Leaseurope

The Voice of Leasing and Automotive Rental in Europe

Brussels, 18 April 2024

Leaseurope comments to the EBA consultation on the management of ESG risks

Leaseurope, the voice of leasing and automotive rental at European level, welcomes the opportunity to comment on the EBA consultation on Guidelines on the management of ESG risks.

Leaseurope fully supports the notion that an institution's business strategy takes into account climate-related and social risks.

We would like to stress that any prudential regulatory initiative in the area of ESG risks should consider as a credit risk mitigation technique the role of leasing companies' expertise in lifecycle management of the assets they finance.

It is our view that the EBA Consultation paper, including the Draft Guidelines on the management of ESG risks, broadly aligns with the ECB requirements and proposes a clear approach and framework to ensure regulated financial institutions identify and manage the ESG risks for their balance sheet, business model, operations and reputation.

Paired with the framework, the EBA Consultation paper puts forwards a set of mandatory requirements, which, when assessed against the principles of proportionality, require additional consideration as to their impact on the leasing industry.

Sustainability in the leasing industry

The leasing industry is in many ways ideally placed to act as a facilitator of the green transition for businesses and households alike. To this aim, the leasing industry currently plays a major role in improving the availability of new, more efficient and greener technologies, without the prohibitive prices that would often deter companies and individuals from upgrading their assets (like factory equipment or vehicles for example) to a more sustainable model. In this way, leasing companies are in a better position to finance sustainable assets compared to other financial service providers.

Leasing has emerged as a key driver in the adoption of green mobility solutions and technologies, encompassing electric vehicles (EVs) and bicycles, fleet management, mobility-as-a-service solutions, and providing advisory services for clients transitioning to low-emission mobility.

Unlike other forms of finance, lessors allow lessees to invest in more sustainable assets while the former retain ownership throughout the contract. With the combination of asset security, specialised asset knowledge and sophisticated management capabilities (including managing assets at end of lease), lessors are well-positioned to promote the adoption of energy-efficient assets. By enabling consumers and companies to avoid both the large outright purchase prices and the possible additional costs associated with the maintenance and upkeep of newer, more innovative assets, businesses are more likely to be offered sustainable finance through leasing.

Leasing is also a crucial source of finance for SMEs[1] to invest in environmentally friendly and energy-efficient assets. Given the unique position of leasing as one of the main sources of finance for SMEs, leasing can provide access to finance to those SMEs and by doing so, support the broader green transition. In fact, leasing remains the most relevant source of external finance to SMEs, according to the latest results of the Survey on Access to Finance of Enterprises 2023[2], with 48% of SMEs stating that they have used leasing and considered using it in the future, followed closely by bank credit products.

A principal function of our industry is to ensure assets are used as a service until the end of their life cycle permitting longer assets lifetimes as upon recovery they can be re-deployed. As a result,we are by nature circular, as required by the European sustainable product policy framework (a new circular economy action plan, 2020), with a long-term approach in risk management, and this long-term approach includes climate change risks.

The risk mitigating role of the leased asset

By ensuring an efficient turnover of assets, leasing companies often hold the newest assets in their portfolios, built and designed in accordance with the latest industry and type approval standards. Therefore, the underlying asset of the lease exposure is by definition less exposed to environmental risks. Beyond a doubt our industry benefits from reduced exposure to certain environmental risk factors and is better positioned to adapt to newly introduced environmental performance standards.

As leasing companies have developed significant expertise, not only the performance of the leased assets, but also the business activities of the respective lessees, **environmental risk factors negatively affecting business performance (e.g. droughts threatening farming activity) can be substantially mitigated.** Moreover, the financing of assets through leasing mitigates the risk of greenwashing, as lessors have a detailed overview of the underlying assets' characteristics.

Leasing companies are well placed to reallocate assets depending on clients' needs

As asset management specialists, leasing companies integrate lifecycle management into their risk management processes, which is a relevant aspect of our business model. This special characteristic allows lessors to **re-deploy assets to other customers, taking into account changing client' profiles and needs, which reduces the risk of potential losses on a leased asset even further.**

General Observations on the EBA consultation

1. It is important to consider the principle of proportionality in the disclosure of climate-related risks. SMEs in Europe should not be forced to report more than required under the Corporate Sustainability Reporting Directive (CSRD) (Listed SMEs European Sustainability Reporting Standard (ESRS)) or the Voluntary SME ESRS standard. Therefore, if banks are required to make

[1] European Commission 2022, Annual Report on European SMEs 2021/2022: SMEs and environmental sustainability Background document

[2] European Commission, Survey on the Access to Finance of Enterprises Apr. – Oct. 2023

disclosure covering SME lending, it should be clear these can be based on reasonable estimates and not require SME customers of banks to make additional disclosures to banks, either as a condition of lending or during the life of finance agreements. It is crucial that reporting requirements for credit institutions allow the assessment of ESG risks from SMEs without increasing compliance cost.

