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for securitisation

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Joint Consultation Paper: STS securitisation-related sustainability disclosure

PCS is an independent not-for-profit organisation dedicated to revitalising a safe securitisation market in Europe for the benefit of the economy, as well as a third-party verification agent under the Securitisation Regulation.

We wish to thank the Joint-Committee of the ESAs for this opportunity to comment on the issue of the disclosures that may be provided by originators of STS securitisations.

Introduction

PCS is extremely supportive of all measures designed to mobilise the European capital markets to finance the imperative work necessary to preventing the looming climate catastrophe. We are also very conscious that such mobilisation can only occur if investors have faith that instruments labelled "sustainable" do indeed contribute to the transition to a sustainable economy. It is self-evident that issues of disclosure are key to generating such faith and trust.

PCS is also strongly of the belief that a deep and safe securitisation market is essential if Europe wishes to mobilise funds in anything like the amounts discussed by policy makers. The current financing channels available in Europe do not appear able, in their current and likely near future state, to generate sufficient financing.

Finally, PCS believes that the approach suggested by the Joint-Committee in the consultation paper of tying up the various disclosure regimes across capital market instruments and market participants into a coherent whole, anchored in the SFDR, is the correct one. This would allow, in theory, investors to compare like-for-like the sustainability value of various alternatives. This would also allow a level playing field where all capital market instruments contributing to the transition to a sustainable economy could play their role. It would avoid regulatory arbitrage where certain types of financing instruments, possibly more suitable to channel funds to the transition, were not allowed fully to play their role as a result of additional and unnecessary burdens compared to their peers.

As we shall seek to explain, though, we do not believe the current proposals achieve the aim intended by the Joint-Committee, although we acknowledge that the Joint-Committee's mandate in this matter made it extremely challenging to do so.

General Considerations

We wish to acknowledge the very narrow mandate that was given to the Joint-Committee of drafting an RTS setting out solely the optional disclosure that can be made under the second paragraph of Article 22.4 and Article 26.d.6 of the Securitisation Regulation as amended by the Capital Market Recovery Package. The Joint-Committee did a very thorough analysis and made detailed and thoughtful proposals in this respect. We also note that the Joint-Committee did take the opportunity to express considerations beyond their narrow brief[1].

It is PCS' contention that this narrow brief is historical and no longer reflects where policy making lies today, including the publicly expressed views of the EBA. We invite the Joint-Committee, therefore, to comment once more beyond its technically narrow mandate and set out the extent to which the mandate no longer reflects current thinking around capital markets and sustainability. It follows, in our opinion, that to stick narrowly to this brief is likely, at best, to generate a disclosure regime that serves little to no purpose and, at worst, to stymie the recovery of the highest quality segment of the securitisation market and its capacity to generate funds for the transition of the European economy to a sustainable basis.

An unfortunate issue of mistiming and sequencing

We have previously contended that a key reason for the failure of the European securitisation market to grow notwithstanding the wishes of policy makers such as the Commission, is the lack of a level playing field between securitisation and other asset-based financing options. We would argue much of this lack of coherence in regulatory approaches – with the inevitable regulatory arbitrage that flows from it - comes from a siloed approach to rulemaking. Rather than a horizontal, holistic approach that analyses capital markets (and financial

[1] See paragraph 8 of Background and Rationale on page 10.

markets generally) as a whole, rulemaking focuses on what are perceived as discrete and narrow technical issues connected to equally narrowly defined products. In this approach scant attention appears to be paid to the overall landscape that results from myriad small but impactful measures.

This regulatory fragmentation is aided by sequencing issues where review periods under legislation occur in a fairly random way depending on the timing of individual regulations, directives and RTS'. This means that a particular legislative proposal will be examined or drafted months before a more important rule is made whose outcome is essential to the proper design of that proposal. We believe that this is what is happening here.

The requirement for disclosure of available sustainability information on the assets securitised through an STS issuance was first voted (in respect of residential mortgages and auto loans and leases) in 2017, when the Securitisation Regulation was passed. It was extended, on an optional basis, for all asset classes and synthetics in 2019.

When these provisions were passed, it was generally assumed that the sustainability impact of a securitisation should be defined by how sustainable were the assets securitised.

