EQUIPMENT LEASING AND FINANCE ASSOCIATION

March 26, 2007

Office of the Comptroller of the Currency
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Washington, DC 20219

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
Attention: No. 2006-33
1700 G Street, N.W.
Washington, DC 20552

Re: OCC Docket Number 06-09 (RIN 1557-AC91)
Federal Reserve Board Docket No. R-1261
FDIC RIN 3064-AC73
OTS Docket No. 2006-33 (RIN 1550-AB56)

Risk-Based Capital Standards:
Advanced Capital Adequacy Framework

To the Agencies Addressed (the “Agencies”):

The following comments are submitted by the Equipment Leasing and Finance Association (“ELFA”) with respect to the Joint Notice of Proposed Rulemaking (“NPR”) published by the Agencies in the Federal Register on September 25, 2006[1] relating to the implementation of the Basel Committee on Banking Supervision’s Revised Framework for International Capital Measurement and Capital Standards (“Basel II”).
ELFA’s comments relate solely to the NPR’s treatment of the residual values of financing leases defined as “retail” under the NPR. ELFA is pleased that the NPR has recognized that wholesale financing leases should be treated as a unity without special treatment for residual values, and it urges that comparable treatment be afforded to retail leases, which include a variety of business and commercial leasing finance transactions – all of which are alternatives to loans as a means of financing the acquisition of equipment.[2]

Under the NPR, banks subject to Basel II would be required to assign to the residual value portion of a retail lease exposure a risk weighting equal to 100 percent of the amount of the residual value.[3] ELFA submits that separating the residual value portion from the remainder of a retail lease in assigning risk weightings creates an inappropriate bias in favor of loans with similar risk profiles, and an inappropriate distinction between retail or small-ticket lease residuals and wholesale large-ticket lease residuals. Breaking out the residual portion of retail leases and assigning to them a 100 percent risk weight would create a needless and undesirable disincentive for institutions to offer this valuable means of equipment financing to small businesses, and would put banks and bank-related leasing companies at a competitive disadvantage vis-à-vis unregulated lessors. It is important to note that (as further discussed below) the size of the equipment lease transaction does not affect the manner in which the equipment exposure is managed.

Industry/Association Background

Organized in 1961, ELFA is a non-profit association that represents companies involved in the equipment leasing and finance industry. ELFA’s diverse membership consists of independent leasing companies, banks and bank-related lessors, financial services corporations, broker/packagers and investment banks; as well as a variety of other service providers. ELFA promotes the leasing and finance industry as a major source of funds for capital investment in the U.S. and other countries. In 2007, the equipment leasing and

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[1] *Risk-Based Capital Standards: Advanced Capital Adequacy Framework and Market Risk; Proposed Rules and Notices*, 71 Fed. Reg. 55829 (Sept. 25, 2006) (“*Basel II NPR*”).

[2] A “retail” lease under the NPR is defined, in relevant part, as an exposure “that is managed as part of a segment of exposures with homogeneous risk characteristics, not on an individual-exposure basis, and is . . . an exposure to an individual or company for business purposes if the bank’s consolidated business credit exposure to the individual or company is $1 million or less.” *Basel II NPR*, 71 Fed. Reg. at 55918.

[3] *Basel II NPR*, 71 Fed. Reg. at 55928.

finance industry is forecast at $234 billion in new business volume. The estimate of lease outstandings approaches $1 trillion.

ELFA's members provide significant value to the economy by offering leasing and financing products to both large and small companies. The industry facilitates the growth and expansion of commercial business in the U.S. by providing lease financing for equipment, thereby reducing capital investment and the risk of equipment obsolescence on the part of the lessee.

Equipment finance organizations provide access to financing for all businesses, including a segment of the market that is typically less sophisticated and has fewer options to meet their finance requirements. These organizations are credit-worthy, but often lack broad access to sources of capital. Many small organizations, with limited sources in the marketplace to meet their financing needs, are dependent upon the leasing product. In fact, a survey of U.S Small Business Administration state small business winners indicates that, in 2006, 86% of such companies lease-finance at least some of their equipment needs. Leasing offers an attractive option, especially for small businesses, with lower monthly payments as compared to a loan, based on equipment usage and value.

How Financing Leases Work

A financing lease provides the lessee with an attractive option to pay for a portion of the equipment through the lease rental stream, without having to purchase the equipment in full. In the financing of equipment, a lease provides the user (lessee) with the ability to pay for a portion of the equipment through the lease term, without necessarily having to pay for the full value of the equipment during the initial term of the transaction. The equipment being leased is for commercial purposes and is used in the lessee's business.

