THE EVOLUTION OF RULES

FOR A SINGLE EUROPEAN MARKET IN LEASING

by

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Abstract

It is argued that completion of the internal market for leasing requires sufficient openness of national markets for competition between rules to take place. This study of the leasing industry in the European Economic Area analyses those aspects of the European Commission's Single Market Programme which are intended to achieve this aim and pinpoints tax harmonisation, banking regulation and mutual recognition of accounting standards as the main areas of Commission regulatory activity which will impact on the evolution of rules for the industry. The paper looks at the structure of each national industry and highlights the constraints and driving forces within each rule system which will influence the process of change. It is concluded that relatively high levels of competition between rules are actually occurring. For some time to come, national markets will continue to be segmented and it is questionable whether a European leasing industry will actually emerge.

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INTRODUCTION

The European Commission's "1992" Programme of legislative measures has as its objective the completion of the Single Market for goods, services, labour and capital. In order to achieve this goal, the Commission has sought to formulate a comprehensive framework of Community-level rules which will remove unnecessary barriers to trade and reduce disparities between national rule systems. The impact of these rule changes on industries within the Community will vary according to the number of rules involved, the complexity of existing national arrangements and the degree of change entailed by the way in which rule systems evolve. The purpose of this paper is to examine the evolution of Single Market rules for the European leasing industry. It does so by identifying the Single Market measures which are relevant to this sector, by examining company responses to existing rules and proposed changes and by assessing the influence which firms have on the design and implementation of new regulatory measures at the Community level. In particular, it poses the question: "Will these changes actually lead to a Single Market for leasing in Europe?"

The Commission has not dealt directly with leasing within the "1992" Programme to the same extent that it has sought to remove barriers to trade in many other sectors. The Community rule changes impinging on the industry have instead come via a number of different Commission initiatives, not all of which have the setting of new rules for leasing as their primary objective. Leasing therefore provides an interesting example of how Single Market rule changes can have an impact on an industry both directly and indirectly. The response of lessors to the proposed changes raises a number of interesting issues for the further development of rules in the European market.

Section two of the paper begins with an overview of the leasing industry at the European level, looking at how lessors organise themselves within the Leaseurope federation, how the lessors are distributed across the Community and who the major players are. The Single European Market (SEM) is deemed, by virtue of the agreement on the European Economic Area (EEA), to cover both the European Community (EC) and European Free Trade Area (EFTA) This brings within the study countries with sizeable leasing industries, such as Sweden which has the sixth largest leasing market in Europe, as well as a number of smaller markets[1].

The European leasing industry in 1985 was largely segmented on a national basis. The third section of this paper therefore tackles the fundamental question of "what measures would be needed to create a single market for leasing?" We consider problems which lessors and lessees most commonly encountered in attempts to carry out cross-border leasing transactions in Europe. The discussion focuses on differences in accounting standards, banking regulation, corporate tax and VAT. In addition a number of non-legislative issues are examined, since factors such as underlying differences in business culture and factors relating to the structure of each national industry also play a significant part in understanding why leasing markets remain highly segmented.

The European Commission has frequently stated that it has no intention of directly regulating the leasing industry. Nevertheless it has also maintained that rule changes in accounting, taxation and the supervision of banks are crucial to the establishment of a single European market. Since the proposed rule changes in each of these areas have specific implications for leasing, the fourth section of this paper looks at the current state of play of extant and proposed single market legislative measures which may affect the leasing operations of firms in Europe and assesses their likely impact on the industry.

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[1]The EEA will, however, exclude Switzerland following that country's rejection of the EEA Agreement in the referendum of December 1992.

The fifth section of the paper evaluates how potential changes in the external rules confronting firms has brought responses from the leasing industry in seeking to influence the rule-setting process. In the final section of the paper, we look at the extent to which a "single market" in leasing has been achieved, or indeed is actually achievable, in Europe.

1. THE EVOLUTION OF RULES IN THE SINGLE EUROPEAN MARKET

1.1 *Changing the rules to achieve a SEM*

The Treaties establishing the European Communities are not only a series of legal rules, but include a set of defined targets towards which the member states have undertaken to converge. The objective of establishing an internal market lies at the heart of these provisions. This fact is borne out by Article 3(c) of the Treaty of Rome, which explicitly sets out the objective of the abolition of obstacles to the free movement for persons, goods, services and capital between member states of the Community, and by Article 8A of the Treaty, introduced by the Single European Act, which sets out the goal of establishing an area without frontiers by 31st December 1992.

Based on the rationale that failure to achieve a single market imposes billions of ECU on European industry each year in unnecessary costs and lost opportunities (Cecchini, 1988), the intention of the European Commission's "1992" Programme was to complete this single market for goods, services, labour and capital in the European Community by introducing nearly 300 legislative measures considered necessary to remove barriers to trade.

In the way that it was formulated as a coherent strategy for completion of the Single Market, the "1992" programme is therefore an unusual case of widespread, pre-announced rule changes for firms and national governments which cuts through the laborious process of negotiation over detailed rules for common behaviour that had paralysed the Community decision-making process since 1966.

1.2 *Scope of the research project*

Assessing the likely impact of these changes is the objective of the Economic and Social Research Council's Initiative "The Evolution of Rules for a Single European Market". Running until 1996, projects within the Initiative are addressing the main issues of the process of integration in the 1990s and look at economic, regional, industrial, social, environmental, institutional and political issues arising from the Single Market programme (see appendix).

While the emphasis of many of these projects within the ESRC's Research Initiative is primarily on the mechanism of rule setting, the task of the present project at NIESR, of which this paper on leasing forms the first part, is to examine a different facet of the paradigm: company and government responses to rule change, evaluating the impact of such responses on the development and interpretation of Single Market rules.

Each of the legislative measures considered necessary for completion of the Single Market represents a change in the "rules" by which both national governments and firms operate. Shipman and Mayes (1991) noted that when changes occur in the framework in which firms and governments operate, corresponding changes occur in the way actors behave. Since the Single Market is intended to alter the way in which different national markets operate, we can therefore anticipate new modes of behaviour emerging at three levels: (i) as agents attempt to influence the Community rule-setting process; (ii) as changes in the written and unwritten rules under which they carry out their business begin to have an impact on firms; (iii) as incremental changes to the new rules begin to take place, even after they have come into force.

This paper deals specifically with the first type of behaviour which we expect to see emerging: the design and formulation of rules at the Community level which are **likely to**

impact on the leasing industry in Europe, and the responses that the proposed rule changes illicit from the industry itself.

The study of the leasing industry is the first of nine[2] which will examine the evolutionary character of the rule changes occurring as a result of the Single Market process. As with the remaining eight industry studies, leasing has been chosen for its strong exposure to more than one type of Single Market rule change and for the existence of a relatively small number of players which may increase the range and strength of rules which govern behaviour.

The methods by which new rules are set for the leasing industry will be examined, and the extent to which competition between rules actually exists in this process – and the extent to which some rule-systems dominate others – will be evaluated.

1.3 *Formulation of rules in the SEM*

In undertaking the "1992" Programme, the Commission has adopted a variety of approaches to the formulation of Single Market rules. Shipman and Mayes (1991) distinguish between five types of measures which may be used at the EC level to accelerate the convergence of national external-rule systems: (i) the imposition of supranational rules on the member states; (ii) negotiated rule changes, involving specialist input from industry representatives; (iii) competition among national rule systems, under which competition is allowed between differing sets of national rules, eventually allowing the most widely accepted system to predominate through an evolutionary process; (iv) the acceptance of internationally adopted standards as the Community standard; (v) the general acceptance of one country's standard as the Community standard. Each of these five approaches contain characteristics which are clearly identifiable in the context of the way in which Single Market rules are evolving for the leasing industry, as will become apparent when we examine the way in which specific Commission proposals have emerged later in the paper.

Under the terms of Article 155 of the Treaty of Rome, it is the Commission which has the sole right of initiative in proposing those EC legislative measures considered necessary for the establishment of a single market in goods, services, labour and capital. Despite the growth of intergovernmentalism since the founding of the Community, it is still the case that the Commission has the role of initiator of legislative measures.

The relevance of the Commission's role as the initiator of Community rules should not overlooked. Helen Wallace (Wallace, Wallace and Webb, 1983) characterised the distinctive approach of the Commission to policy formulation in terms of its openness to new ideas and its accessibility to client groups. The Commission officials responsible for drafting proposed rule changes often rely on interested parties for expert views and technical advice and are receptive to their comments. This role has recently found recognition in the publication of Commission guidelines on its relations with interest groups (OJC 63, 5 March 1993) which acknowledge the role of such parties in drawing up technical rules. Mazey and Richardson (1992) suggest that the "open door" policy of the Commission may itself actually complicate the process by which client groups seek to influence the rule-setters, since by virtue of the wide consultation which the Commission undertakes, no single interest group can secure exclusive access for its preferred outcome. Instead, it is likely to be only one of many groups providing detailed information about diverse technical standards, the views of all of which will be considered by the Commission before a proposed rule change is submitted to the Council.

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[2]The nine industry studies which will be carried out within this research project are: leasing, retailing, construction (services), air transport, machine tools, pharmaceuticals, insurance, motor vehicles and water supply.

By announcing the intention to initiate a general rule change, but not specifying the detail of the new measures, the Commission is not only acting within the spirit of its new guiding principle of "transparency", but also deliberately opening itself to outside influence, both from those covered by existing rules and from those outside them who may be affected by new rules. Firms attempt to influence the Commission as part of this process either by persuasion or by taking strategic actions which affect the projected outcomes of the changes under consideration.

1.4 *Influencing rules and informing the process*

Some aspects of the process by which client groups seek to influence the content of new rules, for example by lobbying or through other forms of persuasion, are clearly observable. Others, are more difficult to identify: Shipman and Mayes (1991) characterise these latter forms of influence as "strategic action", citing as examples actions designed to make an adverse rule-change unenforceable, to promote a rule-change which the agent finds desirable, or to reduce the perceived need for a rule change. We may add to this list by suggesting actions intended to make rule changes so general in their nature or wide in scope as to have little or no impact on the external rule systems within which firms operate.

As Shipman and Mayes acknowledge, both persuasion and strategic action may not only be used to influence the formation of new rules, but may also be used to replicate old rules whenever the costs are perceived to be less than those associated with changing internal rules to fit a new external rule system. This strategy of minimising rule changes will often be based on genuine deep-seated concerns about the credibility of proposed new rules, their suitability for the national rule system or their compatibility with existing rules (particularly the fact that they may have an adverse effect on the operation of existing rules).

In other circumstances, there may be powerful reasons why firms seek significant changes in the external rule system at the policy formulation stage. In the case of those excluded from potential markets by the old rules, or for those inside the rule system who see the potential benefits of new rules as being greater, there will be a significant motivation to seek external rule changes. There may, for example, be perceived benefits from the Single Market for certain players in the leasing industry. Lessors involved in large leasing transactions or those in domestic markets which are reaching saturation point, for instance, may be particularly keen to see new markets emerge as a result of SEM rule changes.

2. THE LEASING INDUSTRY IN EUROPE

2.1 *Defining leasing*

Our first task must be an attempt to characterise what we understand by the term "leasing". Since there is no single agreed definition of the term across Europe, this exercise is immediately problematic. The difficulties inherent in defining leasing are due, in part, to the different treatment given to hire-purchase, rental or other forms of leasing. In several national markets, for example, it is difficult to distinguish between hire-purchase and equipment leasing: many UK and French leasing transactions would be considered hire-purchase agreements in Germany. Differences in the definition of a lease also occur because legal and accounting traditions in each country are, in the main, the result of national regulatory regimes which were established prior to the expansion of the leasing market in the late 1960s and the 1970s. In highly segmented national markets, with low levels of cross-border transactions, a universally acceptable definition of leasing has not emerged.

Nevertheless, despite the wide range of activities which may be characterised as leasing, the basis of all leasing transactions - at least for equipment leasing - is the same: in return for specified payments (rentals) the owner of an asset (the lessor) grants exclusive use of it for an agreed period to the hirer (the lessee). Leasing is therefore

a means by which finance can be arranged for the use of an asset without obtaining title to or actually purchasing it (although in some countries, for example France, there may be an option to purchase). We do recognise that even such a basic definition as this may not comprehensively describe all types of leasing in some European markets however, having acknowledged this fact, it is the definition of leasing that will be used during the remainder of the paper when we refer to the term.

A word of caution should also be given at this stage with regard to the use of statistical information provided from national leasing associations since, for example, some national associations include land and property leasing in their statistics of leasing activities by member companies. This problem is inherent in the lack of a clear definition throughout the Community. Furthermore, since some of the available statistics do not distinguish between the relative size of leases (in France, for example, the average size of a lease is only FF25,000) the limitations of these data in illustrating the volume of leasing activity should be noted.

2.2 *Leaseurope*

At the European level, national associations are organised within the European Federation of Equipment Leasing Company Associations (Leaseurope), an umbrella body comprising the representative associations for the leasing industry in 17 member countries (Austria, Belgium, Bulgaria, Denmark, France, Finland, Germany, Greece, Italy, Ireland, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the United Kingdom). Through the national associations Leaseurope represents 976 leasing companies, accounting for about 87 per cent of the total volume of leasing transactions in these countries (Leaseurope/Arthur Andersen, 1992). In addition, a number of countries are correspondent members of Leaseurope (the Czech and Slovak Republics, Hungary, Morocco, Poland and Slovenia).

Essentially Leaseurope has two main functions: (i) representing the interests of the European leasing industry in discussions with the European Commission and other supra-national organisations, and (ii) organising conferences and other international gatherings. Although originally formed for the latter purpose, a role which it continues to fulfil, as the impact of European Community issues has grown the necessity for Leaseurope to represent the industry in discussions with the Commission has also become increasingly obvious. The role of Leaseurope in providing technical advice to the Commission and conveying the views of its members to Community rule-setters has therefore grown markedly.

In relations with the Commission, Leaseurope is supported by five in-house technical committees which deal with specific areas of concern to the leasing industry: the EC legislative committee, the legal committee, the accounting and taxation committee, the real estate committee and the statistical committee. Each committee consists of technical experts and interested parties from the various countries represented within Leaseurope, and performs a dual function of providing the Commission with support at a technical level and lobbying on behalf of national association's interests.

