V4.0 – as at 1 December 2023

FLA

GREEN FINANCE ROADMAP

Briefing for FLA's Consumer Finance members

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1. Overview

This Briefing Paper sets out some of the challenges FLA members currently face in providing 'Green Finance'[1], together with potential solutions for both member and wider stakeholder consideration. This paper was developed with the help of numerous detailed interviews with CFD members that are lending or advising in this space.

The aim is to create a framework where consumers are appropriately protected and can make informed decisions when taking out Green Finance, while at the same time mitigating some of the risks for lenders in what is a new and evolving market.

Please note that this is a working document and that it will be updated on a periodic basis in line with market developments. We are keen to receive any further feedback from members and key stakeholders. This will help us to update this paper accordingly.

2. Market challenges

Meeting the Government's 2050 Net Zero targets will require an estimated £250billion of investment to decarbonize up to 24 million UK homes[2].

Consumer credit could potentially support a high proportion of retrofitting costs for green improvements such as solar panels, air-source heat pumps, energy efficient boilers, double glazing, or cavity insulation. However, our initial research indicated that many lenders are reluctant to provide finance in these markets due to previous costly liabilities caused by problems with the products or how they were sold to customers by suppliers.

Achieving the 'Net Zero' targets will require the full participation of consumer credit providers, but they in turn require certainty that the risks of involvement do not outweigh the benefits. We conducted a series of interviews with member firms and experts in the field, to identify some of the challenges or 'regulatory blockers', and to explore potential solutions.

The **main** regulatory blockers stem from the **Consumer Credit Act (CCA) 1974**:

- **Section 56** – this provision covers communications / negotiations between a consumer / borrower and the supplier whose goods the lender's credit is financing. A lender offering credit for goods (such as retrofit technology) takes responsibility for what a supplier says to the customer before the credit agreement is entered into, because s56 deems the supplier to be an agent of the lender, even though the lender will not have complete control over everything a supplier says or promises to the customer.

  This has previously led to cases of mis-selling / misrepresentation around the performance of the

[1] Finance provided to fund goods and services aimed at improving environmental outcomes.

[2] This is according to TrustMark – the Government endorsed quality scheme.

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technology, or a service provided and creates a major risk that complaints could be referred to the Financial Ombudsman Service (FOS) - leading to complaints being upheld against lenders.

For example, a consumer purchases solar panels on credit after the supplier states that they will produce a certain number of ‘kilowatts per hour’ of energy in a defined period. As a result of s56, the borrower will have the right to rescind the credit agreement and/ or pursue the lender for damages if the supplier’s assurances prove incorrect or are unsubstantiated – irrespective of the lender not knowing that these statements had been made. Similar claims by solar panel suppliers have resulted in lenders having to pay customers tens of millions of pounds in redress.

- **Section 75** – this makes a lender jointly and severally liable, in certain circumstances, for a supplier’s breach of contract or misrepresentations for goods or services. If the supplier fails to rectify the problem or goes out of business, the creditor is left responsible for dealing with the situation. The risk is heightened where products and technology are still in their infancy and unforeseen problems arise which impede good service levels – such as poor installation.

  Lenders can also be held responsible for consequential losses under s75, for example, if a heat pump needs to be removed and the floor needs to be dug up, the cost of this work and replacing the heat pump would be something that can be claimed against. And where the goods are higher-priced items (such as heat pumps), the overall cost to the lender will be even higher.

- **Section 140a** – this relates to situations where an unfair relationship arises between a lender and the customer. Combined with s56 and s75, this provision can give more flexibility to courts to find against lenders where it is deemed that an “unfair relationship” has occurred. Similarly, FOS will also look at the potential for an unfair relationship when considering complaints, despite s140a solely being the remit of the courts. The burden of proof then sits with lenders to disprove.

  Arguments of alleged ‘unfair relationships’ are often used by borrowers to try and exit agreements when they no longer wish to be bound by its terms. It also has the effect of extending potential lender liability by allowing a borrower to make a claim under s140A, and this can be long after the goods have been financed and repaid.

  By way of example, a consumer may purchase solar panels on their credit card. The consumer can potentially claim under the unfair relationship provision even when the technology has used up a significant portion of its useful life. The lack of a limitation period for bringing a claim also results in claims long beyond a product’s lifespan or the term of a credit agreement.

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The courts may take a wide range of case specific factors into account and will have differing views of what is 'unfair'. This leads to inconsistency of outcomes and uncertainty for lenders. FOS views have also caused problems here for lenders in the past.

