FINANCE & LEASING ASSOCIATION (FLA): BUDGET SUBMISSION

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 15 March 2023.

Recommendations

3. We recommend the following:

   - The introduction of a "**green super-deduction**", to replace some capital allowances and the existing super-deduction which comes to an end in 2023
   - In tandem with the new super-deduction, further **simplification and rationalisation of the capital allowances regime**
   - The introduction of a "**Green Wholesale Finance Guarantee**" for consumer and business lenders
   - Radical reform of the **Consumer Credit Act**

Introducing a new green super-deduction

4. The Government's ambitious net zero goals will be particularly challenging for SMEs. These businesses require support to acquire the assets they need to commit to a lower- carbon future, such as microgeneration equipment, zero-emission commercial vehicles, and battery storage. They also have concerns about stranded assets. The Government has an unprecedented opportunity as we enter the post-pandemic recovery phase to encourage green investment and reduce these barriers for businesses.

5. At the 2021 Budget, the Chancellor of the Exchequer announced a "super-deduction" for expenditure on qualifying plant and machinery assets. The measure was based on the capital allowances regime and provided an allowance of 130% on new plant and machinery investments that would normally qualify for 18% main rate writing down allowance, and a first-year allowance of 50% on investment that would ordinarily qualify for 6% special rate writing down allowances.

6. This measure is time-limited until March 2023, but we believe it should be replaced by an entirely new "green super-deduction" based on similar principles. This new "green super deduction" would be limited solely to green assets and would replace the current complex framework of capital allowances which seek to

incentivise green investment, such as the 100% first year allowance (FYA) for electric vehicle charging points and e-vans, and the 50% FYA for certain plant and machinery which make businesses more energy efficient.

7. A new green super deduction would provide a 130% allowance on “green assets”, including electric vehicles and associated infrastructure, plant and machinery which qualifies for the renewable heat incentive, solar generation equipment and plant and machinery which would substantially reduce a business’s carbon footprint.

8. The measure would be available to businesses regardless of the type of finance they use, including those acquired via leasing or short-term rental. The exclusion of these methods from the existing super-deduction was a significant shortcoming which limited its appeal. The decision to limit access to the scheme may have been based on an historic understanding of how the leasing market functions.

9. A new green super-deduction provides a simple, easy to understand mechanism for businesses to encourage them to invest in greener plant and machinery, at a time when they may otherwise be more cautious in their investment choices.

Simplifying and rationalising the capital allowances regime

10. A new green super-deduction would replace several targeted capital allowances with complex eligibility rules and exemptions. This would in turn provide the opportunity to review those allowances that remain and seek to rationalise them.

11. The Government should work towards a capital allowances landscape which includes a limited rage of broadly applicable allowances, namely:

    a. The Annual Investment Allowance
    b. A new “green super-deduction”
    c. Targeted FYAs for special situations only – to be reviewed

12. Currently many capital allowances 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.

13. With respect to targeted FYAs we would urge the government to initiate a review of these with a view to reducing their number and broadening their scope. This would resolve the issue of multiple allowances with complex eligibility rules, which limit their appeal, especially for smaller businesses.

Green Finance Wholesale Guarantee

14. 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.

15. Consumers too will face expensive choices with respect to investing in electric vehicles, heat pumps, solar panels with battery storage, heat batteries, or external wall insulation. These assets are a significant cost for those customers seeking to lower their carbon footprint and will be unaffordable for many on lower incomes. A guarantee would help to ensure these assets are more affordable and would encourage greater investment in UK production.

16. 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.

17. 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.

18. 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 their customers beyond an affordable level. There is therefore an acute need to reduce the risk of investment in green technology.

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

20. The Guarantee would work in a similar way to the "ENABLE" programme operated by the British Business Bank (BBB). The guarantee would be for

[1] Climate Change Committee, 2021

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, or by using other existing definitions of green assets, such as those eligible for the renewable heat incentive. 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.

21. 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 as it would include consumer portfolios, 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 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.

22. 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.

Consumer Credit Act (CCA) Reform

23. We welcome the opportunity to respond to the Government’s consultation paper (CP) as we have long campaigned for CCA reform. We look forward to submitting our full response to HM Treasury in due course.

24. The credit market is varied both in terms of the product types but also the customer segments. The way a sophisticated, prime customer borrows is significantly different to a low-income consumer taking a small loan to cover a household

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[2] British Business Bank, 2021

[3] Ibid.

emergency. The way the consumer credit regulatory regime is reformed therefore needs to reflect this. Consumers would be better served by a regime in which they benefit from the same consumer protections regardless of product but proportionate to the value or nature of the credit.

25. The starting point for reform should be that the regulatory regime for consumer credit is the same as the FSMA regime for all other financial services products unless there are demonstrably valid reasons for divergence. An additional benefit of this would be that this enables the creation of a single consistent and joined-up set of rules where there is no dispute or ambiguity about the standards that apply. The current regime for consumer credit lacks this, as the requirements of the CCA, CONC and the Consumer Duty pull in different directions, further exacerbated by risk of divergent approaches being taken by FOS and by the courts considering s140 unfair relationships claims. This creates a level of regulatory risk that is significantly higher than for regimes in other comparable jurisdictions, ultimately leading to higher prices for consumers and reduced innovation and investment.

26. A fundamental flaw in the CCA is that it is 'top down': it predetermines the types and characteristics of the products that firms may provide. This constrains innovation and hinders compliance with the Consumer Duty. What is needed instead is a 'bottom up' system which allows firms to develop the products that customers need in an evolving market, subject to an overarching and consistent framework of protection.

About the FLA

The Finance & Leasing Association (FLA) is the leading trade body for the UK business finance (leasing and hire purchase), consumer credit and motor finance sectors. In the twelve months to November 2022, FLA members provided £148 billion of new finance to UK businesses and households, £50 billion of which helped consumers and businesses buy new and used cars, including over 84% of private car registrations. £115 billion was in the form of consumer credit, accounting for over a third of all new consumer credit written in the UK. £33 billion of finance was provided to businesses and the public sector to support investment in new equipment, representing over a third of the UK investment in machinery, equipment and purchased software in the UK last year.

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