As-A-Service & Circular Economy

Understanding the asset financing banks' positions on ESG performance

26 October 2022
READING TIME: 10 minutes
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Introduction

This white paper explores the relationship between As-A-Service providers and asset financing banks. It first establishes the importance of the circular economy to asset financing banks and their challenges, and then offers some tools for communicating the circularity efforts achieved through As-A-Service. Sustainability is an intrinsic part of the As-A-Service model because it allows for extended use, encourages re-use, and reduces the negative impacts of production. This paper is written predominantly from the perspective of manufacturers and/or integrators.

The key takeaways of this white paper are:

- Asset financing banks face corporate social responsibility challenges: growing national and international regulations on circularity and sustainability, stakeholders values, and reputation.
- Demonstrate how activities associated with the As-A-Service business model aids Asset financing banks in achieving their goals.

1. The asset financing banks

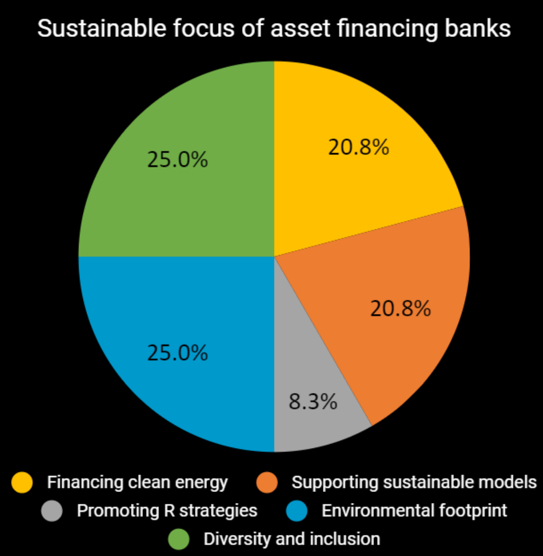
The environmental pressures on banks

Banks' leasing subsidiaries generally follow the same corporate social responsibility (CSR) goals as their parent organizations.

Common sustainable goals of the lenders are: clean energy, diversity and inclusion, and carbon footprint mitigation.

They focus on various industries:

- Technology and smart IoT
- Healthcare,
- Transportation,
- Machineries and construction
- Agriculture



Sustainable finance regulations are increasing. Governance, social and environmental reporting (ESG) regulations are accelerating. In the European Union, several laws and regulations have been passed and are being implemented at a high pace in 2022 and beyond (see below the simplified overview of disclosure requirements for the EU sustainable finance).

Banks and their leasing subsidiaries must act quickly. This is already reflected in their activities, as they are increasingly focusing on sustainable products and solutions.

Below is an overview of the various CSR regulations that apply to lenders in Europe and North America.

European Union	Sustainable Finance Disclosure Regulation (SFDR)	Part of the Sustainable Finance Action Plan, which is aligned with the EU Green Deal: • Transparency for the financial institutions and for their clients, • Prevent greenwashing. Law: REGULATION (EU) 2019/2088
	EU Taxonomy	A classification system that investors can use when investing in projects and economic activities that have a substantial positive impact on the climate and the environment: • Harmonized reporting, • Differentiation opportunity for banks, • Self-awareness, • Risk management practices and resilience. Law: Regulation (EU) 2020/852
	Delegated Acts to the EU taxonomy	Amendments to MiFID II (Markets in Financial Instruments Directive, revised) and IDD (Insurance Intermediation Directive) rules to integrate sustainability preferences into financial advisers' suitability tests.

Canada	Task Force on Climate-related Financial Disclosures (TCFD)	To disclose on: ● Governance: ESG risk and opportunities, ● Strategy: impacts of ESG risks and financial planning, ● Risk management, ● Metrics and targets. This framework is still on a voluntary basis, but by 2024, the Canadian government will start to enforce it.
USA	ESG disclosure	ESG disclosure is a regulation that will be applied soon (however, there is no date yet). "The Federal Reserve started its review into ESG slowly and methodically, focusing on topics such as risk management, governance and scenario analysis"

Specifically, some countries require companies to conduct due diligence to mitigate environmental and social risks such as child labor. If it is not required by law, it is still common practice. This varies from country to country, so it is advisable to do your due diligence and share:

- **Social information**: employment, work organization, health and safety, social relations, training, equal treatment.
- **Environmental information**: environmental policy, pollution, use of resources, climate change.
- **Company focused information**: commitments to sustainable development, subcontractors and suppliers, fair practices, health and safety of clients and users.
- Measures against **corruption** and **bribery**.
- Measures for **human rights**: promotion and respect of the fundamental standards (freedom of association, elimination of discrimination in employment, elimination of forced or compulsory labour, abolition of child labour).

Giving access to data

One of the key challenges for financial institutions is access to new CSR data, which in turn forms the basis for **sustainability risk reviews**. Added to this are new reporting requirements for greater transparency. In other words, what banks are looking for from clients is:

- A **holistic understanding of the product value chain**, rather than just analyzing the impacts of the finished product. If it is not possible to measure the impacts, then it is advisable to categorize according to potential risks and limit yourself to certain categories.
- Review of the **taxonomic eligibility** of the business activity by identifying the environmental objective to which it contributes, assessing compliance with minimum social safeguards.
- **Disclosure** of information in an easily accessible format to verify compliance with these criteria.

