The Voice of Leasing and Automotive Rental in Europe

SPECIALISED CONSUMER CREDIT PROVIDERS IN EUROPE

Leaseurope/Eurofinas Response to the Financial Stability Board Consultation “A Policy Framework for Strengthening Oversight and Regulation of Shadow Banking Entities”

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About Leaseurope
Leaseurope brings together 43 member associations representing the leasing, long term and/or short term automotive rental industries in the 32 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. It is estimated that Leaseurope represents approximately 92% of the European leasing market and in 2011, total new leasing volumes worth €256.6 billion were granted by the firms represented through Leaseurope’s members. More info at www.leaseurope.org.

About Eurofinas
Eurofinas, the European Federation of Finance House Associations, is the voice of consumer credit providers in the EU. As a Federation, Eurofinas brings together associations throughout Europe that represent finance houses, universal banks, specialised banks and captive finance companies of car, equipment, etc. manufacturers. The scope of products covered by Eurofinas members includes all forms of consumer credit products such as personal loans, linked credit, credit cards and store cards. Consumer credit facilitates access to assets and services as diverse as cars, education, furniture, electronic appliances, etc. It is estimated that together Eurofinas members granted over 328 billion Euros worth of new loans during 2011. More info at www.eurofinas.org.

Leaseurope/Eurofinas Response to the Financial Stability Board Consultation "A Policy Framework for Strengthening Oversight and Regulation of Shadow Banking Entities"

Leaseurope and Eurofinas, the voices of leasing and consumer credit at European level, welcome the opportunity to respond to the Financial Stability Board's (FSB) consultation on "A Policy Framework for Strengthening Oversight and Regulation of Shadow Banking Entities".

Before answering the questions posed specifically in the consultative document, our response describes the important role that leasing and consumer credit providers play within the European economy as well as the main characteristics of these firms, the EU regulatory environment for such players and how they are positioned within the EU financial system.

We consider that it is essential the FSB bears in mind the fundamental differences in economic, market and regulatory structures that exist within its wide range of jurisdictions. Hence, the following points must be taken into account in the evaluation and development of any policy framework:

1) Leasing and consumer credit activities do not pose a systemic risk to the broader financial system.
2) Leasing and consumer credit companies should not be confused with the wide range of activities that may fall under the concept of "finance companies".
3) Funding sources for leasing and consumer credit firms vary across the FSB's jurisdictions.
4) The European economy is structurally dependent on debt/bank financing. Economic agents make less use of equity and/or market-based funding compared to those in the US for instance.
5) Financial regulation and supervision is well developed in Europe and already impacts (both directly and indirectly) leasing and consumer credit firms established in the EU. This may not be the case to the same extent in other jurisdictions such as the US and Asia for instance.
6) New legislation would stifle leasing and consumer credit provision and could force some firms, and in particular smaller ones, to leave the market. This would adversely impact competition by reducing the range of finance options available to consumers and businesses.

The above points are developed in more detail further on in our response.

We remain at your disposal should you require any further information on the nature of the activities we represent or additional clarifications on the answers below (please see contact persons below). In particular, we would be happy to provide you with a more detailed analysis of the business models used by European leasing and consumer credit firms.

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I. The Benefits of Leasing and Consumer Credit Activities in Europe

Leasing and consumer credit are key drivers of European economic growth

In 2011, the leasing firms represented through Leaseurope's membership helped European businesses invest in assets worth more than €257 billion[1]. Leasing is used by more European SMEs than any individual category of traditional bank lending taken[2] and is also extremely popular amongst larger corporates[3]. Depending on the country, leasing typically accounts for between 20% - 30% of all business equipment investment[4].

In 2011, consumer credit providers that are members of Eurofinas helped support European consumption by making more than €328 billion goods, services, home improvements and private vehicles available to individuals[5]. Consumer credit supports the social and economic well-being of millions of consumers across Europe.

Leasing and consumer credit provide sales support for manufacturers and distributors

Lease and consumer credit agreements are distributed via several channels, including through bank networks, directly from leasing or consumer credit firms or through the manufacturers and dealers of business equipment, vehicles and consumer goods. This latter channel is often referred to as the "vendor or point of sale channel" and is a specificity of the leasing and consumer credit industries. Point of sale activities provide a convenient one-stop-shop for clients who are seeking to purchase or obtain the use of assets and allow European manufacturers and distributors of goods to sustain and increase their sales.

