EUROPEAN ASSOCIATION OF CO-OPERATIVE BANKS
The Co-operative Difference : Sustainability, Proximity, Governance

Brussels, August 2023

EACB position paper on the proposal for a directive on the Energy Performance of Buildings (recast)

August 2023

The **European Association of Co-operative Banks** (EACB) is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 28 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks' business model. With 4,050 locally operating banks and 58,000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 223 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 85 million members and 749,000 employees and have a total average market share of about 20%.

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Introduction

As the voice of cooperative banking in the Union, the EACB has been closely following the work of the European institutions on the Commission's proposal to recast the Energy Performance of Buildings Directive. While we broadly support the proposal, we wish to raise specific issues (MPS, EPC, data) following the publication of the co-legislators' respective positions, which in our view could hinder the goals of the Directive. We argue in favour of **mortgage portfolio standards that are voluntary (incentivising mechanisms, rather than mandatory requirements with potential counterproductive effects)**, ask for energy performance certificates that are **harmonised** throughout the EU. The financial industry also needs sufficient access to relevant **data** for the framework to be efficient.

Incentives to finance renovation

The Commission's initiative to recast the EPBD is extremely welcome by EU cooperative banks as it will enable them to support the transition to energy-efficient buildings. As access to private

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finance is a key tenet of the new European renovation wave, the EACB firmly believes that green buildings and deep renovations should be financed by appropriate loans where compatible with households' ability to repay, in order to achieve the necessary climate goals.

In this sense, we support the introduction of clear and consistent targets, which will facilitate the provision of financial products and services that support the energy transition. This will not only benefit the environment but also help to reduce energy bills for consumers and improve the sustainability of our cities and communities.

We appreciate the introduction of Article 15, which aims to **stimulate investment and address market barriers**. In particular, we welcome the suggestion of the European Parliament under the new subparagraph 4a). Under this proposed wording, the article will incentivise financing all the while **safeguarding against potential counter-productive lending behaviours**, such as refusing access to credit to households. This would address our concern that mandatory MPS could drive mortgage providers to favour projects that are already green, in order to maintain a certain ratio requirement, to the detriment of worst-performing buildings in need of deep renovation. In this respect, the addition to recital 46, which specifies that an important premium should be given to deep renovations, is also welcome.

Mortgage Portfolio Standards (MPS)

As explained above, the EACB supports the introduction of Mortgage Portfolio Standards **to the extent that these would be voluntary**, rather than imposed mandatory thresholds. In our view, imposing mandatory standards risks deterring financial actors to invest into the most needed renovations.

The EACB does not consider that their implementation would be efficient should they be given a mandatory character. In particular, we have doubts that MPS would set incentives in the right way like the supporters[1] of mandatory MPS do not cease to assume. MPS can easily create disincentives for mortgage finances or direct banks in a direction to finance rather new buildings, but not the transformation of older buildings.

Moreover, when it comes to incentives, there is already a **wide range of prudential regulation pushing banks to reflect ESG aspects** in their lending and risk management policies, ranging from the EBA GL on Loan origination, the Pillar 3 GL, the ECB Guide on climate-related and environmental risks, the revised CRR and CRD, SFDR etc. Banks are already on the way to increasingly reflect EPC label ratings in their loan and risk policies.

Other EU and national legislation, which impose ESG-standards for real estate, have a strong impact on how banks look at mortgage loans and especially on buildings as collateral. Mandatory MPS would duplicate and mainly address "non-problems", as banks are already carefully looking at the financing of energy efficient buildings. In this directive, the co-legislators refer (Art. 2(1.36)) to a wide array of mechanisms to enable the transition of the EU building stock. The EACB appreciates that these measures aim to support mortgage providers as they create new

[1] See for example: Underwriting the Renovation Wave with Mortgage Portfolio Standards for Energy Efficiency; Climate Strategy & Partners, October 2021;

tools and solution that are adapted to their clients. As it is not entirely clear what the standards will look like in practice, **it is key that their flexibility and voluntary nature is preserved**.