2.3 *Market structure*

In the five largest EC domestic markets (France, Germany, Italy, Spain and the UK) leasing has evolved in its present form since the beginning of the 1960s, when the idea of leasing in its modern form arrived from the USA and became increasingly used in the mid-1970s as an alternative form of investment and finance. Throughout this early period, captive lessors (subsidiaries of manufacturers) dominated the market, using leasing primarily as a sales aid. It was only slowly that other types of leasing companies, often the subsidiaries of banks, became commonplace. Even so, by the latter half of the 1970s, bank-based lessors had replaced captives as the main type of leasing company.

The size of the European leasing market increased rapidly in the 1980s and continues to grow. In 1991 Leaseurope members leased moveable equipment to the value of ECU 81bn, an

increase of 2.5 per cent on 1990. This compared with a 12 per cent increase in 1990 on the previous year's figure (ECU 71bn in 1989) (World Leasing Yearbook, 1992 and 1993). In 1983 Leaseurope members leased moveable equipment to the value of ECU 19.63bn.

The highest growth rates in 1991 were 50 per cent in Greece, 38 per cent in Germany, 37 per cent in Austria and 22 per cent in Portugal (World Leasing Yearbook, 1993). This compares with 1990 when the highest growth rates were recorded in Italy (67 per cent), Germany (36 per cent), Portugal (24 per cent), Belgium (21 per cent) and Austria (20 per cent). In 1983, while the UK was already established as the largest European market, the situation was rather different with the largest growth rates in Sweden (218 per cent), Spain (42 per cent) and France (41 per cent) (World Leasing Yearbook, 1985).

The impact of the world recession on the European leasing industry was apparent in 1991, with falls in new business of 30 per cent in Luxembourg, 18 per cent in Finland, 12 per cent in France, 9.7 per cent in Denmark and small falls in new business in the Netherlands, Spain, Switzerland and the UK (World Leasing Yearbook, 1993). This compares with less pronounced falls in 1990, when a small drop in business was recorded in France, Spain and Denmark, with larger falls of 17 per cent in Finland and 11 per cent in Norway (World Leasing Yearbook, 1992).

In 1991 the UK retained its position as the largest market by volume with ECU 18bn, although this was a small decrease on the previous year's figure of ECU 18.8bn. Germany was the second largest market in 1991 with a figure of ECU 15.36bn (an increase on a market volume of ECU 11.1bn in 1990). Italy ranked third with ECU 13.4bn, which compared with ECU 13.36bn the previous year, and France ranked fourth with ECU 13.1bn compared with ECU 15.1bn in 1990 (see Table 1).

Machinery and industrial equipment accounted for 31.2 per cent of business in 1991, with cars (28 per cent) the second largest type of asset leased, followed by computers and business machines (16.6 per cent), commercial vehicles (14 per cent) and ships, aircraft and rail (4.5 per cent) (World Leasing Yearbook, 1993).

2.4 *Major players*

To a large extent it is impossible to generalise about the European leasing industry since, in practice, it remains little more than a number of separate national markets, with few lessors operating on a pan-European scale. Leasing companies operating within the various national markets comprise a variety of enterprises, the form that lessors take often reflecting the external rule systems within which companies must operate. In the UK, for example, banks with substantial tax liability have traditionally been motivated to lease by the attractive capital allowances available on plant and machinery.

Table 1. New assets acquired by Leaseurope members 1990–91 (ECUm)

Country	1991	1990
Austria	2,122	1,548
Belgium	1,671	1,534
Bulgaria	55	73
Switzerland	948	1,026
Germany	15,361	11,091
Denmark	707	780
Spain	7,170	7,569
France	13,100	15,111
Greece	139	97
Italy	13,426	13,368
Ireland	866	864
Luxembourg	121	172
Norway	307	284
Netherlands	2,411	2,559
Portugal	1,288	1,041
Sweden	2,792	2,707
Finland	383	486
United Kingdom	18,081	18,799
Total	80,948	79,109

Source: World Leasing Yearbook, 1993. Leaseurope annual statistics.
Note: Figures include both equipment and real estate leasing.

A common characteristic of most European leasing markets is, however, the role played by the subsidiaries of banks or other financial institutions. In the UK, finance house subsidiaries of the major clearing banks account for about two-thirds of leasing business recorded by members of the Finance and Leasing Association (FLA) (Soper et al, 1992). These subsidiaries generally conduct business in all types of leased assets, from small- and medium-ticket leases to large-ticket deals, reflecting the varied customer base of clearing banks via their extensive network of branches. Merchant banks, although with a different customer base which is more reliant on large corporates, also provide leasing services, particularly in the form of advice on leasing transactions and brokerage (Leaseurope/Arthur Andersen, 1992).

In France the crédit bail sector, which grew rapidly in the 1980s, is dominated by sociétés financières spécialisées, which account for nearly 95 per cent of the market. Although banks rarely engaging directly in crédit bail, sociétés financières spécialisées tend to be owned by other types of player, of which banks and their subsidiaries form the largest group with 65 per cent of crédit bail transactions (Leaseurope/Arthur Andersen, 1992). Motivated by the opportunity to broaden their range of services for customers, banks are able to use local branches to maximise their customer base in leasing.

In other countries, such as Austria, Belgium, Germany, Italy and the Netherlands, bank-owned leasing companies control a significant share of the market, while in Spain, the subsidiaries of national banks account for half of the leasing market. Furthermore, foreign banks, savings banks and joint subsidiaries of banks control most of the remaining Spanish market (Leaseurope/Arthur Andersen, 1992).

In Sweden, however, the situation is rather different. Banks account for a smaller share of the market, with non-bank-owned companies ("independents") accounting for about 60 per cent of leasing business in 1989, although this proportion decreased slightly in subsequent years. In 1990 five bank-owned subsidiaries accounted for 36 per cent of the total volume of leasing (Leaseurope/Arthur Andersen, 1992).

Given these trends in Europe's national leasing markets, it is not surprising that the largest European leasing companies are banks and their subsidiaries. In terms of portfolio size and volume of new business, by far the largest lessors in Europe are Société Générale (SocGen) and Lombard North Central (see Tables 2 and 3).

Table 2. Largest European lessors by annual volume (cost of new equipment added) ($ millions) for the 1991 fiscal year.

Rank	Company	1991	1990
1	Lombard North Central/NatWest (UK)	7,902	6,411
2	Société Générale (France)	7,148	7,699[1]
3	Crédit Lyonnais (France)	4,450[2]	–
4	GEFA Group (Germany)	3,051	2,475
5	KG Allgemeine Leasing (Germany)	3,013	2,549
6	Barclays Mercantile (UK)	2,874	3,565
7	UFB Locabail (France)	2,748	3,450
8	NMB Lease NV (Netherlands)	2,725	1,436
9	NWS Bank plc (UK)	2,230	2,144
10	Forward Trust Group Ltd. (UK)	1,823	2,455
11	Debis AG (Germany)	1,687	–
12	Deutsche Leasing AG (Germany)	1,629	1,251
13	BBV Leasing (Spain)	1,526	1,275
14	Bansaleasing (Spain)	1,510	–
15	Deutsche Genoßenschafts Leasing (Ger)	1,250	–
16	Rank Xerox Leasing International (US)	1,133	980
17	Abbey National Treasury Services (UK)	1,081[3]	–
18	De Lage Landen International (Neths)	859	487
19	SG Warburg & Co. Ltd (UK)	855	836
20	ALD Autoleasing GmbH (Germany)	760	–
21	LICO Leasing SA (Spain)	714	770
22	Royal Bank Leasing Ltd. (UK)	679	649
23	Woodchester Investments plc (Ireland)	676	362
24	FinansSkandic AB (Sweden)	656	1,089
25	Leaseplan Holding NV (Netherlands)	625	–
26	Leasint Spa (Italy)	588	–
27	Lloyds Leasing (UK)	479	770
28	Hambros Bank Ltd. (UK)	442	–
29	CA Leasing (Austria)[4]	442	–
30	Kleinwort Benson Ltd. (UK)	407	–

Source: Asset Finance and Leasing Digest, July 1992.
Notes: 1. Revised figures for 1990 fiscal year. 2. When all operations worldwide are included this figure increases to $4,700. 3. Total commitments for 1991 amount to $2,470 million (1,400 million). 4. Was Osterreichische Leasing.

While Lombard replaced SocGen as the largest European lessor in terms of volume of new business added, with SocGen the second largest, the situation was reversed in terms of portfolio size, with SocGen in first place and Lombard in second place. In addition to Lombard, whose figures include business done by the leasing and asset finance unit of its parent company, National Westminster Bank, UK banks showed a strong presence with Barclays Mercantile Business Finance, NWS Bank (subsidiary of the Bank of Scotland), Forward Trust Group (part of Midland Bank), Abbey National Treasury Services, Royal Bank Leasing and Lloyds Leasing are all included in the top thirty European lessors. UK merchant banks S.G Warburg, Kleinwort Benson and Hambros Bank are also among the largest European leasing companies.

Table 3. Largest European lessors by leasing portfolio ($ millions) for the 1991 fiscal year.

Rank	Company	1991	1990
1	Société Générale (France)	23,751	21,165[1]
2	Lombard North Central/NatWest (UK)	20,973	18,029
3	KG Allgemeine Leasing (Germany)	12,658	10,572
4	Barclays Mercantile (UK)	12,607	11,544
5	Deutsche Immobilien Leasing (Germany)	7,268	7,126
6	NWS Bank plc (UK)	6,941	5,271
7	Forward Trust Group (UK)	6,672	6,563
8	UFB Locabail (France)	6,382	6,634
9	Debis AG (Germany)	4,581	–
10	Bansaleasing (Spain)	4,226	–
11	NMB Lease Holding NV (Netherlands)	3,616	2,222
12	GEFA Group (Germany)	3,591	3,352
13	Lloyds Leasing Ltd. (UK)	3,317	3,740
14	BBV Leasing SA (Spain)	3,088	3,412
15	SG Warburg & Co Ltd. (UK)	2,952	2,628
16	Rank Xerox Leasing International (US)	2,930	2,600
17	Deutsche Genoßenschafts Leasing (Ger)	2,772	–
18	LICO Leasing (Spain)	2,585	2,520
19	Royal Bank Leasing Ltd. (UK)	2,501	2,403
20	Lease Plan Holding NV (Netherlands)	2,500	1,648
21	Deutsche Leasing AG (Germany)	2,423	2,037
22	FinansSkandic Group (Sweden)	2,162	–
23	Woodchester Investments plc (Ireland)	1,785	575
24	Leasint Spa (Italy)	1,682	–
25	De Lage Landen International (Neths)	1,570	1,238
26	Domibail (France)	1,564	–
27	SPEI Leasing (Italy)	1,515	–
28	Abbey National Treasury Services (UK)	1,239	531
29	ALD Autoleasing GmbH (Germany)	1,222	–
30	Leasindustria Spa (Italy)	1,192	1,047

Source: Asset Finance and Leasing Digest, July 1992.
Note: 1. Revised figures for 1990 fiscal year.

Another French bank Crédit Lyonnais, is the third largest lessor by volume. German leasing company KG Allgemeine Leasing, which includes Disko Leasing and Lufthansa Leasing, and is owned by a consortium of German financial institutions led by Dresdner Bank, is the fifth largest by volume and third by leasing portfolio. GEFA Group, which comprises three leasing companies owned by Deutsche Bank, is the fourth largest in terms of volume and twelfth in terms of portfolio size. Irish lessor Woodchester Investments, in which Crédit Lyonnais holds a large proportion of shares, recorded the highest growth rates in 1991, with a portfolio size rising from $575m to $1,785m and the volume of its business increasing from $362m to $676m.

Overall, the major feature of the figures given in tables 2 and 3 is that, throughout the European leasing industry, the largest lessors are banks. This differs from the situation in the United States where most major lessors are captives (subsidiaries of manufacturing companies), although the leading Japanese lessors more closely resemble their European banking counterparts.

In addition to banks, other participants in European leasing markets comprise captives, specialist and independent lessors. Although each of these groups account for varying degrees of the total volume of national leasing markets, their significance in terms of the evolution of a Single Market should not be discounted. In terms of their reasons for participating in the leasing market, non-bank lessors are motivated by a variety of

reasons, only some of which are related to national rules on taxation or the operation of big-ticket leasing. Sales aid remains an important function for captives. Their interests in the evolution of rules for the European leasing industry may therefore differ from those of large finance houses since they are often operating in different sections of the market and for different reasons.

Captives are manufacturer-owned leasing subsidiaries which either underwrite leasing transactions themselves or enter into joint ventures with leasing companies. Often with a price advantage over competitors due to special deals via the parent-company, the use of this type of subsidiary also allows a manufacturer to control the second-hand market for its product effectively.

Specialist lessors operate within niche markets by focusing their business on leasing particular types of assets. Specialist lessors are particularly prevalent in the computer equipment sector and, it has been suggested (Leaseurope/Arthur Andersen, 1992), are able to price more competitively because of their specialist knowledge. Independent lessors retain a small proportion of most European leasing markets. Overall, they constitute the smallest group of players.

2.5 *Pan-European leasing operations*

Market knowledge remains an important barrier to cross-border leasing and, as a result, very few lessors have pan-European operations. Lease Plan (the European operation of US company Dana Commercial Credit) and IBM are unusual in their coverage of several European markets, although there are also a small number of French companies which have operations in the UK and Germany. Generally, however, leasing remains a commercial activity carried out on a national, rather than pan-European, basis.

When lessors take a strategic decision to enter a foreign market, they may do so either by setting up a branch or subsidiary, or by acquisition of an existing operation in that country. In the former case, a parent company must be prepared to take on high costs in the early years until a customer base is established, while difficulties in adapting to local rules can be overcome only by finding high calibre personnel with good local knowledge. The acquisition strategy, on the other hand, presumes that a suitable company can be obtained for an equitable price. Both approaches, therefore, have their own particular drawbacks.

In addition, differences in the external rules which foreign lessors must deal with when entering a new market are also significant and, although some of impediments have been removed by the establishment of a single EC banking "passport", other barriers remain - particularly with regard to tax differentials. Above all it should be stressed that, even at the national level, a large degree of market diversification exists with each national market effectively divided vertically into small-, medium- and big-ticket leasing and horizontally into finance and operating leasing. The prospects for increasing levels of pan-European leasing activity are subsequently likely to be limited.

2.6 *Small- medium- and large-ticket leasing*

Although the distinction between small-, medium- and big-ticket leasing is not recognised in all European leasing industries, in practice the activities which these terms describe are being carried out in each country, regardless of how the transactions are actually defined.

Small-ticket leasing consists of finance deals on small-unit equipment such as computer hardware, photocopying machines, office equipment and cash registers. There are smaller lessors who tend to specialise in this type of lease, but this is not to say that larger lessors do not operate in the small-ticket sector: entry into the market tends to vary, depending on perceived profitability.