The economic roles played by the leasing and consumer credit industries (supporting business investment, private consumption and the manufacturing and distribution of goods) must not be hampered by any ill-suited regulatory initiative.

In particular, any regulatory framework must be designed and applied proportionately to avoid disrupting the supply of leasing and consumer credit products and should not negatively affect competition within the sector (e.g. smaller, local players must not be placed at a disadvantage compared to others).

II. Characteristics of European Leasing and Consumer Credit Firms

Legal entity classification and regulatory requirements in Europe

In Europe, leasing and consumer credit firms either can be banks, bank-owned subsidiaries, independent firms or the financing arms of manufacturing companies (known as captive companies).

[1] Leaseurope 2011 Annual Statistical Enquiry
[2] Sources: Leaseurope; Eurostat; "The Use of Leasing Amongst European SMEs" by Oxford Economics (Nov 2011)
[3] Access to Finance of SMEs, ECB survey
[4] Sources: Leaseurope; Eurostat
[5] Eurofinas 2011 Annual Statistical Enquiry

In the EU, when they are banks or belong to a banking group, leasing and consumer credit companies are required to apply EU prudential regulation (the Capital Requirements Directive and successive legislation), either directly at legal entity level or through the inclusion of their activities in the requirements that are applied to the group at consolidated level. Bank-related leasing and consumer credit companies in Europe, are therefore, by definition, part of the regular banking system. Our membership statistics show that these types of entities make up the lion's share of the European leasing and consumer credit business[6].

Finance companies that are subject to prudential regulation either on a legal entity basis or via requirements applied to a banking group at consolidated level should not be included within the category of "other shadow banking entities". In this context, we do not agree with the scope of the survey of finance companies conducted by national jurisdictions for the FSB. The estimated size of "shadow entity finance company activities" at $4 trillion is overestimated[7].

Depending on the European jurisdiction in which they are established, non-bank owned leasing and consumer credit companies, such as manufacturer or independently owned firms, may or may not be subject to similar prudential regulation.

It is only those firms which are not subject to such regulation that may fall under the FSB's definition of "other shadow banking entities". However, as explained below, these firms do not pose a systemic risk.

Funding structures of European leasing and consumer credit firms

In Europe, while a major share of the leasing and consumer credit industry is owned by banking groups, leasing and consumer credit entities themselves are not deposit taking institutions[8].

As these firms do not receive repayable funds from the public they do not pose a threat to depositors.

Additionally, reliance on short term financing is not a significant feature of leasing and consumer credit funding models. Instead, lessors and consumer credit providers typically match the terms of their funding with those of their contracts. For example, 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.

[6] By way of example, according to Leaseurope's 2010 Ranking Survey of European leasing firms, 19 of the top 20 leasing companies in Europe are bank related

[7] FSB, Global Shadow Banking Monitoring Report 2012, page 27 and Annex 3

[8] Unless they have made the decision to opt for a banking license precisely in order to be able to take deposits, in which case they are subject to the Capital Requirements Directive as any other bank. However, deposit taking providers remain the exception

Leasing and consumer credit firms are therefore not subject to the risk of the type of "runs" or liquidity/maturity mismatches described as being a potential cause for concern when conducted by an entity outside of the regular banking system.

Leasing and consumer credit providers are specialised and prudent

Leasing and consumer credit providers have specialist expertise, perform prudent collateral valuation and have in-depth knowledge of their customers with which they manage the risks that are part of their business.

It is worth stressing that the specialised nature of consumer credit firms and lessors means that they have a unique understanding of their clients and asset markets and are able to track the level of risk they are exposed to very carefully.

For instance, depending on the level of risk they are willing to take on, lessors 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 and consumer credit providers (where applicable) adopt a conservative approach to collateral valuation.

Additionally, when the client is a private individual, these firms are already subject to a comprehensive European regulatory framework and are required to perform a thorough creditworthiness assessment of their customers[9].

