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Impact on Normal Course Business Transactions for Vendors and Dealers in 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.

ELFA has reviewed the Credit Risk Retention Act of 2009 (the "Legislation"), which contains a series of securitization reforms and is set forth at Title 1, Subtitle F of the above referenced legislation. The Legislation will amend the Securities Act of 1933 (the "Act") by adding a new Section 29 thereto as well as amending several existing provisions. The purpose of this memorandum is to set forth ELFA's views of the Legislation and the adverse impact it may have on the vendor financing market. ELFA members are an integral part of the vendor financing market, and our members work very closely with vendors and dealers and have a unique understanding of the importance of vendor financing to the strength of the national economy.

- The Legislation was created in response to significant problems in the derivatives, securities, securitizations and related markets. These problems were so large as to raise risks to the stability of the United States financial system. However, as detailed below, the Legislation will negatively impact many industries and activities that played no part in creating the economic turmoil the Legislation is intended to address. It is imperative that these industries and activities continue to function efficiently and smoothly (as they have done throughout all of this turmoil) to ensure the US economy continues to improve. Application of the Legislation to such industries and activities will only further exacerbate existing economic challenges, primarily by restricting the flow of credit and raising costs.

- The broad reach of the Legislation is evidenced by the use of "creditor" and "loan." "Creditor" is not a defined term in the Legislation or in the Act, meaning that, unless subject to an industry specific usage or as otherwise indicated to the contrary in the Legislation, it is given its everyday definition. That being the case, a creditor can be defined as anyone to whom a debt is owed (Black's Law Dictionary). "Loan" is not defined in the Legislation or the Act. Using its everyday meaning, "loan" means money loaned or credit extended. Using these definitions, the Legislation could apply to

a) credit sales (the vendor sells goods and takes a promissory note back from the buyer rather than cash),
b) purchase money loans (a finance source lends money to a buyer to enable it to acquire goods from a vendor), and
c) receivables financings (a vendor assigns to a finance source its rights to payments due from its customers).

- Each of the loans described above is an important source of financing for many equipment users and their vendors. These loans are sold or pledged as collateral for borrowings by vendors and are a necessary component of their business operations. In many cases, these kinds of transactions are the only cost-efficient source of capital available to these entities. This is particularly true with small businesses. If enacted, the Legislation will require these vendors to retain a substantial portion of the credit risk of each loan it attempts to finance, whether or not a securitization is involved. If these vendors have to reserve for these credit risks, they will have less capital available to redeploy into their business. For example, assume that vendor is receiving $100 for a loan it pledged to a financing source. If vendor has to retain a 10% credit risk for such loan (as proposed in the Senate), it should set aside $10 of the loan as a credit reserve, and will only be able to fund $90 back into its pursuit of new sales. Many vendors will be unable to remain competitive or grow if the capital available to pursue growth opportunities is reduced by 10% (or more).

- There are no positives offsetting this loss of available capital. No claim can be sustained that since the buyers/assignees of these loans are acquiring less credit risk they will be willing to pay a premium for the loan. This claim fails because upon a default by the obligor under the loan, the loan purchaser will almost certainly be looking at a loss despite the risk retained by the vendor. This is certainly the case for loans that are not secured by collateral, as in that case the only source of repayment is the obligor, who has already defaulted in its payment obligation. The fact that the loan purchaser will lose less because of the risk retained by the vendor will not be enough motivation for the purchaser to purchase a loan it would not otherwise have purchased, nor will it cause the purchaser to increase the purchase price for the loan.

- Imposing credit risk retention requirements on these vendors and financing sources will reduce their willingness to credit sell or lend to marginal credits because of the increased credit risk associated with most buyers/borrowers that are small businesses or start-up entities. It is a common mantra of vendors that they are not in the credit business. They are in the sales business. They offer short-term credit to drive sales, and they expect to transfer that credit risk to a financing source better placed to evaluate and accept credit risk. If a vendor is required to retain some portion of this credit risk, the vendor will naturally limit the credit it is willing to extend to those entities most capable of meeting their obligations arising therefrom. Therefore, an auto parts supplier will probably still be willing to sell supplies on credit to the local Ford dealership but it will no longer offer credit to the mechanic trying to open his independent auto repair business. The latter will have to pay cash for his supplies and that will prevent or seriously prohibit his ability to start and grow his business.

- Imposing credit risk retention requirements upon vendors will drive their costs up and distract them from their primary goals. If the Legislation is enacted vendors will have to establish credit departments. This will mean hiring persons to evaluate the credit worthiness of those looking to buy on credit. It will mandate the creation of credit policies and associated recordkeeping and information retention polices, and software and systems to store all this information. The capital necessary to establish an adequate credit function will be capital drained from the primary purpose of the vendor, which is to sell its goods. Moreover, the cost of such capital will have to be recouped from the vendor's customers and that will result in higher prices.

- The industry that finances vendor credit sales and makes capital available to vendors to acquire inventory and for customers to buy that inventory was not the cause of the economic turmoil of the last 18 months. This industry worked and is still working. The participants in this industry, especially the financing sources buying loans or extending credit to buyers of goods, are generally conservative and employ effective due diligence practices. They are careful to evaluate each transaction on its own merits, and will undertake an informed analysis of the customer and its ability to meet its obligations, the purpose of the transaction (especially the use of the assets being acquired), the terms of the transaction, and the value of the collateral. Financing sources often require credit enhancements such as guaranties, letters of credit and other secondary sources of repayment. The Legislation should not attempt to negotiate the nature and extent of such deal-specific credit enhancements, and, as stated above, requiring such credit enhancements from manufacturers and vendors misallocates their resources, which are and should continue to be, deployed solely for the purpose of manufacturing, selling and distributing goods and services.

- Vendors and those financing sources extending purchase money loans and other similar loans to businesses have continued to make credit available through this entire period of economic dislocation, even as some of their own funding sources dried up and/or became more costly. It would make no sense to restrict their ability to offer credit in the future because of problems arising from financial activities unrelated to this industry that were caused by behaviors and actions that are not prevalent in this industry.

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