Since then, a number of voices have been raised, in the context of discussions around a legislative definition of a green bond standard, and made a convincing analysis regarding how an investor should assess the sustainability impact of a securitisation. These voices include the EBA itself in its excellent report on developing a framework for sustainable securitisation [2] and the European Central Bank[3] in a published opinion, as well as trade associations such as AFME and PCS itself. The conclusion of all those voices is identical: when an investor purchases a capital market instrument, *including a securitisation*, the use to which the proceeds are put should define "how green" is the instrument.

Connections between the draft RTS and the EU GBS

The Joint-Committee acknowledges the issue of developing a framework for "sustainable securitisation" in the "Background and Rationale" section of the consultation.[4] In that paragraph, it suggests that the issue of such a framework and the objectives of the draft RTS are separate exercises and should not be conflated.

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[2] "EBA Report – Developing a Framework for Sustainable Securitisation" (March 2022) - https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Reports/2022/1027593/EBA%20report%20on%20sustainable%20securitisation.pdf

[3] "Opinion of 5 November 2021 on a proposal for a regulation on European green bonds" (November 2021) - https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021AB0030&from=EN

[4] See paragraph 5, page 9.

This seems inconsistent with the rest of the consultation paper.

The paper, quite correctly in PCS' view, seeks full consistency with the draft SFDR RTS.

The SFDR's primary purpose is to allow potential investors to assess, prior to investing, the sustainability impact of their potential investments.

The proposed draft also states that the purpose of the RTS would be "to ensure that investors are in a position to take an informed decision as regards the sustainability impact of their investments to assist the transition to a more sustainable…economy"[5].

In its March 2022 report, the EBA stated that the way investors should assess the sustainability impact of their investments in securitisations should be by assessing the use to which the proceeds of the securitisation issuance are put. In the report, the EBA explained convincingly how a focus on assets rather than proceeds would lead to an inconsistent approach across the capital markets to defining sustainability and would lead to what most investors would consider "greenwashing".[6]

But the draft RTS is primarily focused on extensive asset level disclosure; the type of disclosure the EBA and the ECB have stated should ***not*** be the way investors assess the sustainability of securitisations.

Is not all disclosure good?

The argument has been put forward that, notwithstanding the way a potential investor assesses the sustainability impact of a securitisation or any other market instrument should be focused on proceeds, investors should be provided sustainability information on the assets.

This is an attractive argument and PCS agrees with it in principle.

But the problem arises from the sequencing and siloed nature of this rule making.

This RTS is limited not only to securitisation but to STS securitisation. In other words, it is a burden that falls only on the best quality securitisations. It falls on precisely the type of securitisation public authorities have stated should be encouraged.

Disclosure is quite onerous in terms of money and time. By allowing such disclosure to fall only on STS securitisation, the RTS will create yet another

[5] Recital 4 of the draft RTS

[6] The objections to a "green asset" approach are convincingly set out in paragraph 3.3 of the report

regulatory hurdle for this instrument. This discrimination against STS securitisation as opposed to other securitisations or covered bonds or secured financings is not driven by any special feature of STS securitisation and sustainability. It results solely from the sequencing of legislative measures.

Are disclosure and the EU Green Bond Standard not different issues?

Another argument is that the EU Green Bond Standard is a voluntary standard and should not drive the disclosure requirements.

This is unconvincing since the correctly stated ambition of policy makers and regulators is that there must be a consistent approach by investors and issuers to the measurement of the sustainability impact of investments. This approach cannot be fundamentally different depending on whether the issuer has declared the issue to meet or not to meet the EU GBS.

In the context of a securitisation, one cannot have the same transaction be considered "brown" by virtue of its assets if the originator chooses not to apply the EU GBS and "green" by virtue of its proceeds' use if it does choose to apply it.

So, by insisting on heavy asset-based disclosure for STS securitisations only, the draft RTS will lead to one of two outcomes:

(a) Investors will elect to assess sustainability according to the EU GBS proceeds-based approach favoured by the EBA and the ECB. They will therefore ignore the assets-based disclosure as irrelevant. Issuers of STS securitisations (and only they) will be required to go to the expense of disclosing information that is not used by investors and that no other issuer (eg covered bond or secured financing issuer) has to incur; or

(b) Since they have this additional information not provided in respect of any other asset class, investors will de facto apply a higher standard to STS securitisations using both an asset-based ***and*** a proceeds-based approach to assessing sustainability. This will result in an unjustifiable higher standard for STS securitisations and the uneven approach policy makers and regulators have stated they wish to avoid.

What is to be done?