Risk of contagion to the wider system is limited

European leasing and consumer credit firms are closely tied to the traditional banking system, both through the direct ownership of banks or via funding received from banks. In other words, whether bank-owned, captive or independent, European leasing and consumer credit organisations always rely heavily on the banking sector to fund their operations.

With all European banks being required to apply European prudential regulations, the exposures that banks are able to take on in relation to leasing and consumer credit firms are limited in size and closely monitored.

Consequently, the risk of contagion due to the failure of a leasing or a consumer credit company is already contained by existing EU banking regulation.

Moreover, should a leasing company fail, the lessor's creditors would have the right to receive rental payments from the client and so would simply seek to continue the lease, leaving the client's access to the asset untouched. Should a consumer credit company fail, the situation is the same and does not affect either the creditors' or the client's rights on outstanding contracts.

[9] Directive 2008/48/EC on credit agreements for consumers

Leasing and consumer credit *clients* are not affected in the event of bankruptcy of their service provider.

III. The European Leasing and Consumer Credit Markets

Too small to be systemic

The FSB estimates that the global shadow banking sector, as proxied by "other financial intermediaries" was worth $67 trillion dollars at the end of 2011[10]. For the Euro Area, European Central Bank (ECB) statistics for "other intermediaries" amounted to €10.8 trillion (Q2 2011)[11]. This category encompasses the assets of both money market funds as well as financial vehicle corporations in addition to "other miscellaneous intermediaries". Leasing and consumer credit firms may be included in this miscellaneous category, but so will many other firms, including factoring, venture capital companies, securities dealers, financial holding companies and financial auxiliaries. Together, the total assets of all other miscellaneous intermediaries in the Eurozone amounted to €7.6 trillion (Q2 2011)[12].

By way of comparison, total European leasing and consumer credit outstandings taken from Leaseurope and Eurofinas membership activity surveys reached €0.712 trillion and €0.466 trillion respectively at the end of 2011. Although the geographical scope of these figures is not exactly comparable to the ECB estimates of shadow banking activities, these figures provide an indication of the small size of the leasing and consumer credit markets in relation to "other shadow banking activities".

Additionally, as pointed out above, a significant proportion of leasing and consumer credit firms in Europe are banks or belong to banking groups. Therefore, an important share of the portfolios reported in the Leaseurope/Eurofinas surveys are likely to belong to firms that are part of the monetary financial institutions (MFI) category (banks) in most of the monetary statistics referred to by the FSB. This is certainly the case for ECB statistics. These leasing and consumer credit companies that are MFIs form an integral part of the regular banking sector.

Comparisons of the Federations' market sizings to FSB or ECB proxies of shadow banking will therefore always lead to an overestimation of the importance of leasing and consumer credit within the shadow banking sector.

We therefore fully agree with the FSB's Global Shadow Banking Monitoring report (2012) that finds that, despite their economic importance, the leasing and consumer credit industries are of relative small size. Consequently, we also agree with the FSB jurisdictions conclusions that, finance companies, and *a fortiori* leasing and consumer credit companies are not a serious concern from a systemic risk point of view.

[10] FSB, Global Shadow Banking Monitoring Report 2012, page 3
[11] ECB, Occasional Paper Series Number 133/ April 2012, "Shadow Banking in the Euro Area: An Overview"
[12] Idem

No room for regulatory arbitrage in the EU

The FSB is concerned that certain activities will increasingly concentrate in the shadow banking sector as firms try to avoid the ever stricter regulatory requirements faced by the regular banking system. In Europe, the leasing and consumer credit markets have developed to respond to investment and consumption needs and to accompany the development of local industrial production and distribution. The skill set required to conduct such activities is very different to traditional lending and leads to specialisation. Hence, leasing and consumer credit activities tend to be conducted within dedicated legal entities.

Leasing and consumer credit activities are not carried out to circumvent existing (or future) rules, nor will they favour one form of legal entity over another simply to avoid regulation. Instead, this decision is driven by business considerations such as the sources and cost of funding. In the European regulatory environment, the status and form of legal entity is pre-determined by the business's reliance (or ability to rely) on deposits or deposit like-funding. In general, European leasing and consumer credit providers do not rely on such funding.

