

THE ROLE OF LEASING IN CONTRIBUTING TO A SUSTAINABLE GROWTH FOR EUROPE

The need for leasing to be fully recognised as key enabler of the uptake of sustainable and transition assets and implications for financial services' sustainability reporting



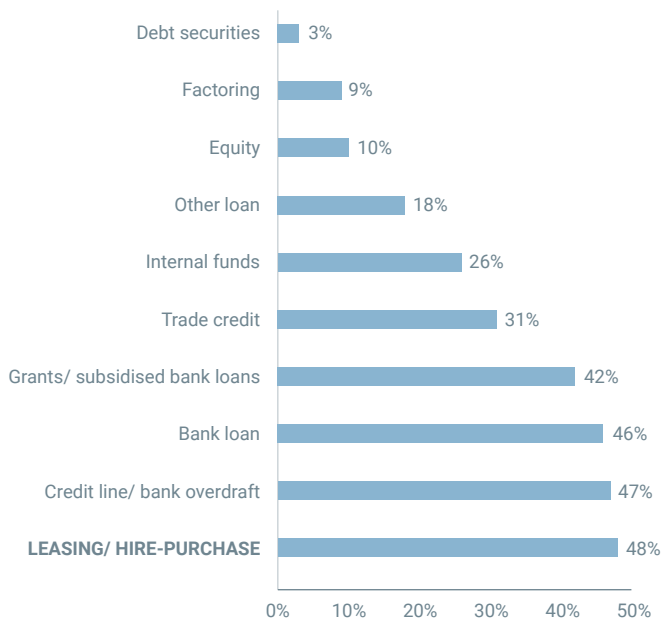
LEASING SUPPORTS SUSTAINABLE INVESTMENT BY SMES

PROVIDING TRANSITION FINANCE TO SMES IS KEY TO ACHIEVING A SUSTAINABLE EU ECONOMY. LEASING IS A VITAL SOURCE OF FINANCE FOR SMES

→ According to the latest results of the Survey on Access to Finance of Enterprises (SAFE survey) 2023, **leasing was the primary external financing source for SMES**, with bank loans following closely behind. The survey indicates that 48% of SMES utilized leasing in the past and considered using it in the future.*

→ Considering the importance of SMES for the EU economy and that most SMES are at an early stage of transition towards low or zero emissions, leasing can provide them with options that promote environmental objectives when upgrading existing technology (not only assets strictly classified as green).

SMES REPORTING IN THE RELEVANCE SOURCE OF FINANCE (APRIL TO SEPTEMBER 2023) IN THE EU-27



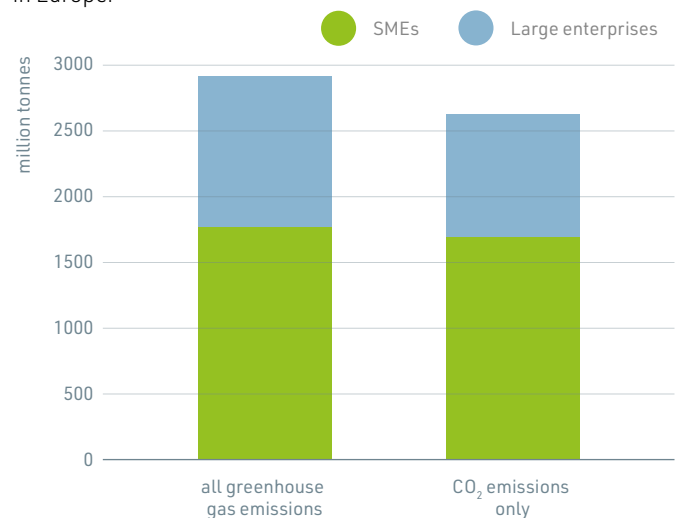
Source : European Commission, SAFE Survey 2023

* Survey on Access to Finance of Enterprises in the euro area: https://single-market-economy.ec.europa.eu/access-finance/data-and-surveys-safe_en

EMISSIONS BY EUROPEAN ENTERPRISES IN MILLION TONS, 2018

Europe's 30 million small and medium-sized enterprises (SMEs) represent 98% of all businesses in the EU.* Together, they represent 63% of all business CO2 and greenhouse gas emissions.