3. Potential solutions

Considering the regulatory blockers outlined above, a range of potential solutions will need to be explored. These may complement each other across the heavily inter-related areas of s56, s75 and s140.

Some examples are set out below:

Solution 1 – Quality Schemes

Green home products could benefit from a specific 'Kitemark' from the British Standards Institution (BSI) for carbon neutral products (i.e., similar to the European CE mark) and from an audit review of product installation to confirm they meet quality assurance standards and deliver.

Together, the approach would help validate the 'greenness' and installation quality, which would feed into reducing underwriting / lending risks, section 56 complaints and section 75 claims.

One example is an installation audit(s) conducted by TrustMark**,** a not-for-profit government-endorsed quality scheme that works with multiple providers of registered tradespeople (e.g., vetted installers). This can help ensure that installations meet quality standards and consumers are better protected when having contracted work carried out in and around their homes. TrustMark enables the data capture on energy efficiency improvement plans, audits the work completed and captures information on financial protection; and delivers a dispute resolution service. The data collected via the audit process can be accessed by the lender to inform their underwriting process.

TrustMark tradespeople will always consider the fabric of the house first before recommending energy efficiency or low carbon measures. This is aligned with the UK Government recommendations on retrofitting properties.

The scheme also requires that a full assessment of a property is carried out before any lending for green improvements takes place. For example, an air source heat pump would be of little value to the borrower where the home is not adequately insulated. This allows consumers to have a holistic view of the planned works.

The TrustMark 'license plus scheme' could assist lenders in being able to check that the work has been done properly, as it is checked at the point of completion and signed by both the customer and auditor. The audit will also demonstrate that the work has been installed to the right technical standards and will track improvement in energy efficiency. This can be used to manage section 75 claims too.

See Annex for a brief illustration of how the scheme operates.

In addition to TrustMark registration, installation businesses delivering energy efficiency or low carbon measures should also demonstrate appropriate certifications for individual measures. For example, Microgeneration Certification Scheme (MCS) for low carbon measures like solar PV & Air Source Heat Pumps; or the supply of replacement windows or doors via Fenestration Self-Assessment Scheme (FENSA); Certified Self-Assessment (Certass); and Assure Certification (Assure).

In addition, some members are already actively participating in the Energy Performance Validation Scheme (EPVS), which is a private scheme aimed at allowing the customer to be assured that the installer has gone through a rigorous onboarding process and has satisfied the scheme that its paperwork is clear, understandable and correct.

Separately, there are some energy assessors in the market that can help organisations achieve accreditation and provide training for firms. Some of these include:

- Quidos: Why join our energy assessor accreditation scheme (quidos.co.uk)
- Elmhurst: Energy Assessment Training & Accreditation - Elmhurst Energy

Solution 2 – Insurance

Another solution would be to create an **Insurance Market** that manages lenders' risk for financed green home solutions. This could more accurately reflect the risk involved for market participants by redistributing the risk, while borrowers retain the same levels of protection.

In the example of TrustMark as above, an additional benefit generated is the ability for insurers to see the quality of the work completed. This will reduce their claims risk on business / tradespeople insurance making it easier for them to insure tradespeople as well as generating benefits for multiple sides of the market.

The development of a new system in this way might also support new financial product development within insurance markets, and by extension the potential for the development of new secondary markets (via securitisation).

The Green Finance Institute (GFI) is currently looking at this with the help of the Association of British Insurers (ABI) and they are working with one of their commercial insurers to progress this initiative. However, development of this solution is at an early stage and there is no guarantee that it will come to fruition.

In the medium to long-term, if a market does develop in this space a voluntary insurance option combined with the likes of quality schemes may be more useful.

It is likely that the lender would need to pay for this option, with the cost then built into the overall price to the customer who would also benefit from this protection. A lender or supplier pays model may also be an option depending on the overall cost.

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Solution 3 – Consumer Credit Act Reform

A third and potentially longer-term solution is the Reform of the Consumer Credit Act (CCA), which the Government is currently coordinating, but which could take up to 5 years to complete. As part of the Review, a more proportionate approach is required in connection with Ss56, 75 and 140a, taking account of how they have worked in practice over recent decades and interaction with newer regulation, for example:

- Under s56, a more measured position is needed as lenders cannot realistically have complete control over everything a supplier might say or do as part of their interaction with a customer. Customers should also seek recourse from the supplier in the first instance, as they are in a better position to swiftly rectify any problems. As part of the CCA Review, we have called for the repeal of s56. Instead, customers need to receive sufficient information they can rely on, and the different parties to a transaction must take responsibility for their actions. This could be part of a *Prescribed Customer Journey* – see below.

