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FINANCIÈRES

ASF RESPONSE

To the EBA Discussion Paper on Simplification and assessment of the credit risk framework

The prudential regulatory framework of specialized credit institutions must be more proportionate to risks.

It is essential to consider the lower risk profile — due to the ownership of the assets financed — of leasing and factoring.

Focus on leasing

The lower risk profile of leasing is due to ownership by the lessor of the assets financed. Businesses need their leased assets to run (vehicles, IT equipment etc.) therefore defaults are low. Leaseurope, the European federation of leasing, has demonstrated¹ that during 2007-2011 crisis years, one-year average default rate for leasing was nearly half the median default rate of regular bank corporate exposures (1.9% compared to 3%). As leased assets are key working tools, defaults often return to a healthy status with no loss (around two thirds of all lease defaults return to health). As the owners, lessors recover much more from physical assets than other types of lenders by selling/re-leasing (up to 82% of exposure at default covered by asset sale on average, depending on asset type).

Despite these observations, current Capital Requirements Regulation (CRR) does not reflect the real risks of the leasing activity. Depending on the approach used, capital requirements are between 5 and 8 times higher than necessary².

It is essential to reconsider leasing prudential requirements against the background of the European Commission's forthcoming report on the competitiveness of the European banking sector.

There is a strong case for a differentiated prudential capital treatment for leasing

Industry reports indicate that low-risk activities are often disproportionately penalised under the new Basel 3 rules, which is clearly the case for leasing.

¹ *Prudential treatment of leasing, A Proposal for Sustainable Growth in Europe. See :*
<https://www.leaseurope.org/data-research/research/low-risk-leasing>

² See Capital Requirements for Leasing: A Proposal Adjusting for Low Risk. A report prepared for Leaseurope by the University of Cologne, December 2017, actualized in May 2019.

Leasing companies using the SA are affected by the current framework far too restrictive for them. For A-IRB leasing companies, the impact of Basel III finalisation is even more acute than for the banking sector overall since the new rules do not reflect the low-risk nature of leasing, particularly because:

- the output floor is based on SA calculations, which are overly conservative for low-risk assets;
- the input floors fail to properly account for the value and security of the physical assets being leased.

The European Commission's transitional arrangements under CRR III – Article 495c have reduced haircuts for leasing and have helped mitigate the impact of Basel III finalisation, but these measures are only temporary.

Leasing demonstrated low risk but it is not recognised by the prudential framework

Credit risk weights under prudential standards (i.e. Basel III and CRR) should reflect the real underlying risks. We believe there is a strong case to be made for differentiating lease finance (where the asset is owned by the finance company during the life of the agreement) with a specific SA risk weight. We also advocate for a better recognition of leasing finance as physical collateral for credit risk mitigation purposes.

Losses within the leasing activity are low³ because the lessor is funding a physical asset crucial to the client's core business activities. As the asset is a key working tool for the lessee, many defaulted leases regrade back to a healthy situation with zero loss. In cases where it is not possible, the lessor can then sell or re-lease the asset to decrease any losses on the default, resulting in low loss rates.

A report prepared for Leaseurope by the University of Cologne in December 2019⁴, which is based on a dataset of detailed contract-level information by twelve major European leasing companies operating across 25 countries, demonstrates that leasing is unjustifiably penalised by the current prudential regulatory framework. The research shows what would be an adequate calibration for leasing exposures compared to its real risk profile. The research is based on the current CRR rules.

Table 1 below presents the main results of the Cologne University research calculations for the current CRR. For all three regulatory credit risk approaches, capital requirements are much higher than the unexpected losses in a simulation of a downturn. As expected, the Standardised Approach yields the highest regulatory capital requirements followed by the F-IRB approach, with the A-IRB approach leading to the lowest regulatory capital requirements⁵. However, even the A-IRB approach requirements are still almost five times higher than the unexpected losses in the simulation.

The realised losses were never higher than the regulatory capital requirements in any of the simulations performed (10,000 per year). Note that the realised losses include expected as well as unexpected losses, whereas capital requirements are designed to cover only unexpected losses. In this respect, the comparison of realised losses and capital requirements is extremely conservative. This result underpins the main conclusion that current regulatory capital requirements do not account for the low risk profile of leasing exposures in an appropriate way. Therefore, introducing even more conservative changes in the prudential framework will have a significant negative impact for the leasing industry.

³ The risk profile of leasing in Europe: the role of the leased asset", Deloitte, October 2013.

⁴ Capital requirements for leasing: A proposal adjusting for low risk", University of Cologne, December 2019.

⁵ The results, presented in the following table ignore any output floor.

