PCS

Setting the Standard for Securitisation

Sustainable Securitisation Today & Tomorrow

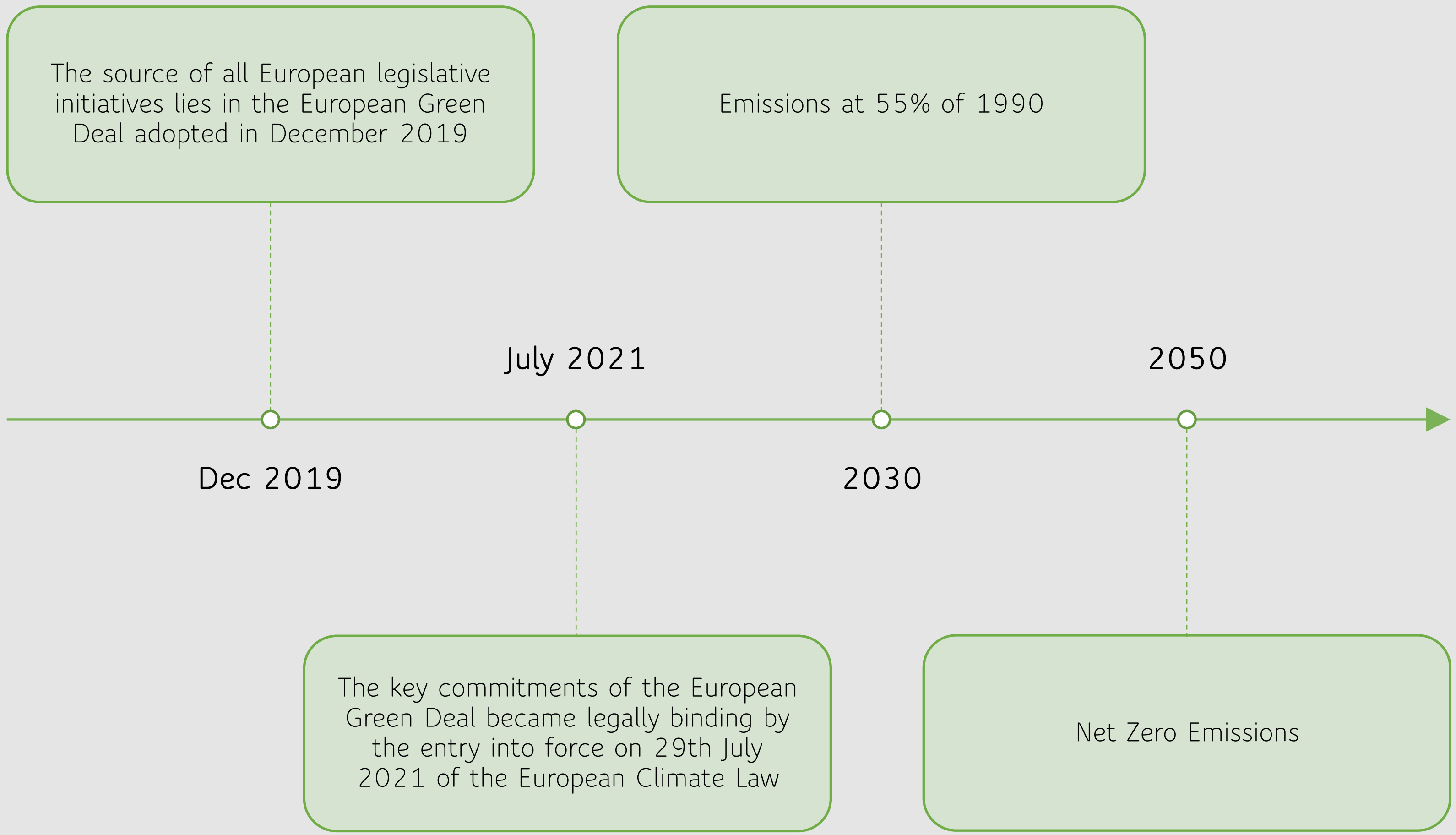
13th October 2021

Agenda

- Setting the scene- the background to ESG and capital markets
- Today – existing ESG rules affecting securitisations
- Tomorrow – what is coming?
- Where are the battle lines forming?

