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Comments on EFRAG's Preliminary Consultation Document regarding the endorsement of IFRS 16 Leases

We are pleased to provide BNP Paribas' comments on EFRAG's Preliminary Consultation Document regarding the endorsement 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 75 countries and has a balance sheet of 1 994 billion euros at 31/12/2015.

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 297 000 new leases in 2015 for an amount of 10.6 billion €, 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 27 countries which manages a total fleet of more than 949,000 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 and we are pleased to be given this opportunity to comment the Preliminary Consultation Document of EFRAG regarding the endorsement of IFRS 16 Leases.

We appreciate the preliminary analysis conducted by EFRAG regarding this endorsement.



Our main comments on the questions raised by EFRAG are the following:

- IFRS 16 is expected to have some impacts on prudential ratios of the banking industry (on solvency ratio, leverage ratio and NSFR mainly). The extent of the impacts will mainly depend on two factors: i/ the size of the network of bank agencies subject to leases and ii/ the prudential qualification of the ROU asset. It is therefore important that an impact assessment is conducted by EFRAG or European agencies and that any ambiguity and regulatory uncertainty is removed well in advance of the application of this new standard.
- As regards the leasing industry, the application of IFRS 16 raises a certain number of disadvantages and potential risks, reinforced by the option of an early application, as detailed in our comments to question 8.
- Furthermore, we advocate for a revision of the dispositions of the standard regarding the impacts to be recognised in P&L by lessees of operating lease (cf. also our comments to question 11) to enable a linear recognition of lease expenses.

We also have these less impacting comments:

- The requirements for the lessees to disclose expenses related to short term leases and low asset value leases subject to the exemption represent an additional operational challenge to identify the amounts at stake and we question the usefulness of this information for which the cost of providing it could largely exceed the benefits.
- The banking industry proposes leases of intangible (licences of intellectual property) as part of retail banking and services activities even if not necessarily material. We do not understand why these transactions are excluded from the scope of IFRS 16, as the application of the standard IFRS 15 Revenues from contracts with Customers leads to similar impacts in financial statements.

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

Yours sincerely,

Lars Machenil



1. Do you have any information or evidence on the extent to which leases (that you are party to or otherwise aware of) will be eligible for each of the short-term and low-value assets exceptions identified in paragraph 24? If so, please provide details.

If you are a preparer, do you expect to use the exceptions? If so, please:

- (i) quantify the number and annual lease payments for each category;
- (ii) indicate the proportion of your leases (by volume and/or value) you estimate to be covered by each of the exceptions.

- As a preparer, we intend to use the short-term and low-value assets exceptions. This will enable to ease the inventory of contracts and the application of the standard IFRS 16.
- The low-value exemption should mainly be used for office equipment (tablet, personal computers, small office furniture and telephones).
- As most leases have a term of 12 months or more, they will not qualify as short term leases.
- At this stage we haven't yet estimated the amount of leases subject to these exceptions.
- We consider it is relevant to provide an exemption for these contracts as the cost of IFRS 16 accounting for these assets would largely exceed the benefits.
- Indeed, recognising a Right Of Use asset ('ROU') and a lease liability for short term contracts or low asset value would not bring useful information to users and would not significantly affect the information provided in the financial statements.
- However requirements to disclose expenses related to short term leases and low asset value leases represent an additional operational challenge to identify the amounts at stake and we question the usefulness of this information for which the cost of providing it could largely exceed the benefits.

2. If you are a preparer, which approach to transition do you expect to take? Please explain your reasons for this decision.

- As a preparer no decision has been taken yet regarding the transition approach to be applied.
- It might be overly burdensome and costly to apply the full retrospective approach. Indeed, we are likely to be in a situation of having lease contracts as lessees in multiple site entities, with a high number of lease contracts and a real complexity to determine the historical borrowing rate to be used or the interest rate implicit in the lease (notably for real-estate leases).

4. EFRAG is interested in understanding whether leases of intangible assets (other than rights held by a lessee under licensing agreements within the scope of IAS 38) are common. Do you have any information or evidence as to how frequently such leases of intangible assets arise in practice? If so, please provide information about the types of intangible assets that are subject to leases and the significance in operating and monetary terms.