Although distinctions are blurred between various size categories of lease, typically

medium-sized leasing involves assets with higher value, including motor vehicles, lifts and industrial plant and machinery.

Large-ticket leasing is commonly understood to refer to the leasing of assets which are of high value and often 'large' in size, such as ships, aircraft, chemical production equipment. The financing of large-ticket deals is often extremely complex. Indeed, leasing may form only part of the final package necessary to complete the transaction.

2.7 *Finance and operating leasing*

While, in practice, the division between finance and operating leasing is somewhat blurred by the fact that many leasing contracts contain elements of both finance and operating leasing, the use of this distinction does serve to indicate a number of differing motivations to lease.

A finance lease transfers to the lessee most of the risks and rewards of ownership of the asset without the lessee obtaining legal ownership. Throughout the lease, for example, insurance and maintenance are the responsibility of the lessee. The lessee will make the initial decision to acquire an asset and decide upon the supplier. The lessor, normally a financial institution or its leasing subsidiary, then purchases the asset. The lessor can expect to recover the full capital cost of the asset, plus a profit margin, from the primary lease rentals. The primary lease period will cover most of the useful life of the asset. Arrangements for early termination of the rental are calculated in such a way as to ensure that all the lessor's primary costs are recovered. Heavy penalties for early termination may therefore be imposed on the lessee for early termination. In the UK, the introduction of SSAP 21 and the requirement for all assets to be capitalised on the lessee's balance sheet, may have reduced the number of transactions defined as finance leases. Traditionally, finance leasing was primarily for reasons of taxation, while operating leasing was motivated by potential benefits of both a commercial and a fiscal nature. Since the advent of SSAP 21 in the UK the distinction has been confused even further.

An operating lease will normally be used in instances where an asset is required for a shorter period than its useful life. A particular form of non-full pay-out contract is what is commonly understood to be "operating leasing". A non-full pay-out contract is a short-term lease, in which the lessee is likely to be only one of several users; leasing rates are therefore only a small proportion of the actual purchase price. Levels of operating leasing are particularly high UK and are low in Germany.

Under a non-full payout contract, the residual value of the asset will be greater than in the case of a financial lease and opportunities will exist for the lessor to sell or re-lease the asset once the agreement has come to an end. In an operating lease, the asset will be purchased, maintained and insured by the lessor. In addition, it is unlikely that the lessor will recover the costs of the asset over a single lease period. Unlike a finance lease, which substantially transfers both the risks and rewards of ownership to the lessee, an operating lease requires the lessor to bear the risks of ownership. Operating leases are commonly used to finance deals in vehicles and aircraft, where there is a viable second-hand market, and computers, where equipment rapidly becomes technologically obsolete.

3. ANALYSIS OF CHANGES NEEDED TO CREATE A SINGLE MARKET

So far this paper has dealt entirely with the current situation of the national leasing markets in Europe. This discussion is supplemented by individual country reports, which can be found in the appendices to the paper, showing how lessors organise themselves into national associations, outlining the structure of each industry and highlighting particular characteristics of the national rule systems within which lessors must operate.

The general discussion which has preceded this section has shown that a number of common

characteristics exist in terms of who the important players in each national market are and what are the basic characteristics of a lease transaction in each country.

In practice, however, leasing continues to be an activity which takes place within highly segmented national markets. Part of the reason for such low levels of cross-border activity can be explained by differences in the rules under which lessors operate within national markets. These differences, often the result of the peculiarities of national legal traditions and the way in which each system has evolved, raise particular questions for the establishment of pan-European leasing operations on three levels: accountancy, banking supervision and taxation.

In each of these areas, differences in national rules have raised specific problems for lessors seeking to enter a new market, whether by setting up a branch or subsidiary, or by engaging in cross-border deals. In terms of what changes would, in principle, be required for the establishment of a Single Market in leasing these issues are of central importance to the industry. This section of the paper will, therefore, look at each issue in detail in order to identify where competition between national rules is occurring, or is likely to occur in the future.

These rules are specifically of a legislative type. In addition, a number of non-legislative rules relating, for example, to business culture and lessor attitudes towards financing assets manufactured outside its home market, also appear to impact on the functioning of national markets. This second type of rules will be looked at in more detail in the final part of this section.

3.1 *Accounting standards*

Although there is an international accountancy standard (ISO 17) its use is voluntary and its impact on the way that national accounting procedures operate is variable. Important differences in national accounting standards still remain. At the root of these differences lie the major distinction between the Continental system, used in most European countries, and Anglo-Saxon approach, used in the UK and Ireland.

In the UK the "Statement of Standard Accounting Practice - accounting for leases and hire-purchase contracts" (SSAP 21) came into force for accounting periods commencing after 1 July 1984. Setting out the basic requirements for lease accounting, the aim of SSAP 21 was to overcome problems associated with the use of finance leasing as a source of "off-balance sheet finance", particularly in distorting the lessees' balance sheets. The introduction of SSAP 21 followed the approach taken in the United States and Canada, and subsequently adopted as the international accounting standard for leasing (IAS 17), despite concern that the provision of financial information under SSAP 21 could be misleading in that assets shown on a lessee's balance sheet could imply legal ownership where title had not passed from the lessor.

This, it has been argued, would be a specific problem where a lessee implies ownership of assets which it actually leases in its accounts and which, in the case of insolvency, the lessor will repossess. The SSAP 21 could, in such circumstances, mislead unsecured creditors who may be unaware that the lease arrangements are specified elsewhere in the accounts and assume that the lessee has legal ownership, as opposed to economic ownership, of the assets. In an attempt to address these concerns, under SSAP 21 it is the lessee's right to use the asset, as opposed to leased asset itself, which is capitalised on the lessee's balance sheet. The distinction in the UK is therefore that whilst the lessor retains legal title to the assets, the lessee obtains the right to economic use provided that the terms of the agreement are maintained.

Under SSAP 21, therefore whether a lease is classified as a finance or operating lease will have important tax implications. The definition of a finance lease, however remains highly subjective: it is a lease which transfers to the lessee substantially all the risks and rewards (other than the legal right) of ownership of an asset. In all other instances, leases are defined as operating leases. The problem which then arises is

that, since all leases transfer some of the risks and rewards of ownership to the lessee, the distinction is one of degree. Under SSAP 21, therefore, a 'present value test' is applied under which it is assumed that all the risks and rewards of ownership have passed to the lessee if, at the inception of the lease, the present value of the minimum lease payments, including any initial payments, amounts to substantially all (normally 90 per cent or more) of the fair value of the leased asset. In practice, since the introduction of SSAP 21, and the simultaneous changes in rules on first-year writing down allowances, many leases are now classified as operating rather than finance leases in the UK.

The accountancy situation in the UK and Ireland differs from that in other European countries where, particularly in France, Germany, Italy and Portugal there is only one set of accounts and, under Continental accounting rules, only legal ownership is recognised. No notion of economic ownership, as it is understood in the Anglo-Saxon accounting tradition, exists in other European systems. Indeed, under certain European legal systems, the capitalisation of a leased asset actually constitutes proof of legal ownership. The fundamental principle that the lessor is the legal owner of the leased asset is the basis of law in Germany, France, Spain, Italy and Sweden. The principle is also embodied in the 1983 Declaration of Seville, which is based on the notion that a lease contract transfers to the lessee the use of the asset in return for rental payments.

In summary, the majority of European countries require that only one set of accounts should be used for both financial reporting and taxation purposes. Nevertheless, this position differs from that adopted by the European Accountancy Federation (FEE) and by the UK and Irish leasing industries which both favour the adoption of an Anglo-Saxon standard as the benchmark for accounts throughout Europe. The fuller discussion of this issue is undertaken in section 4.1 of the paper.

3.2 *Banking regulation*

Highlighting common characteristics of the European leasing industry is made more complex by the differing legal traditions of the various countries, in particular differences between the codified, Roman law countries and the common law Anglo-Saxon countries, and the difficulty in establishing a legal definition of "leasing" in the EC context.

French banking authorities, for example, have taken the view that leasing is equivalent to a credit transaction. This is reflected in the fact that controls on credit-bail were introduced in 1966, as part of legislation which regulates equipment leasing companies as 'sociétés financières' on the same basis as banks and other credit institutions. Some other types of transaction, such as those with no option to purchase at the end of the contract, nevertheless remain outside the French regulatory framework. In Belgium "location-financement" (equivalent to credit-bail) is regulated.

Low levels of regulation in the German market in the past have undoubtedly contributed to the attitude of the German Leasing Association, the BDL, which in its response to Commission proposals, has been keen to maintain existing legal and tax provisions for leasing transactions in Germany. In Germany operating leasing generally refers to short- and medium-term contracts in which the lessee has the right to terminate the agreement with short notice at any time. In the United Kingdom, as in Germany, the Netherlands and Denmark, leasing is not subject to specific regulations or restrictions.

In Spain and Portugal regulatory frameworks have been developed to control the leasing sector. In Spain leasing firms are obliged to register as limited companies and comply with minimum equity provisions. In Italy, where it is common for leasing companies to be incorporated into financial institutions, there are no specific rules on leasing (although new laws are being formulated).

In Greece leasing firms are subject to control by the Bank of Greece. From 1991, leasing companies which are bank-owned subsidiaries are required to maintain capital of Dr2bn, while leasing companies which are not linked to a bank must maintain capital levels of

The related problems of definition and regulation are central to the discussion of the Second Banking Directive which follows later in this paper. It is sufficient here to acknowledge that the Directive has introduced the principles of home-country control and the single banking licence to the leasing industry in the European Community and, with the notable exception of UK non-bank lessors who are not subject to Bank of England regulation, lessors are now free to establish themselves or set up branches or subsidiary in the territory of another Community member state.

3.3 *Taxation*

In comparison to market size, leasing has made a smaller impact in Continental Europe than in the United States, the United Kingdom and Ireland. A contributory factor in this trend is that, in the US and the UK, relatively high levels of tax depreciation are available on a group basis. This factor, in turn, has made leasing a cost-effective source of finance in comparison with other options available for investment in equipment. In European leasing industries outside the UK and Ireland, where such substantial tax advantages do not exist, the main motivation to lease has been to provide an alternative source of finance, particularly to small- and medium-sized undertakings. This is reflected in the fact that the average size of a lease in many national markets is relatively small.

A characteristic common to all European leasing industries is, nevertheless, the tax treatment of rental payments, where in all cases are tax deductible by the lessee and treated as taxable income rentals from the lessor. Lessors are then able to take tax depreciation at a level appropriate to the type of equipment leased. The tax-depreciation figure varies between countries, but generally matches the useful life of the asset.

The main areas of taxation which have implications for competition amongst rules in the leasing industry are corporation tax and VAT. Both have some impact on the way that national markets operate and on the level of cross-border leasing which takes place. It should be stressed, however, that without progress on the comparability of accounting standards the impact of tax harmonisation, if ever achieved, will not be great. While national rules on lease accounting continue to differ, differences in national tax rules will also persist.

3.3.1 *VAT*

In principle, the burden of value added tax (VAT) is designed to fall on the final consumer and, in the case of cross-border leasing, there is exemption from VAT on all transactions in the lessor territory with the exception of transportation (cars, trucks, trains) but including aircraft. Nevertheless, because VAT is a multi-stage tax, the leasing industry is affected in the context of intermediate transactions between lessors and commercial lessees.

At the Community level, the Sixth and Eighth VAT Directives set out rules to standardise the application of VAT and establish provisions on the recovery of VAT. In particular, under the Eighth VAT Directive, lessors may recover VAT paid in another member state. Differences in national VAT arrangements however continue to pose some barriers to leasing in other national markets. In Italy, for example, reimbursement of VAT is delayed for a long period since VAT claims can only be made annually. The consequence of this type of VAT recovery problem is to delay the capital flows associated with a cross-border lease and, ultimately, to discourage lessors from operating in those markets where VAT recovery problems are known to be common, particularly when, as in Italy, VAT repayments are paid at a rate well below normal investment levels.

Problems also exist for cross-border leases in the form of double VAT. Where a product is purchased in country "A" by a lessor operating from country "B" and leasing in country

"C", problems of double VAT may result and, although this should ultimately be recoverable under the Eighth VAT Directive, in practice it may amount to a disincentive to foreign lessors to enter some markets. There are, however, a number of creative measures which can be used by lessors to avoid double VAT. For UK-based lessors carrying out business in Italy, for example, this problem can only be avoided by routing transactions via Germany. VAT problems are therefore clearly not insurmountable for potential cross-border lessors, particularly since it is generally the branch established in the host country, as opposed to the head office in the home country, which is responsible for VAT returns. Overall, cross-national VAT cannot be considered a major barrier to cross-border leasing in the European Economic Area.

3.3.2 *Corporate tax*

Considerable differences exist between the levels of corporation tax applicable in each member state of the Community. Some of these differences provide attractive reasons for lessors to operate under particular national systems. In the UK writing down allowances, although not as attractive as the depreciation rules prior to the 1984 Finance Act, remain an important incentive in the market. The reintroduction of First Year Allowances of 40 per cent in the UK in October 1992 may provide another important stimulus for investment in leased assets.

The UK is not alone in providing certain tax benefits for leases. In the Netherlands, for instance, certain capital gains exemptions are available which increase its attractiveness as a base for leasing operations, while the existence of tax free areas within the Community, such as Shannon airport in Ireland, or the Coordination Centres in Belgium and Luxembourg tend to attract significant numbers of lessees.

For a lessor intending to operate in another national market, the situation is often not so favourable. Withholding tax problems exist for any lessor intending to do business in France, Germany or Italy since withholding tax is applicable to the whole of the lease, not just interest, and constitutes a disincentive to lease in these countries from another country.

There are also specific provisions in UK tax rules which have adverse implications for the establishment of a Single Market. These rules are applicable to UK lessors intending to finance assets outside the domestic market. In order to prevent the export of capital allowances, Section 70 of the Finance Act 1982 reduced the level of writing-down allowance for assets leased outside the UK from the standard rate (25 per cent) to 10 per cent per annum. Furthermore, since Section 70 of the Act also severely restricts contract variations for interest rate and tax changes on export leases, although such variations are common in the UK, the Finance Act 1982 has effectively increased the burden of risk on the lessor. The impact of UK tax rules has, since 1982, been to remove the motivation for UK lessors to enter into direct foreign leasing. Instead, UK lessors now tend to operate overseas leasing activities through international leasing groups, with the assets owned by a foreign leasing company within the group. According to Soper et al (1992) it is the view of UK lessors that the distinction which UK tax rules make between domestic and foreign customers is contrary to the establishment of a Single Market, and it is certainly clear that the present arrangements are contrary to the objectives of the Community's "1992" programme. The issue of taxation, however, remains highly sensitive at the Community level and the position of the Commission remains that the focus of this particular rule change must be on the national rather than the supranational level. At present, there are no indications how the Inland Revenue will resolve the issue.