EU Green Deal

European Green Deal and Climate Law



The Taxonomy Regulation

Regulation

Taxonomy Regulation

REGULATION (EU) 2020/852 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088

Passed in June 2020, came into force in July 2020

- The sheet anchor for all other financial rules around green
- Is only the “E” in “ESG”
- Is a classification system, establishing a list of environmentally sustainable economic activities

The Taxonomy Regulation

What is green?

The Taxonomy Regulation seeks to define what is “green” in finance. It has a number of aims:

- Avoid “greenwashing”
- Avoid fragmentation/create a level playing field
- Shift investments towards green (but coy about how)

The Taxonomy Regulation

What is green?

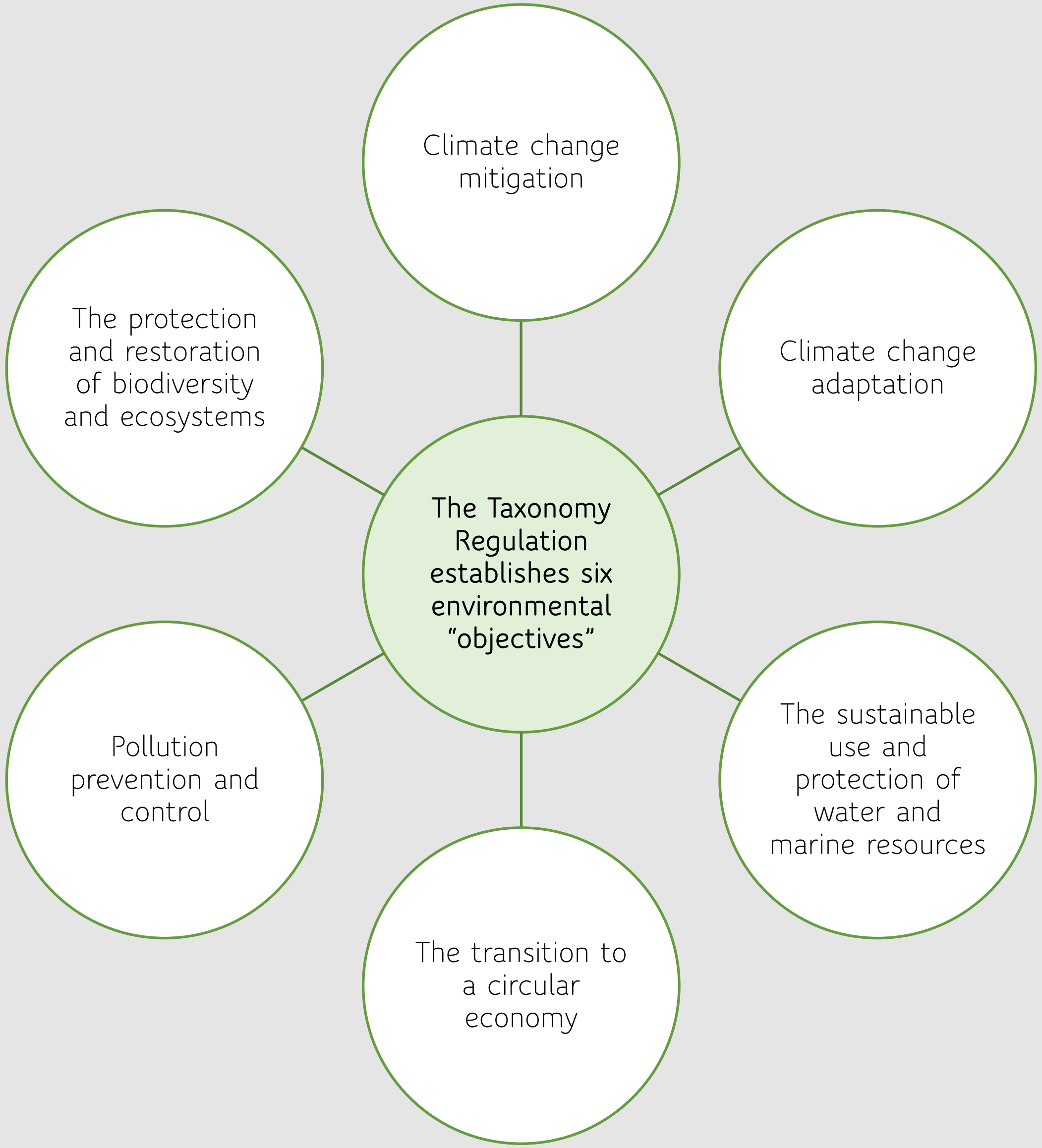
The Taxonomy Regulation seeks to define what is “green” in finance.