IV. Responses to the Consultation Questions

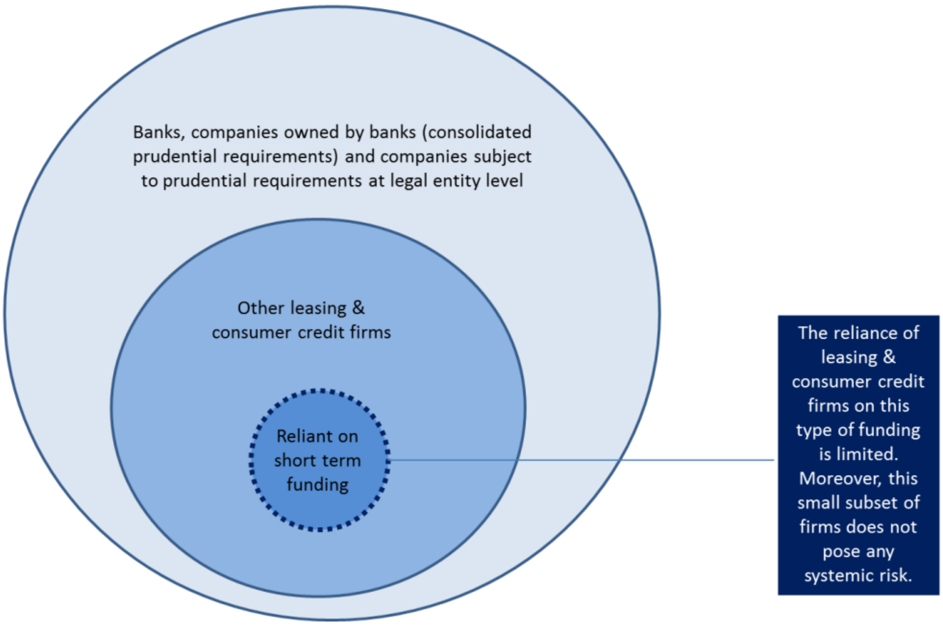
Q1. Do you agree that the high-level policy framework effectively addresses shadow banking risks (maturity/liquidity transformation, leverage and/or imperfect credit risk transfer) posed by non-bank financial entities other than MMFs? Does the framework address the risk of regulatory arbitrage?

We think that the high level policy framework needs to be clarified in order to integrate the FSB's recommended approach to defining shadow banks. In other words, before applying the framework itself and assessing the various economic functions, it is essential to narrow its scope to the subset of businesses that would qualify as posing a systemic risk and/or regulatory arbitrage concerns.

For example, if we apply this reasoning to the leasing and consumer credit industries in Europe, it is only those firms in the inner-most circle in Fig. 1 below that may be subject to the policy framework.

As explained above, we think it is important to recall here that in our view, leasing and consumer credit firms do not pose any systemic risk nor do they give rise to regulatory arbitrage concerns.

Fig 1. Leasing & consumer credit firms that may fall under the scope of the proposed policy framework compared to the entire population of European consumer credit and leasing providers



Q2. Do the five economic functions set out in Section 2 capture all non-bank financial activities that may pose shadow banking risks in the non-bank financial space? Are there additional economic function(s) that authorities should consider? If so, please provide details, including the kinds of shadow banking entities/activities that would be covered by the additional economic function(s).

We consider that the five economic functions are comprehensive.

With respect to the examples of economic function 2 (loan provision that is dependent on short term funding), we wish to make the following additional comments:

Example 1: Deposit-taking institutions that are not subject to bank prudential regulation

In the EU, leasing or consumer credit companies that accept deposits are always subject to bank prudential regulation.

Example 2: Finance companies whose funding is heavily dependent on wholesale funding markets or short-term commitment lines from banks

EU leasing and consumer credit firms are typically not dependent on such sources of finance.