- The current s75A places a requirement on the borrower to pursue the supplier in the event of a potential claim. The lender would bear responsibility to cover the claim only once particular conditions have been met (e.g., the supplier has not engaged, has become insolvent, or the consumer/ borrower can recover only a portion of loss from the supplier). Customers remain well-protected and the risk to lenders is on a more equitable basis. The Review should ideally allow a wider application of s75A in Green Finance lending, in place of s75. A caveat here is that there will still need to be a definition of what constitutes a 'Green Finance' product, which would need to be clarified.

- The introduction of the FCA's new Consumer Duty delivers a comprehensive framework of new consumer protection measures, which arguably replaces the need for s140a. Addressing unfair practices is a cornerstone of the Duty and to retain s140a would lead to unnecessary duplication in what is already a complicated regulatory framework. Its removal would not lead to a dilution of consumer rights, as the Duty is in place.

As CCA Reform will take several years, solutions are required in the interim which mitigate the CCA risks for lenders while ensuring protection for consumers.

One option could include the development of a *Prescribed Customer Journey* (PCJ) when applying for Green Finance, which could be used alongside a quality assurance scheme such as Trustmark (see above). A PCJ might involve customers being given 'Key Facts Information' on the product or service being purchased, as well as other features (e.g., follow-up contact calls / cooling-off periods) scoped in consultation with consumer groups and the FCA. The KFI would need to be in sufficient detail to allow customers to make an informed decision on whether or not to proceed. While

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suppliers may continue to provide information or comment beyond that set out in the KFI, the customer will still have prescribed core information to base their decision on. Consumers would also still benefit from protections under the Consumer Rights Act. There may be an opportunity for the FLA to work with the GFI on developing a Green Finance PCJ.

Other potential solutions

The recording and scripting of sales may be a potential solution for some firms in these markets. But clearly with volume, recording all sales may not be feasible and in the case of scripting on its own, this doesn't necessarily help with s56 complaints.

Similarly, wrap around agreements with manufacturers may help with s75 issues but won't necessarily cover all bases (e.g., potentially s56 mis-sales/misrepresentation). The view from some members is that lenders may be able to manage issues relating to poor quality products and installations from approved sales partners. However, the issue of mis-selling remains to be a challenge. One option may be for the consumer or the lender to claim against the supplier's commercial insurance, especially in cases where the 'advice' has caused the mis-selling.

The role of 'retrofit assessors' could also be a good solution (dependent upon the value of the 'retrofit'), accompanied by properly accredited and certified installers to carry out the work, once agreed by the parties.

The use of PAS 2035 could be beneficial here as it is a 'whole of house' or 'whole building' retrofit specification. This offers an end-to-end framework for the application of energy retrofit measures to existing buildings in the UK and provides best practices for their implementation[3].

4. Other considerations

Outlined below are some other factors that may influence how the Green Finance market currently operates. These include:

Secured Lending

While this paper focuses on Green Finance relating to unsecured lending, it is worth noting that some firms are actively in the process of developing secured lending solutions. This includes products such as Green Mortgages and other funding for retrofitting and Green improvements. Our Second Charge mortgage lender members may play a role in providing these options for customers, especially where customers are keen to carry out green improvements to their homes, but do not want to disturb their First Charge mortgage.

Unlike in the unsecured market, CCA risks will not be relevant for secured lending as it would not count as Consumer Credit.

[3] Whilst Solution 1, in the form of a quality scheme, does all this and more it would in theory be possible for lenders to just take this approach without joining the TrustMark scheme.

However, firms may still want to support customers by ensuring that they are adhering to the high standards being reviewed in the unsecured market (e.g., access to qualified fitters etc.). A similar PCJ to the unsecured market might be useful in this market too.

Cost of funding

The cost of funding Green Products is high, and they are deemed to be less profitable for lenders because of the risks associated with lending in this market.

As a general point, greater competition in this market could reduce the overall costs for consumers. However, the only way to make this a more attractive proposition for lenders is to reduce the risks of doing business in this sector.

Options to mitigate these costs might include:

- **Guarantees**: Guarantees for providers / lenders when funding green products could be created. A definition of the product type would be required here. By way of example, we could include a Government backed solution similar to the previous Coronavirus Business Interruption Loan Scheme (CBILS) that was offered during the Covid pandemic.

