European Banking Federation

Chief Executive

Ref.: EBF_003943

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Brussels, 11 September 2013

Subject: ***EBF Comment Letter on the IASB Exposure Draft - Leases***

Dear Mr Hoogervorst,

The European Banking Federation[1] (EBF) appreciates the opportunity to provide comments on the Exposure Draft (ED) *Leases*. The lease proposals impact the banking industry, as banks act both as lessee and lessor, on a variety of types of lease, for example, of property, office equipment, or as part of structured client transactions. Consequently, the EBF is supportive of the objective to achieve a sound conceptual standard for the accounting treatment of lease contracts.

The 2010 proposals raised significant concerns from many industry participants as to the practicability of the requirements, and whilst the EBF welcomes the decision to reconsider many of these issues, we remain highly concerned about the complexity of the current proposed model for both lessees and lessors.

Our primary concerns are as follows:

- ***Project objectives***
  The objective of the project is to improve the quality and comparability of financial reporting, by providing greater transparency about leverage, assets used in operations and the inherent risks. We do not believe that these objectives have been met. The proposals would require information in respect of leases to be presented in different balance sheet and income statement lines, and so would decrease transparency. Nor do we believe that the dual model accurately or consistently represents the risks in different leases. If the proposals are not an improvement on IAS 17 'Leases' in terms of the understandability of the information provided, we do not believe they should be pursued.

[1] Launched in 1960, the European Banking Federation is the voice of the European banking sector from the European Union and European Free Trade Association countries. The EBF represents the interests of some 4,500 banks, large and small, wholesale and retail, local and cross-border financial institutions. Together, these banks account for over 80% of the total assets and deposits and some 80% of all bank loans in the EU alone.

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- ***Conceptual issues***
  - While we appreciate that the IASB addressed some of the concerns raised with the 2010 proposals, the revised proposal includes several conceptual issues and inconsistencies which add complexity and thus result in a lack of transparency for users.

  - The dual accounting model, with the proposed basis for classification between type A and type B leases based on the level of consumption is also complex and introduces a new bright line, which is less clear than the well-understood finance/operating lease divide in IAS 17.

  - There is still a lack of clarify on how to distinguish a lease from a service contract, which is more important if all leases must be on balance sheet. This flaw affects also when classifying into type A or type B and property or non-property leases. This is another failure of the proposal since opportunities for structuring will remain. These structuring opportunities will depend on how lease agreements are written regarding lease terms, options for prolongations, etc. Although the Basis for Conclusions notes the incentive for structuring is expected to be small, similar lease agreements could still be accounted for differently depending on judgments made when classifying contracts into type A or type B.

  - As expressed in our response to the 2010 proposal, the IASB must aim at establishing a single model for lessor accounting that is consistent with lessee accounting. This is very important for the banking industry as many banks are at the same time lessees and lessors. The ED fails to achieve this.

- ***Disclosures***
  The proposal contains extensive disclosure requirements for both lessees and lessors. New systems would be required to capture and monitor the data, and would require a significant ongoing effort. These requirements are more extensive than if an asset has been acquired by hire-purchase or by loan financing, for example. If the new presentation is meant to improve transparency about lease assets and related risks, we question why such extensive disclosures would also be required.

- ***Cost/benefits***
  The proposal is lacking a cost/benefit analysis validating that the proposed new rules will lead to substantial improvements, in comparison with retaining and revising IAS 17. Implementing the proposal will require significant systems changes and resources to comply, yet we do not believe that the proposal will result in more decision-useful information compared to the current standard.

- ***Regulatory implications***
  There also remains uncertainty about the classification of the right of use asset which will have wide reaching regulatory implications. This uncertainty is an important concern for the European banking industry. Banks often act as lessee in significant lease contracts, particularly of property e.g. bank branch networks and office buildings. Today, banks are not required to hold any regulatory capital for such leases which are classified as operating leases. However there is concern that the new assets should be treated as intangible assets, potentially resulting in a 100% deduction from regulatory capital. The

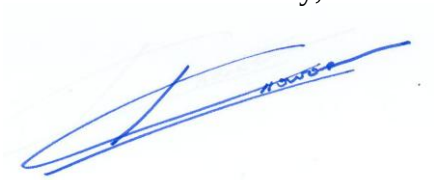
industry is in need of certainty that the right of use asset is a tangible asset, and while this is not a focus for the IASB, we would appreciate if the IASB could be sensitive to this issue, and make the intention of the standard clearer. For example, the ED refers to amortization, as for an intangible, but otherwise references to IAS 16, as for tangible assets.

Consequently, the EBF cannot support the proposals in the ED, as we do not believe these provide a sound conceptual basis for lease accounting, nor do they offer a significant improvement on current practice.

In light of the substantial concerns expressed above, the EBF strongly encourages IASB to further reconsider the current proposal. In this respect and considering that the IAS 17 standard works well, the EBF recommends – in consistency with EFRAG's view – improving supplementary disclosures within the current model under IAS 17 in the short term, whilst more work is done within the conceptual framework on the nature of the right of use asset and the residual asset, on whether economic compulsion is relevant to the determination of a liability, the difference between executory contracts and leases, the presentation of interest on financial instruments, and further consideration is given to the relevance of the rate of consumption of an asset to its accounting.

We appreciate your consideration of our comments and remain at your disposal to elaborate further on our views should you wish so.

Yours sincerely,



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Cc: Mr Wim MIJS, Chairman of EBF Executive Committee