On average, leasing accounts for a quarter of equipment investment in Europe.**



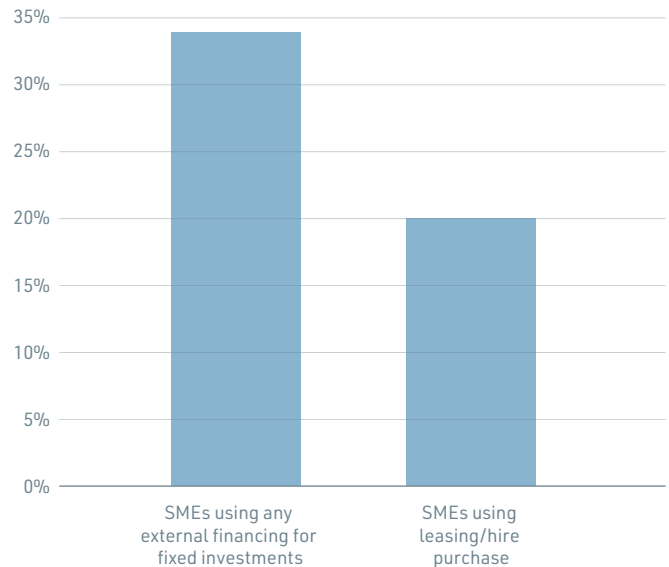
Source : European Commission 2022 - Annual Report on European SMEs 2021/2022 : SMEs and environmental sustainability Background document

* Source : Eurostat / ** Source : Leaseurope Annual Surveys, EC AMECO

1. Small and medium-sized enterprises (SMEs) are defined in the EU recommendation 2003/361, based on the staff headcount and the turnover or the balance sheet total. Small enterprises are defined as enterprises which employ fewer than 50 persons and whose annual turnover or annual balance sheet total does not exceed 10 million euro. Medium-sized enterprises are those which employ fewer than 250 persons and which have either an annual turnover not exceeding 50 million euro, or an annual balance sheet total not exceeding 43 million euro.

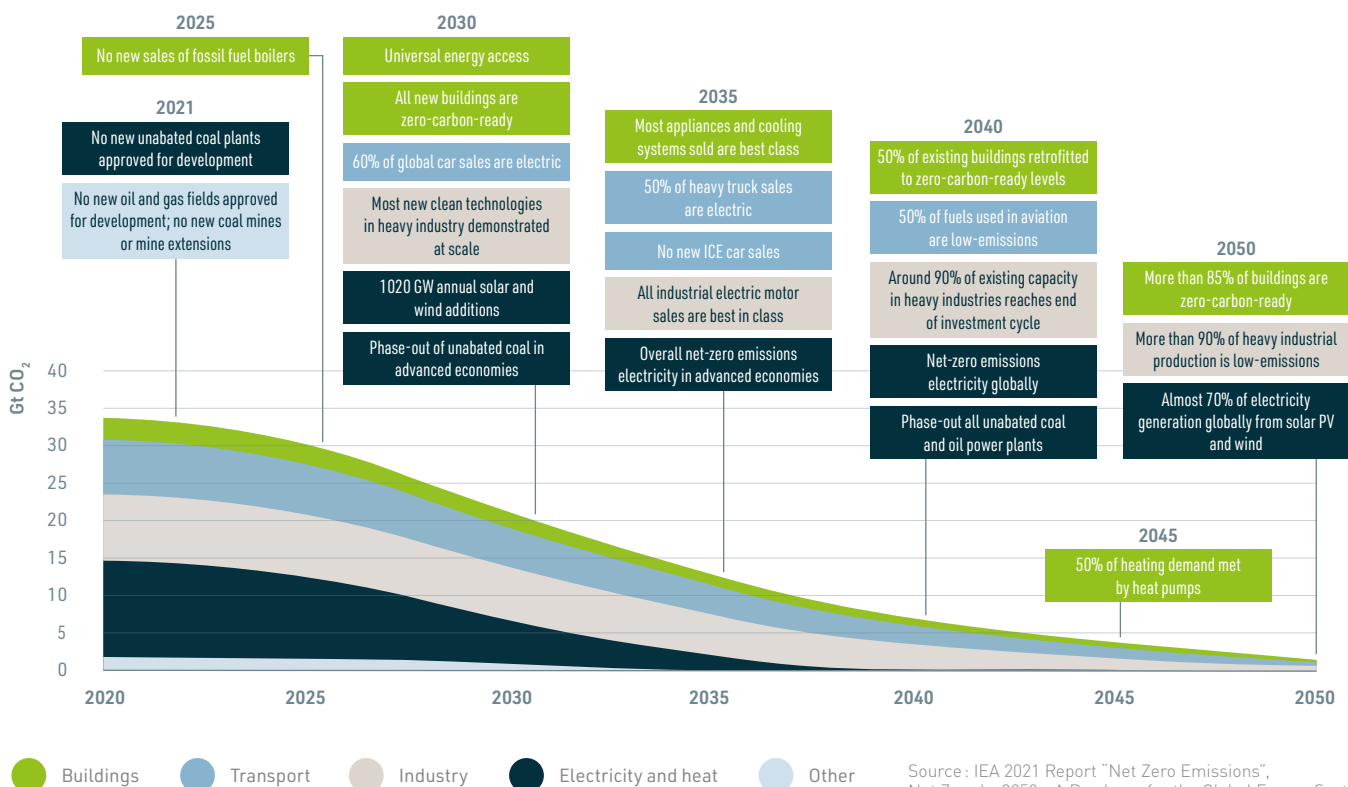
- The European Commission noted that: ‘Sustainable finance is about financing both what is already environmentally friendly (green finance) and the transition to environment-friendly performance levels over time (transition finance)*.’
 - “SMEs need access to different financing instruments to fit their diverse sustainable investment needs. As most SMEs are eco-adopters, i.e. firms seeking to improve the sustainability of their operations, access to debt and other low risk/low return financing (e.g. leasing) is critical to enable these enterprises’ investments in greening.”
- Financing SMES for Sustainability: Drivers, Constraints and Policies, OECD 2022
- Leasing is uniquely placed to address and ease concerns rising out of these needs by assisting SMEs to renovate their equipment without outright purchase. This in particular refers to transport and industry sectors. Leasing is also a natural partner of SMEs on their way to reduction of energy consumption. A large part of leasing companies’ role relates to advise customers, and it can lead to share assets, to optimize fleet size, or to improve driving behaviour.
 - The energy transition creates needs for more efficient assets not just in one area but across all sectors and corporate areas: mobility, heating, renewable energies, buildings...

