July 15, 2005

Re: Calculation of Risk Weights for Residual Value Purposes
International Convergence of Capital Measurements and Capital Standards, Paragraph 524

The Equipment Leasing Association ("ELA") wishes to voice its strong objection to the proposed method of calculation of risk weights for residual values under leasing contracts as defined in the June 2004 report entitled "International Convergence of Capital Measurements and Capital Standards" (the "Accord").

Organized in 1961, the ELA is a non-profit association that represents companies involved in the dynamic equipment leasing and finance industry to the business community, government, and media. ELA's diverse membership consists of independent leasing companies, banks, captives, financial services corporations, broker/packagers and investment banks; as well as service providers like accountants, consultants, equipment managers, executive recruiters, insurance companies, lawyers, publishers, and software providers. ELA promotes the leasing industry as a major source of funds for capital investment in the U.S. and other countries. Headquartered in Arlington, Virginia, ELA is a national organization with more than 800 member companies and a staff of 25 professionals. In 2005, equipment leasing is estimated to be a $248 billion industry.

The ELA maintains a Basel Accord advisory group to inform members of ongoing issues and developments. Members have voiced their concerns over the establishment of a flat 100% risk weight on residual positions which does not reflect the realities of the marketplace in terms of underlying equipment value and attendant historical returns.

Under Paragraph 524 of the Accord, the risk weight on leases with residual values is calculated as the sum of a) the risk weight attached to the discounted lease stream payments (i.e. lessee financial strength) and b) a risk weight of 100% on the residual value amount. The ELA suggests amending this paragraph such that the risk weight attached to the discounted lease payment stream and the residual value are both based on the lessee's financial strength thereby eliminating the fixed 100% risk weighting on residual values. This will ensure the risk weight applied to the residual position more accurately reflects the true risk of the transaction.

In our opinion, the risk weight associated with residual values should be the same as the risk weight applied to the lessee's financial strength for several reasons:

1) The 100% risk weight on residual positions does not adhere itself to one of the Accord's primary objectives of establishing "significantly more risk-sensitive capital requirements that are conceptually sound…"[1] The current one-size fits all approach ignores the realities of the leasing industry. Our proposal introduces risk sensitivity into the residual value risk weighting process in keeping with the Accord's stated goals. A comparison of our risk sensitive recommendation and the Accord's current proposal is attached as Appendix "A".

2) Lessors have historically assigned conservative residual values in transactions resulting in consistent gains on un-guaranteed residual positions. This is a core competency in the leasing industry, which, we believe, the Accord should recognize. Residual realization results are traditionally used in lessor pricing models and are demonstrably more in line with the actual risks undertaken. Also, should impairment be encountered during lease term the residual position would be written down at that time as per GAAP accounting requirements. Accordingly, the application of a fixed risk weight does not give full recognition to the existing mitigating practices and validating results within the industry.

3) The current charge may encourage lessors to enter into higher risk transactions as the residual risk weight may, in many cases, be lower than the risk weight of the lessee, thereby positively affecting the capital charge and potential pricing of the transaction. Conversely, financially stronger lessees may be penalized, as the residual risk weight may be significantly higher than the lessee's financial strength and corresponding risk weight. This could result in bank owned lessors being placed in a disadvantaged position when evaluating lower risk, higher quality transactions compared to an independent lessor not subject to the Accord's regime.

4) Leasing products will be disadvantaged vis a vis comparable bank loan products. The static risk weight applied to a lease residual position may skew the lease transaction's capital charge calculation. The result would be a lower capital charge applied to a loan over an equivalent risk lease. Please see Appendix "B" for an example.

[1] Basel Committee, "International Convergence of Capital Measurement and Capital Standards" Paragraph 5

5) On an operational note, the amended calculation is easier to apply and reduces the need for a two-tiered risk weight calculation.

6) Supervisory monitoring can be easily performed as residual positions are closely tracked with ongoing data readily available.

