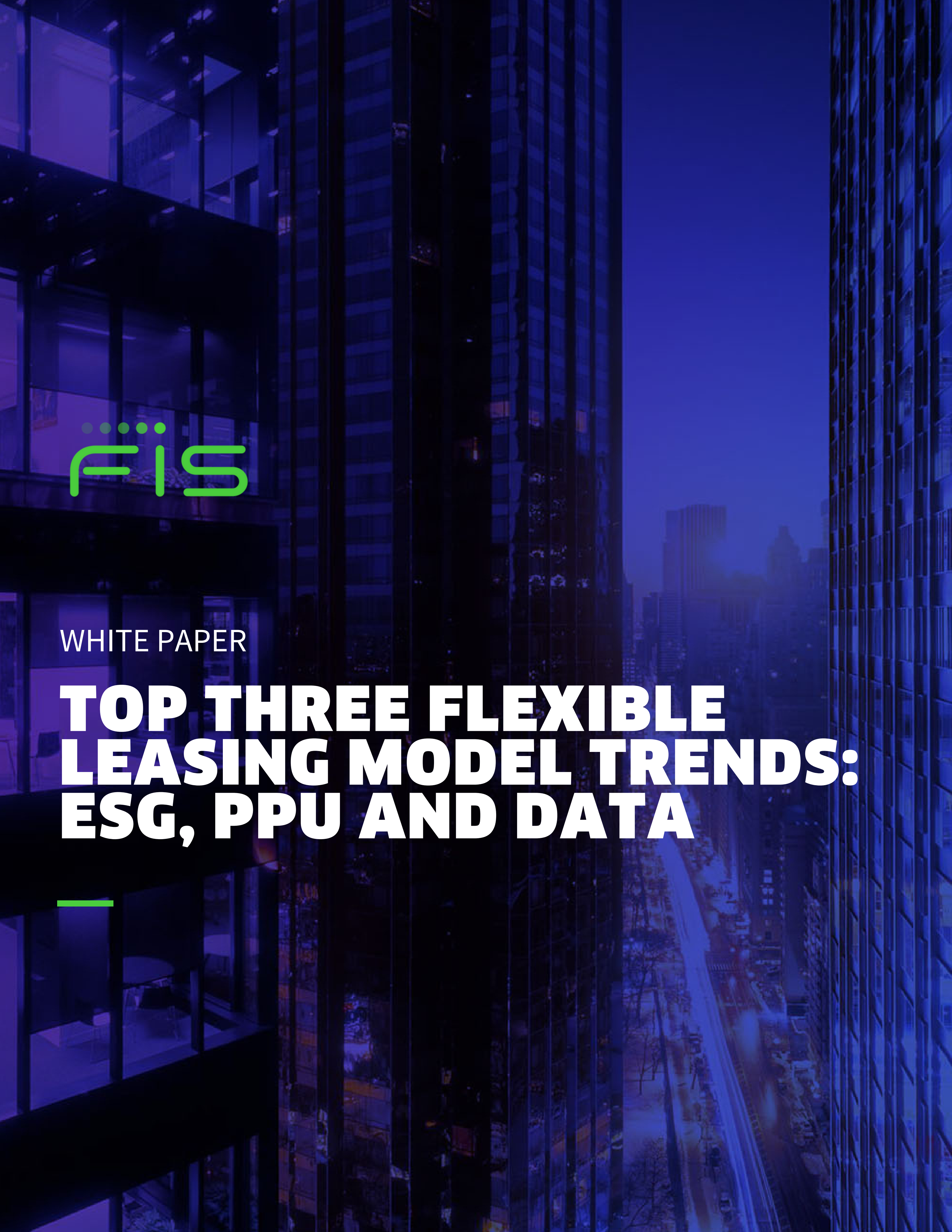

WHITE PAPER

TOP THREE FLEXIBLE LEASING MODEL TRENDS: ESG, PPU AND DATA

INTRODUCTION: NEW FLEXIBILITY

The world is changing and so are the ways that consumers and businesses access finance. When it comes to vehicles and equipment, asset finance has long offered a more flexible alternative to upfront, outright purchases embedding finance at the point of need. But increasingly, traditional leasing models struggle to accommodate the latest trends. Keep reading to uncover three of the latest trends and see if you have the mindset and the operations you need to keep up.

