Leaseurope/Eurofinas Response to the FSB and IOSCO Consultative Document
Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions

7 April 2014

Contact Persons:

Jacqueline Mills
Director, Asset Finance & Research
Leaseurope
+32 2 778 05 66
j.mills@leaseurope.org

Alexandre Giraud
Senior Legal Adviser
Eurofinas
+32 2 778 05 64
a.giraud@eurofinas.org

About Leaseurope
Leaseurope brings together 44 member associations representing the leasing, long term and/or short term automotive rental industries in the 34 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 more than 90% of the European leasing market and in 2012, total new leasing volumes worth €253 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 €312 billion Euros worth of new loans during 2012. More info at www.eurofinas.org.

Leaseurope and Eurofinas Response to the FSB and IOSCO Consultative Document Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions

I. European leasing and consumer credit

In 2012, the leasing firms represented through Leaseurope's membership helped European businesses invest in equipment and automotive assets worth more than €201 billion[1], accounting for near to 20% of all European business equipment investment[2]. Leasing is particularly important for smaller businesses. It is used by approximately 40% of European SMEs[3] and is the type of finance with the most successful application rate amongst SMEs[4].

Consumer credit supports the social and economic well-being of millions of consumers across Europe. In 2012, consumer credit providers that are members of Eurofinas helped support European consumption by making more than €233 billion worth of goods, services, home improvements and vehicles available to individuals[5].

II. General comments on the consultation

Leaseurope and Eurofinas represent European finance companies engaged in business (lease), automotive and consumer finance activities. These activities are conducted by banks, specialised subsidiaries of banks, captive and independently owned companies.

European lessors contribute to financing approximately 20% of all European business equipment investment. Consumer lending providers support European consumption by making goods, services, home improvements and vehicles available to individuals. Taken together, the total outstanding assets of Leaseurope and Eurofinas members was approximately € 1 168 billion at the end of 2012.

In Europe, bank-owned finance companies account for the largest portion of finance company activities. For instance, bank-related leasing companies accounted for approximately 80% of the new leasing volumes granted by the lessors represented in the 2012 Leaseurope Ranking Survey. The market shares for bank-related consumer credit providers is of the same order of magnitude.

Given that a majority of the companies represented through our membership are banks or bank-owned, their activities are either directly subject to the provisions of the CRD4/CRR (and its previous versions) or are taken into account in the scope of prudential consolidation of their banking groups. Firms that are not bank-owned will often also be subject to comparable prudential requirements put in place at national level. Finance companies across the board are covered by conduct of business

[1] Leaseurope 2012 Annual Statistical Enquiry
[2] Total new equipment leasing volumes (source: Leaseurope)divided by equipment gross fixed capital formation (source: AMECO)
[3] The Use of Leasing Amongst European SMEs" by Oxford Economics (Nov 2011)
[4] Eurostat
[5] Eurofinas 2012 Annual Statistical Enquiry

rules and all European consumer credit providers are subject to a comprehensive regulatory framework (including the European Consumer Credit Directive), regardless of their legal entity status.

Short term funding is not a characteristic of our membership's funding structures. Their funding tends to be done on a matched-term basis and is largely bank provided. Today in Europe, few finance companies access commercial paper, asset-backed security or other wholesale funding sources. Like the rest of the European economy, European finance companies are reliant on banks for their funding, contrary to other jurisdictions such as the US where capital market finance is significantly more prevalent.

The banks that fund European finance companies are, by virtue of the CRD4/CRR, subject to large exposure (concentration) limits. This ensures that they do not build up excessive risk to a particular finance company. As a result, the distress or failure of a leasing, auto or consumer finance player would therefore not have a systemic impact, i.e. it would not disrupt the global or European financial system.

Moreover, should the distress or failure of such a firm occur, its clients would not be affected. In the case of a leasing firm for instance, the firm's creditors would have the right to continue to receive lease payments and the clients' access to the leased asset would be untouched. European markets are also sufficiently competitive for other finance companies or banks to step in and take the place of any failed firm.

Based on our statistics and knowledge of our membership base, we are not aware of any European finance company (leasing/auto/consumer) that would have assets in excess of $100 billion and that would not already be subject to the provisions of the CRD4/CRR in Europe (and hence not already taken into account in the previous analysis relating to Global Systemically Important Banks (G-SIBs)).

In light of the above characteristics of European finance companies, we do not see any justification for qualifying any of their activities as being of systemic relevance. We therefore suggest that a most efficient way forward for the FSB/IOSCO and national (European) jurisdictions would be to focus their efforts and resources on identifying other types of potential Non-Bank Non-Insurer Global Systemically Important Financial Institutions (NBNI G-SIFI) activities. Moreover, we are concerned that some of the rather general analysis relating to finance companies contained within this consultation document will feed into other on-going workstreams such as the work of the FSB's WS3 on other shadow banking entities which may cloud the understanding of the true nature and risk profile of these businesses. Any outcome of the latter workstream should also reflect the comments contained in this response.

III. Answers to the consultation questions

Q 2.2

As explained above, based on our statistics and knowledge of our membership base, we are not aware of any European finance companies (conducting leasing/auto/consumer activities) that would have assets in excess of $100 billion and not subject to prudential regulation.

Q 3.1

We agree that finance companies that are directly subject to prudential regulation or that are subsidiaries of regulated banking groups should not form part of the assessment scope for this exercise. As pointed out above, these entities already cover the lion's share of the European market. More generally, we caution against regulatory duplication because finance companies will typically source their funding from regulated entities that are already subject to prudential requirements, including large exposure/concentration risk limits.

