European Banking Authority

Brussels, 19 June 2015

Re: EBA Consultation Paper on limits on exposures to shadow banking entities

Dear Sir/Madam,

Eurofinas and Leaseurope, the voices of consumer credit and leasing at European level, welcome the opportunity to respond to the European Banking Authority's (EBA) Consultation Paper on draft guidelines on limits on exposures to shadow banking entities which carry out banking activities outside a regulated framework under Article 395 para. 2 Regulation (EU) No. 575/2013.

Eurofinas brings together associations throughout Europe that represent consumer credit providers. 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, furniture, electronic appliances, education etc. Leaseurope brings together associations representing the leasing, long term and/or short term automotive rental industries. 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.

The Federations support the work of the EBA in developing technical standards. We see the mission of the EBA as essential and very much welcome the quality of its work as well as its constant dialogue with the industry. This is particularly important for smaller entities as they are not represented in official consultative/advisory bodies and do not necessarily have a complete overview of the ongoing initiatives.

Before answering the questions posed specifically in the consultative document, our response describes the important role that consumer credit, asset finance and leasing providers play within the European economy as well as the main characteristics of these firms.

Benefits and characteristics of specialised financial services activities

Consumer credit, asset finance and leasing are key drivers of European economic growth. In 2014, consumer credit providers that are members of Eurofinas helped support European consumption by making more than €356.3 billion goods, services, home improvements and vehicles available to individuals and households[1].

In 2014, the leasing providers represented through Leaseurope invested in assets worth more €274.2 billion[2] for European businesses. Leasing is used by more European SMEs than any individual category of traditional bank lending taken altogether[3] and is also extremely popular amongst larger corporates[4].

Consumer credit, asset finance and leasing provide sales support for manufacturers and distributors. Consumer credit, asset finance and lease agreements are distributed via several channels, including through bank networks, directly from specialised 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 consumer credit, asset finance and leasing 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.

Consumer credit, asset finance and leasing do not represent a risk to European financial stability. The various risks that are typically associated with so-called shadow banking entities (deposit-like funding, a danger of "runs", liquidity/maturity mismatches, etc.) are not significant in the consumer credit, asset finance and leasing businesses.

In the EU/EEA jurisdiction, the major share of consumer credit and leasing industry is owned by banking groups. Leasing and consumer credit entities themselves are not deposit taking institutions[5]. As these firms do not receive repayable funds from the public they do not pose a threat to depositors. Added to which, unlike other finance products, for loans and leases to consumers and businesses, the risk lies with the finance company rather than the customer.

Reliance on short-term financing is not a significant feature of leasing and consumer credit funding models. Instead, European lessors and consumer credit providers typically match the terms of their funding with those of their contracts. We would like to emphasise that consumer credit, asset finance and leasing clients would not be affected in the event of bankruptcy of their provider. It would not affect a client's rights on outstanding contracts and access to/usage of an asset.

[1] Eurofinas 2014 Annual Statistical Enquiry
[2] Leaseurope 2014 Annual Statistical Enquiry
[3] Leaseurope; Eurostat; "The Use of Leasing Amongst European SMEs" by Oxford Economics, Nov 2011
[4] Access to Finance of SMEs, ECB survey
[5] 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 Basel standards through the EU legislation as any other bank. However, deposit taking providers remain the exception in most EU countries

The risk profile of leasing in Europe[6]

According to an extensive research carried out by Deloitte Paris in 2013, default and loss rates for leases are significantly lower than for traditional SME lending. Based on a portfolio of 3.3 million lease contracts across 15 European countries, the study shows that one-year defaults on leasing Retail SME exposures were 2.7% compared to 4.5% for all Retail SME lending in 2010. Similarly loss rates for leasing were 19.6% compared to 33% for all Retail SME lending.

Consumer credit, asset finance and leasing providers have specialist expertise, perform prudent asset and collateral valuation, maintain established re-marketing channels 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 as well as within equivalent national supervisory frameworks and ensures that lessors and consumer credit providers (where applicable) adopt a conservative approach to asset and collateral valuation.

Additionally, when the client is a private individual, these firms are subject to a comprehensive European regulatory framework and are required to perform a thorough creditworthiness assessment of their customers [7].