It sets out 6 categories

The categories are extremely broad and so rely crucially on technical screening standards to be set out in RTSs

The Taxonomy Regulation

The six environmental "objectives"



The Taxonomy Climate Delegated Act

RTS

The **Taxonomy Climate Delegated Act**

is the first Taxonomy RTS setting out the technical screening standards

Came into force on 12th July 2021

- It only covers first the first 2 objectives

There are two annexes (In total 512 pages!)

- Annex I is 232 pages
- Annex II is 280 pages

It was controversial

- TEG members walked out over forestry/biodiversity
- Nuclear and gas were kicked down the road

EU Green Bond Standard

Legislation

The **Technical Expert Group** on Sustainable Finance (TEG) now renamed as the **Platform on Sustainable Finance**

- TEG issued two reports on a possible Green Bond Standard (EUGBS) in June 2019 and March 2020
- The European Commission issued draft Green Bond Standard legislation on 6th July 2021
- The EUGBS will now make its way through the European Parliament and Council to become law

EU Green Bond Standard

Key Requirements

The new EUGBS will be open to any issuer of green bonds, including issuers located outside of the EU

There are four key requirements under the proposed framework:

Key Requirements
The funds raised by the bond should be allocated fully to projects aligned with the EU Taxonomy
There must be full transparency on how bond proceeds are allocated through detailed reporting requirements
All EU green bonds must be checked by an external reviewer to ensure compliance with the Regulation and that funded projects are aligned with the Taxonomy. Specific, limited flexibility is foreseen here for sovereign issuers
External reviewers providing services to issuers of EU green bonds must be registered with and supervised by the European Securities Markets Authority. This will ensure the quality and reliability of their services and reviews to protect investors and ensure market integrity. Specific, limited flexibility is foreseen here for sovereign issuers