Q 3.2

Size on its own is not an indicator of whether an entity is systemic. It is important therefore that any materiality threshold based on size is *only a filter* and not a factor in its own right to determine whether an entity is a NBNI G-SIFI. Furthermore, we consider that it is indeed important to retain consistency between NBNI G-SIFI and G-SIB methodologies. In this context, we encourage the FSB and IOSCO to align the materiality threshold for initially identifying potential NBNI G-SIFIs with the level of assets of the smallest G-SIB. This would bring the threshold to approximately $200 billion.

Q 3.5

The systemic relevance of an entity in a specific jurisdiction should be taken into account, rather than simply the number of jurisdictions in which an entity operates (e.g. an entity may operate in a large number of countries, but with a negligible presence from a systemic point of view in many of these), together with the risk of transmission of systemic consequences due to material interconnectedness.

Q 4.1

The definition of finance company activities is broadly suitable; however we are not convinced that funding sources are necessarily a relevant part of this definition, particularly in a European context where the majority of finance companies do not take deposits and are reliant on bank funding.

Q 4.2

We do not agree with the description of the systemic importance of finance companies given on page 15 of the consultation. We comment on the various aspects of this description below:

Substitutability

We do not agree that finance companies operate in concentrated markets in Europe. To measure finance company market shares appropriately, one should consider the entire range of finance providers of a given funding type (e.g. business financing, consumer lending, etc.) which will include banking players. In comparison to the balance sheets of universal banks, finance company activities will be relatively small.

Moreover, while the activities of finance companies are economically important in terms of supporting businesses and consumers, this does not mean that they are not substitutable. European markets are sufficiently competitive for another firm, be it a bank, a bank-owned, independent or captive finance company to step in and take the place of any failed firm. Specialisation in itself is not an obstacle. There will always be leasing or consumer credit players already possessing the necessary skills to step in and take over the activities of any distressed or failed business.

Specialisation should also not be confused with (credit) concentration risk. Although some of our members may be active in financing or leasing a specific category of assets (e.g. automotive, IT, etc.), their clients are as geographically and sectorally diverse as those of any other type of lender.

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.

From a lessor perspective, the specialisation in a specific asset category means that there may be exposure to the risk that the second hand prices of this asset category drops unexpectedly. However, part of their specialisation is precisely having the skills to manage this risk. Lessors either enter into arrangements protecting against this, for instance by purchasing residual value insurance or guarantees, by or entering into “buy-back” arrangements with asset vendors. For those who do decide to take on this exposure, they constantly track asset values and any expected downwards movements in asses prices are reflected in their financial reporting as required by IFRS impairment standards.

Reliance on wholesale funding

As we have previously explained European leasing and consumer credit firms typically rely on bank funding rather than other sources of wholesale funding. The consultative document notes that banks reduced funding to finance companies during the crisis, giving the impression that this was in fact due to their inability to fund because of the stress they were experiencing. This situation needs to be nuanced, particularly in a European context. In Europe, when we did witness the reduction of bank funding to finance companies, it mainly occurred around 2010/11 (i.e. not at the start of the crisis) and was due to banks anticipating the implementation of the new Basel 3 framework. Although the Basel 3 requirements were still being fleshed out, European banks were already undertaking strategic reviews of their portfolios. Those who decided to reduce funding to leasing and consumer credit activities as a result of this strategic review, made the decision to sacrifice certain business areas (in spite of their important economic functions and low risk nature) in order to sustain other business areas they considered to be strategically more important to their group's activities. It is more the fact that Basel 3 actually created the wrong types of incentives for bank deleveraging that led to some reduction in finance company rather than the unavailability of funds as a direct result of the financial crisis.

Losses to providers of funding

We do not agree that European finance company distress or failure would ever lead to the disruption of key wholesale funding markets as described in the consultation. Again, the main funders of European finance companies, i.e. banks, are subject to large exposure and concentration risk limits to protect them from such losses.

In summary, we do not think that a case has been made to consider the activities of European finance houses as being of systemic relevance. We wish to recall that the international supervisory community in fact shares this view to a large extent. Indeed, the FSB's Global Shadow Banking Monitoring Report of 2012 noted that, despite their important contribution to the economy, finance company activities are small and therefore not of "serious concern from a systemic point of view".

Q 4.3

The indicators proposed are very general in nature (i.e. transposed from the area of universal banking) and have not been tailored to assess the activities of finance companies.

Regarding the *size indicator*, and as noted above, we not think that size is necessarily a relevant criteria for determining the systemic nature of an entity, particularly if considered in isolation. An entity may be "large" but have a very conservative risk profile. It is therefore key to take this risk profile into account. In general, consumer, leasing and automotive lending are low risk activities. This is because specialised companies benefit from proximity to their client base and have developed risk analysis tools that tend to be more sophisticated than those of universal lenders. Moreover, a number of the products granted by these finance companies are secured on the physical assets being financed. Indeed, the presence of underlying physical assets as collateral acts as a form of credit risk mitigation. This is particularly beneficial for lenders who have specialist knowledge relating to the valuation and remarketing of physical collateral. Recent research conducted by Deloitte illustrates this, with the research finding that loss rates (LGDs) for small businesses and corporates are significantly lower for leases than for loans (Deloitte, 2013, The Risk Profile of Leasing in Europe: The Role of the Leased Asset).

We question the relevance of the *indicators related to interconnectedness*. This appears to be overly complex given the typical funding structures of European finance companies described above.

Regarding *substitutability*, please refer to our comments above.

Lastly, by virtue of their specialisation, finance company business models are *not complex*, particularly compared to those of universal finance providers. Their focus on specific (mono-line) products and market segments implies that their activities are transparent easy to understand, at least in comparison to multi-line businesses. Moreover, as described above, the impact on clients or funders in the event of failure would be extremely limited.