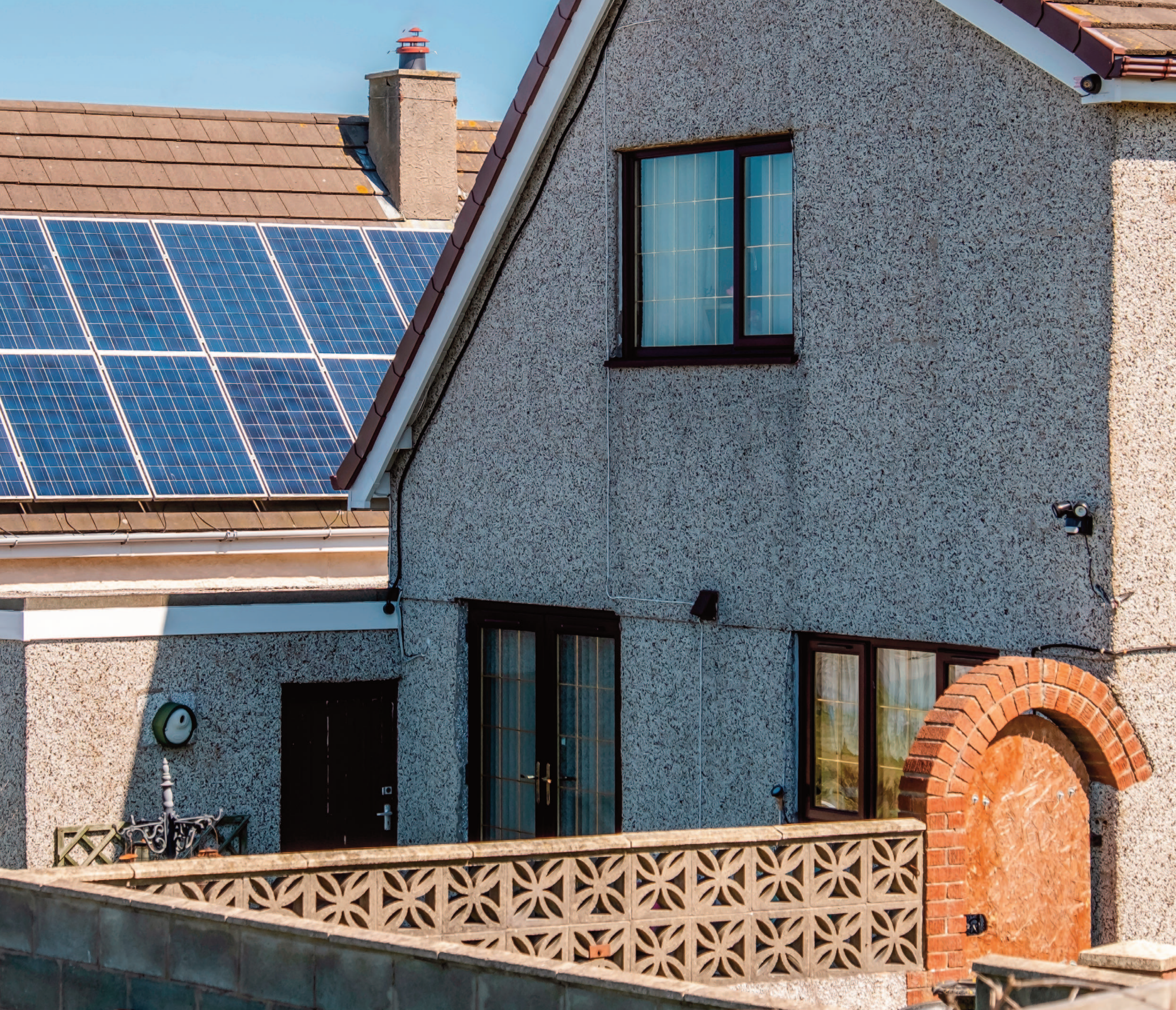
Green Finance Institute

UNSECURED GREEN HOME LOANS: Managing the Risk



Unsecured Green Home Loans: Managing the Risk

From partnerships to intermediaries; what's in the toolkit for managing risk for the unsecured green home lending market?