- As an equipment lessor through our subsidiary BNP Paribas Leasing solutions we lease some intangible assets which are mainly licences, for terms between two and four years. These leases of intangible assets are not expected to be material in regards with our balance sheet.
- According to the criteria of IAS 17 or IFRS 16, these contracts would mainly be considered as finance leases, although there are excluded from the scope of those standards for lessors.



- If we apply accounting principles as detailed in IFRS 15 the promise to grant a licence that provides a customer with a right to use the licence would be represented by a contract asset in the financial statements and interest revenue over time (time value considered when recognising upfront revenue).
- These transactions are financing transactions however they are excluded from the scope of IFRS 16. We consider that the accounting treatment described above would not provide users with more relevant information, nor would it properly depict the contractual substance of these transactions.
- For these reasons we consider that these transactions should be within the scope of IFRS 16 and represented as lease receivables.

6. Do you have any views or information on how IFRS 16 can be expected to affect the behaviour of investors and/or lenders? If so, do you have any views or information on whether and how IFRS 16 could, for European companies that apply IFRS, positively or negatively affect:

- (i) the overall cost of capital;
- (ii) access to finance and cost of credit?

Please provide any available evidence.

- The requirements for the lessees to recognise a ROU and a lease liability for lease contracts may affect the purchase policies and arbitration between leases or purchases. It may lead to reconsider the terms of the leases and reconsider the offer of service.
- Regarding the cost of credit, as a lender providing loans facilities subject to covenants ratios, the impact of IFRS 16 will depend on whether the clients of the banking industry are themselves subject to IFRS and on the characteristics of the loans agreement. Loans agreements may contain clauses establishing a renegotiation of the covenants in the case of a change in accounting standards. Alternatively, in the absence of such clauses and in the case of breaches in covenants ratios due to the change in the lease standard, some waivers or contracts renegotiations should normally be expected.
- The overall cost of capital of this standard for the banking industry can be assessed through the impacts on prudential ratios (Confer also our comments to question 10).

7. Do you have views or information on how IFRS 16 might affect entities' use of leasing? For example, do you expect lessees to:

- (i) reduce their use of leases with a corresponding increase in purchases of assets;
- (ii) reduce their use of leases without a corresponding increase in purchases of assets;
- (iii) seek to change the terms of new or existing leases?

Please provide any available evidence.

- Cf. our comments to question 6.



8. Do you have any additional information or views on how the endorsement of IFRS 16 can be expected to affect the leasing industry in Europe? EFRAG is particularly looking for views from the leasing industry.

Please provide any available evidence.

- The lease industry (and particularly the leasing of vehicles which is part of retail banking and services activities) is expecting their clients who apply IFRS to ask for more detailed information on the contracts.
- This is becoming a worrying situation as many clients are considering an early application of IFRS 16, in order to apply this standard at the same time as IFRS 15, which is applicable for annual reporting periods beginning on or after from 1 January 2018.
- These clients are relying on the leasing industry to give them the appropriate information needed to apply IFRS 16 and are thus somehow carrying forward part of the cost of implementation of the lease standard to the lease industry. Indeed, the information to be provided to clients are complex due to the dispositions of the standard related and notably those related to the discount rate to apply, the identification of lease payments to be considered for the determination of the lease liability and the corresponding right of use asset, the determination of the lease terms and the dispositions relative to leases modifications
- If the lease industry is not able to meet their clients' requirements, the clients could try to find alternative financing solutions which may be more costly for them and could increase their level of indebtedness, in comparison with a financing through a lease (instead of having a lease liability representing only discounted future lease payments, they would need to finance the whole asset value, including the residual value).
- The remaining time available for the lessors to develop the appropriate IT systems and be ready to deliver the expected information to the clients (lessees) is too short and the analysis of the standard has started but some discussions are still on-going to ensure a proper understanding of the standard (for example on dispositions on modifications).
- Furthermore, we advocate for a revision of the dispositions of the standard regarding the impacts to be recognised in P&L by lessees of operating lease (cf. also our comments to question 11) to enable a linear recognition of lease expenses in order to simplify these dispositions of the standard. Beyond the cost issue of the IFRS model, these dispositions seem to create an issue for the clients who could prefer an amortisation expense over the lease term and could therefore move away from operating contracts (independently from the obligation to recognise a right of use asset and a corresponding lease liability).