SFDR

Regulation

SFDR is the **"Sustainable Finance Disclosure Regulation"**

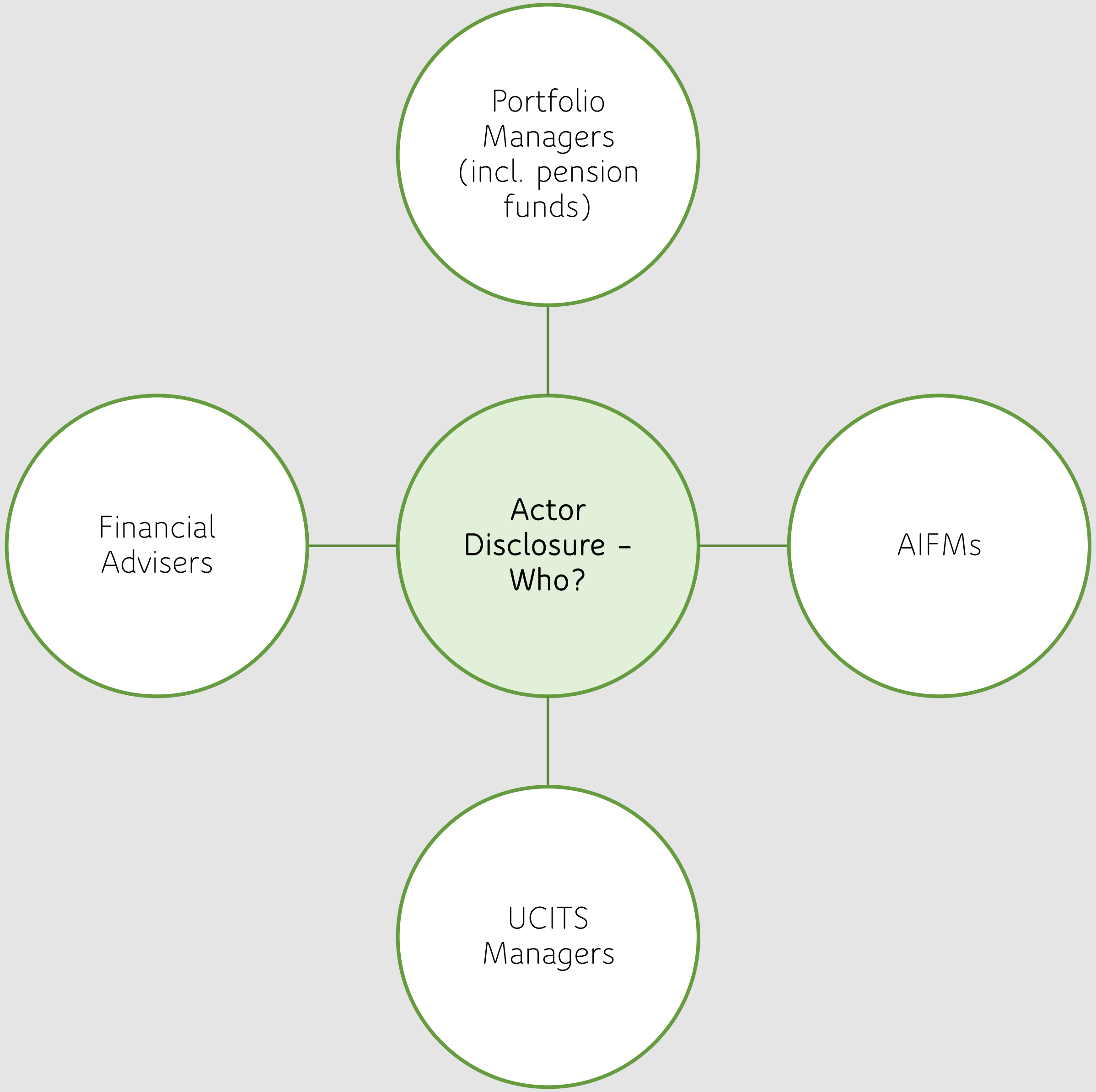
REGULATION (EU) 2019/2088 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 27 November 2019 on sustainability-related disclosures in the financial services sector

Passed in November 2019, came into force 10th March 2021

- The aim of the SFDR is to impose disclosure requirements on "manufacturers of financial products" (basically funds) and financial advisers
- Not applicable for banks (they fall under NFRD)
- SFDR imposes actor and product disclosure requirements

SFDR

Actor Disclosure Who?



SFDR

Actor Disclosure What?

Actor Disclosure – What?

=

Sustainability Risk Policy

+

Sustainability Impact Policy

- mandatory if large
- comply or explain if small

+

Remuneration Policies
(compatibility with above)

SFDR

Product Disclosure What?

There are "pre-contract" mandatory disclosure

There are ongoing mandatory disclosures

The rules distinguish between disclosures that are mandatory for all products and additional disclosures required for any product claiming ESG