One of the benefits to the user (lessee) of leasing versus buying the equipment is that the lessor ascribes, at lease inception, an end-of-term value to the equipment. The value is determined after research and analysis conducted by individuals having experience with that particular market and equipment. Therefore, the lessee only pays for a portion of the value of the equipment through the rental stream. At the end of the lease term, the lessee can determine if it is in its best interest to purchase the equipment, extend the lease term, or return the equipment. The customer is able to mitigate the danger of obsolescence in this manner, with the lessor assuming the risk through the assignment of end-of-term value and providing end-of-term options to the lessee.

Leasing is especially attractive to small businesses because they are able to have the use of the equipment without having to provide a substantial investment up front for the purchase. If they purchased the equipment through a traditional loan financing, the customer would be required to provide a significant down payment, resulting in greater cash expense when compared to the lease.

As further detailed below, it is important to note that unlike equipment secured loans, the equipment values in lease transactions are not only continuously monitored but actually adjusted for decline in value. Similar to a "mark-to-market" approach, equipment residuals are written down at the time permanent impairment is recognized. This provides a more timely monitoring process than experienced with secured lending.

It should be noted that the foregoing description applies equally to whole and retail leases.

The NPR's Treatment of Retail Lease Residual Risk-Weighting

The proposal to apply a 100 percent risk weight to the residual portion of a retail lease transaction, as currently set forth in the NPR, will result in a significant disadvantage to regulated leasing organizations in the U.S. The playing field will be more challenging and costly, and accordingly, non-competitive for regulated bank and bank-related leasing and finance organizations. This risk weighting and resulting additional capital charge will make the commercial leasing product non-competitive when compared to the economic capital requirements of a commercial loan with similar risk attributes, causing the institution to allocate capital to the "less expensive" loan product vs. the lease. We believe this will result in a significant decline in the financing alternatives available to small businesses that will no longer have access to the same equipment finance products.

This small business customer base would suffer the most significant financial impact of the higher risk weighting of lease residuals as these companies lack the capital to purchase equipment outright, would most likely incur the cost of a down payment on a loan and would no longer have as attractive a lease financing option available due to the additional cost of funds assessed on the lessor. This customer segment of the leasing industry represents a significant component of the U.S. business economy.

A Proposed Alternative Treatment of Retail Lease Residual Risk Weighting

ELFA respectfully submits that retail lease finance transactions, just as with wholesale leases, should be treated on a unified basis with no separate risk-weighting of the residual component. As we have explained above, equipment leasing and finance organizations underwrite and manage both wholesale and retail leases on a unified basis, providing credit underwriting analysis and ongoing risk management oversight for lease transactions throughout the term of the lease. The residual component of an equipment lease transaction, whether it is small- or large-dollar in value, is managed within or as part of the overall lease transaction. Risk management practices evaluate the entire exposure at risk, including the rental stream and the residual value. These components should not be separated for regulatory purposes.

The management of the residual component occurs throughout the lease term: specifically, prior to the lease commencement or at underwriting; during the term of the lease and at end of the lease term. The asset management process includes determining the current and future value of the particular equipment being leased prior to lease inception. Throughout the lease term, equipment values are monitored, and if necessary, impairment charges are taken to reflect accurate values, as per accounting policy further discussed below. Near the end of the lease term, the asset management process includes identifying sources for equipment sale and working with the lessee to determine their equipment needs.

Equipment values are reviewed on an ongoing basis to determine if residual positions are accurate, and the overall risk ratings and Loss Given Default (LGD) reflect this information. Applying a separate capital allocation for the residual component is overly conservative as the risk is already captured and reflected in the Probability of Default (PD)/LGD Basel framework. Additionally, U.S. GAAP requires that the residual value of a lease, or portfolio of leases, reflect the lower of cost or fair value. When permanent impairment is identified in the residual or residual value estimates are otherwise revised, the result is reflected in the net investment of the transaction during the lease term. Therefore, any impairment or other residual value changes are accurately factored into the Facility Rating (FR) and LGD at the time the changes are identified.

In practice, equipment finance companies manage lease transactions and equipment in order to maximize the gain on sale of equipment, over the booked residual. The value of the equipment in excess of the booked residual is recognized as an equipment gain at the end of the lease term. Lessors actively manage the end-of-lease process to help ensure that they obtain gains (realized value in excess of booked residual) for the equipment. Lessors consistently realize gains on the sale of the equipment in excess of the booked residual on a portfolio basis.

The lease product does not represent a higher level of risk to the financial institution than a secured loan to finance the acquisition of the equipment, and, therefore, the lease product should not be penalized by applying a more conservative risk weighting approach to the residual component. By doing so, the impact reaches far beyond the companies offering the financing.

We appreciate your consideration of our views in this matter. We are prepared to meet with you to discuss it further, if necessary.

Sincerely,

Kenneth E. Bentsen, Jr.
President