Table 1: Comparison of regulatory capital requirements and unexpected losses split by years

	2007	2008	2009	2010	2011	Total
Standardised	8.17%	7.97%	8.33%	8.44%	8.50%	8.31%
IRB-Foundation	5.29%	5.41%	5.92%	5.94%	5.92%	5.76%
IRB-Advanced	4.03%	4.57%	5.56%	6.12%	6.50%	5.55%
Unexpected loss	1.03%	1.45%	1.29%	0.65%	0.52%	1.09%

For the reasons expressed above we are convinced that leasing should have a differentiated prudential treatment as its business model and risks are completely different than other types of lending. To adjust the prudential framework to the real risk of leasing we agree with the following proposals supported by Leaseurope for better recognition of leasing's low risk :

a) STANDARDISED APPROACH	
Amend Art. 122 & 123 CRR to include new leasing risk weights	Proposed risk weights for leasing exposures: 50% Retail leasing / 65% Corporate leasing
IRB-FOUNDATION	IRB-ADVANCED
b) Add specific haircut for leasing collateral of 20% OR equivalent overcollateralization of 125%	
c) Specific leasing collateral in Art. 230(2) Table 5 CRR: 20% leasing LGD	d) Specific LGD input floors for leasing portfolios (both Corporate & Retail): 10% secured leasing / 20% unsecured leasing

In 2026, there is a momentum for leasing prudential treatment in CRR.

In CRR3, the specific characteristics of lease financing have been recognized with a mandate given to the EBA in Article 495c to better analyze the risk parameters of lease exposures. Currently these parameters are inadequate: under the standardized approach, the risk of leasing exposure is subject to the same prudential treatment as that on traditional credit exposure. Under the IRB approach, CRR3 only grants a transitional adjustment on a temporary basis.

The EBA has started its work to conduct its mandate and launched a large data collection expected to end in June 2026. If EBA's following report is conclusive, Article 495c of CRR3 provides for a delegated act by the European Commission to confirm a reduction in the risk weighting of leasing exposures.

Focus on factoring

The current prudential framework does not provide for factoring activity a proper balance between risk sensitivity and complexity.

SA-CR lacks recognition of the short maturity and of the high recovery rates of purchased receivables, as a direct exposure to the debtor as well as a collateral to the exposure to the assignor for the advanced funds (not considered at all).

The IRB framework allows for specific treatments that provide better risk-sensitivity but:

- In FIRB, the regulatory LGD for exposures collateralized by receivables is too high.
- In AIRB, estimating risk parameters requires many default events that in factoring are uncommon, and the estimate of specific models for purchased receivables can create

different “layers” in the overall IRB model of banks or banking groups, increasing complexity. Moreover, AIRB models are no longer allowed for certain exposures groups, and the output floor significantly reduces the premium for accepting the increased complexity.

The use of the IRB corporate purchased receivables framework and specific rules is currently limited due to its implementation complexity. We therefore propose to transpose the core, risk sensitive principles of that framework into SA CR, which is operationally more practicable for specialized non-bank intermediaries and bank owned factors alike.

The following targeted reforms would reduce unnecessary capital absorption and enhance proportionality under SA-CR :

1. Review risk weights for non-recourse purchased receivables (exposure to buyers / accounting debtors):
 - Under SA-CR, reassess the current RW applied to exposures to buyers where receivables are purchased without recourse, explicitly recognising the short effective maturity and historically high recovery rates of trade receivables, by providing a discounted RW in case of exposures to purchased corporate receivables with maturity up to 90 days;
 - In fact, firms often continue paying their trade suppliers even after interrupting repayments toward banks, in order to avoid production disruptions and preserve as long as possible the continuity of their supply chains.
 - Further, most factoring programs are covered by credit Insurance policies
 - EUF estimates based on EU-wide data indicate that the appropriate risk weight for purchased receivables is, on average, 28%, calculated using a top-down approach and assuming a 90-day maturity. Even a more conservative RW for purchased receivables from unrated debtors could offer a balanced compromise that still recognises the specific risk profile of trade receivables within the prudential framework, while ensuring both sound capitalization of the underlying risk and the preservation of the IRB premium.

2. Allow a substitution approach for recourse transactions (exposure to clients):
 - Under SA-CR, allow factors to use the buyer’s (accounting debtor’s) RW for exposures to clients in recourse purchases when operational control of cash inflows and strong security on receivables are in place (e.g., direct collection, controlled accounts, robust reconciliation).
 - This mirrors the IRB-foundation rationale, where purchased receivables are eligible as funded CRM, but implements it in a standardised, low-complexity manner suited to SA-CR. The measure would recognise the triangular risk structure of factoring and align capital requirement with the true obligor risk that ultimately drives loss potential.

Finally, the implementation of such proposals would only require applying, within SA-CR, the key risk-sensitive principles already embedded (but rarely used) in the IRB purchased-receivables framework.