% OF SME FIXED INVESTMENT AND USE OF LEASING IN THE PAST 6 MONTHS



Source: European Commission, SAFE Survey 2023

IEA CHART, ROADMAP TO NET ZERO



* Sustainable Finance – Investing for a sustainable future in June 2023

A LITTLE MORE ON LEASING

ADVANTAGES FOR BUSINESSES AND FOR THE EU ECONOMY

- Leasing can play a unique role in the EU economy as a link between manufacturers/suppliers and businesses, particularly SMEs (for which leasing is often the only available financing instrument), as well as end-users. As a result, leasing can be a facilitator of economic activity and enabler of green and digital transition by making all types of assets more widely available to a broader range of customers and by offering a variety of solutions answering to customers' needs.
- Longer leases and leases where ownership of the asset will transfer to the customer at the end of the contract are usually termed 'finance leases' in the national accounting rules used by European SMEs. Shorter leases without a transfer of ownership are usually termed 'operating leases'. Finance leases are typically used for manufacturing equipment, and operating leases for vehicles and technology.
- Both types of leases involve leasing companies buying assets and offering use of the assets to the small and large companies in return for monthly payments, the lessor taking residual value risk.
- Regardless of the accounting treatment, all leases play a significant role in supporting companies' sustainability journeys and they should not be differentiated or excluded from the EU sustainability rules (classification or reporting, i.e. GAR).
- In the case of operating leases, the finance provider will efficiently manage the preparation of the returned asset so that it can quickly be used by another SME, or at the end of its useful life responsibly dispose of the asset, maximising the use of recycling so that it can quickly be leased or sold to a new user. In addition, lessors are experts of refurbishment. For longer leases (typically finance leases) the asset may be returned to the lessor at the end of its useful life. Lessors are experts at refurbishment and recycling as part of the circular economy, handling hundreds of thousands of assets per year through specialised facilities.
- In this way, operating leases are integral part of the circular economy (CE). Lessors have an incentive to ensure that assets are durable and sustainable, as they often have to deal with the asset after the lease term, therefore encouraging investment in higher-quality, more sustainable assets.
- The EU Taxonomy now includes operating leases (DA of June 2023), in a recognition of the potential of leasing to contribute to the transition to a circular economy (CE).
- Leasing creates competition with other forms of financing due to the flexibility and the low-risk of the product.
- Leasing offers to the lessees the advantage to benefit from financing for a time period that matches the useful life of the asset at issue.
- The lessor purchases the asset directly from the supplier and leases it to the lessee, ensuring that the asset meets specific standards and requirements. This direct involvement can include verifying the environmental characteristics of the asset. This differs from traditional loans, where the financial institution provides funds directly to the borrower, who then purchases the asset himself.
- Leasing allows businesses to manage their working capital more effectively by spreading payments to use the asset over the contract period. It is often more affordable and quicker to obtain than other forms of finance and provides greater operational flexibility in comparison to the outright purchase of an asset.