PCS acknowledges the limited mandate provided to the Joint-Committee. But we would argue that the best course of action would be for the Joint-Committee in its response to draw the Commission's attention to the following facts:

(a) The need for a consistent approach to the assessment of the sustainability impact of capital market instruments strongly argues against disclosure standards that fall only on a sub-set of securitisations.

(b) Imposing special and onerous disclosure standards solely on that sub-set will further worsens the uneven playing field and renders more arduous the declared EU strategic aim to revive a strong securitisation necessary (i) to maximise funding for the transition to a sustainable economy, (ii) achieve a capital markets union (CMU) and (iii) allow banks to continue lending to the economy.

(c) Special and onerous disclosure requirements on STS securitisation only are not justified by any specific characteristic of that instrument.

Further, we note that the EU GBS is not yet agreed and the overall disclosure standards and practices around SFDR are not yet settled. Therefore, a fully fleshed out disclosure standard for securitisation generally should wait until the basic foundations of sustainability analysis in the European Union are laid out. Therefore, defining a comprehensive disclosure regime solely for STS securitisations is premature and should not be driven by the vagaries of legislative timing.

Finally, when the foundations of sustainability analysis are laid down, regulators and policy makers should then craft a consistent, holistic set of disclosures for all asset-based instruments. This would ensure a level-playing field where similar instruments are subject to similar regulatory burdens, avoiding the otherwise inevitable regulatory arbitrage.

Consistent disclosure

To achieve disclosure for STS that is consistent with other instruments but, crucially, with the EBA's own approach to assessing the sustainability impact of capital market instruments, PCS urges the Joint-Committee to craft a disclosure standard that focuses on the key metric advocated by the EBA: use of proceeds.

In respect of asset disclosure, the best course of action, until the foundations are laid down, is to have very light disclosure of a general nature. Once the EU GBS standards are finalised, the taxonomy RTS's complete and the SFDR bedded in, the markets will set the level of disclosure necessary for SFDR investors to comply with their own disclosure obligations. Trying to "front-run" these standards without knowledge of the end-state is most likely to result in onerous and unnecessary disclosure rules.

Optionality

PCS believes that the Joint-Committee may wish to clarify a key aspect of the draft RTS which we felt was somewhat ambiguous.

The legislative mandate to the Joint-Committee to craft a draft RTS on disclosure appears in Article 1.9. (6) and the new article 26.d.6 both as set out in the Capital Market Recovery Package. This mandate relates solely to the new sub-paragraph (2nd subparagraph of paragraph 4 of the old article 22 and the new article 26.d). That sub-paragraph is explicitly about optional disclosure that may be made by, but is not required of, originators and sponsors.

That the RTS relates solely to optional disclosure is acknowledged in the consultation paper.[7]

But other parts of the consultation appear to treat these disclosures as mandatory. This is particularly true of Article 1.1 and 1.2 of the draft RTS.

PCS would suggest that, to reflect the nature of the Joint-Committee's legislative mandate and avoid a discrepancy with the level 1 text of the Securitisation Regulation (as amended by the Capital Markets Recovery Package), the text of the draft RTS be amended to reflect the optional nature of the proposed disclosure.

Responses to specific questions

Question 1: Do you agree that it is preferable to make disclosures available in a stand-alone document based on the SFDR template and consider any potential related adjustments to ESMA's disclosure RTS at a later stage?

Yes. Reporting duties and format under Article 7(1) were designed to track prior to issuance and over time the credit evolution of the securitised assets. To attempt to shoehorn sustainability data into the same format and the same frequency of reporting is likely to create difficulties that will be costly to resolve without any discernible benefit.

In addition, if the EU GBS does result in the outcome called for by the EBA and sustainability of securitisations is analysed based on the use of the proceeds of issuance, the ongoing reporting will need to focus on that use of proceeds. Such reporting will need to be consistent with that utilised for other capital market instruments. To require such sustainability reporting to fit the Article 7(1) format and frequency is likely to be either impossible or hugely inefficient. It will also make cross-instrument comparison for investors extremely

[7] For example, in the introduction to the Executive Summary (page 7), paragraph 4 of Background and Rationale (page 9) or in paragraph 31 under Question 11 (page 18)

challenging since no other bond issuer is required to complete an ESMA template.

To require additional and heavy asset-based disclosure – via Article 7(1) or otherwise – is also contradictory to the aims and approach suggested by the EBA, the ECB and others. We refer you to our earlier analysis.