The EBA is concerned that certain activities will migrate systemically away from the regulated sector. **The consumer credit, asset finance and leasing markets have developed to respond to business investment and consumption needs and to accompany the development of local industrial production and distribution.** The skills required to conduct such activities are very different from traditional lending and led over decades to the creation of dedicated entities. These activities have not been designed and are not carried out to circumvent existing rules. It is worth highlighting here that many specialised financial services firms, established to help distribute manufactured goods existed way before many other banking institutions.

Q1. Do you agree with the approach the EBA has proposed for the purposes of defining shadow banking entities?

Article 395 of Capital Requirements Regulation (CRR) requires the EBA to issue guidelines to set limits to exposures to shadow banking entities which carry out banking activities outside a regulated framework. In developing the guidelines, the EBA shall consider whether the introduction of such limits would have a detrimental impact on the risk profile of institutions, on the provision of credit to the economy or the stability and orderly functioning of financial markets.

[6] See *The risk profile of leasing in Europe, the role of the leased asset,* report by Deloitte France, prepared for Leaseurope

[7] Directive 2008/48 on credit agreements for consumers

We see the EBA's current proposed definition of shadow banking entities as too wide. Though we appreciate the EBA's intention to conduct an exhaustive identification of all financial activities currently not subject to EU prudential and supervisory requirements, the various entities and activities encompassed have very little in common. We are concerned that the general nature of this definition could lead to the stigmatisation and possible decline of the provision of essential services by non-deposit taking entities, such as consumer credit, asset finance and leasing. We think that given the important contribution these activities make to the real economy, this should be avoided.

The current definition would essentially lead to the introduction of a specific "shadow banking risk" disconnected from the risk profile of the various activities concerned. We consider it critical that the EBA bears in mind the fundamental differences between the various types of suggested shadow banking activities and entities. We strongly believe that Article 395 CRR allows the EBA to introduce further granularity and proportionality in the definition of shadow banking. This would be consistent with the work undertaken at international level by the Financial Stability Board (FSB). We refer here, in particular, to the FSB's proposed high-level framework for identifying "non-bank non-insurer global systemically important financial institutions". International standard-setters have been developing detailed sector-specific indicators for finance companies, market intermediaries, investment funds and asset managers. We call on the EBA to introduce at least such differentiation in its proposal. We would also advocate for product level differentiation as being the most relevant for the definition of the scope.

Regarding the treatment of consumer credit, asset finance and leasing subsidiaries, we agree with the EBA that undertakings included in the consolidated supervision of their mother company should be excluded from the scope of the guidelines. In the EU/EEA jurisdiction, the major share of the leasing and consumer credit industry is owned by banking groups. When they belong to a banking group, specialised financial services providers, irrespectively of the type of products/services they offer, are always subject to European prudential regulation through the inclusion of their activities in the requirements that are applied to the group at consolidated level.

We also support the exclusion of financial institutions authorised and supervised by local competent authorities and subject to prudential and supervisory requirements comparable to those applied to credit institutions in terms of robustness. However, we think this latter aspect of the guidelines' negative scope could be improved. Other criteria should be taken into account.The standards to which specialised financial services providers are subject to depends on the status under which they operate, their risk profile as well as local market characteristics. We think the notion of risk is central and should be included in the scope of the guidelines. Against this backdrop, duplication of requirements for firms should be avoided at all cost.

Eurofinas and Leaseurope would like to make the following recommendations:

→**The suitability of stricter limits to exposures to shadow banking entities shall be assessed against the European jobs and growth agenda**. Against this backdrop, we think a wider impact assessment to evaluate the outcome of such limits as well as the riskiness of various activities should be carried out. In the meantime, national supervisory authorities shall be provided with sufficient flexibility to adjust the perimeter of these provisions to local characteristics.

→ **The guidelines should not be disconnected from the risk profile of the various entities covered by its scope**. In line with international recommendations, we think a distinction between the main types of suggested shadow banking entities such as finance companies, market intermediaries

and investment funds should be introduced. National supervisory authorities should be encouraged to distinguish, upon justification if need be, between the various types of entities as well as products where appropriate[8].