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- Leasing is ideally placed to finance productive investment in a vast range of sectors and activities (including infrastructure, industrial technology, capital-intensive projects, healthcare, environmental technologies, etc.), and throughout all stages of a firm's development (from young start-ups to companies that are far along their life cycle). It is also useful to support the public sector (e.g. leasing to schools, hospitals, etc.).
- Leasing addresses one of the general barriers that inhibits the development of sustainable energy production, i.e. a lack of access to capital. In fact, leasing already facilitates the financing of equipment such as wind turbines, biofuel processing plants, photovoltaic panels, long lasting battery cells and so forth, allowing Europe to produce cleaner and more sustainable energy. Lessors take the financial risk on behalf of the users and support the uptake of sustainable assets.
- The uptake of green mobility is encouraged via leasing and therefore, the leased car fleet in Europe has become steadily less carbon emissive over the past few years. Bicycle leasing is getting more popular in countries like Germany, Belgium, and the Netherlands. Leasing has also contributed to the rejuvenation of European commercial vehicle and bus fleets in order to adopt necessary fuel-saving and safety technologies. By bringing less emissive, more recent and safer technologies to the market, leasing companies not only rejuvenate Europe's vehicle fleet, but also ensure that at the end of the lease, high quality assets are released at affordable prices into the European car parc, allowing more highly polluting vehicles to be sent for recycling.
- The expertise provided by lessors should be also highlighted as they develop several solutions adapted to users' needs to support the electrification of the corporate fleets of their customers such as 1. by providing advice to orientate customers to specific products depending on their situation, 2. by proposing products aimed at smoothening the charging experience, 3. by providing information about tax treatments or benefits that can be complex.

See Figure below.

01 BATTERY ELECTRIC CARS

New leased electric cars purchased grew by over **45%** to account for **18%** of total new leased cars in 2023.

02 RENEWABLE ENERGY GENERATING EQUIPMENT

In 2023, new leasing volume for this asset type amounted to circa **2 B€**, **↑18%** compared to 2022.

03 BICYCLES

In **2023**, new leasing volume for bicycles continued to expand, reaching nearly **3 B€**, **↑25%** compared to 2022.

04 BUSINESS INVESTMENT

> **¼** of business investment in Europe was facilitated by leasing industry, with **SMEs being the biggest clients**.

05 CIRCULAR ECONOMY FACILITATOR

In addition to leasing new vehicles, leasing companies also leased second-hand vehicles. On average, one-third of new car leasing contracts involved used cars in 2023.

Source : Leaseurope Annual Survey 2023 [provisional], data reported by national-member associations.

OUR RECOMMENDATIONS

LEASEUROPE INVITES EU POLICYMAKERS TO WORK TOGETHER WITH THE LEASING INDUSTRY TO ENSURE THAT IT CAN SUPPORT EUROPE'S POLICY OBJECTIVES FOR A GREEN AND COMPETITIVE ECONOMY AS MUCH AS POSSIBLE

Existing reporting measures based on the EU Taxonomy Regulation for environmentally sustainable activities, including the Green Asset Ratio (GAR), do NOT capture 'transition finance' and SME finance.

01. All transition finance, including both finance and operating leases and all finance for SMEs as well as larger companies, should be recognised in the disclosures that banks and other financial companies are required to make in their reports (GAR).

European Investment Bank's Green Eligibility Checker acknowledges the relevance and contribution of transition assets¹.

Corporate reporting requirements should not ignore activities which, although do not qualify as Taxonomy-aligned, actually contribute to transition. Companies should be allowed to disclose all their activities that, in addition to Taxonomy-aligned activities, are essentially contributing to transition finance. Otherwise, part of the companies engagement in the green transition goes unreported and unnoticed.

See Figure on next page.