2. The leasing industry is supportive of a recognition of both physical and transition risk, with regards to their expected impact on business operations, when data are available. In fact, the incorporation of these principles is already commonplace with the industries we represent, asasset life cycle management requires leasing companies to take a more holistic approach to risk management.

3. The special challenges and opportunities that arise in connection with the management of ESG risks should be recognised, communicated and expressed within each company's corporate culture. As ever, implementation thereof, should be subject to the principle of proportionality.

4. We have to take into consideration that in the initial stage of the integration of ESG factors new risks may appear, and therefore it may absorb additional capital for credit institutions that need to increase their expertise in managing those risks. In the future, it is likely that enterprises and households will be less risky for ESG factors and creditors will have an improved ability to hedge themselves from the ESG risks. Therefore, to achieve financial stability in the long term we need a gradual and proportionate incorporation of ESG in our business models, controls and prudential regulation, taking into account all available data.

Specific comments on the EBA consultation

A leasing portfolio consists of largely 2 financial products, Financial lease and Operational Lease. References are made to the EBA LOM (EBA/GL/2020/06). As explained in the EBA Guidelines, the EBA LOM requirements are only applicable to Finance Lease.

It would benefit the EBA Consultation paper to clarify:

- whether the scope is limited to Financial Lease (in consistency with the EBA LOM), and;
- whether exposures to operational lease are to be considered (in consistency with the ECB Guide on Climate-related and environmental risks), or if the extension to Operational Lease is limited to financial institutions having a significant share of Operational lease (In line with §14.B - *ref §14. B) the assessment of the impact of ESG risks on the most significant activities, services and products;*).

We support the establishment of a level playing field on leasing exposures across all types of actors in the industry. **(EBA: Question 4, Question 8)**

When taking a more proportionate approach into consideration, the topics below will need further clarification:

- Leasing companies are characterised by short term and a high number of small exposures. The major exposures are linked to Asset Risk, or in other words the sell-off of collateral. The short-term nature of the leasing products limits the exposure to Credit Risk. The gradual decline of credit quality over a longer period is less relevant for the leasing business, confirmed by internal Materiality Assessments. As such, we have concluded that incorporating ESG in PD models, with the function to support the evaluation of the repayment capability, should not be a mandatory requirement in the leasing business, and a fit for purpose approach would be preferred. **(Question 15)**

- Leasing companies have a large number of small retail, SME and corporate exposures. The risk evaluations and data collection (Chap. 4.2.1) should be in line with the exposure of the client. The opposite, as per §94.B) would be excessive for leasing companies. It is our conclusion that proportionality should be applied on the data collection for the leasing industry, and we ask the EBA to provide clarity on this. **(Question 4, Question 6, Question 20)**

Given the leasing business characteristics, the risk categorisation is not always relevant on a client level. When considering the main risk, i.e. Asset Risk – residual value, the relevant risk categorisation is not linked to the client, but to the vehicle type (Car, LCV, bike) and drivetrain (BEV, PHEV, ICE). It is our conclusion that leasing companies should have the freedom to choose the most relevant risk categorisation, as this forms the basis for the Materiality Assessment and other risk evaluations, and we ask the EBA to provide clarity on this. **(Question 4, Question 20)**

Given the limited place a leasing product has in the overall cost/debt structure of a company, leasing companies have limited influence when engaging with their customers. As interaction with the clients on the transition, leasing companies can and will engage in wider efforts to support the client's transition plans (support EV transition, provide general and practical information, support with large clients on their fleet, provide multi-modal mobility options). However, leasing companies are not in a position to steer the transition plans of clients. This enabling role, rather than a steering one, leads to the conclusion that the requirements for engagement with the clients for leasing companies should be considered in proportion to their limited leverage. A portfolio approach is to be considered as a better fit. (Ref §42.A); §72.E); §103,) **(Question 10, Question 17, Question 22)**

The EBA sets in §13 the requirements for the short-, medium- and long-term evaluations. Leasing companies finance on a short term. This means that a time span of 8-10yrs already translates into twice the full turnover of the financed portfolio. Any horizon over 10yrs has limited business relevance for leasing companies. It is our conclusion that the business relevance and long-term time horizons, linked to risk evaluations and transition plans, is recognized by the supervisor. Application of the proportionality should lead to a maximum time horizon of 10yrs for the long-term Materiality Assessments/Climate Stress Test models. **(Question 4.)**