The EACB also wishes to underline that mortgage and financial service providers act as enablers of the transition. The final decision to purchase a green building or renovate a poorly performing one rests with the final user, ie. the borrower. The role of banks should remain to incentivise and facilitate these transactions by making dedicated financial tools available. **Having mandatory MPS that could outpace the rhythm set up for the market as a whole could endanger both the credibility and the risk profile of the banking sector.**

Besides this general concern, we have reservations on the appropriateness of mandatory MPS as a policy tool:

- Mandatory MPS do not create the right leverage to improve buildings energy efficiency due to the relevant differences between properties that serve as collateral for mortgages as compared to the overall building stock;
- Mandatory MPS risk creating the wrong incentives by diverting investment into already quite efficient homes, while leaving stranded those older, less efficient and high-emissions buildings in need of renovation. Crucially, only a minority proportion of the European existing building stock is financed by a mortgage[2]. This means that the features of the overall building stock are very different to those of the mortgaged building stock, the latter being strongly biased towards newer homes as older ones' mortgages are already repaid or have low outstanding debt.

While we appreciate the Parliament's effort to mitigate this risk of *"counter-productive lending behaviours"*[3] , there remains an impossible dilemma for banks, and specifically for cooperative banks as they are more exposed to remote areas, rural and small villages buildings and less affluent clients. Their business model is typically more oriented towards mortgage financing than other type of banks. Under voluntary MPS, it should be possible to account for the financing of lower energy performance properties, where a proper renovation plan is set for future improvement. **Under mandatory MPS, cooperative banks would either comply at the risk of withdrawing support to local communities and less affluent customers, or they would keep supporting poorer households and financing more challenging buildings at the risk of not being able to comply with MPS or even banking prudential metrics** (as buildings energy efficiency requirements embedded into MPS are taken into consideration by supervisors as part of transition risk).

[2] In Spain, where there are 26.6 million mortgages, the outstanding amount of mortages is 5.3 million, according to the Spanish Mortgage Association. http://www.ahe.es/bocms/sites/ahenew/language_english/ and the National Statistics Institute https://www.ine.es/index.htm

[3] *"such as reducing or refusing access to credit to households living in low energy performance…or limiting their mortgage lending to consumers purchasing high energy performance class dwellings"* (Art. 15 (4a) Parliament report)

Indeed, cooperative banks often operate in geographically limited areas which harbor fewer new constructions. Opportunities to finance households should be ensured also in those areas, and as such, portfolio standards should take into account the different levels of regional development and related limitations, and avoid penalizing smaller regional banks. As cooperative banks operate in different regions and not only in growth centers, interest subsidy elements are of particular interest to them. Furthermore, consolidation of portfolio standards at group or central entity level should be permitted. Finally, Cooperative banks would benefit from taking part in schemes such as the development of environmentally conscious community housing. This would constitute a differentiating factor, even with small scale investments.

In our view as local and cooperative banks, **not only access to finance, but also financial stability and economic growth could be endangered by mandatory MPS, without really making a significant contribution to the reduction of CO_2 emissions, which ultimately depends on the asset owner's decision.**

For these reasons, the EACB takes the view that voluntary MPS, as initially proposed by the Commission and endorsed by the Council, would be the right policy measure, as banks' mortgage portfolios would improve over time by following and fostering the renovation schemes set up by Member States. They will be also aligned with supervisory requirements set out by National Competent Authorities in order to control and reduce transition risk for banks.

Pay-as-you-save financial schemes

The EACB fully concurs that **innovative financial schemes** can effectively enable the transition of the building sector. By way of example, cooperative banks have already developed and put into practice innovative schemes to boost energy performance of buildings. These tools include impact lending with subsidised rates linked to the achievement of ESG goals by the borrower; and energy performance contracts including commitments from the energy operator involved in renovation.

However, we fear that the development of common Union standards by the Commission could **interfere with banks' individual commercial practices and also have unintended consequences in term of financial stability through banks' asset quality deterioration or undue risk taking**.