7) The amendment may only have a minimal effect on the overall Accord but its significance to the leasing industry cannot be underscored. This change reflects proven industry practices.

Our recommendation provides an accurate and realistic approach to calculating the true risk associated with residual values and eliminates certain disadvantages currently housed in the Accord. In addition, it reduces the additional burden of double calculation while respecting the Accord's guiding principles.

On behalf of our members, we urge you to adopt the proposed amendment as an indicator of risk measurement in the leasing marketplace.

We would be pleased to meet with you or your representatives to discuss this matter further. We thank you in advance for your consideration.

Sincerely,

Michael Fleming

Michael Fleming, CAE
President
Equipment Leasing Association

APPENDIX A

RESIDUAL VALUE CALCULATIONS
BASEL II ACCORD versus ELA PROPOSAL
(millions of dollars)

Lease Types	Lease Portfolio Residual Portion Only	Basel II Capital Calculated @ 8% Column "A"	ELA Proposal (Use Obligor risk weighting) Column "B"	Difference Value / Percentage Column "C"
Small/medium Ticket - Retail	650	52	44	(8) - 15%
Large Ticket	500	44	31	(13) – 29%
Totals	1,150	96	75	(21) – 22 %

This sample portfolio, provided by an ELA member, outlines the residual portion of a portfolio of small-, medium-, and large-ticket leases.

The risk weightings and resultant capital charges applied to this residual portfolio are calculated using the two methods described in Columns "A" and "B":

Column A: Accord's flat 8% capital charge (i.e. 100% risk weighting on residuals), and
Column B: ELA's application of the lessee's financial strength risk weight (i.e. obligor risk weight) to the residual value component. The numbers above were provided by our member using PD/LGD model.

The differences, expressed in capital as well as percentages, are noted in Column "C".

The ELA's proposal results in a 22% reduction in required capital for this portfolio. Since the residual value risk weight is now calculated in the same manner as that of the lessee's financial strength, it indicates that this is a portfolio of financially strong lessees.

Conversely, should the risk weighting of a lessee's financial strength result in a capital charge in excess of 8% (i.e. financially weaker lessees), the required capital allocation under the ELA proposal for the residual portion would also exceed 8% in keeping with the use of the obligor risk for both components.

The above discussion relates to residual value only. Changes in required capital for complete lease transactions (i.e. lessee financial strength + residual value) will not be as dramatic given the small residual component in most transactions.

This alignment of the residual risk capital calculation with that of the lessee's financial strength is more in line with the Accord's objectives. Financially stronger arrangements benefit from this approach while weaker transactions require more capital in keeping with the increased risk.

APPENDIX B

Basel II Risk Weights

Loans versus Leases with Residual Positions

Asset Type	Exposure (000's)	Asset Capital*	Credit Capital**	Total Capital*** Required
Loan	100	None	4	4
Lease	100	1.6	3.2	4.8

NOTE

- The obligor is assumed to be the same for both the loan and the lease.
- The lease exposure includes Booked Residual Value of 20 %

* Asset Capital is the amount of capital assigned to the residual portion of the lease (i.e. Exposure of 100 X 20%) X 8% capital = 1.6 % capital

** Credit Capital is the amount of capital assigned to the obligor's financial strength using the PD/LGD formula. In this example the loan has a capital requirement of 4%. The lease, which only apportions 80% to the obligor risk due to the 20 % residual component, has a capital requirement of 3.2%.

*** Total Capital Required is the sum of Asset Capital and Credit Capital.

In our opinion, an asset supported by a lease agreement is analogous to a loan with a balloon payment at the end. However, the lease is in a superior position as it has direct ownership of the asset. Lessor historical experience indicates that the loss experience on asset disposals is less than the assumed LGD due to the lessor's ability to deal with the asset to protect and optimize value.

The total required capital for the same obligor under both asset types indicates that more capital is required for a lease than a loan. Consequently, leases with residual positions are disadvantaged under the Accord. Applying the obligor risk weighting to both the payment stream as well as the residual position would eliminate this distortion.