The standards in Section 5 may overlap to some national regulations such as the minimum Requirements for Risk Management (MaRisk) in Germany. In particular, given that the EBA Guidelines also tend to be principle-orientated in this subject. However, the sections in which granular requirements are specified are problematic. For instance, we would like to highlight **Section 4.2 "Identification and measurement of ESG risks".**

Granularity/proportionality in section 4.2: The detailed requirements for the collection of ESG data in accordance with paragraphs 23a and 23b should be deleted, as they (1) are not aligned with the type and scope of the procedures and methods used for risk assessment and evaluation and (2) are not proportionate in relation to the requirements of the user. Under no circumstances should the data requirements to be provided to SMEs exceed those in the reporting standard of the voluntary reporting standard for SMEs (VSME).

- Explanation to point (1): Paragraph 23 contains detailed specifications on the ESG data to be collected. However, it remains unclear on what methodological basis and with what procedures this data should be used to assess risks. This harbours the danger of "data cemeteries", the creation of which is associated with considerable bureaucratic burdens but no added value in risk management. It is better if the methods and procedures for risk assessment are first selected on an institution-specific basis and the data requirements are then harmonised - also on an institution-specific basis.

- Explanation to point (2): Proportionality is maintained in data collection in accordance with section 4.2 in relation to the counterparty (large companies vs. nonlarge companies). However, the decisive factor in assessing proportionality is which companies are obliged to collect this data. No differentiation is provided for here that follows the principle of proportionality. As a result, data collection is independent of the size, complexity and risk content of the obligated company. This places a disproportionate burden on small and medium-sized companies, which is not commensurate with the actual risk due to the low volume of business.

Under paragraph 42 and paragraph 105, companies are required to proactively influence the ESG risk profile of their counterparties. Among other things, the transition plans of counterparties are to be reviewed (Article 42a (ii)). This transfer of audit obligations is far too extensive, as the audit obligations are regulated elsewhere. In addition, the obligations for small and medium-sized companies are hardly applicable to large counterparties.

Furthermore, we ask for additional attention to the paragraphs related to transition planning. While there are valid arguments for having client centred transition plans in the broad financial sector, the transition plans within the leasing industry are and will be asset based. Regardless of the sector we are active in, bringing more zero-emission vehicles to the market instead of ICE vehicles, or completing individual transportation with public means of transportation, brings the leasing companies closer to the Paris-aligned 2030 and 2050 targets. This is confirmed by the SBTi validation processes. We would ask this to be included in the considerations on transition plans and ask that green assets (as per EU Taxonomy) are left out of the expectations on exclusion lists or high risk exposures. **(Question 22)**

Finally, we support the idea of having more guidance on the evaluations of S and G in the evaluation of ESG risks. Whether this needs to be done in these EBA Guidelines, or can be addressed in a Best Practices guide following suit on the EBA publication (ref the ECB Guide and Best Practices timelines), is open for consideration. **(Question 5)**

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About us

Leaseurope brings together 44 member associations representing the leasing, long term and/or short term automotive rental industries in the 31 European countries in which they are present. The scope of products covered by Leaseurope members' ranges from hire purchase and finance leases to operating leases of all asset categories (automotive, equipment, machinery, ICT and real estate). It also includes the short-term rental of cars, vans and trucks. It is estimated that Leaseurope represents over 90% of the European leasing market.

Asset finance and leasing markets have developed to respond to business investment and consumption needs as well as to accompany the development of local industrial production and distribution. The types of institutions represented by the Federation include specialised banks, bank-owned subsidiaries, the financing arms of manufacturers as well as other, independently- owned institutions.

In 2022, the leasing firms represented through **Leaseurope's membership helped European businesses, households and the public sector invest in assets that is estimated worth more than 404 billion EUR**, **reaching about 930 billion EUR** of outstandings at the end of the year[3]. **Leasing is the most relevant external financing source for SMEs** and is also popular amongst larger corporates[4]. Leasing is also useful to support the public sector (e.g. leasing to schools, hospitals, etc.).

Leaseurope is entered into the European Transparency Register of Interest Representatives with ID n° 430010622057-05

[3] Leaseurope 2022 Annual Statistical Enquiry.

[4] European Commission, Survey on the Access to Finance of Enterprises Apr. – Oct. 2023