In recent years, the global shift towards environmental sustainability has spurred significant growth in the green home finance market. This trend presents a promising opportunity for lenders to tap into a rapidly expanding market while simultaneously contributing to environmental conservation efforts.

However, the expansion of the green home finance market poses unique challenges and risks for lenders. Whilst verifying the proper allocation of funds to green projects can be a consistent challenge across all types of green home finance, scaling the unsecured green home finance market introduces an additional set of barriers. The Green Finance Institute's publication **Unsecured Green Home Loans: Demystifying the Market** unpacks the challenges facing the unsecured green home finance market, notably, effective risk management. Industry stakeholders across the market are directly addressing the challenge through innovative mechanisms for managing risk:

Managing risk

Quality Assurance Schemes

Provided by Government-baked bodies and include:
- Installation validation services
- Quality Assurance on installations via data capture, desktop and on-site audits
- Remediation and corrective action, if non-compliamce detected
- Consumer and Financial protection including dispute resolution

Sales Validation Schemes

Provided by organisations (may not be Government-backed)
- Validated consumer and installer contracts
- Assurance audits
- Customer satisfaction analysis

Partnerships

Partnership (e.g. with scaled installers or energy companies)
- Tightly controlled processes to prevent negative outcomes
- Agreement of risk ownership and responsibility

Insurance models

Corporate insurance models may look to directly insure a lender against risk that a lender has low visibility or control over

Quality Assurance Schemes

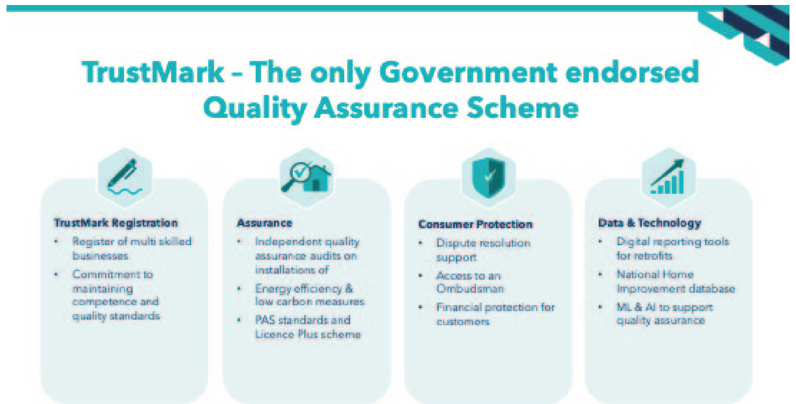
Government-backed quality assurance schemes, exemplified by **TrustMark**, can play a crucial role in mitigating risk for lenders. Home improvement businesses, that join schemes like TrustMark, demonstrate their dedication to upholding quality standards. Through expert oversight of installations and stringent quality control measures, these schemes ensure the integrity of property renovations & improvements, particularly in mitigating risks associated with substandard installations, notably in energy-efficiency and low-carbon installations. These schemes enhance consumer protection, and by capturing property level data offer increased visibility into potential risks faced by lenders and facilitate robust risk management strategies.

Case Study: TrustMark Quality Assurance

TrustMark is the only Government-endorsed quality scheme for home improvements. From a standpoint of strengthening consumer protection, TrustMark's mandate is to drive-up quality standards across the industry and improve the protection offered to homeowners, and landlords, when having work done at their properties; and to organisations that fund the work.

TrustMark is a not-for-profit, social enterprise built on 4 key pillars:

1. **TrustMark Registration** – an easily accessible register of **15,000+ competent** businesses, employing tradespeople, who demonstrate a commitment to high standards of quality, good trading practices and consumer protection. This register spans the gamut from small businesses to the large institutions such as the energy companies and building firms covering c. 114 home improvement trades.
2. **Quality Assurance** – independent assurance audits of the home improvements and comparison against recognised installation standards - funded by government schemes and/ or other funding sources e.g. banks, lenders, asset managers, insurers – delivering risk mitigation services.
3. **Consumer Protection** – a requirement placed on TrustMark registered businesses to provide financial protection, supported by dispute resolution and access to the Dispute Resolution Ombudsman.
4. **Data and Technology** - Support to the Assurance and Consumer Protection services and enable the creation of a National Home Improvement Database. Data is captured on individual home improvement plans, actual installations completed, insurances linked to the installation, a risk assessment of the installation including comparison to plan, progress in EPC/EPR ratings and remediation requirements, if any. AI and Machine Learning tools are applied to identify risk, provide quality assurance, and deliver reporting across risk measures.