Therefore, not requiring this disclosure within the ESMA templates should not merely be seen as a temporary measure.

If, once the EU GBS and the SFDR disclosure regime across capital market instruments are settled, it turns out that the required disclosure for securitisations (and not just STS) does fit into the ESMA templates, then the matter should be revisited then. But we refer back to our sequencing concerns about reaching conclusions on small, siloed sections of the market before the larger issues have been settled.

Question 2: Do you agree that originators should disclose information in the principal adverse sustainability impacts statement, about whether and, if so, how principal adverse impacts on sustainability factors are taken into account in the originator's credit granting criteria? Do you agree that the disclosed information should rely on and cross-reference existing disclosures?

PCS agrees with both the EBA and the ECB that sustainability analysis of securitisations should be based, as with other instruments, on the use of proceeds.

PCS also believes that avoidance of regulatory arbitrage requires a level regulatory playing field.

If use of proceeds is the key metric of sustainability, then three possibilities exist.

(a) The proceeds are used by the originator for its general business. In that case, PAIs of the whole business, not just the securitised assets, should be disclosed.

(b) The proceeds are used for a specific stated purpose. Then, the PAIs of that purpose should be disclosed.

(c) The proceeds are reinvested in the line of business from which the securitised assets are generated (eg a banks issues a mortgage backed security and commits to reinvest the funds into its mortgage business). Then the PAIs in the credit granting criteria are appropriate disclosure.

To avoid regulatory arbitrage though, PCS recommends that this type of disclosure be extended holistically to all other asset-based capital market instruments on the same basis. We therefore recommend that the optional nature of these disclosures be stressed until a disclosure regime for such instruments (non-STS securitisations, covered bonds, secured financings and asset sales) is devised.

Question 3: Do you agree that originators should disclose information about whether, and if so how, PAI indicators on sustainability factors are considered in the selection of underlying exposures to be added/repurchased to/from the pool at the time of marketing or during the lifetime of the securitisation? Do you agree with the level of information required?

See our response to Question 2.

See our comments above in "Consistent Disclosure". Based on these comments, PCS generally considers the required disclosure excessive and premature.

Question 4: Do you agree with the approach taken in the draft RTS which aims for full consistency with the draft SFDR RTS?

Yes. PCS believes that the avoidance of regulatory arbitrage and "greenwashing" requires a fully consistent approach across all capital market instruments.

However, we draw you attention to our analysis in General Considerations above. It appears to us that the principle of full consistency with SFDR will not be met merely by a mechanical replication of the SFDR RTS in this RTS.

Additionally, we note that a number of originators will not be regulated under the SFDR. Therefore, requiring such originators to make disclosure under this regime could impose substantial and undue burden on them and discourage them from using (or render it impossible for them to use) securitisation if such disclosures were made mandatory.

Question 5: Do you agree with the inclusion of the new mandatory non-green asset ratio indicator for all asset classes covered by the RTS?

We note that the green asset ratio is a concept applicable to prudentially regulated credit institutions in the European Union. To ask originators which are not subject to the green asset ratio and do not have the systems to calculate it, to do so solely for STS securitisation disclosure would once more unfairly discriminate against such instruments and limit the capacity of securitisation to finance the transition to a sustainable economy.

This is particularly true since non-bank originators are the market players most likely to have few options outside of securitisation to finance themselves and therefore to raise funds for sustainable lending.

To the extent that originators are credit institutions and have access to the necessary data, PCS has no objection to this disclosure. Again, though, PCS would recommend a level playing field that would require such disclosure for all asset-based instruments issued by credit institutions.

Question 6: Do you agree with the proposed PAI indicators for residential real estate?

We refer you to our analysis in General Considerations above and specifically to our conclusions set out in Consistent Disclosure. Based on these comments, PCS generally considers the required disclosure excessive and premature.

Question 7: Do you propose to add any additional specific indicators for this asset class?

We refer you to our response in Question 6.

Question 8: Do you agree with aligning the PAI indicators for motor vehicles with the screening criteria for motor vehicles established in the Taxonomy Regulation?

We refer you to our analysis in General Considerations above and specifically to our conclusions set out in Consistent Disclosure. Based on these comments, PCS generally considers the required disclosure excessive and premature.

Question 9: Do you agree with expanding the indicators to potentially cover these additional aspects at a later stage?

We refer you to our analysis in General Considerations above and specifically to our conclusions set out in Consistent Disclosure. Based on these comments, PCS generally considers the required disclosure excessive and premature.