- **Grants**: Some form of grant or funding mechanism for consumers (including non-prime) could be useful. There is currently more of a challenge in terms of demand for products rather than a supply issue, albeit there are still supply chain challenges (refer below) – but consistency of approach is key here.

- **Tax incentives / reliefs**: These could be useful, but such incentives will not increase confidence in green investment if they are launched and then subsequently withdrawn. Longer-term certainty is required.

- **Interest-free loans**: The Government could also do something to support lenders by helping them to provide interest-free loans to help pass on the benefit to customers. The structure of these schemes would need further consideration.

- **Bank of England support**: Support through prudential / capital reliefs to incentivise the green finance market may be a welcome approach for lenders.

- **UK Infrastructure Bank** – There may be a role here for the UKIB[4]. One of their two key objectives includes working with the private sector and local government to increase infrastructure investment in pursuit of tackling climate

[4] It's worth noting that UKIB cannot cater to the retail market (minimum ticket size £25m). However, there is nothing stopping them working with the UK Government on grant schemes, which they already do in the public sector. This could help simulate and aggregate demand, especially in the domestic market.

change – helping the Government meet its Net zero by 2050 goal. This includes 'retrofit', an area they are currently looking to understand and how they position themselves.

Any scheme created needs to be simple, efficient, understandable, and easy to administer. It also needs to avoid interrupting the supply chain. Previous schemes, such as the 'Green Deal' / 'Green Homes Grant', were seen to be too complex, bureaucratic, and lacked consistency.

In some parts of the market, regulatory reform might also be a partial solution here. For example, through the use of affordability checks. FCA/FOS could start to recognise future savings in affordability calculations for Green / Net Zero products. However, definitions of product types will be vital here.

Education

There is a general lack of awareness in terms of what 'Green Products' are available, what they do, and how they operate. This applies to both lenders and their customers.

Both regulators and the Government could help with improving consumer education. This could be through FAQs to help bridge the 'trust-gap' as well as the 'education-gap' relating to the products offered.

There may also be some merit in exploring the financial benefits of green products and promoting these.

The Green Finance Institute (GFI) is already beginning to do some of this educational piece in relation to the different green products out there. The FLA could look to further collaborate with GFI on this.

Training

An area of focus that we may want to explore further as an industry is the potential for a voluntary UK training scheme. This could help to support the long-term aspirations of firms to improve the UK residential housing stock. This could entail a combination of training for lenders and other market participants (e.g., retrofitters / advisors). Some members have already indicated that they would be in support of this initiative.

'Green Washing'

The term 'green washing' has arisen as a regulatory concern due to the absence of adequate labelling. The key question in relation to this is whether a product is genuinely green.

One option to help with this problem is to introduce a set of standards / certifications as to what constitutes a Green Product may help. It is anticipated that the FCA may do some further work in this area, but there is scope for some Government lobbying here. Again, there may be a role for the GFI here.

Third Party risks

There are third-party risks that relate to s75. This concerns the role of third parties and how they might be held accountable as part of the supply chain.

There have been some concerns around the quality of third-party contractors in the past. As noted earlier, appropriate quality schemes could help reduce this risk.

Suppliers going out of business

Similarly, in the past there have been problems with some suppliers entering the market and then exiting it due to various reasons (e.g., going out of business). This was particularly prevalent with solar panel suppliers.

Some of the solutions outlined above could help to ensure that firms have the proper systems and controls in place to support borrowers in the event of a firm going out of business, or being unable to service its requirements towards customers.

Financial promotions

This includes misleading information being provided to consumers, and potentially leads back to s75, s56 and FOS claims.

This might be an area where FCA guidance on Green Finance promotions might be helpful.

EPC ratings

There is general consensus among FLA members, and wider market participants, that EPC ratings are inaccurate and not fit for purpose. The view is that these are often dated and not fully reflective of a property's status.

The Government is about to launch a new review and consultation in 2024 around EPC ratings, and this is likely to lead to a change in this metric. However, the EPC standard is likely to remain prominent in the market.

The EPC scheme could be adapted to be more user friendly for homeowners and for green mortgage ratings. More help/guidance for understanding how a particular rating is given and how to increase home EPC ratings to A or B ratings to qualify for a green mortgage could be helpful.