The TrustMark Assurance function includes a reporting capability that allows lenders validate use of funds, assessing whether the lending has been used for the intended purpose[1]. TrustMark's Assurance remit covers the UK Government's Capital funded, Grant Funded and Lender funded home improvement schemes. The Assurance oversight covers insulation and low carbon installations. The latter are currently audited and assessed against MCS standards.

By tagging property assessments, recommendations, and improvements to unique property reference numbers on the TrustMark Data Warehouse, and linking them to loan/ mortgage applications, TrustMark facilitates the tracking of property enhancements. Additionally, by monitoring improvements in Energy Performance Records (EPR) and Energy Performance Certificates (EPCs), TrustMark is able to support the evidencing of property improvements and monitor the progress of energy & carbon footprint across their portfolios.

[1] This does not include Transaction Validation as required by the FCA

Managing Risk:

TrustMark's model looks to specifically address risk that a business may misrepresent the benefits to a customer of home improvement work:

- Via the Framework Operating Requirements and **Code of Conduct** - all TrustMark Registered Businesses need to adhere to the code and the Consumer Rights Act, which includes provisions against mis-selling.
- Via the Quality Assurance Process – TrustMark captures installation and product information and compare against relevant installation standards – **PAS 2030** or **Building Regs** – or through a **Home Improvement Lodgement** which is a limited verification process that supports the needs of financial services companies who lend for energy efficiency and low carbon improvements.
- Via Regular audit/monitoring of businesses and complaints made to TrustMark.

To address potential breach of contract, all Trustmark tradespeople and Registered Businesses are required to adhere to the **Code of Conduct and Customer Charter** which includes the requirement to have clear contracts (ideally using Trading Standards approved templates) in place. In the event of a dispute between the consumer and tradesperson, where the dispute resolution process finds the tradesperson is at fault, TrustMark encourages the business remedy the position. Should this not rectify the position, the business is deregistered from TrustMark. The threat of this ultimate sanction plays an important role in delivering good contract management behaviour among the businesses/ tradespeople.

Where the installed measures are uploaded to TrustMark's Data Warehouse, TrustMark is able to offer independent audit of the work carried out to confirm they have been delivered to recognised standards, and support customer dispute resolution and remediation processes.

TrustMark's service offering can be either deeply integrated into a lender's existing process, or can operate as a standalone service. Examples include Barclays' home improvement incentive programme which requires use of a TrustMark installer. Government funded schemes mandate the use of TrustMark tradespeople and use of the Data Warehouse is mandatory to access funding and provide risk oversight for OFGEM and Department of Energy Security and Net Zero.

Financial services firms including secured and unsecured lenders, asset owners, and insurers, who use TrustMark will be able to mitigate risk to customers' properties stemming from poor installations, especially of energy-efficiency and low-carbon measures. TrustMark also aids in mitigating risks from regulatory mandates such as Section 75 of the Consumer Credit Act (CCA) and potentially Section 56 through independent quality assurance audits of installations.

Beyond risk mitigation, TrustMark seeks to bridge the trust gap consumers often face when engaging with home improvement practitioners. By promoting adherence to a recognised standard and certification, TrustMark aims to instil confidence in the market, paving the way for enhanced consumer trust and industry credibility. Through these efforts, TrustMark endeavours to foster a marketplace characterised by reliability, transparency, and consumer-centric practices.

Sales Validation Providers

Some organisations, like **EPVS**, provide key validation and oversight to lenders. These schemes ensure installer competency and regulatory compliance conduct thorough checks and ongoing monitoring. By integrating into installers' sales processes, they offer constructive feedback and support to ensure adherence to standards. Additionally, they facilitate consumer funding access and address installation issues as they arise. Their objective is to establish a transparent and dependable framework that fosters trust among lenders and consumers alike.