3.4 *Other issues*

National rules other than those on accountancy, banking regulation and taxation also influence the potential for a Single Market in leasing. Access to the type of financial information which a lessor requires in order to make a credit decision, for instance, is often difficult for foreign lessors to gain access to. While access to financial

information in the UK market remains relatively easy to obtain, the dominant position of banks as the major lessors does, in certain national markets, hinder the ability of lessors whose head office is based in another country from gaining access to sufficient appropriate financial information about potential lessees to make a considered financial decision. This situation is a particular problem in those European markets where, under national rules, access to financial information is available only where a lessor is part of a banking group. This situation effectively discriminates against corporate lessors who are denied access to information on the basis that they are not a "bank".

Other national rules which create problems for lessors intending to carry out cross-border business are of a non-legal kind. Such rules may take the form of discriminatory behaviour, such as the behaviour of local money markets who may seek to protect domestic money markets by placing additional demands on foreign lessors who wish to enter a market. The impact of this type of discriminatory behaviour is impossible to quantify. Nevertheless, the effect of non-legislative rules as a significant barrier to cross-border business should not be discounted.

4. EXISTING AND PROPOSED SEM MEASURES

The Commission has always stated, both officially and unofficially, that it has no intention of directly interfering with the European leasing industry, unless on the express invitation of the industry itself. Where regulation does impact on the European leasing industry is through those measures which, although not directed at the leasing market, nonetheless influence the way in which lessors and lessees conduct their business.

4.1 *Accounting standards*

In the period 1990 to 1993, the Commission has specifically considered the issue of lease accounting through a lengthy process of detailed consultation and discussion at the Community level. To understand fully the Commission's reasons for addressing the issue of accounting for lease transactions, it is important to appreciate the historical context in which the current situation has developed.

The two relevant sets of Community rules, for the purposes of this discussion, are the Fourth and Seventh Company Law Directives. The Fourth Company Law Directive (78/660/EEC) lays down rules for the form and content of company accounts, while the Seventh Directive establishes common provisions for the consolidation of company accounts. Both these measures are "general" directives in the sense that they relate to all financial reporting by companies in Europe. They are not rules specifically concerned with leasing.

These two general directives took over ten years to be implemented into national legislation in all member states of the European Community. Acknowledging the growing importance of certain forms of finance compared with the early 1980s (when the directives were originally conceived) in 1990 the Commission Directorate-General responsible for accounting standards (DG XV) decided to set up an advisory forum to look at a number of specific issues not dealt with by the Fourth and Seventh Directives. The forum comprises Commission officials, representatives from national and international accounting standard-setting bodies and other interested parties whose business is affected to a significant extent by the particular accountancy question under discussion (including, in this instance, Leaseurope). The status of the advisory forum is that of a consultative committee rather than a standard-setting body. No voting takes place and the outcome of discussions will result only in a paper to be used as the basis of further Commission consideration of a specific issue.

Noting the rapid growth of leasing since the early 1980s and the findings of earlier studies such as the work done by FEE, which had shown that the Fourth Directive did not contain the rules necessary to regulate accounting for leases, DG XV decided fairly early on that the first of a number of specific issues to be addressed by the forum should be

leasing.

As the first step in its consultation procedure, DG XV asked European accountancy federation, FEE, to prepare a report as the basis of discussions within the forum and, although this report contained no clear conclusions, it had two important implications for the subsequent process of consultations. The most notable characteristic of the FEE report was undoubtedly its support for the international accounting standards authority norm, IAS17. IAS17 effectively embodies the Anglo-Saxon approach towards accountancy and, given that FEE is a member of the international accounting standards authority, it is perhaps not surprising that it should express a preference for this approach. The second implication of the FEE report to the forum, which became apparent from FEE's response to initial reactions from some members of the national delegations at Leaseurope, was that the adoption of a "mutual recognition" approach, using IAS17 as a benchmark, was its suggested way forward on the leasing question. The suggestion from FEE was that, after identifying common characteristics in each system, the forum should choose a preferred method, those countries which did not follow the preferred method then being required to provide additional information in notes annexed to the accounts. The provision of non-balance sheet reporting in a note is a principle already embodied in the Fourth Company Law Directive. Article 43(7) of the Directive requires that the leasing commitments should be published in the appendix to the lessee's balance sheet.

Despite the initial concerns of some national leasing industries within Leaseurope, for whom the preferred option for a European accounting standard was the Declaration of Seville, in the Spring of 1993 a compromise appeared to have been be reached, based on the principle of mutual recognition of differing national accounting standards, supplemented by the use of notes by the lessee to explain the status of the capitalised asset. On the basis of this principle, it is now anticipated that notions of economic and legal ownership, and the distinction between financial and operating leasing, will be acknowledged in the final paper to emerge from the advisory forum. The main impact of the forum is likely to be a recommendation that finance leases make more disclosures, with all essential information appearing on the lessee's balance sheet.

At the time of writing the position is that a new draft paper will be submitted to the advisory forum in May 1993, where it is possible that the text will be considered acceptable by participants in the forum. They may, however, decide that more time is needed to consider the implications of the document. If it is acceptable to the forum, the final paper will then be considered by the contact committee (comprising representatives of the national governments) before going before the European Commission which, despite the fact that the paper originally emanated from a DG XV initiative, will reach a collective decision based on the forum's findings. The Commission's decision may be that the paper should be published, either as a discussion document, a Commission Recommendation or a legal rule, or that no action should be taken as a result of the forum's deliberations. The outcome, at this stage, is difficult to predict although it is likely that some form of non-binding statement of best-practice will emerge later in the year.

Most of the discussion in the advisory forum's draft document is likely to centre on the definition of financial leasing contained in the proposals. Following the suggestion of Leaseurope, the method of identifying a finance lease will now be based on a number of criteria, each of which will carry an equal weighting.

For the Continental approach to accountancy, the compromise would mean that for the first time the notion of finance and operating leases will be accepted. The IAS 17 (SSAP 21) Anglo-Saxon accounting standard would not, however, be imposed throughout the Community as had been feared. Instead, while countries adopting the Continental approach towards the capitalisation of leased assets would acknowledge definitions of finance and operating leases, countries adopting the Anglo-Saxon approach to accounting, with leased assets appearing on the lessee's balance sheet, would be obliged to provide additional information on the legal ownership of those assets in notes annexed to the accounts.

4.2 *Banking regulation*

Community rules relating to banking supervision generally apply to 'credit institutions' whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account. Community rules thus cover a number of types of credit institution in addition to banks. A number of separate Community rules also refer to 'financial institutions' who, not being credit institutions, have as their principle activity the granting of credit facilities, including credit guarantees, to acquire participation or to make investments.

The main elements of existing EC legislation of relevance to the leasing industry are the First Banking Directive, the Directive on Consolidated Supervision of Credit Institutions, the Directives on the Own Funds and Solvency Ratios of financial institutions, and the Second Banking Directive. There are also Commission Recommendations on Large Exposures and on Deposit Guarantee Schemes. The Bank Accounts Directive (86/635/EEC), which sets minimum financial reporting standards for banks and other credit institutions, does not have any significant impact on the European leasing industry.

The First Banking Directive (77/80/EEC, OJL 322/30, 17 December 1977) sets out the conditions on which supervisory authorities in the member states may authorise credit institutions to operate within their jurisdiction. To receive authorisation a credit institution must meet an unspecified initial capital requirement test, have separate capital from the resources of its proprietors and have at least two company directors of "sufficient repute" and "sufficient experience". The Directive also permits credit institutions established in one member state to set up business in any other member state on a non-discriminatory basis. Member states were required to implement the Directive by 1979.

The First Banking Directive was augmented by the Directive on the supervision of credit institutions on a consolidated basis (83/350/EEC, OJL 193/18, 18 July 1983). The Consolidated Supervision Directive provides that credit institutions shall be subject to supervision on a consolidated basis if that institution owns, directly or indirectly, 25 per cent or more of the capital of another credit or financial institution. Supervision is carried out by the authorities in the member state in which the head office of the credit institution owning the share of capital is located. Member states were required to introduce measures to comply with the Directive by 1 July 1985.

The Directive on the own funds of credit institutions (89/299/EEC, OJL 124/16, 5 May 1989) has the objective of establishing a common definition for the capital base of credit institutions as a basis for setting minimum levels of capital adequacy. Member states are required to implement the Directive by 1 January 1993.

The Directive on solvency ratios of credit institutions (89/647/EEC, OJL 386/32, 30 December 1989) uses the definition of capital established by the Own Funds Directive to set a minimum harmonised risk asset ratio (capital adequacy) which must be met by all credit institutions. The aim of the Directive is to lay down a uniform method of assessing the ability of credit institutions to meet credit losses arising from the default of their customers. The Directives require all financial institutions to retain a minimum of 8 per cent solvency ratio between that institution's capital and assets, together with differing risk weightings, depending on the type of assets. Member states were required to adopt measures necessary to comply with the Directive by 1 January 1991, and ensure that credit institutions maintain the solvency ratios specified after 1 January 1993.

Following on from the earlier measures, the Second Banking Directive (89/646/EEC, OJL 386/32, 30 December 1989) sets minimum capital requirements of ECU 5m for an authorised bank and provides for the recognition of licences granted in any one member state in all other member states without the institution concerned having to go through a separate licensing process in each subsequent member state in which it wishes to carry out its

business.

The main objective of the Second Banking Directive, in conjunction with the Own Funds and Solvency Ratio Directives, is to enable credit institutions authorised to operate in one member state of the Community to set up branches and operate in other member states without obtaining authorisation from the supervisory authorities in the latter country.

As a result, from 1 January 1993, any credit institution may operate throughout the Community under a single banking licence (the "passport") once authorisation has been obtained from the national supervisory authority in the country in which its head office is established. The Second Banking Directive therefore establishes a system by which the equivalence of national banking rules must be recognised, subject to minimum provisions set out in the Directive, anywhere in the Community. Included within the scope of these provisions are finance leasing and hire-purchase, and condition sale or credit sale activities.

The issue of the single banking licence raises important issues for the UK leasing industry where national rules, drawn up by the Bank of England, differ from those in other countries in one important respect. Since the Bank of England ("the Bank") defines the scope of the Directive as applying to institutions which carry out deposit-taking and credit-giving activities, some independent and captive lessors do not come under the authority of the Bank and are subsequently not eligible for the single Community "passport". This situation arises because the definition used by the Bank (for the purposes of the Directive) differs from that of supervisory authorities in other parts of the Community. While the Bank of England requires that a financial institution offer both deposit-taking and credit-giving facilities, under the rules applied by the supervisory authorities in other European countries the approach is to look chiefly at the credit making activities of the institution and to consider this sufficient to be regarded as a financial institution, and hence be eligible for the passport.

Concerns have been raised by certain parts of the UK leasing industry that the Second Banking Directive will therefore exclude certain types of UK lessors from eligibility to the passport - chiefly captive and independent lessors which, since they are not the subsidiaries of banks and do not offer deposit-taking facilities, are not subject to supervision by the Bank of England. It is now widely recognised, however, that while the Second Banking Directive provides leasing companies which are regulated by the Bank with the Community "passport", its provisions relate only to the establishment of branches of existing authorised institutions, who may offer services on a cross-border basis. Other UK lessors are still able to set up subsidiaries in another member state in order to conduct business elsewhere in the Community.

4.3 *Taxation*

4.3.1 *VAT*

There is no doubt that VAT disparities between member states materially affect pricing of cross-border leasing transactions and, in the past, the Commission's strategy has been to propose two different bands of VAT, harmonised across all member states. The Commission, seeking to achieve unanimity on tax harmonisation in the Council, achieved little progress in this area and, undertook a change of policy, which resulted in progress being achieved in 1991 and 1992 on the establishment of a minimum rate for VAT.

Following a non-binding agreement on VAT rates in 1991, in July 1992 finance ministers of the twelve member states reached agreement on the principle that a legally binding minimum standard rate of VAT is required in order to achieve the proper functioning of the single market. This agreement will result in the maintenance of a minimum VAT rate of 15 per cent by all member states as of 1st January 1993. The agreement is for a five year period, after which time the arrangement will be reviewed.

The symbolic values of this agreement are potentially greater than the agreement itself,

since although only a minimum threshold for VAT was agreed, the measure is the first time that all member states (in particular the UK) have acknowledged the principle that a common VAT threshold is necessary to achieve a single market for goods and capital in the Community.

4.3.2 *Corporate tax*

The Directive on taxation of parent companies and subsidiaries came into force on 1 January 1993. The aim of the directive is to overcome the problems of double taxation which have occurred for companies operating subsidiaries in some member states. In other areas, however, the progress of Commission proposals on the approximation of national rules on corporate tax have been notable chiefly for the lack of progress achieved. Consequently, following withdrawal of the 1975 proposal for a Directive on direct taxation in 1990, the Commission established a Committee of independent experts, the Ruding Committee, to examine the extent to which national corporate tax regimes impact on competition and investment decisions within the European Community.

Proposing a new Community approach, based on the coordination of differing national tax regimes, the Ruding Report of 18 March 1992 concluded that, in order to reduce disparities between national corporate taxation rates, a minimum rate of 30 per cent should be introduced throughout the Community, and that member states limit the maximum rate of corporate tax to 40 per cent. These rates should be accompanied by greater transparency of national tax incentives. Although the Ruding Committee was unable to agree on the form that a single Community tax system should take, it confirmed this still remains the ultimate goal for the Commission.

The Committee's report furthermore stressed that distortions in Community competition continue to occur due to differences in the accelerated depreciation provisions available to companies under some national tax systems. The Report therefore recommends that a uniform treatment of depreciation be adopted, in accordance with the Commission's 1988 proposal, and sets out suggested minimum and maximum tax rates for each type of asset.

Although concentrating on general problems associated with assessment of the tax base, the Ruding Report does specifically call upon the Commission to harmonise basic tax provisions for leasing transactions in the Community. As has been noted earlier in this paper, however, before this task can be undertaken, harmonisation of accounting standards would be necessary first. The accounting standards issue is therefore crucial to the whole question of leasing taxation. Given the likely outcome of deliberations by the accountancy advisory forum, the adoption of a principle of mutual recognition of national accounting standards will not lead to the level of harmonisation necessary for the Ruding Report's recommendations on leasing to become practicable.

