ELFA Best Practices Roundtable

Industry Update

Bill Phelan – President
Tom Ware – Senior Vice President

April 4, 2017
National Activity
Thomson Reuters/PayNet Small Business Lending Index (SBLI)
(January 2005 - January 2017)
Lending Activity – National

January 2017
YoY Change

More Investment
Less Investment

>150 115 90 <60
Growth Sectors

SECTORS DRIVING GROWTH
January 2017 vs. January 2016 YoY Growth

14.3% Entertainment
9.8% Administration
8.1% Public Admin
6.6% Construction
Lagging Sectors

- Transportation: -14.0%
- Mining: -11.6%
- Agriculture: -9.5%
- Health Care: -8.2%

SECTORS THAT ARE LAGGING
January 2017 vs. January 2016 YoY Growth
Loan Past Due – National

Thomson Reuters/PayNet Small Business Delinquency Index (SBDI)
(31 - 90 Days Past Due)
(January 2005 - January 2017)
Loan Past Due – National by Industry

Thomson Reuters/PayNet Small Business Delinquency Index (SBDI)
(31 - 90 Days Past Due)
(January 2005 - January 2017)
Default Rates – National

- Average: 3.0%
- Recession 2009: 6.3%
- 2016: 1.8%
Default Rates – National by Industry

- Transportation: 2016 - 4.1%
- Construction: 2016 - 2.1%
- Retail: 2016 - 1.8%
- Manufacturing: 2016 - 1.8%
Lending Activity vs. Loan Performance

Cycle Change?

SBDI 91-180 Day Delinquency Index

SBLI Originations Index

1Q10 1Q09 1Q11 1Q12 1Q05 1Q06 1Q08 1Q07 1Q14 1Q15 1Q16

RECESSION CONTRACTION RECOVERY EXPANSION
Portfolio Performance
Credit Score Thru Economic Cycle

- Bad Rates Shift
- 660 Looks Good Now
- Not So Good in Recession

<table>
<thead>
<tr>
<th>Score</th>
<th>2004</th>
<th>2008</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;600</td>
<td>22.9%</td>
<td>40.2%</td>
<td>18.5%</td>
</tr>
<tr>
<td>600-619</td>
<td>15.1%</td>
<td>25.2%</td>
<td>16.4%</td>
</tr>
<tr>
<td>620-639</td>
<td>9.0%</td>
<td>17.4%</td>
<td>10.7%</td>
</tr>
<tr>
<td>640-659</td>
<td>5.2%</td>
<td>10.2%</td>
<td>6.3%</td>
</tr>
<tr>
<td>660-679</td>
<td>3.0%</td>
<td>5.5%</td>
<td>3.5%</td>
</tr>
<tr>
<td>680-699</td>
<td>1.5%</td>
<td>2.7%</td>
<td>1.9%</td>
</tr>
<tr>
<td>700-719</td>
<td>1.1%</td>
<td>1.3%</td>
<td>1.1%</td>
</tr>
<tr>
<td>720+</td>
<td>0.7%</td>
<td>0.5%</td>
<td>0.6%</td>
</tr>
</tbody>
</table>
Projected Default Rates by County
January 2014

[Map of the United States showing projected default rates by county with a legend indicating probability of default.]
Projected Default Rates by County

January 2017
Changing Regulation
March 26, 2015

Bank for International Settlements
Centralbahnplatz 2 and Aeschenplatz 1
CH-4002, Basel, Switzerland

Dear Sir/Madam:

The Equipment Leasing and Finance Association (ELFA) provides this response to the Bank for International Settlements (BIS) Revisions to the Standardized Approach for Credit Risk - Consultative Document, dated December 2014. The ELFA is the trade association representing over 600 financial services companies and manufacturers in the $903 billion U.S. equipment finance sector. ELFA members are the driving force behind the growth in the commercial equipment leasing and finance market and contribute to capital formation in the U.S. and abroad. Overall, business investment in equipment and software accounts for 8.0 percent of the GDP; the commercial equipment finance sector contributes about 4.5 percent to the GDP. For more information, please visit http://www.elfaonline.org

This response is based on empirical evidence of historical default rates of various segments of corporate lending, which is assigned a 100% risk weighting under Basel III. Many types of borrowers use commercial and industrial lending for credit – municipalities, large corporations, middle market companies and small and medium sized businesses (SME). Credit forms include various types of lending facilities. Large corporations use public or private bonds or bank loans. Municipalities use general obligation or revenue bonds. Small and medium sized businesses use term loans or revolving lines of credit. BIS has assigned a 100% risk weight to corporate lending in aggregate, which is made up of these varied borrowers and credit facilities. An analysis shows
1. Standardized Approach (Rated Exposures)
   a) Risk Weight from Lookup Table

2. Internal Ratings Approach (Unrated Exposures)
   a) 100% Risk Weight
For jurisdictions that use external ratings for regulatory purposes

<table>
<thead>
<tr>
<th>External rating of counterparty</th>
<th>AAA to AA-</th>
<th>A+ to A-</th>
<th>BBB+ to BBB-</th>
<th>BB+ to BB-</th>
<th>Below BB-</th>
<th>Unrated</th>
</tr>
</thead>
<tbody>
<tr>
<td>“Base” risk weight</td>
<td>20%</td>
<td>50%</td>
<td>100%</td>
<td>100%</td>
<td>150%</td>
<td>100%</td>
</tr>
</tbody>
</table>
Basel III – Small Medium Enterprises (SME’s)

- For Unrated Corporate SME’s
- 85% Risk Weight
- SME defined as sales <€50 million
New FASB regulations
  • “Current and Expected Credit Loss” (CECL) will require accounting for expected lifetime Losses

PayNet now building models to predict lifetime Losses (not just Defaults)

Which requires:
  • Loss Given Default (LGD)
  • Exposure at Default (EAD)
  • Probability of Default (PD) – beyond two years
8 Factors Drive Loss Given Default (LGD):

The Deal

- Equipment Type: Copier – Truck
- Transaction Size: $20k – $500k

The Timing

- Time to Default: 12 months – 36 months
- Economy: Recession – Booming Times

The Parties

- Borrower: Deadbeat – Deep Pockets
- Lender: Experience in Asset Class
- Relationship: New Customer – Repeat
Competitive Environment
Average Transaction Term of Originations

Seasonally Adjusted 2006-2016

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Average Transaction Term</th>
</tr>
</thead>
<tbody>
<tr>
<td>2nd Quarter 2009</td>
<td>54.0</td>
</tr>
<tr>
<td>4th Quarter 2016</td>
<td>57.7</td>
</tr>
</tbody>
</table>
Banks Reducing All But Highest Quality

Below Avg or Worse
Average
Above Average
High
Grand Total
Independents Growing Share

- 2008
- 2009
- 2010
- 2011
- 2012
- 2013
- 2014
- 2015
- 2016

- Below Avg or Worse
- Average
- Above Average
- High
- Grand Total
Default Rates – National

WHERE ARE DEFAULTS HEADED?

2016: 1.8%
2017: 2.1%
Where are Defaults Headed?

**Transportation**
- 2016: 4.1%
- 2017: 4.5%

**Construction**
- 2016: 2.1%
- 2017: 2.4%

**Retail**
- 2016: 1.8%
- 2017: 2.1%

**Manufacturing**
- 2016: 1.8%
- 2017: 2.0%
Thank You

William Phelan  ●  Tom Ware

www.SBInsights.net