In particular, we are concerned by Article 15(4), (7) and Article 2(36a) on **pay-as-you-save schemes**. The amount of financial savings depends on the price of energy throughout the term of the loan, making it difficult to estimate this amount and to calibrate its monthly repayment. Mandatory variable payments based on the variable amount of financial savings seem not as appropriate as a fixed instalment based on the borrower's ability of repayment. Moreover, according to the CCD and MCD, the consumer credit or mortgage lender must assess the borrower's ability to repay the loan on his/her income. So, from our point of view, the monthly repayment of loans to individuals should be based first and foremost on ability to repay. That is why it would be more appropriate, should this provision be retained in the final text, at the very least that the introduction of such schemes be left to the discretion of Member States.

It is necessary to leave the initiative to the banks to create incentives. Any solutions that are too precise could run up against the current regulations to which they are subject, particularly when it comes to granting loans.

Furthermore, it does not seem appropriate to include the projected energy savings resulting from a major renovation of a property in the calculation of debt capacity. In fact, these energy savings are highly dependent on the actual quality of the materials used, the quality of the finish and, in particular, the workmanship of the craftsman. As a result, real savings are extremely uncertain from one project to the next."

Cooperative banks, due to their local reach and proximity to all relevant actors (homeowners, construction companies, regional authorities, …), are uniquely positioned to be a catalyst force in the Renovation Wave[4] initiative. The EACB considers that integrated energy renovation schemes such as **"one-stop-shops"[5]** are the right way to foster buildings renovations by offering to homeowners a complete range of services (construction project, temporary relocation when needed, access to grants and tax relief schemes, financing and advice on innovative financial schemes…) that will help to accelerate their decision making process while better coordinating all stakeholders.

However, considering the huge differences in the legal frameworks of different Member States and regions, their building market structure, financing practices, tax systems, the EACB believes that only voluntary schemes can be flexible enough to adapt to local needs, where again, cooperative banks have the expertise to underpin the coordination of such schemes.

Energy Performance Certificates (EPC)

The EACB agrees with the wording of recital (54) stating that a common approach to the energy performance certification of buildings would contribute to an EU level playing field and increase transparency for consumers. We would argue that the framework should be as harmonised as possible, while taking into account the specificities of the local building stocks and climate conditions throughout the EU Member States. We thus support even **further harmonisation of the Union EPCs under Articles 16 to 19**.

Without a uniform key figure definition and methodology to determine EPCs at EU level, it becomes challenging to collect the correct data and effectively carry out the necessary evaluations. Minimum harmonisation does not enable optimal comparability of certificates across the EU, which may have the effect of distorting mortgage providers' portfolio selection when seeking to align with MPS.

Moreover, it is not clear whether mortgage providers would be expected, when calculating energy indicators, to rely on the methodology prescribed in the Member State where they are registered, or where the building in question is located.

[4] https://energy.ec.europa.eu/topics/energy-efficiency/energy-efficient-buildings/renovation-wave_en

[5] https://e3p.jrc.ec.europa.eu/sites/default/files/documents/publications/jrc113301_jrc113301_reportononestopshop_2017_v12_pubsy_science_for_policy_.pdf

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The Parliament's proposal to amend Article 7(2) (new subparagraph 2a), empowering the Commission to set out a **harmonised EU framework for calculating life-cycle Global Warming Potential**, is welcome for those same reasons.

As regards EU cooperative banks in particular, **we would welcome a simpler system for obtaining energy classification of buildings (including in particular for small houses and old buildings)**. Failing that, an energy class could be modelled for detached houses/small buildings and prove very useful, also in the context of Taxonomy alignment reporting.

Availability of data for financial institutions

Finally, in order to ensure that financial institutions' activities are based on data that is accurate and complete, the Directive should ensure that they can **access such data in a machine readable format which ensures a feasible IT operability in order to include such information into banks' existing datasets**.

In particular, financial institutions will need to evaluate the Taxonomy-alignment of real-estate projects, which can only be done if the right data is readily available and reliable. For institutions to carry out their evaluations against the needed datasets, the data made available pursuant to Article 14 (Data exchange) and Article 19 (Databases for energy performance of buildings) should, at the least, not be subject to further limitations as suggested by the Parliament ("aggregated and anonymised").

The EACB considers that banks should be able to access energy performance in a public database on behalf of the customer, possibly as a chargeable service. A useful solution would be to combine energy class information with credit rating models; access to this information would equally be beneficial to the insurance sector.

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