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The German Leasing Association provides comments on the European Banking Authority's Discussion Paper "The Role of Environmental Risks in the Prudential Framework"

Dear Sir or Madam,

the German Leasing Association (BDL) welcomes the constructive dialogue and appreciates for the opportunity to comment on EBA/DP/2022/02.

About the BDL

The BDL represents the interests of the German leasing industry, which generates a new business volume of around EUR 70 billion annually. This means that the leasing industry finances about one third of all equipment investments in Germany, with a disproportionately high share in the investment supply of German small and medium-sized enterprises. Around 150 leasing companies are organized in the BDL, which together represent a share of over 90 percent of the German leasing market. The business model of leasing companies is characterized by small and medium-sized enterprises, anchored in the real economy and bears very low-risk.

The importance of the leasing sector for the transition to a sustainable economy

The life cycle of a leasing transaction usually begins with the lessor acquiring the object desired by the lessee from the manufacturer/dealer. The object is then made available to the lessee for a contractually agreed basic rental period and against payment of a usage fee. At the end of each leasing contract, the object is sold/marketed, which is an integral part of the business model.

During the entire term of the leasing contract, the lessor remains the owner of the leasing object. For success in leasing, therefore, it is not only knowledge of customer needs and market conditions that is decisive, but also the object and utilization competence of the lessor. The holistic view of the entire life cycle of leasing objects is inherent in the leasing business model and corresponds to the model of a sustainable circular economy, in which the aim is to reduce the use of resources through durable construction, maintenance, repair, reuse and refurbishing of the objects.

Furthermore, leasing is indispensable for the technological change towards a sustainable economy, as the implementation of technological progress is closely linked to leasing as the preferred form of investment and financing. With the expertise and experience of six decades, the leasing industry is therefore predestined to finance the necessary transformation processes and to accompany companies as a partner into a sustainable, digital and innovative future.

The leasing industry is already making a significant contribution to the ecological transformation by electrifying vehicle fleets and financing new mobility concepts. For example, the leasing share of newly registered electric cars in Germany will be over 40 percent in 2021. The use of e-bikes as company bicycles has only become widespread through leasing.

Leasing customers appreciate the simple and low-risk access to new technologies that leasing makes possible through mostly monthly payments and short contract terms. This lowers the barriers to the adoption of new technologies, accelerates market penetration, encourages behavioral change in the use of new technologies and promotes the transformation to a sustainable economy.

Comments on the consultation paper

- Section 3, paragraph 11e: We support the EBA's approach to maintain the strict separation of expected and unexpected losses also in the representation of environmental risks. This means that only unexpected losses are to be covered by Pillar 1 capital requirements and expected losses are primarily to be reflected in the accounts.

- Section 4.2, paragraph 25: The existing risk-based approach should be retained. In connection with this, environmental risks should not be evaluated as a new risk category, but as a risk driver or risk factor of existing risk categories. The connection is made through a series of transmission channels that feed into the existing risk categories.

Linked to the comments on 1 and 2 is the view that double counting should not occur through the consideration of environmental risks. This would be detrimental to established risk management systems and threaten financial stability through the misallocation of risk capital.

- Section 4.2, paragraph 27: Due to the non-existent connection between environmental risks and liquidity and leverage ratios, these should also be excluded from consideration.

- Section 4.2, paragraph 29: Since environmental risks are fundamentally not new and may not be counted twice, it seems logical that the disclosure of environmental risks may not lead to an increase in capital requirements in the overall system.

Section 4.4, paragraphs 46-48: Skepticism about lump-sum adjustment factors is appropriate, since adjustment factors are less differentiated than a sound, risk-based approach. The lack of differentiation encourages misaligned incentives and the misallocation of risk capital.

We strongly suggest that the risk-based framework of Pillar I should continue to be aligned with the objective of financial stability. Environmental policy objectives should be taken into account

outside the prudential framework of Pillar 1. Against this background, the allocation of environmentally related risk factors to the known risk types is the central challenge.

- Section 5.2.2, paragraph 76: If external ratings are available and used to determine risk weights (in SA), it can be assumed that environmental risks will be incorporated into the assessment over time. A separate, additional consideration of environmental risks, on the other hand, carries the risk of double counting.

- Section 5.2.2.e, paragraph 91 et seq.: If no external ratings are applicable (in SA), it is necessary to develop an appropriate risk weighting to take environmental factors into account. However, this requires a significantly improved information base. The CSRD can provide starting points (cf. paragraph 93). In this context, we agree with the assessment that the EU taxonomy is largely unsuitable for these purposes, as it is not conceptually designed to provide a risk-oriented assessment of classified economic activities (cf. paragraph 97).

The conclusion in section 5.2.3.e can be extended to the Pillar 1 IRB approach. Thereafter, any adjustments to the Pillar 1 prudential framework should be risk-based, and the EU taxonomy can provide starting points where appropriate, although it is not conceptually designed for risk-based assessment under the IRBA.

- Section 5.3.1, paragraph 118: The adjustment of the key valuation factors PD and LGD to distinguish environmental risk factors appears possible in principle, but is linked to additional information. In contrast, overrides should be possible as a pragmatic form of adjustment, but should be limited to individual cases.

- Section 5.4.2, paragraph 138 et seq.: As already stated, all changes to the supervisory framework should serve the objective of promoting financial market stability. Adjustment factors should therefore be determined on a risk basis. Purely environmental adjustment factors lead to misallocation of risk capital.

- Section 5.4.3, paragraph 143 et seq.: The conclusions are correct. The integration of environmental factors into existing risk categories should be given preference over adjustment factors in order not to encourage double counting.

We urge that our comments be taken into consideration, as otherwise there is a risk of misaligned incentives and financial market stability being jeopardized by the misallocation of risk capital.

Should you have any questions or require additional information, please do not hesitate to contact us. We look forward to continuing the constructive dialogue.

Yours sincerely

German Leasing Association (Lobby Register No R001688)

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