Santander
CONSUMER FINANCE

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Boadilla del Monte, November 26,2010

Ms. Françoise Flores
Chairman
European Financial Reporting Advisory Group
Email: Commentletters@efrag.org

Subject: Response to ED/2010/9 Leases

Dear Ms. Flores,

Santander Consumer Finance, as the leading Consumer Finance House in Europe and as subsidiary of Banco Santander, S.A., appreciates the opportunity to comment on the Exposure Draft Lease Accounting (ED/2010/9) (henceforth ED) and support Banco Santander, S.A. response to this ED.

We give our support to the efforts of the European Financial Reporting Advisory Group (EFRAG) and the IASB, to improve International Financial Reporting Standards, in order to provide users of financial statements with information which is of better quality and of greater relevance, thereby aiding comparability.

Current accounting model for leases has long been criticised for failing to meet the needs of users of financial statements. However, we are not convinced that some of the proposals included in the ED offer an effective improvement in comparability or provide additional relevant information to the users of financial statements and we deem it introduces very significant changes in the lease accounting treatment that might even affect the economic rationale of some types of the lease business if the final standard is not modified.

We want to express our general support to the observations and suggestions included in the draft of the EFRAG response letter, however, we have some minor dissenting opinions that will be elaborated later in the detailed answers to the questions proposed by the IASB.

As for the IASB's ED, we believe it does not really meet the reasons why it is said the current accounting model for lessees should be modified, i.e., to enhance the comparability among the financial statements of different companies and to better suit the need of users of financial statements. In this regard, although the proposed standard might make easier to put side by side the financial statements of companies with different ways of financing their properties and other significant assets, it introduces a new distortion that certainly will make harder to compare the performance of lessees in different stages of the investment cycle.

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Moreover, we consider that the proposed standard is contrary to the principle of correlation of incomes and expenses, as it introduces an artificial distribution of lease costs, that can cause the net result of a contract (the benefits obtained from the underlying asset minus the lease cost) whose expected cash flows through the term of the operation are always positive and which is expected to render an overall profit to the lessee being significantly in the red in the early years of the lease. If the lease operations are significant enough this may result in an overall profitable company making public negative results. We deem extremely doubtful that this outcome can be regarded as an improvement.

Conceptually, it seems very difficult to understand the change in the accounting treatment of the so-called right-of-use (ROU), as the definition of this ROU in the application guidance of the ED (B.4) is essentially the same that the one in the current standards (IFRIC 4.9) -which is only natural as the rights and obligations associated with a lease contract have not changed in the meantime- and the conceptual framework in which the criteria for the recognition of an asset in the financial statements are established remains unchanged.

It is said in the basis for conclusions on the ED (BC 7) that the proposals are consistent with the existing conceptual framework but none justification is offered for the change in the treatment of an item which had not been previously classified as a recognizable asset. In our opinion the characterization of the ROU of the leased item for the lease term as an asset itself does not fit in the current IFRS framework and, as we elaborate later in our response to the IASB's questionnaire, it is based on the confusion between an asset and the requisites required for its recognition in the financial statements.

Although the Board may be well aware of the problems that can arise from such as inconsistency and it is also said in the basis for conclusions on the ED that the consistency between the lease accounting model and the conceptual framework currently being developed would be possibly only once the framework project has advanced further, we deem it is an unwise approach to develop it to suit an already developed standard. It is our conviction that the framework should be established in advance of any particular standard if the purpose is to develop a high quality complete and consistent set of standards and in consequence we do find the Board's approach rather troublesome, specially taking into account that the recognition and derecognition of assets has been a highly questioned point in the aftermath of the failure of some financial institutions.

Additionally, we do not share the Board's proposal about the lessee's accounting treatment of the expenses linked to a lease contract. In short, we believe that all of them should be recognized in the lessee's income statement on the basis of a direct association with the economic benefits which are expected to arise from the leased item. In other words, if the benefits are deemed to be distributed following a straight-line pattern over the term of the lease, the same criterion should be used for the expenses. The advantages of this allocation are, in our opinion, very significant, as it is simpler for lessees to apply, it aligns the income statement and the tax treatment of leases -at least in some jurisdictions-, it reflects the way in which most lease contracts are priced and, it remains the strongest reason in favour of this approach in our opinion, the allocation of expenses reflects the pattern in which the economic benefits from the leased item are received by the lessee.

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In practical terms, this implies that the amortisation of the ROU and the liability -the obligation to pay rentals- would net to zero in the income statement through the entire term of the lease and also that, if there is no impairment of the ROU, its amount and the one of the liability would remain the same in the subsequent measurements. Although the IASB rejected in the preliminary Discussion Paper the so-called linked-approach, which has a similar impact on the profit and loss account, the reasons for that rejection -mainly, that a liability always must have a financial cost- are not, from our point of view, irrefutable and, as we will further elaborate, the same net effect can be obtained with the appropriate temporal allocation of the amortization cost of the ROU.

Finally, we agree with the EFRAG's criterion that rentals that are under the control of the lessee, such as contingent rentals on usage or performance of the asset, should not be included in the measurement of lease assets and liabilities. Moreover, in our opinion this criterion should also be applied to the other types of contingent rentals, since we believe that all kinds of them are contingent liabilities and consequently should not be included in the measurement of assets and liabilities arising from a lease.

Please find attached our comments to questions from the ED.

Thank you in advance for your consideration of these comments.

Yours sincerely.

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