At a later stage, once the legislative landscape of European sustainable finance has been agreed, we would welcome a consistent disclosure regime for all asset-based finance.

Question 10: Do you agree with applying the mandatory indicators for social and employee, respect for human rights, anti-corruption and anti-bribery matters to the manufacturer of the vehicle?

PCS is in principle supportive of this type of disclosure – subject to our general comment that it should not be limited to the small sub-set of STS securitisation.

Practically, though, we note that this may be a relatively easy task for auto transactions originated by captives or from dealer networks dealing with one manufacturer. However, this would impose a potentially very substantial burden on a lender to customers buying an unlimited range of cars. For example, a fintech lending to purchasers of second-hand cars generally would potentially have to source information on a dozen or more manufacturers across the world.

Therefore, any requirement here should be circumscribed to originators dealing with one manufacturer and preferably “captives”.

Question 11: Do you propose to add any additional specific indicators for this asset class?

No.

Question 12: Would you agree with using the SFDR real estate PAI indicators for commercial real estate securitisation?

We refer you to our analysis in General Considerations above and specifically to our conclusions set out in Consistent Disclosure. Based on these comments, PCS generally considers the required disclosure excessive and premature.

Question 13: Would you consider it useful to provide originators of securitisations consisting of corporate debt including trade receivables a template to disclose standardised information on principal adverse impacts on sustainability factors?

We refer you to our analysis in General Considerations above and specifically to our conclusions set out in Consistent Disclosure. Based on these comments, PCS generally considers devising additional templates at this stage to be premature.

Question 14: Would you agree with applying the draft SFDR RTS PAI indicators to exposures to corporates?

We refer you to our analysis in General Considerations above and specifically to our conclusions set out in Consistent Disclosure. Based on these comments, PCS generally considers the required disclosure excessive and premature.

Question 15: Would you agree with applying the proposed application of the same draft SFDR RTS PAIs focusing on the seller in the case of securitisation consisting of trade receivables?

We refer you to our analysis in General Considerations above and specifically to our conclusions set out in Consistent Disclosure. Based on these comments, PCS generally considers further extensions of disclosure premature.

Question 16: Would you agree with adopting the proposed proportionate approach to SME loan?

PCS always believes in a proportionate approach but also wishes to stress that proportionality should extend beyond the extremely narrow silo of STS securitisations or even securitisations generally and apply to all capital market instruments.

Question 17: Would you propose to add any additional specific indicators for these three types of securitisation?

No, for the reasons outlined in Consistent Disclosure above.

Question 18: Would you agree that there are no appropriate PAI indicators for securitisations backed by consumer loans or by credit card debt? If not, which PAI indicators would you propose for these loan types?

Yes.

The key definition of the sustainability impact of lending – as set out by the EBA itself – is whether the proceeds of lending are used to help transition to a sustainable economy or have a neutral impact on the sustainability of the economy or have a negative impact on the sustainability of the economy. There is no theoretical justification for applying a different standard depending on whether the borrower is a capital market issuer, a large corporate or an individual.

There is no realistic way for a lender to determine with any accuracy the sustainability impact of the spending by a consumer of the money borrowed through a loan or a credit card. Therefore, requesting PAI indicators generally for these asset classes serves no purpose.

We note however that it is possible for lenders to offer loans solely for green purposes – eg loans to purchase electric vehicles or solar panels. With big data, it may also be possible for credit card lenders to assign a sustainability value to certain purchases. So, it may well be possible for specific lenders securitising very specific portfolios to provide sustainability data. But these

cases would be so idiosyncratic that the devising of a special reporting template would appear excessive and of very limited value.

Question 19: Do you consider that it would be useful to develop standardised PAI indicators on sustainability factors for other types of securitisation?

At some point, we do. But see our analysis in General Considerations above and specifically to our conclusions set out in Consistent Disclosure.

Conclusions

PCS acknowledges the seriousness with which the Joint-Committee has approached its task. We also acknowledge the narrowness of the mandate which was given to the Joint-Committee.

Unfortunately, we fear that for reasons not resulting from any action of the Joint-Committee but by the vagaries of legislative timing and the siloed approach to rule making, this mandate is the wrong mandate, at the wrong time for too narrow a sub-set of capital market instruments.

Within the mandate provided we urge the Joint-Committee to proceed as set out our sections entitled “What must be done?” and “Consistent Disclosure” above.

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