FINANCE & LEASING ASSOCIATION (FLA):

BUDGET SUBMISSION OCTOBER 2021

Introduction

1. The Finance & Leasing Association (FLA) is the leading trade body for the UK asset, consumer and motor finance providers of leasing and hire purchase. Many of the FLA's members are independent, non-bank lenders who provide finance to underserved groups or deliver funding in markets where banks may be unwilling or unable to offer finance.

2. This paper sets out the FLA's key priorities ahead of the Chancellor's Budget Statement on 27 October 2021.

Recommendations

3. Our proposals support the Government's objectives of achieving net-zero, supporting SMEs, and improving the business investment by increasing business productivity and 'levelling up' the country.

4. Our recommendations fall into three categories: financing decarbonisation, tax reform and helping SMEs grow.

   We recommend the following:

   - Financing decarbonisation
     - The introduction of a "Green Wholesale Finance Guarantee" for consumer and business lenders
     - Support for Green Securitisation
   - Tax Reform
     - Radical Reform of Corporation Tax and Allowances
     - Include leasing in the super-deduction
   - Helping SMEs Grow
     - Create an Independent Liquidity Funding (ILF) Scheme
     - Ensuring access to finance
     - Strengthening the British Business Bank
     - Extending and creating a successor to the Recovery Loan Scheme
     - Supporting the role of the Small Business Commissioner

Financing Decarbonisation

Green Finance Wholesale Guarantee

5. The Government's ambitious targets for net zero will mean manufacturers changing business models and what they offer in a very short space of time. Their customers may also struggle to justify making changes to their business practice by investing in

potentially unproven assets without adequate incentives. With an estimated £50 billion[1] of annual investment needed from 2030 to achieve net zero by 2050, there is considerable risk for all parties when choosing to invest in green assets.

6. Some technologies, such as electric vehicles, are becoming increasingly established, but models may date quickly with newer models having a far superior range. The pace of this development makes it difficult to predict the future residual value of such assets for lenders. Other technologies are too new or not widely adopted, such as micro combined heat and power generation (mCHP), so asset costs are high to begin with, dissuading their use. This makes lending on these assets a risky proposition, in case that technology does not progress to more widespread adoption. This leaves lenders having to price borrowing on the basis that an asset may become obsolete, increasing the cost for customers.

7. Other risks which are greater than for non-green assets include: the lack of a secondary market, the time it will take to develop a secondary market, the unproven nature of the technology being funded which contributes to a higher frequency of satisfactory quality disputes for which lenders are liable.

8. While the market will undoubtedly respond to these challenges the Government's timetable is very short, and it is unlikely that the market can deliver a solution at the speed needed without support, or without increasing prices to customers beyond an affordable level. There is therefore an acute need to reduce the risk of investment in green technology.

9. We believe this can be achieved with a Green Finance Wholesale Guarantee, available to wholesale funders of both consumer and business portfolios.

10. The Guarantee would work in a similar way to the "ENABLE" programme operated by the British Business Bank (BBB). The guarantee would be for wholesale funders (investment institutions) who are financing lenders. It would provide a second loss guarantee for lenders on a portfolio of green receivables. "Green" receivables would be defined as lending used to support purchase or investment in a green asset as specified by the Government's forthcoming taxonomy of green assets. The guarantee would provide up to 75% cover for portfolio losses more than an agreed "first loss" threshold in exchange for a fee charged to the wholesale funder.

11. The current ENABLE programme has guaranteed £800 million of lending. A special housebuilder's variant has provided a guarantee for a further £1 billion[2]. A Green Finance Wholesale Guarantee would likely have to guarantee a much larger amount of lending, but as this guarantee is spread over several years the potential liability to the Government would be more limited. In any case the percentage of non-performing portfolios in which the guarantee under ENABLE has been triggered is

[1] Climate Change Committee, 2021
[2] British Business Bank, 2021

very low, with the scheme generally providing a profit for Government of 1.1% last year, despite the pandemic increasing the amount of non-performing lending, and 2.2% being the target return in other years.[3] It is expected that the wholesale green finance guarantee would operate on a similar semi-commercial basis, generating a modest profit for the Government.