4.4 *Other issues*

4.4.1 *Structural fund guidelines*

Progress in the evolution of tax and accountancy rules for leasing in Europe have been slow because high levels of competition between national rules are taking place. Where common interests exist, it is more likely that competition amongst national rules will be overcome. The initiative launched by the Financial Control Directorate-General of the European Commission (DG XX) to draft structural fund guidelines is perhaps the best example of this in the context of the leasing industry and demonstrates that, where common benefits can be seen from agreement, differences between competing rules can be overcome, or at least put to one side, and augmented by Community rules which produce advantageous results for all players.

Initially, DG XX took the decision to draft general guidelines for the leasing industry for a number of reasons. Primary amongst these was that, although there had been a long experience of using leasing as a method of financing projects benefiting from Community grants and loans, the Commission recognised that there was a lack of coherence in its

approach to leasing as a form of finance[3]. The clarification of the eligibility of investment projects involving leasing finance was considered particularly important because of a number of characteristics of this financing mechanism, specifically the fact that the user is not the owner of the asset, but also other issues such as the uncertainty as to the residual value of the asset. The need to clarify Community rules was an acknowledgment that, in the case of certain Community Funds, reservations had existed in sanctioning the financing of Community-funded projects which involved leasing.

Furthermore, the decision to draft structural fund guidelines on leasing was in recognition of its growing importance as a form of investment and a means of offering lessees particular advantages in terms of tax benefits and flexibility which could not be obtained from other types of investment. The Commission also decided to clarify the eligibility of leasing for Community funding because of the particular benefits that leases offer for small-and medium-sized enterprises (SMEs), for whom other forms of finance are often difficult to secure during the initial start-up period of a business.

As a result of these motivating factors, in October 1989, the Commission adopted "General guidelines on the treatment of leasing in the framework of the Community's structural financial instruments", to be circulated within the Commission as a document to clarify the eligibility of leasing for Community finance.

The general guidelines introduced concepts of finance and operating leasing into the Community context and, despite the lack of applicability of these terms to some national industries represented within Europe, the distinction between the two forms of leasing was retained for internal Community purposes.

In recognition of the fact that more detailed guidelines were needed after an initial period of reflection on the operation of the general guidelines, by 1992 more detailed structural fund guidelines for leasing had been drawn up by Financial Control, entitled "Detailed guidelines on the treatment of leasing in the framework of the Community's structural financial instruments". The aim of this second document is to provide a checklist of relevant points to be considered by authorities responsible for the approval of projects financed with Community funds, both within the Commission and at the national level, to bring about the development of a common approach to the use of leasing and to ensure that Community interests are effectively safeguarded.

The process of consultation which led to the drafting of detailed guidelines began with the setting up of an internal Commission working group to assess the issue. This working group, at an early stage, sought technical advice from Leaseurope.

As a result of the deliberations of the working group it appears likely that, when the detailed guidelines are finally adopted, not only will the distinction between direct and indirect leasing referred to in the general guidelines remain, but reference to the differences between finance and operating leasing will also be retained. This latter distinction is not likely to be considered appropriate by all national leasing industries represented within Leaseurope, and it is anticipated that, when finally adopted, the detailed Commission guidelines will acknowledge that making this distinction is not always practicable due to variations in tax and accounting treatment.

As part of the normal Commission process of consultation, the accounting standards services within DG XV, who are responsible for consideration of the question of accounting for leases, were aware of progress on the structural fund guidelines for

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[3]According to the text of a speech given by Mr. Lucien de Moor, Director-General for Financial Control of the Commission of the European Communities to the Leaseurope Working Meeting, Barcelona 1992, entitled "The Intervention of Structural Funds in Leasing Operations".

leasing when considering the Commission advisory forum document on accounting standards for leases. The work of the two services in relation to the leasing industry is not, therefore, mutually exclusive.

5. THE NEGOTIATION OF SEM MEASURES

5.1 *Co-ordinating a response*

The role of any trade association is to represent the collective views of its members. At the European level, when national interests within an association vary, the process of change which that organisation seeks to influence becomes all the more complex. The European-level association will be required to take account of competing national interests, often interests which will seek to maintain the benefits accrued to their national industry by the characteristics of a particular rule framework, while seeking to achieve changes which will open up the domestic markets of other countries. Each constituent part of a European-level organisation will have its own set of priorities and goals which must be taken into account.

The role of a European-level organisation thus becomes one of placing diverse interests within a coherent strategy for co-ordinated action which will also take account of the diversity of national traditions. Only after this difficult task has been achieved can a European-level association focus its attention on influencing the rule-setter.

5.2 *Influencing the process of change*

In formulating Single Market rules for leasing the Commission has adopted a number of approaches in order to accelerate the convergence of national rule systems. The approaches used reflect the specific requirements of the issues themselves, and the impact that the industry itself has had on the rule-setting process.

5.2.1 *Accounting standards*

The accounting standards issue has been seen by some members of Leaseurope as central to the whole bargaining process with the Commission and has dominated the rule-setting agenda as far as the industry is concerned. The European industry's response to the perceived threat of new Community accountancy rules has been to advocate as the European norm the method most widely used in its member countries, namely the Continental approach as set out in the Declaration of Seville.

Within the accountancy advisory forum, set up by the Commission to consider the issue, specialist input was sought from both the leasing industry and the accountancy profession. While Leaseurope advocated the use of Continental accounting standards, the European accounting federation recommended the Anglo-Saxon approach used in the United States and the UK. After considering various options, including accepting an international accounting standard (IAS 17) or an equivalent national standard (SSAP 21) as the Community norm, it is now likely that the Commission will not seek to impose a uniform set of supranational accounting rules on the national leasing industries in Europe. Instead, the advisory forum seems likely to recommend establishing a framework within which mutual recognition of differing national traditions can be observed. Within this framework, competition among national rules would continue to take place, with the most widely used system of accounting practice eventually emerging through an evolutionary process of change.

Commission adoption of the mutual recognition approach to the accounting standards question would, while not resolving the differences between the Leaseurope position and that of the European accountancy federation, ultimately allow competing national rules to determine an evolutionary outcome to the accounting standards question.

5.2.2 *Banking regulation*

With regard to banking regulation, the formulation of Single Market rules has focused primarily on the Second Banking Directive. Based on the principles of mutual recognition and home-country control, the single banking licence is now available to most European lessors.

In that it allows most lessors to set up a branch in another member state without being subject to banking supervision in that territory, the directive is acceptable to most European lessors. Some potential problems with the application of the single Community licence do, however, remain particularly due to the fact that some lessors are not actually covered by Community provisions on banking supervision. This issue has been raised in the UK, where lessors who are not part of a banking group, are not recognised as financial institutions by the Bank of England and therefore are not entitled to the "passport" under the Second Banking Directive. There are no indications, however, that the Commission intends to take further action on this issue, taking the view instead that the issue is one to be dealt with by the appropriate supervisory authority in each member state.

With the Community "passport", the rule-setting process has achieved an outcome which is acceptable to the majority of European lessors. The mutual recognition approach has, however, led to difficulties for UK non-bank lessors due to the Bank of England's particular interpretation of its supervisory duties.

5.2.3 *Taxation*

Following publication of the Ruding Report the Commission is now seeking ways to achieve the gradual convergence of national rules on taxation. In the absence of the necessary political will to achieve progress on this issue, however, the stimulus for rule change is dependent on a change in the attitude of national governments. Possible rule changes are being held up by a preference for national tax regimes and by the uncertainties surrounding the Maastricht Treaty and the timetable for European Economic and Monetary Union. Harmonisation of corporate tax systems is consequently not an immediate concern for the European leasing industry.

Important issues still need to be addressed. In the UK, the reduced level of writing-down allowance for assets leased outside the UK effectively restricts the operation of the Single Market. The Commission, however, maintains that this is an issue to be resolved by the domestic rule-setter.

5.2.4 *Structural fund guidelines*

The draft detailed Community structural fund guidelines for leasing are indicative of the level of complexity required to achieve agreement amongst the various national members of Leaseurope. Because of potential for mutually beneficial returns from the achievement of an agreement, namely clarifying the eligibility of leasing transactions for structural fund financial assistance, and the fact that the guidelines are not binding rules, differences between national rules were overcome and agreement was reached with relative ease.

Despite concerns that the establishment of definitions of finance and operating leasing in Commission structural fund guidelines would set a precedent for the way in which the Commission would view the industry in the future, it was possible for representatives of the European leasing industries to reach agreement on their response to the draft text.

6. EVOLUTION OF A SEM FOR LEASING

The fundamental question which has been addressed in this paper is the extent to which the convergence of national rules and the establishment of a Community regulatory system are necessary for the operation of a single European market in leasing. In literal terms, achievement of this goal would require at least common accounting practice, with the implication of similar treatment of products for taxation purposes, and the introduction of a common regulatory framework within which lessors can operate.

The achievement of these objectives, in practice, requires sufficient openness of national markets to enable competition amongst rules to operate. The Commission's Single Market Programme is intended to achieve progress towards this through its various initiatives on the mutual recognition of accounting standards for leases, home-country supervision for branches of financial institutions in another member state, and harmonisation of corporate taxation and VAT. Thus far, the Single Market Programme has failed to achieve these aims: many of the crucial barriers which must be removed to achieve sufficient openness remain in place.

Progress on the establishment of a Single Market for leasing has been slow for a number of reasons. There is no co-ordinated attempt by the European Commission to address the evolution of rules for leasing systematically. Where progress has been achieved, for example with the adoption of structural fund guidelines for leasing, or through the deliberations of the accountancy advisory forum, the initiative for Community action has come from particular Directorates-General with specific policy objectives. As the Commission itself maintains, there has been no attempt to tackle the issue of leasing per se, nor will it do so unless expressly asked to by the European leasing industries themselves.

In the rule-setting process the Commission has, in common with the classic model of the Community policy-making process, turned to industry experts for specific advice on technical matters. Leaseurope has therefore formed an integral part of the process of change affecting the industry at the European level.

The role of Leaseurope, as an umbrella organisation representing each European leasing industry, is to concentrate on the objectives sought by the majority of its members. In recent years, this role has required focusing attention on the issue of accounting standards. Should the forum conclude its consideration of the lease accounting question, while the issue of accounting standards is likely to remain an important one, it may become a less time-consuming question for Leaseurope.

Where change is occurring, and is likely to occur in the future, is at the level of competition between national rules. Quite high levels of competition between rules are actually taking place and this process will continue without Commission regulation. The role of the Commission should therefore be to provide an appropriate level of support to enable the industry to fulfil this task, as it has done through the structural fund guidelines, and should maintain a suitable regulatory framework within which competition between rules can take place. Within this framework, although significant levels of developments are unlikely in the short- to medium-term, some change in the way that national leasing markets operate may occur over a longer time-scale. In general, however, the segmentation of national markets is likely to persist in the short to medium term.

Non-legislative barriers remain. Local knowledge and expertise are an important stimulus for lessees in their choice of a lessor and they will often see the benefits of retaining all their interests within one finance house. For lessors, entrenched attitudes towards financing foreign-produced assets remain. This means, for example, that lessors from some European countries do not in practice provide finance for foreign-produced goods, while equivalent finance for domestically-produced goods would be relatively easy to obtain.

Changes in lessor and lessee behaviour in the European leasing industry are likely to occur slowly. The level of cross-border transaction, will ultimately be determined by the perceived financial benefits of operating in a new market, as will the decisions of lessors to set up a branch or subsidiary in the territory of another Community member state.

In the final instance, the routes by which a Single Market will evolve in leasing will be on two levels. The first will at the level of cross-border transactions, an activity which already occurs in big-ticket leasing where the benefits of financing assets from a foreign-based lessor may be considerable and where potential exists for the development of the sales-aid market. The second level on which a Single Market for leasing will evolve is through the setting up of branches or subsidiaries of a leasing company in other national markets. At present only a few examples of pan-European operations exist.

7. CONCLUSIONS

Despite potential impact resulting from the mutual recognition of national accounting standards and simplification of supervisory procedures through the introduction of the Second Banking Directive, national leasing industries within Europe are likely to remain highly segmented and their rule systems extremely diverse.

A system of European rules will develop only slowly and will not necessarily be the result of Community regulation of the industry. Change is more likely to occur as a result of competition between existing national rule systems, leading to the evolution of an appropriate and sustainable framework of rules for the European leasing industry.

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APPENDICES

NATIONAL LEASING MARKETS

Introduction

The way in which a Single Market in leasing is likely to develop will be influenced by a range of internal and external rules, past and present market conditions, and expectations of the future. Each national market involves a complex environment within which financial, organisational and regulatory constraints all have an impact on the behaviour of firms. These factors can provide a stimulus to firms in their decision to lease. The particular characteristics of each national market therefore provide an important rule system within which crucial constraints and driving forces will contribute to the evolutionary process of development for leasing in Europe.

These appendices provide an overview of the important factors in each national leasing market. Separate appendices outline the situation in the six largest leasing industries (Germany, France, the United Kingdom, Italy, Spain and Sweden), while Appendix VII provides an overview of other European markets.

In preparing these appendices we are indebted to the work of Leaseurope and Arthur Andersen (1992), whose survey of leasing in Europe formed the basis for our work.

We have already acknowledged earlier in this paper that, to a large extent, generalisations about the characteristics of a European leasing industry are impossible to make because the leasing industry in Europe remains a series of highly segmented national markets. Each country study therefore begins with a description of the way that lessors organise themselves into interest groups in order to influence the rule setting-process and is followed by an analysis of the structure of that market. The particular characteristics of each national rule system, particularly in terms of accounting standards, banking regulation and taxation, will then be looked at in turn.

In producing an overview of the market structure of each national leasing industry there remain, however, a number of informational deficiencies which make comparability of data obtained from national sources extremely difficult. It is therefore not practicable to reproduce tables containing equivalent information for each country.

APPENDIX I

GERMANY

Although there are over 1300 leasing companies in Germany, the industry remains fairly concentrated, with the 86 members of the Federal Association of German Leasing Companies, the Bundesverband Deutscher Leasinggesellschaften (BDL), accounting for over 82 per cent of the market share of all leasing and almost 100 per cent of the real estate market. The leased assets of BDL member companies increased to Dm107.7bn in the year ending 1989 (World Leasing Yearbook, 1992).

German leasing companies can be broadly categorised as either captive lessors (subsidiaries of manufacturers), financial institutions or independent leasing companies. Although independent lessors constitute a numerically large number of the 1300 leasing companies in existence, captive lessors and financial institutions account for a large proportion the market due to the volume of annual business dealt with (Leaseurope/Arthur Andersen, 1992).