1.ESG

Environmental, social and corporate governance (ESG) is already a well-known and well-used term in the world of business – and for many good reasons. As climate change continues to take its toll on the planet and scrutiny increases on corporate values and company structures, there's more pressure than ever for firms to demonstrate sustainable, fair-minded and transparent practices. For the asset finance and leasing industry, the ESG challenge is real. Firms need to look at their customers through an ESG lens – not just once but at every key stage:

Onboarding
For ESG due diligence on commercial customers, asset finance providers may need to factor ESG into anti-money laundering (AML) and know your customer (KYC) checks. If the customer is a large organization, this could mean monitoring for news or social media coverage of any controversial issues or activities that contravene ESG requirements. When it comes to smaller businesses, online reviews might indicate poor business practices and therefore, a higher likelihood of default.

Assessment
Throughout the credit assessment process, assessment practices and score carding should consider factors like composite ESG scores, as assigned by ratings agencies. For larger organizations, these scores are available and further work by regulators such as the Securities and Exchange Commission (SEC) and the Financial Conduct Authority (FCA) and additional standardization of rules will improve these metrics. The challenge for businesses lending to small-to-medium enterprises (SMEs) is a common framework, especially for businesses who are too preoccupied with running the day-to-day business to invest time with reporting on ESG factors.

Monitoring
With ongoing reviews of ESG-related KPIs, the ideal monitoring process will automatically alert lessors to breaches or potential problems at lease and portfolio level – keeping a constant eye on financial risks stemming from climate change, natural disasters, environmental damage, and social and corporate issues.

Organizations must review their own lending criteria and set targets in terms of sustainability, social justice and corporate responsibility. The most visible example of this within transportation finance is the goal to meet global emission targets through the switch to zero emission vehicles. Within equipment finance, the targets are more nebulous, especially where vendor finance relationships encompass a broad range of assets. The key here will be working with OEM suppliers and partners throughout the entire asset life cycle, from use to re-use. This will encourage the focus on the second trend:

2.Usage

The primary selling proposition of a pay-per-use (PPU) product is that the end customer pays only for their use of the asset, thereby focusing their attention on how much that usage costs them. Since the utilization of most assets requires the consumption of some sort of fuel or energy, PPU can be a useful nudge towards improved environmental awareness and responsibility. However, that is insufficient to claim reliable sustainability credentials – it requires a change in mindset.

PPU is not just another lease variation. A genuine PPU product will be based on a rental agreement. In many markets this is subject to specific legislation – often a different, usually lighter, regulatory touch, in comparison with finance and leasing.

From a provider's perspective, the customer contract associated with a PPU product separates any one individual customer from the depreciation of the asset over its entire lifetime on the financier's books. This makes the periodic rental for that same customer more affordable over the term of their asset use than would be the case for a comparable, traditional, short-term lease which ended with the asset's return and disposal or remarketing. When the first customer has finished their use, the asset is returned to the owner and, subject to any refurbishment, made available to the next client. This introduces utilization risk, as well as logistics and reconditioning costs, but the idea is that all these costs are amortized over an extended life cycle with the asset owner and with the total duration of that life cycle demonstrating increased environmental responsibility on their part.

The benefit, however, of taking on utilization risk is a growing acceptance amongst customers, especially business users, that such convenience has an associated cost. Indeed, some PPU and subscription providers explicitly offer alternative schemes, whereby the more flexible and less expensive the termination cost, the higher the regular contracted payment. The important perspective for the customer is the ability to terminate at short notice and at a pre-determined cost. Ironically for many customers, and potentially a source of relief to PPU providers, there is growing evidence that just because the customers have the flexibility around early termination doesn't mean that they exercise that option. One OEM offering a standard 12-month package is already seeing typical customers extending beyond 18 months. Furthermore, retention rates with PPU products already appear to be higher than with conventional finance and leasing arrangements.

There is a natural limit to the convenience with costs; the early explosion of consumer subscription services and retraction within the market suggested that limit had been breached. One way of mitigating that is offering additional services to support the asset and optimize usage.