→ **The guidelines should not apply to those entities that are already subject to a comprehensive supervisory framework**. Eurofinas and Leaseurope are of the opinion that, besides the appropriateness of an established prudential and supervisory regulation in terms of robustness, the peculiarities of the regulated activities should be considered simultaneously with regard to:

- the nature of the activities/business (consumer credit lending or financial leasing cannot reasonably be treated the same way as money market funds)
- the existence, nature and level of risks (systemic risk in particular)
- the possibility of "run" effects (sudden and massive withdrawals of funds by clients)

An amendment of the guidelines could be envisaged along these lines.

Q2. Do you agree with the approach the EBA has proposed for the purposes of establishing effective processes and control mechanisms? If not, please explain why and present possible alternatives.

Q3. Do you agree with the approach the EBA has proposed for the purposes of establishing appropriate oversight arrangements? If not, please explain why and present possible alternatives.

We support the EBA's approach in respect of control mechanisms and oversight arrangements which reflect current practice amongst our members.

We think the EBA should nevertheless clarify whether it wishes to introduce additional Pillar 2 requirements or whether compliance with the existing framework is sufficient. Our understanding is that the latter already covers exposures to shadow banking entities. We see no strong reasons to introduce specific types of arrangements for such exposures. We think the scope of the guidelines is far too diverse for the application of a uniform mechanism.

We are concerned by the requirement to implement a "robust process for determining interconnectedness between shadow banking entities, and between shadow banking entities and the institution". We think an obligation to assess the interconnectedness between shadow banking entities outside an institution's portfolio is a disproportionate requirement. Unless there are specific reasons/concerns, it should be possible to limit such an assessment to the links between entities that are part of an institution's portfolio.

Q4. Do you agree with the approaches the EBA has proposed for the purposes of establishing aggregate and individual limits? If not, please explain why and present possible alternatives?

Though it is technically possible to set an aggregate limit to exposures to the shadow banking sector, we do not think such a requirement is needed. As mentioned above, the shadow banking sector is heterogeneous and we do not think the introduction of a distinct limit to such a diverse range of firms and types of activities will bring substantial added value in risk management and supervision. A more nuanced definition based on entities/products would be more useful.

[8] See *The risk profile of leasing in Europe, the role of the leased asset,* op.cit.

We support the list of information criteria identified by the EBA to set individual limits on exposures to shadow banking entities. We think these elements are consistent with the type of information currently collected by lending institutions to set limits to any types of individual clients or connected clients.

Q5. Do you agree with the fallback approach the EBA has proposed, including the cases in which it should apply? If not, please explain why and present possible alternatives. Do you think that Option 2 is preferable to Option 1 for the fallback approach? If so, why?

As a general observation, we would like the EBA to clarify that a certain degree of subjective assessment and proportionality is required between the general and fallback approaches. Institutions should not be required to automatically apply the fallback approach in cases where only one type of information is missing. Further guidance could be useful.

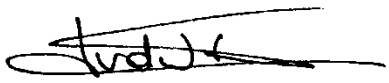
We would support a fallback approach based on option 2. Again, this is justified by the heterogeneity of the shadow banking sector. We think option 1 would lead to the treatment of exposures to all entities as one single client. We do not think this is in line with the development of enhanced risk-sensitive regulatory frameworks and internal modelling.

Q6. Taking into account, in particular, the fact that the 25% limit is consistent with the current limit in the large exposures framework, do you agree it is an adequate limit for the fallback approach? If not, why? What would the impact of such a limit be in the case of Option 1? And in the case of Option 2?

We believe it is very important to have a consistent approach between all individual exposures. However, A 25% limit in the entirety of an institution's exposures to shadow banking entities would be excessively constraining. Should option 1 be retained, we think a dedicated impact analysis on the effect of such a limit on firms' portfolios should be conducted.

I remain at your disposal, should you be interested in discussing any specific issue. Alternatively feel free to contact my colleagues Alexandre Giraud (a.giraud@eurofinas.org - tel: + 32 2 778 05 64) and Rafael Alarcon Abeti (r.alarconabeti@leaseurope.org – tel +32 2 778 05 69)

Yours sincerely,



Tanguy van de Werve
Director General

Eurofinas and Leaseurope are entered into the European Transparency Register of Interest Representatives with ID n° 83211441580-56 and 16013361508-12.