Market structure

Growth in the German leasing market has been particularly strong due to high interest rates on capital borrowing, which has made leasing an attractive alternative form of finance, and due to the impact of German unification. New business in equipment leasing amounted to Dm 40bn in 1991, with transactions in the five new Länder estimated to be Dm 3bn (World Leasing Yearbook, 1992).

Between 1976 and 1990 the total value of leased assets grew from Dm6.3bn to DM40.1bn and by 1990 leasing accounted for 10.2 per cent of total capital investment in Germany (see Table 1).

Table 1. *Total value of assets financed through leasing in Germany* 1976–90

Year	Total investment (Dm bn)	Financed by leasing (Dm bn)	Share of total investment (%)
1976	164.5	6.3	3.8
1977	176.4	7.7	4.4
1978	192.4	9.8	5.1
1979	217.3	11.8	5.4
1980	238.8	13.2	5.5
1981	239.0	16.5	6.9
1982	232.4	17.3	7.4
1983	241.9	20.2	8.3
1984	247.6	19.4	7.8
1985	264.1	21.4	8.1
1986	280.8	24.5	8.7
1987	292.3	28.4	9.7
1988	314.6	31.9	10.2
1989	348.8	36.0	10.3
1990	392.4	40.1	10.2

Source: IFO Institut, Munich.

In 1990 the industrial and service sectors, together with the consumer market, represented 97 per cent of all new leasing business in Germany (Leaseurope/Arthur Andersen, 1992).

The impact of unification on the German leasing industry has been considerable. Other conventional forms of lending have in many cases proved difficult for companies in the new Länder to secure, particularly because financial statements dating from the old regime have tended to be poor and inaccurate. Partly as a consequence of this, leasing has become widespread in the eastern states, often as part of a sales-aid package provided by captive lessors.

Special tax provisions have been introduced in the five new Länder to promote investment which have enabled lessors to offer particularly favourable conditions in leasing contracts. These provisions take the form of a special investment tax credit (12 per cent until 30 June 1992 and 8 per cent until 31 December 1994 on all new investment in equipment, except cars and aircraft). All equipment leased under the special tax provisions must remain in the new Länder for at least three years, and private use must not exceed 10 per cent of the total usage.

Favourable terms for leases in eastern Germany have been accompanied by large numbers of lessors in the equipment sector setting up branches or subsidiaries in the new Länder. According to the World Leasing Yearbook (1992) over 100 lessors are now operating out of the new states. A major contributory factor in the growth in branches and subsidiaries is undoubtedly the provision, contained within the special tax provisions, that to be eligible for the special rates all new investment must go through a lessor established in the new Länder.

In addition to tax provisions, a number of other subsidies and higher depreciation rates are also available in eastern Germany. Subsidies for new equipment and real estate (including leasing) are available at levels of up to 23 per cent of the value of the investment. Furthermore, up to 50 per cent of the first year can be written down in the year of purchase, or the completion of buildings or capital goods. This latter incentive cannot, however, be used in conjunction with special investment tax provisions.

National rules

Accounting standards

The concept of economic ownership, originally formulated as a means of distinguishing between instalment purchase transactions and rental agreements, essentially determines the way that leased assets are capitalised for the purposes of commercial and tax accounts. The significance of this concept for the capitalisation of leased asset is therefore crucial to an understanding of why a Community accounting standard based on the Anglo-Saxon approach would be unacceptable to German lessors.

Under German civil law, the lessor is normally both the economic and the legal owner of the asset, except in certain circumstances where the lessee can exclude the lessor from exerting an influence over the asset in the long term. In accordance with Section 39 of the Fiscal Code (Abgabenordnung) the economic owner is defined as the person who can exclude the legal owner from use of the asset.

Specific fiscal rules (leasing decrees of the Federal Fiscal Court) exist to distinguish between economic ownership in the case of full payout leases (where rental payments on the leased asset cover the acquisition and production costs of the asset and all incidental expenses, including the lessors's financing costs) and non full payout leases (where is is assumed that the lessee will be only one of several eventual users of the asset and where rental payments will only cover a small part of the total acquisition and production costs of the asset).

If, under these specific fiscal rules, the lessor is the legal and the economic owner of the asset, he must capitalise the asset on his balance sheet and depreciate it on the basis of its commercial life. Rental payments received from the lessee are then treated as income in the lessor's accounts. In the case of full payout lease where the lessor

is the economic owner, the lessee does not, therefore, capitalise the asset. Rental payments are treated as operating expenses in the lessees accounts and financial obligations, such as leasing contracts, which do not appear on the balance sheet must be disclosed in notes to the accounts. Most lease contracts in Germany take this form.

Where rules established by the Federal Fiscal Court do not apply, economic ownership of the leased asset lies with either the lessor or the lessee, depending on which party would benefit from an increase in the value of the asset, or which party bears the risk of any reduction in the value of the asset. Economic ownership will lie with the lessor if he bears the risk of a reduction in value or the benefit of an increase. Economic ownership will lie with the lessee if he bears the risk of a reduction in value and, in addition, stands to benefit from an increase. The asset is capitalised on the balance sheet of the economic owner.

Since no distinction is made between commercial and tax accounts, where economic ownership lies with the lessor, the asset must always be capitalised in the lessor's balance sheet. In such circumstances, rental payments made by the lessee are tax-deductible. If the asset is capitalised in the lessee's balance sheet (and is therefore defined as a credit purchase) rental payments are no longer tax deductible. Considerable tax benefits therefore accrue to the lessor provided that the asset is not capitalised in the lessee's balance sheet. These benefits would be lost under Anglo-Saxon accounting procedures.

Banking regulation

While independent lessors are not generally subject to banking supervision, leasing firms which are owned by banks come within the scope of supervision by the Bundesaufsichtsamt (Federal Office for Banking Supervision) and are required to meet the same capital requirements or consolidation of credit exposure as credit institutions. Bank-based lessors will be required to undergo group supervision when leasing activities are consolidated with those of the parent credit institution.

Group supervision will apply when a credit institution has at least a 40 per cent shareholding in a leasing subsidiary, or where that credit institution directly or indirectly exerts controlling influence over the activities of its leasing subsidiary. When these criteria are met, the parent company must take the activities of the leasing subsidiary into account when determining its capital requirements for the purposes of supervision.

Where a credit institution has at least a 50 per cent shareholding in a leasing subsidiary, or where that credit institution directly or indirectly exerts controlling influence over the activities of its leasing subsidiary, the parent company must take into account the credit exposure of leasing activities when determining its overall exposure to borrowers.

Under the supervisory procedures of the Bundesaufsichtsamt the single Community banking licence, established by the Second banking Directive, would be available to German lessors which fall within the scope of the above provisions.

APPENDIX II

FRANCE

Membership of the Association Française des Sociétés Financières (ASF) is compulsory for all organisations offering crédit bail or location avec option d'achat, with the exception of banks. Despite difficult market conditions, membership of the ASF has remained relatively stable, falling slightly from 257 in 1990 to 254 in 1991. In 1991 there were 10 new members, 14 companies leaving the market, and 8 transfers of business (World Leasing Yearbook, 1993).

Table 1. Largest French leasing companies, 1991 (in order of value of assets acquired in 1991)

	Equipment leasing[1] New business 1991	
	Amount (Ffmn)	Market share (%)
BNP Bail	6.7	10.9
UFB Locabail	6.1	9.9
Slibail	5.4	8.8
Société Générale	4.8	7.8
Ucabail	3.6	5.8
Locafrance Equipement	2.9	4.7
Bail Equipement	3.2	5.2
Cecico	2.8	4.5
Diac Entreprises	1.6	2.6
Sovac Entreprises	1.4	2.3
Total	38.5	62.7
Total market	611.4	100

Source: World Leasing Yearbook (1993).
Note: 1. Crédit bail only.

Market structure

The leasing sector in France has expanded rapidly since the early 1980s, although it has slowed down considerably in more recent years, reflecting a general reduction in investment levels during difficult economic conditions in the early 1990s. In 1991 new corporate leasing business in France fell by 11.5 per cent to FrF76.6bn (see Table 2).

Competition for new business between lessors has increased, resulting in lower margins. The incidence of bad debt has also increased as the number of lessees going out of business rises. Increased competition has resulted in the introduction of innovative provisions into contracts to the benefit of lessees, such as the provision of support services for computer and fleet vehicle lease transactions, and the inclination of lessors to take on some of the risks relating to the residual value of the leased asset (Leaseurope/Arthur Andersen, 1992).

Table 2. Total value of assets financed through corporate and consumer equipment leasing in France 1990–91 *(FF bn).*

Type of lease	1990	1991	1990–91 (%)
Total leasing to companies	86.5	76.6	–11.5
crédit–bail	71.4	61.4	–13.9
LOA	5.4	5.0	–6.2
location financière	9.7	10.2	4.8
Total leasing to final consumers	18.0	14.7	–18.3
with purchase option	17.8	14.5	–18.7
without purchase option	0.15	0.17	10
Total	104.5	91.3	–12.6

Source: World Leasing Yearbook, 1993.

National rules

Types of lease contract

Leasing transactions in France may take the form of a number of distinct forms of contract, according different legal status to each and carrying with them different implications for the rights and obligations of lessors and lessees. The four main types of contract are crédit–bail, location simple, location avec option d'achat and crédit–bail immobilier.

A leasing contract whereby the lessee has use of an asset for a fixed period of time (without an option to purchase) is available as location simple while, in addition, arrangement where the lessee has an option to purchase at the end of the contract period are available as crédit–bail, location avec option d'achat and crédit–bail immobilier. This option to purchase distinguishes the French leasing market from that of some other national leasing industries, where an option to purchase at the end of the rental period is a hire purchase agreement, rather than a lease. The rules governing the type of lease contract offered by French lessors are therefore markedly different from some European countries.

Under the Civil Code, location simple is defined as a rental contract where the lessor provides the lessee with an asset for use during the period of the lease[1]. The lessee does not have an option to purchase and must return the asset at the end of the contract.

Crédit–bail is defined by law as being a transaction involving the leasing of material and equipment, purchased for the purpose of such leasing by companies which remain the owner thereof, and where such a transaction, however qualified, provides the lessee with an option to purchase all or part of the leased asset, upon payment of a predetermined purchase price which takes into account, at least in part, the rental payments[2]. Since crédit–bail allows for regular rental payments forming part of the operating costs of the lessee's company, considerable tax benefits may result. Crédit–bail does not apply to the leasing of goods for private consumers.

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[1]Articles 1708 and 1709 of the Civil Code.

[2]Article 1 Law No. 66–455 of 2 July 1966, as amended by the Ordnance of 28 September 1969.

The crédit-bail sector is dominated by specialised financial institutions (sociétés financières spécialisés) which control approximately 95 per cent of the market. The remaining 5 per cent of the market is taken up by banks, although rarely engaged directly in crédit-bail contracts.

Specialised financial institutions may be categorised as bank-owned companies, captive lessors, insurance-owned companies and some others. The market share of the four categories of specialised financial institution is shown in Table 3.

Table 3. Share of French leasing market by type of institution, 1990

Type of institution	Market share (%)
Bank-owned	65
Captive	16
Insurance company owned	13
Others	6

Source: ASF (1990) and Leaseurope/Arthur Andersen (1992).

Because leasing to consumers cannot be carried out under the conditions of a crédit-bail contract, as an alternative consumers can enter into a location avec option d'achat (LOA) contract. An LOA contract has the same features as a crédit-bail contract, but is regulated by different legal provisions under consumer protection law[3].

A crédit-bail immobilier contract may be used where property is leased for commercial use. Specific legal and taxation provisions are applicable, and the lessor may trade as a Société Immobilière pour le Commerce et l'Industrie (SICOMI). SICOMI status carries with it a number of tax advantages, however the 1991 Budget announced the abolition of SICOMIs by 1 January 1996, and this process began on 1 January 1991 with the removal of special tax conditions for the financing of office construction, at that time representing a third of all SICOMI business (World Leasing Yearbook, 1992).

Since leasing companies offering crédit-bail or location avec option d'achat contracts in France are (with the exception of banks) required by law to be members of the ASF, over 95 per cent of regulated leasing business in France is carried out by members of the ASF (Leaseurope/Arthur Andersen, 1992).

Accounting standards

No notion of economic ownership is recognised in France. Taxation rules are therefore based on the concept of legal ownership and, as legal owner, the lessor must capitalise a leased asset on his balance sheet. By way of an exception to this rule, in circumstances where equipment is sold under a sale agreement with a retention of title clause (Vente avec Clause de Réserve de Propriété) depreciation is carried out by the lessee, despite the fact that legal ownership remains with the lessor until the final purchase payment is made.

In general, however, the lessor retains legal ownership of the asset under location simple, and under crédit bail and location avec option d'achat contracts prior to the exercise of a purchase option. The depreciation of the leased asset is therefore shown on the lessor's balance sheet until a purchase option is exercised, when the lessee becomes the legal owner of the asset and capitalises it on his balance sheet. When,

[3] Law No. 78-22 of 10 January 1978.

under crédit-bail or location avec option d'achat, the lessee exercises a purchase option, the lessor writes off disposal of the asset to the profit and loss account.

This differs from the situation in some other European markets, where the economic owner of the asset (the lessee) may benefit from tax depreciation rules. Where a French lessor provides cross-border asset finance to a lessee in this type country, therefore, it is relatively easy for both parties to benefit from local depreciation allowances.

Banking regulation

French banking supervision by the Commission Bancaire extends to lessors taking retail deposits to those conducting operations such as crédit bail, even though deposit taking may not be part of their normal business activities. Because both crédit-bail and location avec option d'achat provide the lessee which an option to purchase, both are treated as credit operations by the Commission Bancaire. Location simple, which does not provide the lessee with a purchase option, is not subject to banking supervision under French law.

By including within the scope of banking supervison both companies which accept deposits and those that give credit, through the Second Banking Directive French banking law accords eligibility for the single banking licence to non-bank lessors who provide crédit bail facilities. Crédit-bail companies will therefore be able to set up a subsidiary in the territory of another member state without being subject to local banking supervisory rules.

