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Impact on the Equipment Finance Syndication Market of the House Financial Regulatory Reform Legislation (H.R. 4173)

The Equipment Leasing and Finance Association (ELFA) is the trade association that represents companies in the $600 billion equipment finance sector engaged in the financing, utilization, and investment of and in capital goods. This industry provides capital to businesses, governments and the non-profit sector for investment in capital plant and equipment. ELFA members are the driving force behind the growth in the commercial equipment finance market and contribute to capital formation in the U.S. and abroad. ELFA has over 600 members including manufacturers, independent and captive lease and finance companies, banks, financial services companies, broker/packagers, investment banks, and service providers.

Discussed below are serious concerns of the ELFA regarding the likely impact of the House Financial Regulatory Reform Legislation (H.R. 4173) (the "Legislation") on the syndication market in which many ELFA members participate. According to the ELFA's Survey of Equipment Finance Activity, in 2009 alone a minimum of $38.2 billion worth of equipment loans and leases exchanged hands in the syndications market (as part of sales of entire portfolios, or as "one-off" sales of transactions), almost exclusively between sophisticated financial institutions who specialize in buying and selling such investments. The concerns outlined below are shared by most equipment financiers, whether bank-owned or independent, large or small – all to whom access to the syndication market is a key component of their ability to deliver desperately needed credit and liquidity to the customers they serve, especially in these relative stagnant economic times.

The broad sweep of the Legislation captures not only its apparent primary target (i.e., sales of loans as a part of a securitization), but also any loan sale by a creditor, including "one off" and portfolio sales that typify the equipment finance syndication market (the "Market"). Practices in this Market already embrace arm's-length negotiated protections that are time-tested, tailored to specific concerns and provide the precise recourse and other contractual protections required by investors. Imposing legislative risk allocation in the Market would be fixing something that is not broken, and by attempting to do so, the financial institutions in the Market and, more importantly, their customers would suffer unintended and unwanted consequences.

The majority of the financial institutions participating in this Market both buy and sell financing transactions. Buyers are able to evaluate each syndication opportunity on its own merits, conduct extensive due diligence and impose their own underwriting standards. Typical syndication documents include negotiated representations, warranties, covenants and conditions, and any buyer holdback, retained subordinated interests or recourse to the seller is addressed by tailored remedies.

The extent to which the seller retains recourse liability for an unrecovered investment is one of many business terms heavily negotiated between the parties. For reasons relating to the relationship between the buyer and seller, or specific to the syndicated transaction, the parties might agree that the seller retains no recourse, incurs conditional or limited recourse, or provides full (100%) recourse. Retention of recourse in the Market is often related to the buyer's opportunity to evaluate the collection risk in the context of the other business considerations related to the syndication. Transaction-specific factors considered when allocating collection risks include price, customer relationships, market segment of the customer or the desire of the seller or buyer to enter into or exit a transaction or market. As described above, there are many factors considered by the parties in determining the level of recourse – most or none of which the Legislation actually does, nor possibly could, take into account.

A seller's willingness to retain collection risk is also related to its ability to mitigate this risk. The seller's opportunity to mitigate its collection risk is largely impacted by the manner in which the sold loan or lease will be serviced and administered after it is sold. In the majority of cases, the buyer is responsible for all aspects of servicing and contractual enforcement after it acquires the transaction. Thus, the buyer (not the seller) bills and collects all payments, monitors contractual compliance, declares defaults and pursues remedies. It is the buyer's competence with respect to such servicing matters that often dictates the extent of any collection loss. Other matters that might exacerbate the collection risk include a decline in collateral value, and further dispositions by the buyer. It would be extraordinary (and certainly an inefficient allocation of risk and related reserve capital) for participants in the Market to allocate any collection risk to the seller if it related to these or other circumstances outside of the seller's control. Furthermore, any "forced" allocation of credit risk would also lead to a purchase price failing to reflect a true "market" price as determined by two sophisticated institutions based on their negotiated allocation of risk taking into account all the facts and circumstances.

There is no meaningful bargaining or sophistication imbalance among the buyers and sellers in the Market, and they have successfully relied on their freedom of contract to negotiate a specific allocation of risks with respect to collection and other future contractual performance by borrowers and lessees. The free buying, selling and trading of transactions in the Market has been its hallmark for decades. The resulting liquidity enables Market participants to provide billions of dollars in additional credit to small and large businesses in the U.S. acquiring capital equipment and consumable raw materials, as well as to U.S. equipment manufacturers, vendors and other customers.

The Legislation would diminish availability of credit to equipment lessees and borrowers. If as a condition to syndicating its financing transactions a financing party must retain a credit exposure without an opportunity to avoid or mitigate that risk by accepted Market practices, far fewer transactions will be sold. As a consequence, less credit capacity will be available to enter into additional transactions with customers, or to provide credit to new customers, the overall credit markets will tighten even further than they are today and general economic activity will most certainly suffer. One would be very hard-pressed to cite any examples of abuses in the Market that have led to our recent economic turmoil, nor any that would at all merit legislative or regulatory protection of buyers of lease and loan financing transactions. Therefore, we strongly submit that it would be a mistake, leading to harmful and presumably unintended consequences, to allow the Legislation (intended to address other issues that have played a role in the recent upheaval of certain of our financial markets) to be expanded to cover markets that are well established, function very efficiently and allocate risk appropriately.

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