Example 3: Finance companies that are dependent on funding by parent companies in sectors that are cyclical in nature and/or are highly correlated with the portfolios of the finance companies

Contrary to the US for instance, European captive firms are traditionally reliant on bank funding and have not always been able to depend on inexpensive funding through their parents. This bank funding is subject to the large exposure/concentration limits of prudential regulation applied to European lenders, thus preventing excessive build-up of sector specific risk. It is important to note that, where funding would be channelled via manufacturers to their captive firms, it would also be subject to large exposure limits and manufacturers and their captives are treated as a single client (exposure) group by a bank for this purpose. Additionally, we do not see why captive leasing and consumer credit companies would be more exposed to concentration risk than other types of lenders would be. We would expect them to have an equally diversified client base. The FSB should not confuse potential market risk on (physical) assets with credit risk on a portfolio of (financial) assets.

Example 4: Finance companies whose funding is heavily dependent on banks that use these companies as a means to bypass regulation/supervision

In the EU, the activities of all financial companies that are subsidiaries of banks will be taken into account through regulatory and supervisory requirements applied at consolidated group level. While the risk management policies of leasing and consumer credit companies may indeed be different to those of banks, this does not mean that they are necessarily more lax. By way of example, lessors are able to offer their products in situations where bank lending has been less readily available or otherwise limited[13] because they are the legal owners of the assets they lease, which provides built-in security.

Q3. Are the suggested information items listed in the Annex for assessing the extent of shadow banking risks appropriate in capturing the shadow banking risk factors? Are there additional items authorities could consider? Would collecting or providing any of the information items listed in the Annex present any practical problems? If so, please clarify which items, the practical problems, and possible proxies that could be collected or provided instead.

N.A.

Q4. Do you agree with the policy toolkit for each economic function to mitigate systemic risks associated with that function? Are there additional policy tool(s) authorities should consider?

Our comments are restricted to the policy tools recommended for economic function #2.

Tool 1: Impose bank prudential regulatory regimes on deposit-taking non-bank loan providers

This is already the case in the European Union.

[13] Basel 3 will force banks to re-price loans which in turn may have knock-on effects such as limiting SMEs access to leasing

Tools 2, 3, 4: Capital requirements, liquidity buffers and leverage limits

It is difficult to comment on tools 2-4 as their usefulness depends entirely on their design and calibration. For instance, the new requirements developed by the Basel Committee would not be appropriate for application to leasing and consumer credit firms as they cater for large, internationally active deposit taking entities.

Moreover, the types of requirements described in tools 2-4 would only be appropriate to deal with the situations where there is clear evidence that leasing and consumer credit companies may pose a systemic risk (i.e. to the limited population of firms illustrated in Fig 1. Above). It has not yet been demonstrated that any such firms exist.

Tool 5: Limits on asset concentration

Again, we think that the FSB should be careful not to confuse physical asset risk and credit risk/concentration risk. Indeed, as explained above, there are significant benefits in the specialisation of leasing and consumer credit providers. The presence of physical assets (even if of the same type) is a beneficial form of security for these firms.

Tool 6: Restrictions on types of liabilities

We agree that entities that make use of these forms of financing should have appropriate securitisation and risk management practices in place. However, this should not have a negative impact on an entity's ability to access a diverse range of funding sources.

Tool 7: Monitoring of the extent of maturity mismatch between assets and liabilities

We do not disagree with the monitoring suggested in tool 7. We agree with the FSB that the definition of appropriate mismatches and availability of resources are significant challenges. This must be considered carefully and in conjunction with industry.

Tool 8: Monitoring of links (e.g. ownership) with banks and other groups

As explained above, there is no risk of contagion to the wider financial system with respect to leasing and consumer credit activities in the EU context. Moreover, this is true whether the leasing/consumer credit provider is bank or manufacturer owned.

Q5. Are there any costs or unintended consequences from implementing the high-level policy framework in the jurisdiction(s) on which you would like to comment? Please provide quantitative answers to the extent possible.

Our concerns would be that leasing and consumer credit products are not able to continue to fulfil their important economic roles and that competition in the sector may suffer. Moreover, given that there is already a myriad of regulatory initiatives being carried out in the EU that will impact European leasing and consumer credit firms (both directly and indirectly), we strongly caution against any attempt to introduce further regulation at this point. New legislation could force some firms, and in particular smaller firms, to withdraw from the market, thereby restricting the choice of finance options available to consumers and businesses. Lastly, it must be ensured that there is an international level playing field for leasing and consumer credit providers – new regulatory initiatives developed by the FSB must carefully consider the impacts in terms of global competition.