- During the transition period, assuming that the client is complying with relevant legislation: relying on **third-party certification schemes, assurances, and labels** while ensuring that any gaps are filled through research by the bank or portfolio manager or, in the case of intangible issues, closing the deal while the assessment is still underway.
- Engage with **sustainability experts** and train teams on sustainability.

With all these regulations, banks and their leasing subsidiaries are facing significant pressures. Their stakeholders need them to comply as quickly as possible to avoid government pressure and negative public reaction.

2. Disclosing environmental efforts

Before investing, asset financing banks will analyze the As-A-Service project using different tools. It is important to understand them before seeking funding with a circular approach.

ESG screening

Project screening is the first step. Asset financing banks will analyze the As-A-Service project before funding it. The table below provides a general overview of what it entails:

Negative screening (avoid the worst performers)	**Norm-based screening (use an existing framework)**	**Positive screening (include the best performers)**
Excluding certain sectors, companies or projects for poor ESG performance relative to industry peers, or based on specific ESG criteria, e.g. the Crédit Mutuel stopped all investments in the fossil fuel industry in 2020.	Screening investments against minimum standards of business practice based on international norms (e.g. UN treaties, Security Council sanctions, UN Global Compact, Universal Declaration of Human Rights and OECD guidelines).	Investing in sectors, companies or projects selected for positive ESG performance relative to industry peers (e.g. most banks invest in green energy).

Asset financing banks apply a wide range of techniques to conduct an in-depth analysis and identify ESG risks.

It typically involves three steps:

- **Investment research**: identifying material ESG factors that may impact downside risk. Investors may use tools like the MSCI ESG ratings or Sustainalytics.
- **Security valuation**: incorporate the material ESG factors into financial analysis and valuation, e.g. through internal credit assessments, forecasted financials and ratios, relative ranking, relative value/spread analysis, and security sensitivity/scenario analysis.

- **Portfolio management**: including the ESG analysis in decisions about risk management, portfolio construction, asset allocation and scenario analysis.

Disclosing

To guide the CSR pitch to asset financing banks, the manufacturer or integrator of the As-A-Service solution must be able to answer the following questions:

- How much Greenhouse Gas (GHG) emissions does the project emit?
- How does it compare with before the project was set in motion? For this question, the Life Cycle Assessment tool provides key data to demonstrate the environmental impacts. The CSR value chain also shows where the impacts lie.
- How does the As-A-Service project improve positive social and environmental impacts?

Much of the ESG work of financial institutions relates to the CO_2 reduction targets they seek to achieve. “Net zero” or “carbon neutral” means the balance between GHG emissions and absorption. There are two main strategies: **reduce** GHG emissions and **offset** unreduced emissions by removing an equivalent amount of GHGs from the atmosphere.

At the organizational level, it means:

Reduce → Offset → Neutralise → Communicate

To avoid greenwashing, it is important to be precise in the reduction activities and plan. The first step is to reduce. By presenting how the As-A-Service solution reduces GHG emissions, we prove to asset financing banks that investing in the project is also beneficial to them.

An organization can be considered “net zero” or “carbon neutral” once it has achieved a long-term objective of 90-95% decarbonation, combined with the permanent removal of emissions that could not be avoided. It is not recommended to use these terms because they imply that the organization's activities emit absolutely no emissions. It is advisable to communicate the **planned and completed efforts** to mitigate impacts (including the standardized and approved tool used) and the certifications obtained.

Communicating yearly on the progress:

- Having a webpage to disclose all ESG policies and reporting documents.
- Report to mandatory organization, if applicable. For example ADEME in France, for organizations with over 500 employees.
- Voluntary report on platforms such as GRI (The Global Reporting Initiative), EcoVadis and CDP, which offer a standardized format and comprehensive questionnaires.
- Transparency being the key word.

3. Conclusion

The EU commission wants to incentivise Product-As-A-Service or other models where producers keep the ownership of the product or the responsibility for its performance throughout its lifecycle. It means there are increasing advantages in switching to such a circular business model. It is an opportunity for manufacturers and integrators to attract asset financing banks by showing alignment with the regulations. It is a way for everyone to improve transparency and trust, thus building a strong long-term relationship.

Black Winch supports organizations to create and/or improve their As-A-Service business model according to their objectives: feasibility analysis, improving profitability, securing the market share, improving customer loyalty. By turning and developing the product-based linear business model into an **in-house subscription model**, it will bring value to the end users, the stakeholders and the shareholders.

The Black Winch experts help organizations to develop a successful As-A-Service business model through a proven methodology. With a personalized framework, Black Winch helps to build or adapt an As-A-Service offer, find financial partners, train teams, and provide the financial engineering required to ensure the success of the project. Additionally, it opens the door towards the circular economy and sustainable development. Black Winch is proud to be part of the 1% for the planet movement.

From a buzzword to a business model, are you ready to take your organization to the next level? Contact info@blackwinch.eu.