Case Study: Energy Performance Validation Scheme (EPVS)

In 2015, Claims Management Companies found success in making mis-selling claims directly against lenders, particularly where the loan involved solar PV, heat pumps, and other renewable or energy efficient products where fuel savings, income, grants, or other benefits were claimed. The volume of claims – sometimes unfounded, but always persuasive – resulted in lenders withdrawing from the market. This resulted in a decline in retail sales of renewable products, and impacted a wide range of stakeholders' businesses.

The Consumer Code HIES presented a package of safeguards to several lenders in an attempt to bring them back into the market, and the Energy Performance Validation Scheme went into pilot in 2016. Its success led to the Scheme being spun off from HIES in 2017 so that it would be able to demonstrate its independence and impartiality on audit, and it became part of the newly formed **Certi-fi Schemes Limited**[2].

On applying to become a member of EPVS, an installation company is required to evidence that they have the competency to give consumers accurate performance estimates, product and installation design using accepted industry methodology. EPVS conduct a review of the applicant's website, contract, and all consumer facing documents to ensure that there are no unfair terms or unevidenced claims, and that all information is clear. Once approved, the EPVS member can gain potential access to consumer funding through an EPVS lender partner. All new members have only interim approval for the first three months, whilst undergoing enhanced monitoring.

To support treating customers fairly, every consumer finance and cash contract, along with design, performance estimates, and supporting evidence (such as bills and photographs.) is uploaded to the EPVS portal for analysis and validation. EPVS works closely with lenders to fit into their processes, making amendments to the EPVS process in line with the requirements of a lender's risk or governance teams. However, the lender does not pay the installer until they have confirmation that the contract has been EPVS validated. This is done either by an API link, or by the lender's manual access to the EPVS portal. EPVS also works closely with the lender's customer service and complaints teams, delivering industry expertise to support an efficient, effective and fair outcome for the consumer.

The EPVS model validates all types of renewable energy design and sales, including solar PV, storage, and heat pumps. However, EPVS has also been involved in validating savings on various heating products, such as infra-red radiator systems. Where service contracts have been sold, EPVS contacts the consumer to ensure thorough understanding of the agreement terms. Increasingly, system benefit estimates that incorporate variable and time of use energy tariffs, as well as grid balancing and arbitrage services, are becoming more widespread, and EPVS has worked with providers of these services to ensure that the consumer receives a reasonable and achievable illustration of these savings and income drivers.

EPVS validates use of funds for the products to be installed on all contracts, which must be energy generating or saving systems. Aside from the core product, EPVS members will install insulation, monitoring, system management, and other peripheral products that reduce costs and carbon. As part of the EPVS validation service, potential installations are reviewed, ensuring they meet the stated criteria, and compliance calls to consumers ensure that it is those products that are being installed. EPVS reports to lenders detail the products funded and may produce estimates of the carbon savings the funded products will achieve over their lifetime – a key input to lenders' green credentials.

[2] Certi-fi Schemes Limited also owns the Flexi-Orb Installation Scheme.

Managing Risk:

Different features of EPVS look to directly address the risk of misrepresentation:

- The onboarding process evidences that installers have the competency required to produce accurate designs and performance estimates and have compliant sales documentation and processes
- EPVS ensures that each applicant is a member of the relevant regulatory bodies and the ongoing validation process evidences that Installers can consistently meet those requirements
- During the EPVS validation process, voice contact is made with c20% of members' finance customers, to confirm an ethical sales process and ensuring that the information has been understood
- Before validation, every finance contract uploaded to the EPVS portal must contain a scripted voice recording – key questions remove any future query as to what the salesperson 'said'
- All consumers validated under the Scheme receive an EPVS Certificate, and are invited to direct any performance estimate queries to the EPVS team
- All verified consumers are invited to leave a review of the installer's sales process.