12. The UK Climate Change Committee predicts £50 billion of investment will eventually be needed every year from 2030 to meet net zero targets. From 2022-26, the expected lifespan of the green wholesale guarantee, on average £26 billion will be needed annually. Of this, we expect the Wholesale Guarantee to support £5 billion of lending annually- the remaining £21 billion comes from a mix of Government infrastructure investments and existing green finance initiatives (including green finance bonds), individual consumer spending, commercial investment and institutional investment. Because the Guarantee includes an expected loss for the funder (typically at least 10%), and the Guarantee would be for 75% of the amount above this, the exchequer risk would be £3.37 billion. For comparison, the British Business Banks' current annual exposure is £8 billion. The Guarantee would be in addition to the support provided by the Government's Green Finance Framework including its Green Finance Bonds.

Green Securitisation

13. Securitisation is an important funding mechanism for FLA members providing access to a broad range of investors which would free up capital and/or liquidity via publicly listed securitisations or private bilateral transactions. It has a critical role in financing the real economy whether the asset classes reflect households financing cars to get to work or businesses investing in their growth in a tax-efficient way.

14. As part of HM Treasury's review of the Securitisation Regulation, the UK Government has the opportunity review to consider broadening the asset classes eligible for securitisation. These could include a new category of green assets to stimulate investment in, for example, low emission vehicles. One way the Government could display its green credentials would be for the Bank of England to invest in pools of environmentally friendly securitised assets.

15. This would stimulate investment in greener assets and potentially reduce costs for customers.

Tax Reform

Radical Reform of Corporation Tax and Allowances

16. We believe it is imperative to reform corporation tax rules to allow "full expensing" for capital investment. This would be a radical change to the tax system but would

[3] Ibid.

contribute significantly to increasing productivity, growth and help all businesses meet the Government's Net Zero targets.

17. "Full expensing" – allowing businesses to deduct the cost of investments they make immediately rather than over the life of the asset, regardless of the type of finance used to acquire the asset – would encourage investment in new green assets and result in more rapid economic recovery, as the tax benefits of new investment would be realised much more quickly.

18. Other countries that use this approach have benefitted from significant investment growth, particularly in plant and machinery investment.

19. Currently capital allowances and the Annual Investment Allowance cannot be claimed by finance and leasing companies which purchase vehicles and lease them to businesses and consumers. If lenders, including leasing companies, could offset purchases of EVs against their tax position this would enable them to offer much more competitively priced finance/rental payments for ULEVs. Research undertaken by the British Vehicle Rental and Leasing Association (BVRLA) suggests passing on the benefit of capital allowances could lead to customer savings of £20-£30 a month.

Temporary inclusion of leasing in the capital allowances regime: changing the Super-deduction

20. The current super-deduction allowance (SDA) scheme must be expanded to include leasing and short-term hire. These are two of the most common ways that businesses acquire new plant and machinery.

21. In 2019, £904m of leasing new business was written for plant and machinery assets. None of this investment by businesses would have benefitted from the deduction had the policy been in place at the time. Additionally, in the construction industry, plant and machinery are often highly specialised and hired-in on a project-by-project basis. Up to 70% of construction plant is used in this way. For commercial vehicles,1-in-5 trucks and 1-in-6 vans on the road are leased or rented.

22. The SDA has the potential to unlock billions of pounds of future investment on a sustainable basis for growth were they to include investment in plant and machinery acquired via leasing or short-term hire. We note that the decision to limit access to the scheme may have been based on an historic understanding of how the leasing market functions.

23. The SDA is due to end in 2023. We strongly urge the Government to extend its life while a new regime is put into place (see Radical Reform of Corporation Tax and Allowances).

Helping SMEs Grow

Creating an Independent Liquidity Funding (ILF) Scheme

24. Independent (non-bank) lenders play an essential role in the consumer, motor and small business finance landscape. Independent lenders support small business across the UK and enable under-served consumer groups to access credit. The success of independent lenders is also important from a systemic point of view. The failure of or reduced lending by independent firms would affect the stability of the market, the competitiveness of financial services and the choice available to customers of finance products.

25. Independent lenders have limited access to liquidity support, as compared to banks that have access to Term Funding with additional incentives for lending to SMEs (TFSME). Liquidity support may be necessary during times of crisis – the FCA's recent survey on financial resilience highlighted significant differences with respects to the effects on liquidity of the pandemic. For non-bank lenders, who may be reliant on wholesale financing, liquidity support would provide a lifeline when wholesale markets restrict lending criteria.

