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Comments on IFRS 16 Leases - Endorsement advice

We are pleased to provide BNP Paribas' comments on EFRAG's Draft Endorsement Advice of IFRS 16 Leases.

BNP Paribas, Europe's leading provider of banking and financial services, has four domestic retail banking markets in Europe, namely in Belgium, France, Italy and Luxembourg.

It operates in 74 countries and has a balance sheet of 2 077 billion euros at 31/12/2016.

BNP Paribas holds key positions in its two main businesses which are Retail Banking and Services and Corporate and Institutional Banking. We are an actor in all fields of leasing, as shown by our activities:

- As an equipment lessor in 21 countries through our subsidiary BNP Paribas Leasing solutions which wrote over 308 800 new leases in 2016, and through equipment leasing activities carried out in our retail banking activities in varying locations
- As a vehicle fleet lessor and manager through our subsidiary Arval, present in 28 countries which manages a total fleet of more than 1 028 000 vehicles
- As a property lessor through our investment Solutions division, which includes property management and investment activities and property portfolios held by our insurance companies
- As a property lessee for a portion of our retail branches and head office and administrative locations, throughout the world
- As an equipment lessee for a portion of our office, IT and general business equipment.

We are therefore impacted by IFRS 16 as both lessor and lessee as already highlighted in our comments to the Preliminary Consultation Document of EFRAG in December 2016.

We appreciated the preliminary analysis conducted by EFRAG regarding this endorsement which gave EBA the opportunity to provide a qualitative and quantitative analysis of this standard for the institutions and its views on the expected prudential impacts based on the current prudential framework. We also appreciate the Ex ante Impact assessment of IFRS 16 performed by "Europe Economics".



While we acknowledge that the prudential consequences of an accounting standard go beyond EFRAG's prerogatives, we do believe that the interaction between accounting and prudential requirements must be taken into account in assessing whether a standard is conducive to the European public good, which encompasses, according to our understanding, the impacts of a standard for the European economy.

Indeed, the interaction of an accounting standard with regulatory requirements is important for the banking industry as the cost of capital requirements affect its lending capacity.

EBA qualitative analysis on the prudential impacts enables to alleviate the uncertainty regarding the prudential treatment of the Right of Use asset, notably by highlighting that the RoU asset has to be considered as a tangible asset, if the underlying asset is tangible¹. This point is fundamental for the banking industry as intangible assets shall be deducted from prudential own funds. We however would prefer that such analysis is fully confirmed in the appropriate EU regulatory framework in order to avoid any uncertainty

Based on EBA comment letter on EFRAG's Preliminary Consultation Document and to the ex ante Impact assessment, we note that EFRAG has not identified conclusive evidence that indicates that IFRS 16 would pose a risk to financial stability in Europe.

We however would like to draw EFRAG's attention on the following points:

- Together with other prudential measures, this standard adds a further pressure on banks' capital levels, and hence on their lending capacities,
- The banking industry appears not be the industry the most affected by the lease standard based on the ratio of Present Value of operating leases to total borrowing². However this ratio is not representative of the impacts on capital requirements of the banking industry.
- EBA estimates that the « impact of IFRS 16 to EU banks is of rather limited significance depending mainly on the materiality of the RoU assets compared to the existing assets of a bank ». Nevertheless as the implementation of IFRS 16 is only at an early stage, we cannot exclude that the First Time Adoption impacts of this new standard may be different from this first analysis. The extent of the impacts will mainly depend on two factors: i/ the size of the network of bank agencies subject to leases and tangible assets subject to leases, ii/ the lease term assessment.
- The lease term will be directly affected by the legal environment and by the judgment required in assessing whether a lessee is reasonably certain to exercise an option to extend a lease, or not to exercise an option to terminate a lease, based on facts and circumstances. As the standard is not yet implemented, we have no reliable view on the extent of this issue. It shall be noted however that property lease in France are “baux 3/6/9” and would probably be considered as having a 9 years term.

¹ Cf. the appendix of *The EBA's views on the adoption of International Financial Reporting Standard 16 Leases (IFRS 16)*: «The EBA considers that the same treatment as for finance leases under IAS 17 could be followed under IFRS 16 for RoU assets and therefore considers for prudential purposes all leased assets (RoU and those similar ones to finance leased assets under IAS 17) as tangibles - if the underlying asset is tangible.»

² Cf. *Ex ante impact Assessment of IFRS 16 22 February 2017 conducted by Europe Economics*



We furthermore fully support EBF letter and proposition regarding prudential requirements for operating leases of lessees. EBF proposes to make a distinction in the prudential treatment between operating leases and financial leases (based on the transfer of risks and rewards), which would preserve the current treatment of leases for solvency, leverage ratio and NSFR until the interaction between accounting and regulatory treatment is fully addressed and analysed.

Finally, although considered and reflected in the Draft Endorsement Advice, we reiterate our comments emphasised in our response to EFRAG's preliminary Consultation document regarding the disadvantages and potential risks raised by IFRS 16 for the lease industry, reinforced by the option of an early application.

Should you have any questions regarding our comments, please do not hesitate to contact us.

Yours sincerely,

Lars Machenil