02. This principle should be included in a clear way :

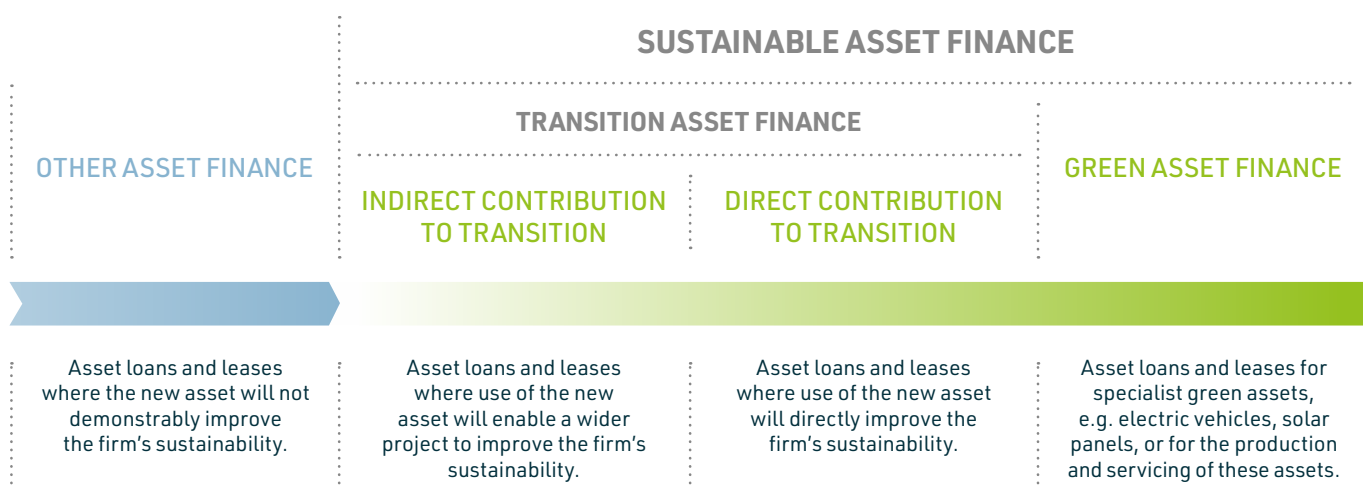
- > in the EU definition of green loans that is being developed following the recent Opinion of the European Banking Authority. According to the December 2023 EBA Report on Green Loans², a high-level definition for green loans "should include all types of loans and advances with known use of proceeds such as term loan, investment loan, project finance, refinancing loan, financial and operating leasing..."
- > in the future sector-specific European Sustainability Reporting Standards and the International Financial Reporting Sustainability Standards.
- > in the reviewed rules for EU Taxonomy reporting and particularly in the KPI for financial/credit institutions, the GAR.

See Figure below.

03. Leasing activities should be explicitly recognised as environmentally sustainable activity under the EU Taxonomy (and/or as an enabling activity) associated with an extended number of sectors (NACE). Leasing can contribute to sustainability objectives not only via transport activities (automotive, rail, water, air) - as already recognised in the Taxonomy DA -, but also via the manufacturing and the energy sector. E.g. manufacture of renewable energy technology, electricity generation using solar photovoltaic technology, transmission and distribution of electricity, storage of electricity, distribution networks for renewable and low carbon assets, and electricity generation from wind power (related to energy generated assets, to manufacturing machinery, equipment and machinery used for construction). The role of leasing in facilitating access to agricultural equipment should also be acknowledged, **as well as various types of construction and production equipment (e.g. metal, plastic, wood processing, medical devices, cargo handling, etc.) and ICT equipment.** All provisions in the EU taxonomy that refer to the "purchase of assets", should also include the "leasing of assets".