APPENDIX III

UNITED KINGDOM

The UK equipment leasing industry, consists of over 1000 companies. The industry is represented in Leaseurope by the Finance and Leasing Association (FLA), which was formed on 2 January 1992 by a merger of the Equipment Leasing Association (ELA) and the Finance House Association (FHA). The decision of the two associations to merge stemmed from the fact that, with tax considerations being less important and with traditional divisions between sectors of financial services becoming less rigid, a united association would make both administrative sense and would strengthen the lobbying power of the UK industry (Soper et al, 1992). The FLA is now organised into an Asset Finance and Leasing Division, which covers the interests for leasing and other business in the commercial sector, a Consumer Finance Division and a Motor Finance Group.

The Association has over 100 members, including finance house subsidiaries of the four largest UK clearing banks. The latter account for over 65 per cent of all new business undertaken by FLA members (Leaseurope/Arthur Andersen, 1992). Finance houses generally offer finance and operating leases and vehicle contract hire, and in addition provide other forms of credit facility, such as hire purchase and consumer credit. The remainder of the FLA's membership consists of merchant banks, captives (subsidiaries of manufacturers) and lessors specialising in certain types of asset.

Captive lessors offer lease contracts on equipment relating to their manufacturer parent company, for example fleet leasing facilities for motor vehicles, and often have a price advantage over other lessors since they are able to offer special discounted rates from parent companies. Captives and their parent companies have an additional incentive to lease since, by offering guarantee residual values for leased assets, it is possible to effectively control the second-hand market for their equipment (Leaseurope/Arthur Andersen, 1992).

Specialist lessors, concentrating on certain types of assets, retain significant niche markets where technical knowledge is important, for example in computers. In addition, small independent lessors do exist, although they represent a small proportion of the overall market.

The value of real-estate leasing in the UK is much greater than that of equipment leasing, however the two sectors are distinct entities in the UK, largely because much less favourable tax depreciation is available for real-estate leasing. Real-estate leasing tends to be dominated by specialist companies.

New business for FLA members in the equipment leasing sector fell by 1 per cent in 1991 to 10.2bn while the market share for fixed investment in plant and equipment increased by 2.6 per cent to 23 per cent (World Leasing Yearbook, 1993).

Table 1. Largest UK leasing companies, 1990 (in order of value of assets acquired in 1990)

	Assets acquired for leasing in 1990[1] £m	Income receiveable in 1990[1] £m	Net book value of leased assets at 31.12.90[2] £m
Lombard North Central plc[3]	3,324	3,097	4,150
Barclays Mercantile Business Finance Ltd.	1,943	1,995	4,001
Lloyds Leasing Ltd.[4]	1,586	1,828	2,625
NWS Bank plc[5]	1,250	748	1,616
TSB Group Ltd.[6]	792	622	1,273
Forward Trust Group Ltd.	742	1,173	2,478
S.G. Warburg & Co. (UK) Ltd	448	270	828
Royal Bank Leasing Ltd.	360	337	1,071
All other ELA members	3,850	2,640	6,765
Total ELA members	14,295	12,710	24,807

Source: Soper, Munro & Cameron, (1992).
Notes: 1. Includes purchase option business as well as pure leasing.
2. Leasing only (no purchase option).
3. Including the business of National Westminster Bank plc.
4. Including the business of Lloyds Bowmaker Finance Group.
5. Subsidiary of Bank of Scotland Group.
6. TSB Group Ltd. comprises two ELA member companies, Hill Samuel Asset Finance Ltd. and United Dominions Trust Ltd.

Market structure

In 1990 the UK continued to be the largest leasing business in Europe, accounting for 23.8 per cent of the total European leasing business, and the third largest in the world behind Japan and the United States (World Leasing Yearbook, 1992).

Table 2. Total value of assets financed through leasing, 1990

Type of asset	ECU bn	£bn	Share of global investment
Moveable assets	18.8	13.4	31.8%
Real estate	1.2	0.9	not available
Total	20.0	14.3	–

Source: Leaseurope/Arthur Andersen, (1992).

In 1989 investment financed through leasing rose to 19 per cent of total investment (Leaseurope/Arthur Andersen, 1992), although the UK leasing market is currently experiencing the effects of the general economic recession, which has brought with it an increase in bad debts, arrears and insolvencies.

In 1990 the total value of moveable assets financed through leasing in the UK , including business with and without purchase options, was ECU18.8bn see Table 2). This figure

represented 28.5 per cent of all UK fixed investment in plant and equipment (World Leasing Yearbook, 1992).

National rules

Types of lease contract

Unlike some other countries (such as France, where under a crédit bail contract the lessee has the option to purchase at the end of the lease) in the UK an option for the lessee to purchase the leased asset may not be given. It is this element which distinguishes leasing from other forms of finance and allows the benefits of capital allowances to accrue to the lessor.

In the UK leasing can be distinguished from hire purchase agreements on these terms. In the latter case, legal title of the asset does pass to the lessor. This could occur at the end of the agreement, when all instalment payments have been made and the terms of the contract are complete. However, because the UK tax system recognises at the outset that a hire purchase agreement ultimately involves a purchase rather than the lease of an asset, the hirer rather than the financier can claim capital allowances, even if the financier retains legal title to the asset.

Whether finance taken is in the form of a lease or a hire purchase contract will often depend on whether the financier or the user is in the best position to make use of capital allowances at that time. Indeed, both lease and hire purchase agreements are often available from the same leasing companies. Where the lease option is used, the particular form of the agreement will depend on the specific requirements of the lessor and lessee.

Accounting standards

A description of UK accounting standards was given in section 3.1 of the main paper. The introduction of the Statement on Standard Accounting Practice 21 – Accounting for Leases and Hire Purchase Contracts (SSAP21) removed the benefits of off-balance sheet financing for leases in the UK. Prior to this, finance leases had been considered an off-balance sheet form of finance; there was no obligation on the part of the lessee to disclose leases in their published accounts.

Taxation

Between early 1970s and the mid-1980s, tax considerations and the benefits of off-balance sheet financing for lessees provided the main stimulus for the growth of leasing in the UK. In 1971, of a first-year tax allowance of 100 per cent on all capital expenditure in plant and machinery was introduced with the aim of stimulating investment in manufacturing and business. The 100 per cent tax depreciation available on plant and machinery also had the effect of attracting profitable banking groups, with substantial tax liability, to equipment leasing. The benefits of tax depreciation rules were then passed on to the lessee in the form of favourable lease arrangements. From 1984, the 100 per cent first-year allowance was gradually phased out and replaced by a 25 per cent writing-down allowance. The phasing out of the first-year allowance led to a temporary increase in leasing activity

The current situation is that capital allowances equivalent to tax-deductible expenses are normally available at statutory rates on expenditure on assets, including plant and machinery, industrial buildings and structures. In order for the lessor to qualify for the capital allowance, legal ownership of the asset must lie with that party. All assets qualifying for capital allowances are "pooled" and the capital allowance is calculated at 25 per cent p.a.. A general pool includes all plant and machinery. Separate asset pools exist for cars, short-life assets, and foreign leased assets (the latter calculated at 10 per cent p.a.).

Certain tax incentives to lease remain, particularly where the lessee has no tax liability; where a small tax timing benefit can be exploited; and where off-balance sheet financing continues to be important for lessees in operating leases.

APPENDIX IV

ITALY

Two trade associations exist in Italy: the Associazione tecnica delle Società Finanziarie di Leasing e di Factoring (A.TE.FI) and the Associazione Italiana Leasing (ASSILEA). A.TE.FI and ASSILEA members account for over 90 per cent of the total volume of leasing business (Leaseurope/Arthur Andersen, 1992). Since 1990, the two leasing associations are both represented by a joint delegation to Leaseurope, the Rappresentanza italiana presso Leaseurope - Commissione Congiunta, and this joint representation is reflected in the apparently large increase in Italian leasing business reported in Leaseurope statistics in 1990.

While over 1000 lessors operate in the Italian market, about 50 of the largest lessors account for almost all leasing business conducted (Leaseurope/Arthur Andersen, 1992). The Italian leasing industry is dominated by bank-owned leasing companies. Two large captive leasing companies, the Fiat subsidiary Savaleasing and Olivetti Leasing also have significant market shares, while independent lessors, such as ILC Italia, continue to retain a presence in niche markets.

Table 1. Largest Italian lessors (by volume) 1991 in Lire bn.

	volume 1991	% increase since 1990
Italease	1,411	12.7
Isefi	899	12.0
Selma BPM	813	37.6
Locat	771	23.9
Centroleasing	735	-2.2
Agrileasing	731	12.3
Leasint	729	13.8
Montepaschi	656	13.0

Source: World Leasing Yearbook (1993).

Market structure

In 1991 leasing represented 15 per cent of total investment in Italy (World Leasing Yearbook, 1993) although growth in the value of new leasing contracts slowed down considerably that year (see table 2). Approximately 30 per cent of all leasing business is subsidised by preferential interest rates and is due, in particular, to government investment incentives for Southern Italy. Subsidies are obtained through government agencies and constitute loans granted to lessors at reduced interest rates which are passed from the lessor to the lessee in lease rentals.

Since the beginning of the economic slowdown in the second half of 1990, Italian leasing companies have sought to consolidate their market position by streamlining their operations and through mergers and acquisitions (Leaseurope/Arthur Andersen, 1992).

Table 2. Growth of Italian leasing contracts 1988–1991

	1988	1989	1990	1991
Number of contracts drawn up	192,000	209,000	369,519	370,000
Value of contracts (ILbn)	8,873	10,025	23,782	24,215

Source: World Leasing Yearbook (1993), A.TEFI 1988–1989, A.TE.FI & ASSILEA 1990–1991.

National rules

Types of lease contract

Lease contracts are not specifically defined under the Italian Civil Code. According to Leaseurope/Arthur Andersen (1992), in the absence of a legal definition a lease contract may, in theory, be regarded as either a conditional sale or as a loan. The legal status of a lease contract in Italy is therefore unclear.

In general terms, either a finance or an operating lease may be used. A finance lease (locazione finanziaria) in Italy may take the form of a contract where the lessee assumes all the risks involved with the asset and has the option to purchase at the end of the lease period. Specific tax benefits may accrue from locazione finanziaria contracts. An operating lease (locazione operativa) involves the leasing of an asset for a period of normally less than two years and no purchase option will be available at the end of the lease term; a locazione operativa contract will often also involve the provision of other services such as maintenance and insurance cover for the asset.

Accounting standards

No notion of economic ownership exists in Italy. Only the legal owner may capitalise an asset in his accounts. Under locazione finanziaria and locazione operativa contracts (where the lessor retains legal ownership of the asset throughout the duration of the lease) the lessor must record capitalisation in his accounts. Where the lessee exercises a purchase option under a locazione finanziaria contract, the lessee may capitalise the asset in his accounts once he becomes legal owner of the asset.

Banking regulation

Following adoption of the Second EC Banking Directive, leasing companies have sought the introduction of a comprehensive regulatory regime for the leasing industry in Italy, including the introduction of a legal definition of a lease contract into Italian law. Clarification of the legal position of leasing in Italy is chiefly sought as a means of enabling Italian credit institutions to be eligible for the single Community banking licence, which would permit Italian lessors to conduct business in other EC countries. The appropriate form of national legislation is still under consideration by the Italian government.

Taxation

The introduction of new taxation rules in 1988 (Testo Unico delle Imposte sui redditi) removed some of the tax advantages of leasing. The Testo Unico does, however, provide greater clarity regarding the tax treatment of leasing transactions. A number of smaller leasing companies, which had been set up specifically to benefit from the tax position prior to the Testo Unico have subsequently left the market.

For foreign lessors with no permanent branch or subsidiary Italy, prior to the introduction of the 1988 consolidated legislation on income tax, lease payments made by

an Italian lessee were subject to a deduction of 21 per cent of the total rental amount. Because of some remaining confusion over the relationship between the consolidated legislation and other tax laws, problems remain for determining the level at which foreign leasing companies should be taxed on income generated in Italy.

Specific VAT problems also exist for both export leasing and the financing of assets in Italy by foreign lessors. For export leasing, the transfer of goods from the supplier to the leasing company is subject to Value Added Tax while the transfer by the lessor to a foreign lessee is exempt from VAT, being regarded as the provision of a service to a non-resident. The profitability of an Italian lessor may therefore be affected in the interim period before VAT is recovered. Italian legislation currently being proposed should eradicate this trade barrier by permitting lessors to purchase VAT-exempt goods for export purposes. For assets financed by foreign leasing companies, provided such lessors are established elsewhere in the European Community VAT may be recovered at the the asset is purchased or imported under Presidential Decree 633/72. In practice, however, foreign lessors continue to experience significant delays in receiving VAT returns.

APPENDIX V

SPAIN

In Spanish leasing industry is represented by the Asociación Espanola de Leasing (AEL), with a membership of 96 leasing companies. AEL members account for 95 per cent of all new leasing business done in the Spain. It is estimated that, at the end of 1989, there were was a total of 122 leasing companies in Spain (Leaseurope/Arthur Andersen, 1992).

The majority of leasing business by volume is carried out by bank-owned subsidiaries. In 1990, 50 per cent of leasing transactions were carried out by the national bank subsidiaries, 14 per cent by subsidiaries of savings banks, 11 per cent by the joint subsidiaries of banks, 7 per cent by the subsidiaries of foreign banks, 9 per cent by captive lessors, and 9 per cent by other leasing companies (AEL, 1990 and Leaseurope/Arthur Andersen, 1992).

Market structure

The Spanish leasing industry grew by an average rate of 77 per cent each year between 1985 and 1988 at a time when generous tax treatment was available for leases. The introduction of the General Accounting Plan in 1988 has been a contributory factor in the fact that, between 1989 and 1990, a 4 per cent decrease to Pesatas 1,113,066m was recorded in the total volume of investment financed through leasing in Spain (see table 1).

Table 1. Total value of assets financed through leasing in Spain, 1990

	ECU bn	Pesatas bn
Movable assets	7.6	981
Real estate	1.0	132
Total	8.6	1,113

Source: Leaseurope/Arthur Andersen (1992).

Together with the onset of economic recession from 1990 and the associated increase in bad debts, it is possible that a further reduction in leasing business may result in the loss of some small leasing companies from the market in the near future.

National rules

Types of lease contract

The characteristics of a lease contract are set out in Law 26/1988. This sets out the definition of an arrendamiento financiero contract, which should give the lessee a purchase option on the leased assets exercisable at the end of the lease term. An arrendamiento financiero must comply with rules relating to the minimum term of the contract, the composition of rental sums and strict disclosure requirements. An arrendamiento financiero benefits from special accelerated tax depreciation rues not available for other forms types of lease contract.

A small number of non-arrendamiento financiero lease contracts are concluded each year, but numbers remain low due to the beneficial tax rules available under arrendamiento financiero terms.

