

Paris, 7 December 2016

Jean-Paul Gauzès
President
EFRAG
35 Square de Meeûs
1000 BRUSSELS

**IFRS 16 – Leases
European endorsement process
ASF response to
EFRAG'S Preliminary Consultation Document regarding the endorsement of IFRS 16 Leases**

Dear Mr President,

The ASF is the professional organisation that represents specialised financial institutions in France with regard to banking law. Its business finance division brings together property and equipment leasing institutions in particular. These institutions also provide operating and finance leasing services. They carried out €27.9 billion of new lease finance transactions in the year ended 31 December 2015, and manage a portfolio totalling €80.3 billion.

Following its contributions to the preparation of IFRS 16, published in January 2016, the ASF is pleased to be part of the work undertaken by the EFRAG, which has been tasked by the European Commission with issuing an opinion on the standard's endorsement at European level.

Accordingly, we wish to make the following observations in connection with the abovementioned consultation, and consider that the related impacts on European public good should be included in the opinion that the EFRAG submits to the European Commission.

➤ **Impact of the standard on the behaviour of investors, lenders, lessees and lessors (questions 6, 7 and 8)**

Generally speaking, it is very difficult for the ASF to assess and especially quantify the direct effects that the new standard will have on the various players. However, all ASF businesses agree, as do the national accounting authorities, that the lessees concerned by the standard (listed companies that draw up consolidated financial statements) will, based on internal centralised and streamlined decision-making processes, choose between leasing and purchasing on the basis of two major factors: (i) the impact on the balance sheet, and (ii) the articulation between the lease's financial cost and its usage flexibility in terms of financing, development and investment.

By introducing notably (i) an inappropriate distinction between leases and service contracts¹ and (ii) an overly complex substantive right of substitution², IFRS 16 (i) runs counter to the current direction of the European lease finance market, specifically in operating leases, and (ii) will have a considerable impact on the business model and the behaviour of clients of institutions in Europe currently offering lease products that include services.

¹ Encouragement of major companies to discontinue leasing in favour of purchasing and services (move to recognise the same economic reality as a purchase and/or service contract rather than a lease contract).

² The substantive right of substitution application conditions are so rigid that they will prevent efficient management of assets, harming both lessee and lessor and, more widely, economic activity.

For many years these institutions³ have been structuring their offerings and developing partnerships⁴ with a view to meeting the expectations of all of their customers (not all of whom are listed companies that draw up consolidated financial statements), who increasingly require an all-in service and are less and less attached to ownership; this is a real trend today that can be summed up by the phrase "from ownership to usage".

Given increasing demand and the flexibility of the offering, lease financing today represents a key financing and investment method for European companies and for Europe's economy. In 2015, Europe had the world's second largest leasing market (€315 billion in new financing, up 9%), outstripping the United States (€244 billion, up 4%)⁵.

It is essential that the EFRAG draws the European Commission's attention to the risk that the standard's endorsement could impair the functioning of the lease financing market. It would lead to a calling into question of the lessors' offering and have a profound impact on the nature of information supplied to lessees, raising complex IT and commercial issues. These impacts would concern all companies that have relationships with European leasing institutions and, as a knock-on effect, impede the financing of and investment in Europe's real economy and undermine its flexibility and responsiveness.

➤ **Non-application of the standard to SMEs**

While the ASF is well aware that the initial purpose of the reform that has been presented as an improvement of the comparability of large listed companies' financial statements. But the adoption of the standard in the European Union would pose a severe risk of contagion from the new standard to areas outside its scope.

From the outset, the ASF has stressed the importance of excluding SMEs from this standard's scope because of its conceptual complexity and practical issues surrounding its implementation. Unfortunately, current discussions underway with experts of major French companies on these questions bear out this conclusion. IFRS 16 is not tailored to SMEs. It is too complex and costly. It would therefore be inappropriate to apply it to SMEs.

Whereas the IASB does not state its position, leaving it to the relevant national bodies to decide whether to introduce the standard into national legislation, it strikes us as essential that the EFRAG takes a stand at European level.

Moreover, we believe that in the current context of Brexit, which raises legitimate questions about the IASB's governance and the EU's effective weight, a lack of response on this point would be unacceptable to the European Commission.

We therefore think that it would be wise and prudent for the EFRAG to expressly recommend in its opinion that Member States ensure that they do not apply IFRS 16 directly to SMEs, and that the standard does not spread indirectly to SMEs' financial statements.

➤ **Prudential treatment of the "Right of use" (ROU)**

The Basel Committee – an international organisation – has been consistently lobbied to state a position on the prudential treatment that it intends to apply to the ROU. The banking and financial sector needs confirmation from the Basel Committee that the ROU's prudential treatment will be consistent with the classification of a lease contract's underlying asset as tangible or intangible.

Moreover, decisions are pending on other prudential questions, concerning the ways of treating the ROU when calculating solvency, leverage and liquidity ratios.

³ It should be borne in mind that these are the only institutions capable today of combining in a single offering financial components, physical assets and services, and thereby providing access to finance and investment in such an adaptable, flexible way.

⁴ With manufacturers and industrial companies producing all types of materials and with suppliers of all types of service.

⁵ Source: Leaseurope.

It strikes us that at a time when the EFRAG has been asked by the European Commission to issue its opinion on the endorsement of an international standard, particularly with regard to European public interest, it needs all the applicable prudential rules at its disposal so as not to skew analysis and especially the cost analysis. The stakes for French banks, most of whose branch networks are leased, are considerable⁶.

It is therefore essential to find out what the ROU prudential treatment will be before deciding whether or not to apply the standard in Europe. For this reason we believe that the EFRAG should only submit its opinion once a response has been received from the Basel Committee.

Therefore, given the reserves we expressed, should the EFRAG recommend to the European Commission to adopt the IFRS 16 standard and the Commission choose to follow the EFRAG opinion, an implementation delay for lessees would be appropriate in order to limit their costs.

I would like to thank you in advance for considering and acting on the content of this letter.

Yours sincerely,



Françoise Palle-Guillabert

⁶ The cost to be borne in equity by the institutions could have a substantial impact on their customers' finance costs.