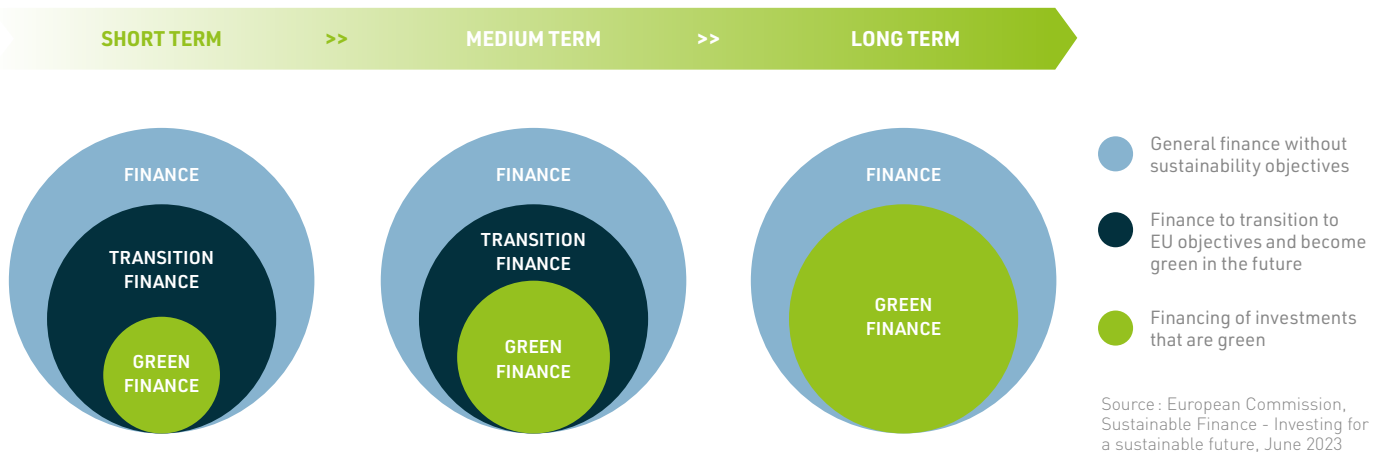
04. All leasing solutions should be eligible to fall within the scope of Taxonomy as long as the economic activity contributes substantially to the specific environmental objective. The criteria for substantial contribution (SC) to Taxonomy environmental objectives should not differentiate in favour of or against a specific type of leasing (financial, operating, hire purchase).

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2. <https://greenchecker.eib.org/>
3. P.51

INVESTING IN THE TRANSITION



05. The particularities of the leasing industry should be given proper consideration, especially due to the fact that the leased asset is legally owned by the lessor during the contract, and not always by the service provider. The actual user of the asset should be facilitated.

For example, the first criterion for SC to CE requires that the ownership of the asset **remains always** with the provider, thereby restricting leasing activities to only operating leasing contracts and it excludes financial leasing from being considered Taxonomy aligned. Therefore, a big part of leasing activities are excluded from the possibility to be Taxonomy aligned, even though leasing is inherently related to CE (irrespective of the type of leasing).

06. Implications for the calculation of Green Asset Ratio (GAR) for financial undertakings should be duly considered. For instance, activities, where “ownership remains with the company providing this service” cannot be calculated in the GAR (GAR includes only financial leases). Consequently, even if they are considered Taxonomy-aligned under the Taxonomy DA, operating leasing activities will not be included in the final percentage of the GAR. This will result in reducing the whole Taxonomy-alignment of the company and showing a non-realistic image of the companies’ activities.

07. The DNSH criteria should be realistic and they should not render it extremely difficult for leasing companies to comply with them. For example, the requirement to comply with external rolling noise requirements under the DNSH criteria in order for electric vehicles to be considered as Taxonomy aligned (CCM objective) renders alignment almost impossible due to the unavailability of information.

08. EU policymakers should deepen collaboration with asset manufacturers to help them publish and divulge in an accessible fashion Taxonomy-required information on the assets, which financial institutions need to provide greener service. Lessors cannot control the product design which is under control of the manufacturers (OEMs) and is not disclosed at the asset model level. Reliable data from producers on CO₂ emission is indispensable.

09. To promote and encourage the uptake of green and transition assets in Europe, it should be ensured that leasing products are subject to equal treatment (comparing to credit) when it comes to the eligibility for EU/national funding. Where EU/national/regional subsidies are available for more sustainable assets, such assets should systematically be eligible when they are funded through leasing, as when they are through credit. Lack of clarity in the eligibility of leasing for subsidies benefitting assets crucial to the green transition may undermine SMEs’ choice and therefore the whole sustainability growth. **EU funding programmes should make explicit references to leasing as a source of finance and targeted provisions on eligibility criteria should take into account the specificities of leasing transactions (end-user might not be the asset owner) and accommodate the differences of the various forms of financing.**

ABOUT LEASEUROPE

Leaseurope, the European Federation of Leasing Company Associations, is an umbrella body bringing together 44 national associations throughout Europe representing bank-owned, captives and independent lessors as well as long and short-term automotive rental companies. Visit the Leaseurope website at www.leaseurope.org