Leaseurope

The Voice of Leasing and Automotive Rental in Europe

European Banking Authority
One Canada Square, Canary Wharf
E14 5AA, London
United Kingdom

Brussels, 1 October 2015

Re: Discussion Paper and Call for Evidence on SMEs and the SME Supporting Factor

Dear Sir/Madam,

Leaseurope welcomes the opportunity to respond to this discussion paper. 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 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 2014 total new leasing volumes worth 275.7 billion Euros were granted by the firms represented through Leaseurope's members.

In general we wish to ensure that any possible further changes to the calculation of regulatory capital do not result in banks restricting the provision of finance to small businesses in Europe, particularly through leases. Leasing is an important SME financer with low default and loss rates, as shown by our various research reports. Especially in light of current regulatory measures aimed at supporting SME finance, such as the discussion on long-term financing and the proposed Capital Markets Union, increasing capital requirements for SME lending would seem counter-productive. Your discussion paper mentions that approximately €10.5 billion in capital had been saved by those banks reporting to the EBA in 2014 due to the SME supporting factor. When compared to total EIB and EIF SME lending schemes' contribution of €22 billion in 2014, it is clear that the SME supporting factor is an important tool in promoting SME access to finance in Europe.

Q5. Do you see merits in having a harmonised definition of SMEs for reporting purposes? Yes/No. Please explain and provide specific examples.

Yes. We agree in principle with the idea of a more harmonised definition of SMEs for reporting purposes, although the practicality of this raises some concerns. The 2003 Commission Recommendation lists annual turnover, balance sheet and employee limits in order to qualify as an SME, although annual turnover less than €50 million is the only mandatory indicator. Article 501 CRR adds a limit on the amount owed by any individual SME to maximum €1.5 million. If the qualifying criteria for the SME supporting factor were extended to include employee and/or balance sheet limits, this could exclude many small SME contracts where this level of data collection would be overly burdensome. Likewise, ongoing data collection on counterparty turnover etc. would be overly burdensome for high volumes of small contracts. We are concerned that banks will need to start collecting recent financial statements from small businesses, many of which in Europe are not required to file their accounts on public record, which would raise the cost of lending to SMEs. Data collection on counterparty characteristics at origination should suffice, particularly for smaller and/or shorter duration SME lending.

Q6. Do you agree with the proposed measures of SME riskiness? Yes/No. Are some of these measures more relevant than others? Yes/No.

No. We agree with the EBA's assessment that the probability of default (PD) would be the ideal measure of SME riskiness, but that differences in definition of default and SMEs present comparison issues. However, comparison of PDs for SMEs versus larger firms should be possible within a particular country, where these definitions are likely to be relatively comparable across credit institutions, or within a particular credit institution even, where the definitions will certainly be comparable.

We feel that using non-performing loans (NPL) as a measure of counterparty riskiness is useful in general, but presents problems in the context of capital requirements. The purpose of capital requirements is not to cover all risk, but specifically the unexpected losses. Expected losses are covered by loan loss provisions. NPLs for SMEs are generally higher than for large firms as they have less resources and are thus more adversely affected by exogenous shocks, however banks do take this into account in their loan loss provision calculation. Contrasting NPL figures with loan loss provisions would present more insights, as would evaluating unexpected losses.

We would also agree that profitability, leverage, activity, liquidity and coverage are good indicators for assessing SME riskiness in general, however this should be set against the backdrop of banks' management of these risks and with the lack of data availability for these indicators concerning smaller entities.

Another element to take into account would be the effect of diversification on SME portfolio risk. Most SME portfolios consist of a large number of smaller contracts across a diverse range of sectors and business models. Therefore unsystematic risk is mitigated to a much larger degree than for large firm portfolios.

Q9. Do you agree with the proposed methodology to assess the own funds requirements in relation to SME riskiness? Yes/No. If no, please provide alternative methodologies or indicators, if available.