Accounting standards

From 1991 the off-balance-sheet advantage of leasing was effectively removed with the coming into effect of General Accounting Plan requirements that the lessee capitalise certain leased assets as intangible assets. This measure necessitates by law that both the leased asset and the outstanding payments for the asset must be capitalised on the balance sheet of the lessee.

The General Accounting Plan also requires that the lessee must reflect the financial and economic status of the lease. To achieve this objective, since a lessee is not the legal owner of the asset, he must instead capitalise the asset as a right of use (an intangible fixed asset).

Banking regulation

Under Spanish law, companies taking rental deposits and those carrying out certain credit operations (such as arrendamiento financiero) are regulated by the Banco de Espana (Spanish Central Bank). Banking supervision therefore encompasses both the protection of retail depositors and the control of credit.

Taxation

Under the 1988 General Accounting Plan, a lessee no longer has to account for expenditure such as rental and depreciation in the commercial accounts and in order to qualify for tax deductions. Tax deductions are available for all qualifying items in tax accounts.

APPENDIX VI

SWEDEN

Since 1 August 1991, banks have been permitted to carry out leasing business in Sweden for the first time, and this liberalising measure resulted in the resignation of 12 finance houses owned by banks from the Association of Swedish Finance Houses (the Finansbolagens Förening) at the end of 1990. These bank-owned finance houses have subsequently become members of the Swedish Bankers' Association (Svenska Bankföreningen). The Association of Swedish Finance Houses now has 33 members and, together with the Swedish Bankers' Association, accounts for 80 per cent of all leasing business undertaken in Sweden (Leaseurope/Arthur Andersen, 1992).

Market structure

The Swedish leasing industry is the sixth largest in Europe, with a total volume of movable assets financed through leasing of Skr20.3bn in 1990 (see table 1).

Table 1. Total value of assets financed through leasing in Sweden, 1990

	ECU bn	Skr bn
Movable assets	2.7	20.3
Real estate	1.6	11.7
Total	4.3	32.0

Source: Leaseurope/Arthur Andersen (1992).

Following the removal of currency controls between Sweden and the European Community in 1989, leasing in foreign currency has increased to a share of 20 per cent of leasing business in 1990 (World Leasing Yearbook, 1992).

Following deregulation and economic slowdown, the immediate prospects for the Swedish leasing industry is of increased competition, although it is unlikely that a significant number of lessors will cease to trade, most notably because the industry underwent important changes relatively recently with the Finance House Act The 1988 Finance House Act introduced strict requirements for all companies undertaking financial leasing. Up to half of the finance houses trading at this time left the market as a result of the new regulatory measures.

National rules

Accounting standards

Leased assets are capitalised and depreciated in the accounts of the lessor. Since there is no notion of the lessee assuming ownership of the asset, it is not capitalised in the accounts of the latter. Where a significant proportion of the lessee's assets are leased, additional information must be disclosed in notes to the commercial accounts (Leaseurope/Arthur Andersen, 1992).

Banking regulation

In the region of 100 leasing companies are regulated under Swedish law and are covered by the Financial Supervisory Authority (Finansinspektionen). All companies engaged in financing activities must be in possession of a licence issued by the Finansinspektionen. Of the 100 regulated companies, 15 are bank-owned subsidiaries, while the others are captive lessors, or owned by distributors, insurance companies or private individuals. In 1989 non-bank owned lessors accounted for 60 per cent of the market, although this

amount had decreased by 1991.

All leasing companies are subject to supervision, even those that do not take retail deposits in the course of their business, since they offer credit facilities. The approach to banking supervision in Sweden therefore corresponds closely to that in France and Spain, and differs from supervision in Germany and the UK, where supervision is only for the purposes of regulating deposit-taking institutions (Leaseurope/Arthur Andersen, 1992).

Regulation of the Swedish leasing industry is currently under review by a government commission has been set up to propose new legislation affecting the industry, including tax and accountancy provisions. The commission's report on the sale and leaseback of real-estate property was published in 1991 and a further report on the leasing of moveable assets is expected in 1993.

APPENDIX VII

OTHER EUROPEAN MARKETS

Belgium

Leasing companies in Belgium are represented by the Association Belge des Entreprises de Leasing (ABEL) the members of which account for approximately 90 per cent of the total leasing business in Belgium.

Market structure

In 1990 the volume of business dealt with by Belgian Leasing Association members increased by 18.4 per cent compared to 1989. The value of assets leased in 1990 was BF98,580m, with the largest increases occurring in machines and industrial equipment leasing. Nevertheless, motor vehicles accounted for 45.4 per cent of total volume leased.

Overall, leasing accounted for 7 per cent of total investment in moveables and immovables in 1990 (World Leasing Yearbook, 1992).

National rules

Types of lease contract

Belgium is one of the few Community countries in which a legal description of leasing is set down. This contained in Royal Decree No. 55 of November 10, 1967. Leasing is defined as full pay-out leasing with a purchase option, under which the lessor retains legal title to the asset. Title is transferred only when the lessee exercises the purchase option. Operating leases (normally non-full pay-out leases) do not fall within the definition of a lease under Belgian law, and consequently have the status under law of a hire contract. Even so, for accounting purposes, an operating lease must be recorded as such on the balance sheet of the lessee.

Banking regulation

Under Royal Decree No. 55, lessors must be approved by the Ministry of Economic Affairs. In 1990 over 200 leasing companies were is possession of approval from the Ministry of Economic Affairs to carry out business as a lessor.

Netherlands

The Dutch Leasing Association (the Nederlandse Vereniging van Leasemaatschappijen) represents lessors operating in the equipment and real-estate sectors. Approximately 90 per cent of all leasing business in these sectors is carried out by NVL members. Vehicle leasing forms a separate part of the market, the leasing companies in this sector being members of the Dutch Autoleasing Association (Vereniging van Nederlandse Autoleasemaatschappijen - VNA).

Bank-owned subsidiaries dominate the Dutch leasing industry. In particular, the three largest Dutch banks, ABN-AMRO, NMB Postbank and Rabo have large shares of the leasing market, as do the subsidiaries of a number of large foreign banks. Insurance company-owned leasing subsidiaries are, however, notable by their absence from the Dutch market.

Market structure

In 1990 leasing accounted for over 10 per cent of all investment in moveable assets in the Dutch market (World Leasing Yearbook, 1992). Both finance and operating leasing

contracts are dealt with by the large Dutch leasing companies.

Bank-owned subsidiaries, together with Lease Plan Nederland NV and Leaseco Nederland BV, account for the majority of business in the Dutch leasing industry. In addition, captive lessors remain common in the computer and vehicle leasing sectors.

Leasing is not specifically regulated under Dutch law.

Denmark

Leasing companies in Denmark are represented by the Association of Danish Finance Houses (Danske Finansieringsselskabers Forening), the membership of which accounts for 80 per cent of total leasing business in Denmark.

Market structure

The volume of new leasing business fell to DKr6,122m in 1990 from DKr6,452m in 1989, however growth was achieved in both international and real-estate business (World Leasing Yearbook, 1992).

Portugal

The Portugese leasing industry is represented by the Associaçao Portuguesa de Empresas de Leasing.

Market structure

In 1990 the new leasing business in Portugal rose to Esc200bn, an increase of 37 per cent on the 1989 figure of Esc145bn. Leasing transactions accounted for 10 per cent of all new investment in Portugal in 1990 (World Leasing Yearbook, 1992). The number of leasing companies operating in Portugal also increased from 13 in 1989 to 18 at the end of 1990.

Irish Republic

The Irish leasing industry is represented by the Irish Finance Houses Association, the 18 members of which include bank-owned subsidiaries of the Irish and UK clearing banks. The motor vehicle leasing sector has its own trade association, the Vehicle Leasing Association of Ireland.

Market structure

Since neither the Irish Finance Houses Association nor the Vehicle Leasing Association publish statistics, an accurate assessment of the volume of leasing business in Ireland is difficult to make.

In general terms, however, it is clear that the Irish leasing industry as grown substantially since the 1971 Finance Act, which introduced 100 per cent capital allowances for lessors. In addition, the world's largest aircraft leasing group, GPA, is based in Shannon, County Clare.

National rules

Corporate tax

The 1988 and 1990 Finance Acts announced the intention to eliminate these accelerated capital allowances by 31 March 1992. Subsequently lessors would be able to obtain only an annual writing down allowance of 10 per cent.

The Irish Finance Houses Association has lobbied the Irish government with the aim of seeking the establishment of writing down allowances equivalent to the 25 per cent level available in the UK. Failure to adopt measures equivalent to the UK tax position are likely to adversely effect the prospects for continued growth in the Irish leasing industry.

Luxembourg

The Association Luxembourgeoise des Sociétés de Leasing has five members, who collectively account for nearly all of the domestic leasing market in Luxembourg.

Market structure

Domestic lease contracts consist mainly of finance leasing for capital goods. New assets for leasing fell from Lfr6,969m in 1989 to Lfr6,451 in 1990, largely as a result of a fall in the levels of cross-border leasing (World Leasing Yearbook, 1992).

Cross-border leasing has benefitted from the low VAT rate in Luxembourg, particularly in relation to business with Belgium, which has high rates of VAT, only 50 per cent of which is recoverable.

National rules

Banking regulation

The leasing industry is not specifically regulated under Luxembourg law. Furthermore, since 1 January 1991, leasing companies are no longer under the direct control of the Institut Monétaire Luxembourgeois (the Luxembourg banking commission). The major practical implication of this change is that leasing companies are no longer considered financial institutions, are no longer required to seek authorisation from the Finance Ministry and are not required to establish a minimum level of capital.

Greece

The introduction of leasing to Greece is a relatively recent occurrence. The first leasing company in Greece was created in 1987. The recent development of the industry also means that accurate indicators of the volume of leasing business are not yet available.

The industry, which is represented by the Association of Greek Leasing Companies, has expanded rapidly despite problems in the national economy as a whole.

APPENDIX VIII

LIST OF PROJECTS WITHIN THE ESRC SINGLE MARKET INITIATIVE

Calibrating Regional Incentives to the Quality of Mobile Investments - Dr Ash Amin, CURDS, University of Newcastle-upon-Tyne, Newcastle-upon-Tyne NE1 7RU, tel 091 222 6000 x 8016, fax 232 9259.

European Cohesion: competition, technology and the regions - Dr Ash Amin, CURDS, University of Newcastle-upon-Tyne, Newcastle-upon-Tyne NE1 7RU, tel 091 222 6000 x 8016, fax 232 9259

Participation of Non-Member States in Shaping the Rules of the EC's Single Market - Dr Christopher Brewin, Department of International Relations, University of Keele, Keele, Staffs, ST5 5BG, tel 0782 621111 x 3685, fax 0782 613847

Competition Between Metropolitan Regions in the Single European Market - Professor Paul Cheshire, Faculty of Urban and Regional Studies, University of Reading, Whiteknights, Reading RG6 2AB, tel 0734 875123 x 8736, fax 0734 313856

The Legal Implementation of the Single European Market at National Level - Professor Terence Daintith, Institute of Advanced Legal Studies, 17 Russell Square, London WC1B 5DR, tel 071 637 1731 x 200, fax 071 436 8824

The Future of Public Procurement in Europe: rules, public choice and the single European market - Professor Keith Hartley, Institute for Research in the Social Sciences, University of York, Heslington, York YO1 5DD, tel 0904 430000, fax 0904 433433

The Interaction of Trade, Competition and Technology Policy in the Single Market - Dr Peter Holmes, School of European Studies, University of Sussex, Falmer BN1 9QN, tel 0273 606755 x 2063

Human Resource Regimes and the Single European Market - Professor Robert Lindley, Institute for Employment Research, University of Warwick, Coventry CV4 7AL, tel 0203 523503, fax 0203 524241

A New Strategy for Social and Economic Cohesion After 1992 - David Mayes, NIESR

1992: the Stimulus for Change in British and West German Industry - David Mayes, NIESR

The Implications of the Evolution of European Integration for the UK Labour Market - David Mayes, NIESR

The Harmonisation of EC Securities Market Regulations - Dr George McKenzie, Centre for International Economics, University of Southampton, SO9 5NH, tel 0703 595000, fax 0703 593939

Regulatory Institutions and Practices in the Single European Market - Professor Michael Moran, European Policy Research Unit, Department of Government, University of Manchester, Manchester M13 9PL, tel 061 275 4889, fax 061 275 4751

The Free Movement of Workers and the Single European Market - Professor David O'Keeffe, Department of Law, University of Durham, 50 North Bailey, Durham DH1 3ET, tel 091 374 2000 x 2039, fax 091 374 2044

Environmental Standards and the Politics of Expertise in the Single European Market - Dr Geoffrey Pridham, Centre for Mediterranean Studies, University of Bristol, 12 Priory Road, Bristol BS8 1TU, tel 0272 303030, fax 0272 732657

Lobbying in the EC: a comparative study - Professor Jeremy Richardson, European Public Policy Institute, University of Warwick, Coventry, CV4 7AL, tel 0203 523523

Regulation and Competition in the European Air Transport Industry - Dr Paul Seabright, Department of Applied Economics, University of Cambridge, Sidgwick Avenue, Cambridge, CB3 9DE, tel 0223 335200, fax 0223 335299

Rules for Energy Taxation in the Single European Market - Stephen Smith, Institute for Fiscal Studies, 7 Ridgmount Street, London WC1E 7AE, tel 071 636 3784, fax 071 323 4780

The Consequences of Finnish Membership of the EC for the Finnish Food Industries - Professor Henri Vartiainen, The Helsinki Research Institute for Business Administration, Meritullinkatu 3 D 00170, Helsinki, Finland, tel 010 358 0 171 600, fax 010 358 0 170 950

Comparative Competition Policy - Professor Stephen Wilks, Department of Politics, University of Exeter, Amory Building, Rennes Drive, Exeter EX4 4RJ, tel 0392 263263, fax 0392 263305

The Evolution of Rules for a Single European Market - Stephen Woolcock, RIIA, Chatham House, St James's Square, London SW1Y 4LE, tel 071 930 2233, fax 071 839 3593

The Competitiveness of Spanish Industry in the 1990s: Unleashing the Potential - Professor Manuel Ahijado, Universidad Nacionalde Educacion a Distancia, Faculdad de Ciencias Economicas Y Empresariales, Madrid, Spain, fax 010 34 1 544 8207

The Role of the Firm in the Evolution of Rules for a Single European Market - David Mayes, NIESR

The Implications for Firms and Industry of the Adoption of the ECU as the Single Currency in the EC - David Mayes, NIESR