26. Asset finance, hire purchase, leasing and second charge mortgages are a key part of the funding "mix" available to businesses. Small independent non-bank providers play a particularly important role in the lending market. In the USA, such entities are deemed "systemically important" by regulators and during the last credit crunch, the OECD identified that "*SMEs have long been heavily reliant on traditional bank finance, but especially the crisis has shown that it is therefore necessary to broaden the range of financing instruments available to SMEs and entrepreneurs to improve their financing*"[4] The UK should build on this to support this sector more directly.

27. We propose the establishment of an Independent Liquidity Funding Scheme to support these lenders in times of crisis and allow them to maintain help to SMEs and individuals. The scheme would be administered by the Bank of England and be modelled on Term Funding. It would provide rapidly accessible funding at a competitive rate. This would provide an alternative to wholesale (block) funding and would be charged at a similar rate, subject to the lender meeting conditions.

Ensuring access to finance

28. There is a plethora of information available to SMEs on what finance is available and where to find it. We have worked together with the British Business Bank (BBB) to provide that information and guide businesses. In 2019, the Department for Business, Energy & Industrial Strategy (BEIS) launched a website to help SMEs. We welcomed this development and offered to work with BEIS to build on this. The Covid-19 pandemic meant that the Government focused on supporting businesses through the lockdowns and this delayed any changes to this new site.

[4] OECD / Wehinger, G. (2014) SMEs and the credit crunch: Current financing difficulties, policy measures and a review of literature.

29. We know from speaking directly to small businesses and the bodies that represent them that they continue to be overwhelmed by the resources that are out there.

30. We recommend that BEIS continues this site and works in partnership with us and the SME representative bodies to ensure that the site aggregates content to make it easier to know where to go to find the right finance at the right time as well as being a gateway to other information to help the firms run its business This would need appropriate resources by the Government.

31. As part of this it is critical to continue supporting the Growth Hubs as they play an important role in providing information to SMEs and assisting them on a range of issues.

Strengthening the British Business Bank

32. Many FLA members work closely with the British Business Bank (BBB) to ensure that small businesses can access the right finance at the right time.

33. During the Covid-19 pandemic and government-imposed lockdowns, the BBB demonstrated its ability to deliver a range of support schemes quickly. These schemes supported independent lenders and in turn SMEs.

34. We recommend that the BBB is strengthened so that it has more resource to develop and create new schemes where appropriate as well as being given further funding to deploy where there is a market gap or a liquidity freeze.

Creating a successor to the RLS

35. The Government's support schemes including the Recovery Loan Scheme (RLS) and the 2020 schemes that were put in place have helped to deliver much needed funding to businesses. However, these schemes are temporary, time-limited interventions responding to a specific economic need.

36. Prior to these support schemes, the Enterprise Finance Guarantee Asset Finance variant ensured that lenders finance assets or businesses outside of their risk appetite. We worked closely with the BBB to develop the variant and make sure it worked for the market. The need for a scheme like this still exists.

37. We propose that the Recovery Loan Scheme (RLS) is extended to provide certainty to businesses until a longer-term successor scheme is developed. This scheme would retain the best features of the RLS scheme including assignment of guarantee, and retention of the lender fee arrangement. We have been in discussion with the BBB and are happy to work with HM Treasury and BEIS regarding the successor scheme.

Supporting the Small Business Commissioner

38. We have previously recommended the expansion of the remit of the Small Business Commissioner. We welcome the steps that have already been made to increase the powers at the Commissioner's disposal. These will increase business confidence and certainty for smaller businesses.

39. The Commissioner's functions go beyond dispute resolution and includes signposting businesses to appropriate sources of help. We also believe the role of the Small Business Commissioner should be further expanded to identify problems areas that SMEs face and be able to recommend policies to address them e.g., dealing with the regulatory burden.

40. We further recommend an increase in the Small Business Commissioner's budget to enable the office to achieve its objectives.

About the FLA

The Finance & Leasing Association (FLA) is the leading trade body for the UK asset, consumer and motor finance providers of leasing and hire purchase. In 2020, FLA members provided £113 billion of new finance to UK businesses and households. Over £86 billion was in the form of consumer credit, accounting for over a third of all new consumer credit written in the UK. Nearly £27 billion of finance was provided to businesses and the public sector to support investment in new equipment, representing over a third of UK investment in machinery, equipment and purchased software.

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