In the aviation sector, this kind of service aggregation has long been a key part of asset finance arrangements. Rather than own their planes, most airlines lease them and pay for a large package of services on the side, with OEMs typically taking care of maintenance on an ongoing basis and keeping aircraft safe. In a pay-per-use world, this model will need to be extended to the whole auto and equipment finance industry. In auto finance, that means a full range of services that keeps cars on the road, including taking care of servicing and repairs, annual taxation, insurance, tire changes, wear and tear, etc. As the owner of thousands of assets, firms can source and provide these services more efficiently and cost-effectively than individual users.

Similarly, to the ESG challenge adapting to this new world comes back to one solution: Data.

3.Data

The subject of data ownership has sometimes been contentious, as well as becoming highly sensitive since the introduction of GDPR (General Data Protection Regulation) legislation in 2018. Data ownership, at least in the case of automotive assets, has generally been divided between the OEM, who would claim they need certain usage data – duration of use, distance covered, mechanical performance – on the grounds of product liability, warranty and maintenance responsibilities, and the vehicle owner/driver, who would claim the time and location of the vehicle's deployment is their business alone. However, where the vehicle owner is a vehicle leasing company, the actual economic owner and legal titleholder in that case seems to get squeezed out altogether.

In a commercial setting, however, where the end customer is a business, the driver is using the vehicle for business purposes and the owner (certainly in the same example with an operating lease or rental product) is indisputably the lessor. Those easy assumptions of data ownership can be more readily challenged. Most important is that consent is actively sought and given, and for that fact to be recorded. In the immediate period following GDPR implementation, there was often nervousness about asking for that consent, with fear that the request would deter customers and that it would not be granted. Over time and with familiarity, those nerves are easing, and providers are asking more confidently for consent. At the same time, an increasing number of providers are making their offers on the condition that consent is being granted.

As either the original data owners, or having secured access to data, some data custodians immediately turn their attention to monetizing the data, perhaps charging simply to release the data to the next consumer in the chain, often the supplier of a service enabled by that data. Ultimately, it will usually be the end customer who is in some way paying, most obviously via the cost of the service(s) being provided to them.

The question is, does that payment need to be so obviously transactional? Or could it instead be more palatably framed as providing a benefit? This would mean that an end customer providing data to a service provider could expect advantageous pricing and/or additional or superior services versus the customer not willing to provide the same data. This is the same principle that lies at the heart of open banking.

Open banking initially required a huge regulatory framework and Europe can lay claim to leading that with PSD2. It has since evolved and taken a market-led form in a number of countries such as India, Japan and Singapore without a formal or compulsory regime. In the United States, the highly fragmented and state-based regulation means that a market approach is the only way and banks see open APIs as a competitive advantage and worthy of investment.

For asset finance organizations in Europe the key objective of the upcoming EU Data Act is that manufacturers and designers of smart products will have an obligation to share data with the users of those products and with third parties designated by users. This will have a fundamental impact on the Internet of Things and, for all asset finance organizations, the opportunity arises to take advantage of this data in the financing models and for third parties offering services alongside the finance. But there is a challenge.

The first wave of data aggregation in banking came through screen scraping and still exists in some forms despite the regulation steering banks to share via APIs. In order to take advantage of the vast amounts of data devices can generate, asset finance organizations need to get the fundamentals right – open APIs that can consume and use data as well as flexibility in their core platform to apply the data to the core financing and additional services.

Conclusion: Flexibility is the future

Getting a single, one-size-fits-all asset finance solution to meet these requirements is a tall order. Today, a componentized offering sharing common data and architecture can bring together compatible best-of-breed components that support different objectives in an optimal way.

As well as a componentized model, the ideal system offers flexibility in two forms. First, it lets you easily adapt the underlying software applications and deliver your own changes either through configuration or low code tooling. Second, through APIs, it integrates seamlessly with other third-party technologies and allows you to benefit rapidly from the latest innovations along the entire supplier/user/funder value chain. When the next trend is only ever around the corner, you need a whole ecosystem of modern technology to keep meeting its demands head-on. And with new methods of asset finance now requiring a radical change of mindset, you can't let inflexible systems hold you back.

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