Other more immediate solutions that are starting to emerge include technology providers who assess what a house retrofit needs from several different data sources. These are not intended to replace EPC ratings but may act as a supplementary measure for performance. Here are some examples:

- Susy Home; SuSy: Making sustainable homes achievable for all
- Snugg; Snugg – Making Home Energy Efficiency Simple and Affordable

- Parity Projects: [Housing Stock Analysis for Net Zero - Parity Projects]

Supply Chain challenges

Linked to the Third-Party Risks referenced above, there is also a lack of 'retrofit' expertise for certain products. According to TrustMark, there is currently a need for an extra 270,000 'retrofitters' to tackle this challenge.

One solution to this challenge is for firms to work with the Government to overcome the skills shortage that exists for certain products (e.g., heat pumps) and to build up the supply chain. The FLA could usefully act as a conduit here between the Government and other interested parties, such as TrustMark and GFI.

The Government recently announced £8.85 million to train up to 8,000 people to retrofit and install insulation. Whilst this is a good start, it currently goes nowhere near addressing the current shortfall documented above.

5. Next steps

The FLA will continue to work with members to explore how the Green Finance market can be improved for both lenders and consumers. This includes prioritising and working through the solutions and options put forward in this document.

We will also continue to collaborate with the GFI, the FCA, and the Government, including TrustMark, in developing a workable framework.

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December 2023

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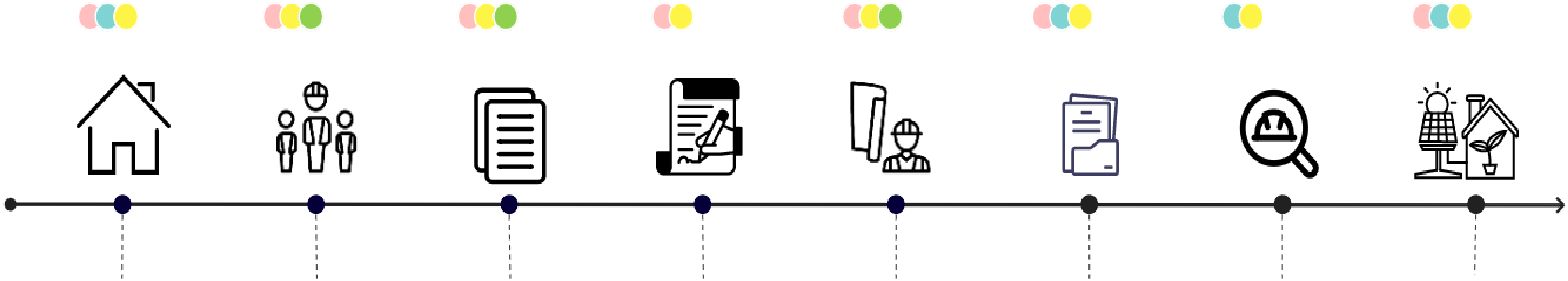
Annex - Trust Mark Scheme Illustration



Consumer starts journey investigating possible energy efficiency solutions to improve their property.

TrustMark website to link out to gov,uk website site [https://www.gov.uk/improve-energy-efficiency] for consumer research options.

Installers that hold the Licence Plus trades will be identified on the TrustMark 'Find A Trader' search.

Consumer engages a TrustMark Licence Plus Installer who will signpost them to independent information on what options may look like.

Consumer decides to proceed with improving their property, Installer engages a TrustMark registered Retrofit Assessor to perform property assessment and produce an EPC; identifying the staged improvements that can be included in the project to create a plan of future improvements.

Based on the 'whole-house' assessment, conversations with the Installer and Assessor and a responsibility to complete their own due diligence, the Consumer can decide on what measures best fit their circumstances and desires for energy efficiency improvements.

The Licence Plus Requirements state that any proposed improvements should be based on a 'whole-house' fabric first ideology.

Consumer and Installer agree the contract for the improvements that will be installed and the works start.

Works completed based on the agreed contract ensuring that the Consumer is kept informed of any issues that may occur.

The Retrofit Assessor will return to the property and complete the post-EPC assessment

On completion, the Installer is responsible for providing the Consumer with a copy of all documents / manuals relating to the measures installed and the financial protection / guarantee relevant to each measure.

Once works are complete, the Installer must record the project in the TrustMark Data Warehouse.

This information will include what was installed, when, pre- and post-EPC references and the financial protection given to the Consumer.

On completion the Consumer will receive a certificate of lodgement automatically from the Data Warehouse.

Lodged work under the Licence Plus Scheme will be subject to risk based QA process.

