



Charting the Sea of Regulatory Changes

Manufacturers use equipment finance captives and point of sale financing to increase sales and profitability, right? Maybe. The current regulatory environment, which seems increasingly over-reaching and ill-defined, has made the answer to this question less and less clear.

Now, in addition to navigating an ever-changing global economy and developing competitive products, manufacturers of capital equipment, technology equipment and software are finding themselves wading into a sea of issues like FIN 45, special purpose entities, the Patriot Act and Sarbanes-Oxley, to name a few. And that's in addition to the complex world of revenue recognition interpretations, which will continue to evolve as FASB and IASB draft new standards. For many manufacturers, the cost of all these activities has been high.

Dollars and Cents

It is estimated that companies will spend about \$1 million for every \$1 billion in revenue to comply with Sarbanes-Oxley alone. One estimate suggests that U.S. companies will spend \$35 billion in 2005 to comply with "Sarbox"—that's about 20 times the cost originally estimated by the SEC. Since Sarbox requires publicly traded companies to improve their financial reporting clarity and maintain higher standards of internal governance, it's not surprising that most of those dollars go towards added personnel, technology and services to help track and report on multiple accounting entities, conduct tests on internal control procedures, maintain records and more. The cost to audit and certify a firm's compliance with Section 404, which is widely considered the most onerous of Sarbox's provisions, has contributed significantly to this price tag. The more operating units, the more certifications.

Increased Risk: Knowing Your Customers

As a creditor and source of funds, captive finance companies of publicly traded manufacturers are now responsible for assisting in the fight against terrorism. The Patriot Act requires creditors to use government databases to check the backgrounds of individuals, partners and guarantors personally responsible for repayment of the transaction—as well as those of the corporations and their owners. Although the Patriot Act currently applies to regulated financial institutions, non-regulated finance companies are expected to be subject to similar requirements in the near future. In addition, the Office of Foreign Asset Control (OFAC) requires public and private lenders to perform similar checks on third party vendors to whom they make payment. As a result of these types of searches, a lender may be required by law to refuse to extend credit to a client or prospective business partner. Ultimately, the individual or business in question could be investigated by the U.S. Treasury Department as a result of potentially suspicious search results. Willful non-compliance, or simply ignoring collective evidence of suspicious activity, could result in judiciary action.

In order to conduct these background checks, manufacturers who offer captive financing need to gather some very personal information (including social security numbers, addresses and dates of births) and retain it for several years beyond the end of the financing term. This could create yet another series of regulatory nightmares: How will the captive retain the information and be able to access it for compliance testing purposes while securing its clients' rights to privacy? What liability does the captive and its parent incur if a valued customer is unable to close a transaction in a timely manner or is erroneously reported to the U.S. government as a result of the lender's actions?



Charting the Sea of Regulatory Changes cont....

Is “Transparency” Clouding the Picture?

Under certain circumstances FIN 45 requires manufacturers to disclose and recognize residual and credit support arrangements in their financial statements. The appearance of additional liabilities can skew critical financial ratios, which could impact the manufacturer’s access to credit and capital markets. FIN 46 requires potential consolidation of previously bankruptcy remote special purpose entities. Now more than ever, a manufacturer needs an equipment finance partner who clearly understands the impact on the manufacturer’s financial accounting of what once seemed like a routine leasing arrangement.

Compliance: At What Cost?

The cost of compliance is not limited to the simple budget allocations needed to acquire systems and people to help the manufacturer achieve compliance. Managers at all kinds of manufacturers, big and small, say they feel as if they are drowning in wave after wave of regulatory-required activities as they make decisions about how to manage cascading compliance deadlines. The impact of a distracted management team can have a much more devastating cost than the simple dollars and cents it requires to comply.

A Beacon of Light

Traditional financial institutions have a definitive advantage as they tackle many of these issues. As a regulated institution, a bank-owned equipment finance company, such as Key Equipment Finance, already has support systems in place to handle the burdens of heavy regulatory oversight. Because of the existence of compliance personnel, tracking systems and internal auditors of information quality and control, bank-based financial institutions have become some of the earliest adopters of many of the new requirements. This pays off now and in the future since compliance with new requirements is accomplished with less distraction from their primary business goal: to finance equipment and software.

As a seasoned equipment finance company, with long-standing manufacturer sales-aid financing programs in 25 countries around the globe, Key Equipment Finance can help steer you away from dangerous waters. With 1,100 employees around the globe, \$12 billion in assets and \$5 billion in annual originations, it’s our job to stay on top of the changing tax, accounting and oversight issues that affect equipment and software financing transactions for our business partners. We work with you to create equipment finance products that align with the current regulatory environment, your company’s financial objectives and, most importantly, the equipment finance needs of your customers. Plus, you’ll also have the regulatory expertise of KeyCorp, a \$91 billion bank-based financial institution, behind you.

For more information on our equipment financing programs, please contact Stephen Interlicchio at (800) 523-3398 x240 and visit us on the web at KEFonline.com.

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