Schemes employs highly competent engineers in both electrical and heating disciplines to reduce the risk of a breached contract. Where product or installation issues do arise, EPVS takes a consultive and supporting role to work with members for a fair outcome for the consumer. However, where an amicable arrangement cannot be agreed, EPVS works with the member's Consumer Code and/ or Certification Body's complaints, remedial and dispute resolution processes to ensure a fair outcome is reached. Additionally, EPVS also provides expert reports and witness statements to courts and to the Financial Ombudsman Service. Ultimately, EPVS reserves the right to remove a member from the scheme, which severely impacts their ability to obtain consumer funding elsewhere.

EPVS is recognised as an Installer sales aid, helping to facilitate the market, to create a robust, compliance-driven environment for lenders. With a unique position fully integrated into Installers' sales processes, EPVS engages directly with customers for validation services, offering immediate feedback and identifying training needs. This involvement is seen by Installers as integral to their compliance efforts, with EPVS recognized as a valuable resource rather than a hindrance. Consumer calls are viewed as an opportunity to instil confidence in design and performance estimates, aiding in sales without being intrusive. EPVS attracts new members looking to maintain compliance and competitiveness in a shifting industry landscape. It also supports previous members in refining their exit strategies, which enhances confidence in compliance practices for potential buyers.

Partnerships

Some lenders have partnered with scaled installers or energy companies to offer unsecured green home loans. These partnerships present several advantages:

Scalability: Partnering with scaled providers enables lenders to efficiently reach a broad base of homeowners. Unlike managing multiple smaller-scale partnerships, collaborating with a single scaled provider streamlines operations and extends the reach of green home loan offerings to a larger audience. Many of these organisations are already part of quality schemes like TrustMark.

Risk management: Partnering with established installers or energy companies can allow lenders to adopt a more controlled approach to risk management. Before entering an agreement, a lender can agree specific standards and protocols in both the sales process and in the installation. This can directly reduce the likelihood of misrepresentation, sub-standard installations, or project setbacks that could impact the performance of a loan.

Issue resolution: In the event of post-installation issues, partners with ample resources and expertise are well equipped to promptly address and resolve problems, minimising potential disruptions and financial losses for both customers and lenders.

Contractual agreements: Lenders can negotiate contractual terms with potential partners to establish procedures for managing claims and resolving disputes. Leveraging the financial stability and robust balance sheets of these partners can instil confidence in lenders that obligations will be met and consumer claims addressed promptly.

By leveraging strategic partnerships, lenders can foster a resilient and impactful green home loan ecosystem. These partnerships can enhance the reliability and efficiency of loan offerings but also contribute significantly to broader strategic objectives of promoting renewable energy adoption and environmental sustainability.

Insurance Models

The insurance industry has the potential to play a valuable role in lifting barriers and catalysing the scale of the unsecured green home loan market. Where lenders of unsecured green home point-of-sale face challenges managing risk, insurance has an opportunity to step in. No live models currently exist, but the Green Finance Institute continues to work with the insurance industry to explore this solution.

Conclusion

Effective risk management is essential for the sustainable and resilient growth of the unsecured green home lending market. Through a combination of quality assurance schemes, sales validation schemes, strategic partnerships with scaled installers or energy companies, and innovative insurance models, lenders can navigate the unique challenges of the market while maximising opportunities for growth and impact.

Quality assurance schemes like TrustMark provide crucial oversight and validation to instil confidence in both lenders and consumers. Sales validation schemes, such as EPVS, offer verification and support, further enhancing the reliability of green home loan offerings. Their combined efforts can bolster trust and credibility in the market, ensuring the integrity and quality of green home financing initiatives.

Strategic partnerships with scaled providers streamline operations and extend the reach of green home loan products, while also mitigating risks through controlled oversight and issue resolution mechanisms. These partnerships enable lenders to efficiently manage risk while reaching a broader base of homeowners.

Looking ahead, innovative insurance models hold promise in further mitigating risk and unlocking the additional potential of the unsecured green home lending market. Collaborative efforts between the Green Finance Institute and the insurance industry continue to explore and develop solutions to address risk management challenges.

By leveraging a diverse toolkit of risk management strategies, lenders can not only navigate the complexities of the unsecured green home lending market but also drive positive environmental impact and support sustainable communities for years to come.