10. Do you have any information or views on whether IFRS 16 is likely to endanger financial stability in Europe?

Please provide any available evidence.

- IFRS 16 is expected to have some impacts on regulatory ratios of the banking industry based on the current prudential framework (solvency ratio, leverage ratio and NSFR mainly) whereas the changes in the accounting standards do not reflect any change in the risk profiles. The extent of the impacts will mainly depend on two factors: i/ the size of the network of bank agencies subject to leases and ii/ the prudential qualification of the ROU asset.
- Beyond the size of the network of bank agencies, the amount of ROU asset will depend on the lease term. 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.

- For prudential purposes, intangible assets are deducted from prudential own funds and have therefore significant impacts on solvency ratio. It is therefore fundamental that we obtain a clear confirmation from the regulator, through a Q&A for example, that the ROU will not be considered as an intangible asset for prudential requirements, in order to remove any ambiguity and regulatory uncertainty.
 - If the ROU asset was considered as an intangible asset by the regulator, the impacts on prudential ratios would be material and could represent an issue.
 - If the ROU asset is not considered as an intangible by the regulator, it will affect the solvency ratio but to a lower extent (if ROU weighted at 100%).
- In any cases, IFRS 16 will also affect the leverage ratio and the NSFR ratio.

11. What is your view on the relative costs of applying IFRS 16 and US GAAP? Do you have any other views as to the advantages or disadvantages of IFRS 16 compared to US GAAP? Please provide any available evidence

- The main differences between IFRS and US Gaaps relates notably to provisions for leases of low-value assets and the requirements for lessees’ accounting of operating leases.
- As a consequence, applying IFRS 16 could be more complex than applying US Gaaps mainly as:
 - Accounting in P&L is not the same,
 - the disclosures requirements could be different for leases of low-value assets.
- Regarding the first issue, according to IFRS 16 principles, the interest margin of lessees will be affected, whereas it will not be the case in US Gaaps (in IFRS, lease rentals will be somehow split between interest expense and depreciation, compared with a simple spreading of the expense in operating expense over the lease term in US Gaaps).
- Regarding disclosure requirements, as there is no exemption under US Gaaps for leases of low-value assets, no specific disclosures might be requested. Indeed, we understand that the FASB believes that an entity will be able to adopt a reasonable capitalization policy under which the entity will not recognize certain lease assets and liabilities that are below a certain threshold. As such, no specific disclosures could be expected in US Gaaps contrary to IFRS which explicitly requires some disclosures for leases of low asset value (cf. our comments to question 1).

12. What is your view on the one-off and ongoing costs for preparers? (Please indicate whether you are (a) a lessee; (b) a lessor; (c) both a lessee and a lessor or (d) neither a lessee nor a lessor). Will preparers that already report finance leases have lower costs than preparers without finance leases? Please provide any evidence you have on the expected magnitude of the costs.

We are currently launching the lease project and we are not in a position yet to assess the total expected cost of IFRS 16 transition or future on-going costs.



14. If a lessee has to develop new systems to support the accounting for leases, to what extent do you, as a lessee, expect internal benefits from the information provided by the new information? Please quantify to the extent possible.

Do you agree with the benefits for users and preparers identified above? Are there any additional benefits for users and preparers?

Please provide any available evidence.

- At this stage no internal benefit has been identified.
- We understand that no IT tools are available so far in the market to process the information requested by IFRS 16.
- The transition process and lease contracts follow-up need to be manually performed or if we need to develop our own IT tools, transition costs could be material. Furthermore, the fact that no standardised IT tool exist will require strengthened internal controls.

16. Are there any issues that have not been raised in this Preliminary Consultation Document that should be considered by EFRAG? Please explain your view.

We think that the technical assessment of IFRS 16 against the endorsement criteria (Appendix 2 of the EFRAG's Preliminary Consultation Document regarding the endorsement of IFRS 16 *Leases*) should be more explicit on the reasons why an asset and a liability need to be recognised in the financial statements and notably in regards to the notions of the conceptual framework.