duplication of the provisioning which is already inherent in the conservative LGD levels set for the IRBF approach. Moreover, given the heavy minimum requirements for recognising collateral in Annex VIII, Part 2 § 8 – 11, the current situation is deemed to be excessively burdensome for credit institutions.

Furthermore, the above requirements contribute to severely increasing the level of capital a lessor would have to hold under the IRBF approach in comparison with the other approaches (see Schmit, M. "Credit Risk in the Leasing Industry" Journal of Banking & Finance 28 (2004) 811-833.).

In addition, they will have a seriously negative impact on the financing of small and medium sized entities. In numerous cases the financing of movable assets by leasing is the only opportunity for those companies to invest in working capital. Usually 100% of the purchase price (e.g. 100.000 Euro) of an asset will be financed by the credit institution. Given a degree of collateralisation of 140%, the institution could only benefit from more favourable (although conservative) LGDs for a portion of the necessary sum to be loaned, in this specific case about 71.000 Euro. The small or medium sized company would therefore have to provide other types of collateral, which would be excessively costly for vast majority of these entities, thus potentially jeopardising their access to finance.

In light of these arguments, we recommend that the required rate of collateralisation should be re-examined and set at 100%.



Amendment 3 Annex VIII, Part 3, paragraph 72

Table 5 sets out the applicable LGD* and required collateralisation levels for the secured parts of exposures:

Table 5
Minimum LGD for secured portion of exposures

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Minimum LGD for secured parts of exposures

	LGD* for senior claims or contingent claims	LGD* for subordinated claims or contingent claims	Required minimum collateralisation level of the exposure (C*)	Required minimum collateralisation level of the exposure (C*)
Receivables	35 %	65 %	0 %	125 %
Residential real estate/commercial real estate	35 %	65 %	30 %	140 %
Other collateral	40 %	70 %	30 %	140 %

Table 5 sets out the applicable LGD* and required collateralisation levels for the secured parts of exposures. **However, when the requirements for the recognition of physical collaterals and leasing provided in Annex VIII, Part 2, points 10 & 11 are met and the financial institution is able to show that the LGDs are in line with the ones in Table 5, the required minimum collateralisation level of the exposure shall be 100%.**

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Receivables	35 %	65 %	0 %	125 %
Residential real estate/commercial real estate	35 %	65 %	30 %	140 %
Other collateral	40 %	70 %	30 %	140 %

Justification

The minimum collateralisation level of exposures has a negative impact on the financing of SMEs. Indeed, the financing of movable assets is often the only opportunity for those companies to invest (generally 100% of the purchase price) in working capital. Furthermore, this condition is an inadequate duplication of the provisioning which is already inherent in the levels of LGD with the result of severely increasing the level of capital a lessor would have to hold under the IRBF approach in comparison with the other approaches (See Schmit, M. "Credit Risk in the Leasing Industry" Journal of Banking & Finance 28 (2004) 811-833) Thus, a level of overcollateralisation of 140% does not take into account the commercial and economic substance of leasing transactions and should therefore be adapted to 100% as proposed above.