Yes. Asset correlation analysis should provide a good measure of systematic risk in the context of capital requirements. However, an additional analysis of unexpected losses would be ideal. In a 2013 research paper undertaken by Deloitte on behalf of Leaseurope, a Monte Carlo simulation was used on historical contract data to estimate total loss distribution curves. The 99.9th percentile value was then taken as the credit VaR, from which the expected loss (PD x LGD) was subtracted to obtain the unexpected loss for leasing to SMEs.[1] This study found that the true level of riskiness of the SME leasing portfolio in our sample was equivalent to an implicit risk weight (i.e. unexpected loss) of 0.634%. When compared to regulatory risk weights of 4% - 6% calculated from the same sample portfolio under the various approaches, it is clear that capital requirements over-estimate the riskiness of leasing to SMEs. Performing a similar analysis of unexpected losses for all lending to SMEs would provide much greater clarity when assessing own funds requirements.

Q11. Do you agree with the above interpretation of statistical data on lending trends and conditions? Yes/No. If no, please explain.

Yes. We agree that access to finance remains a key issue for European SMEs, particularly micro firms, as evidenced by increasing rejection rates and stagnant new lending. The decrease in credit demand due to the financial and Eurozone crises should also be taken into account. In light of this, we would advocate that any measures aimed at improving access to finance for SMEs should be welcome.

Q14 In your experience, is there an impact of the SME supporting factor on the volume of SME lending compared to other loans? Yes/No. Please explain and provide evidence.

Yes. In our opinion, there has not been enough time since the introduction of the SME supporting factor (less than 2 years) to gauge if there has been a real impact on SME lending. However, we do have evidence that SMEs' use of leasing has increased. A recently released Oxford Economics report on leasing to SMEs, conducted on behalf of Leaseurope, shows that an estimated €121 billion in SME leasing was done in 2014, compared to €104 billion in 2013, a growth of 16%.[2] This rise was not echoed in total leasing figures, where growth from 2013 to 2014 was 9%.[3] Micro SMEs in particular seem to be accessing leasing more than in previous years, with 19.6% of their investment being financed by leasing in 2014 compared to 15.4% in 2013. While we can show that leasing to SMEs has grown more than for large firms between 2013 and 2014, it is impossible for us to attribute this to the introduction of the SME supporting factor. However, we also have no evidence as to why this would not have an impact, as it encourages parent banks and investors to support businesses with a large number of SME clients, such as leasing, while incentivising these firms to increase their SME portfolios. The Oxford Economics research highlights the vital and increasingly important role leasing has to play in financing European SMEs, therefore it will be important that this form of finance is not restricted going forward.

[1] Deloitte, September 2013, "Implicit Risk Weights for SME Leasing in Europe". Available upon request.
[2] Oxford Economics, July 2015, "The Use of Leasing Amongst European SMEs". Available upon request.
[3] Leaseurope 2014 Annual Statistical Enquiry.

Q16. Do you consider SMEs are a consistent group when it comes to access to credit or should a distinction be made between different types of SMEs (e.g. micro, small and medium ones)? Yes/No. Please explain and provide specific examples.

We would not advocate for making distinctions between different categories of SMEs, as this would increase the difficulty for firms to apply the SME definition in practice (see response to Q5). However we would advocate for a differential treatment for leasing to SMEs. The lessor's ownership of the leased asset is a valuable and efficient form of in-built security which makes leasing extremely low-risk, a major advantage compared to other financial products. The previously mentioned Deloitte research demonstrates that default and loss rates for leasing to SMEs are significantly lower than for traditional lending. According to this study, which was based on a portfolio of 1.5 million lease contracts in 15 European countries, one-year defaults on leasing Retail SME exposures were 2.7% compared to 4.5% for all Retail SME lending in 2010. Similarly, Loss Given Defaults for leasing were 19.6% compared to 33% for all Retail SME lending. If the purpose is to increase lending to SMEs in a low risk manner, lowering capital requirements for leasing to SMEs is an ideal instrument for achieving this.

We are happy to discuss the full findings of this research with you, which we believe make a compelling case for introducing specific risk weights for lease SME exposures.

I remain at your disposal, should you be interested in discussing any specific issue. Alternatively feel free to contact my colleague Hayley McEwen (h.mcewen@leaseurope.org - tel: + 32 2 778 05 71).

Yours sincerely,

Tanguy van de Werve, Director General