The initial 5 lodgements of all Installers will be inspected onsite, either by TrustMark or their Scheme Provider to ensure that the works are compliant with the relevant standards and validate the delivery of the measure.

Lodgements will be subject to desktop audit by the TrustMark Audit Team to ensure the appropriate documents and financial protection have been recorded.

The TrustMark Audit Teams will notify the Installer should any non-compliance be identified from either the desk-top review or onsite inspection.

The non-compliance will be managed until compliance is evidenced.

Consumer can now progress their Retrofit Net Zero journey based on desire, finance availability and needs

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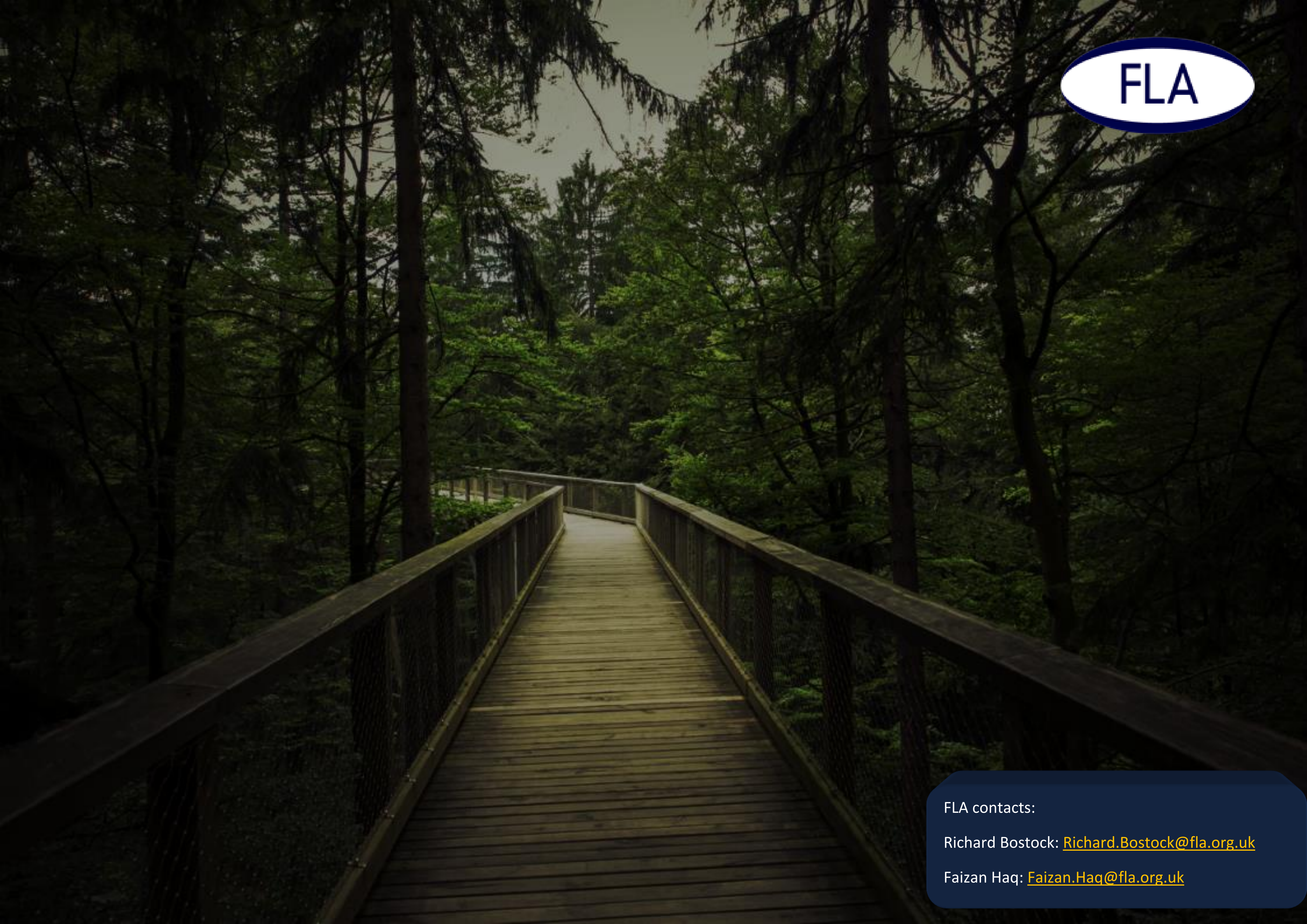

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