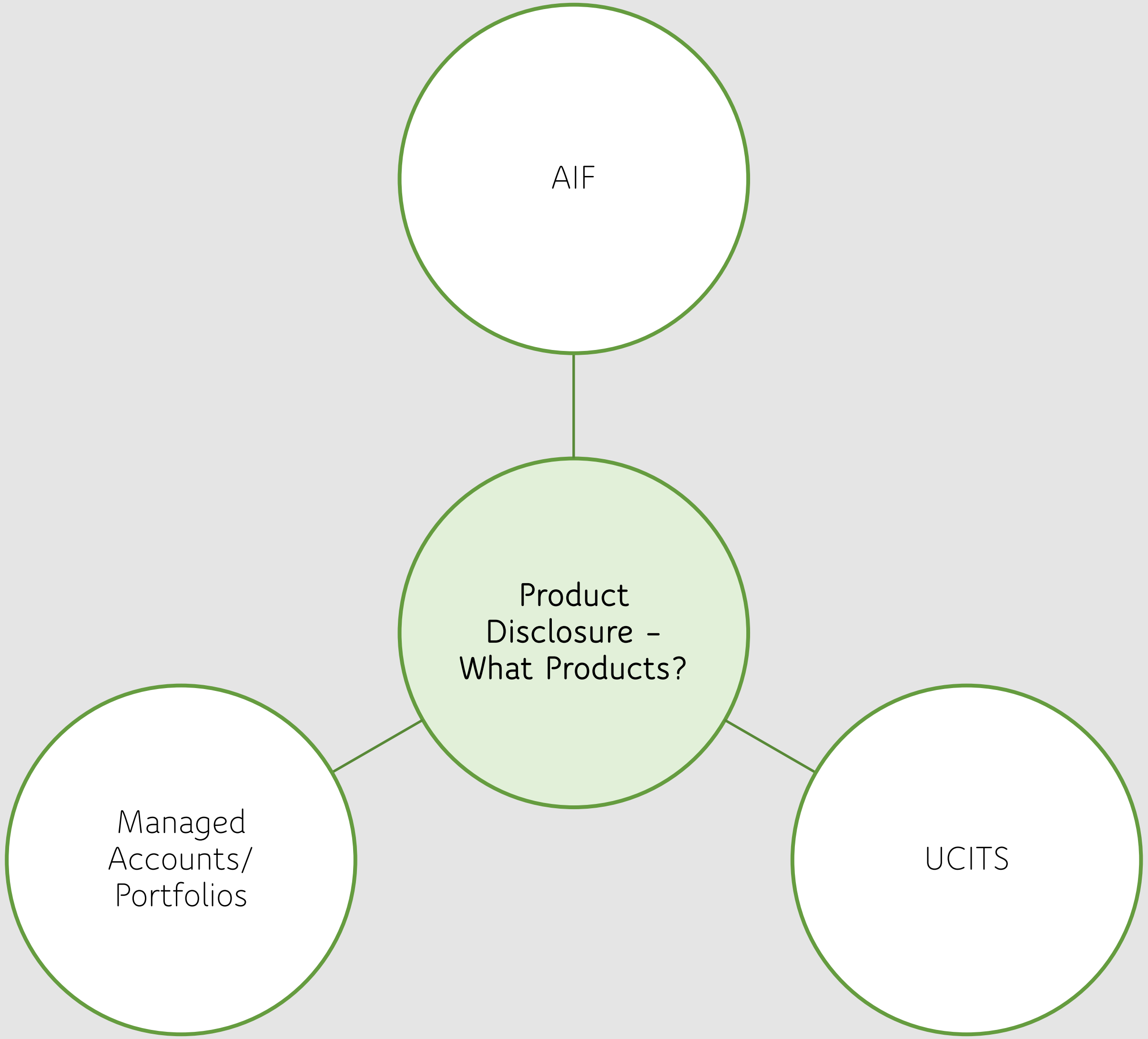
How is sustainability risk integrated in the product (or why irrelevant)

What is the principal adverse sustainability impact of the product (or why irrelevant)

For ESG claims only - how exactly is the product ESG

SFDR

Product Disclosure What Products?



SFDR

State of Play

Ultimately, SFDR reporting will be on mandatory templates (like the securitisation ESMA templates)

Much detail awaits clarification at Level 2 **BUT** the Joint Committee of the ESAs has issued a final draft RTS on 2nd February 2021

On 25th February 2021, the Joint Committee told NCAs to use the final draft until the RTS is formally passed

The first mandatory reporting is not before 30 June 2022 but for a 2021 reference period

NFRD

How does it link to securitisation?

NFRD stands for "Non-Financial Reporting Directive"

DIRECTIVE 2014/95/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups

- It applies to all large corporates *including banks*
- It is an offshoot of the EU's standardisation of corporate reporting across Europe
- Article 8 of the Taxonomy Regulation requires any undertaking subject to disclosure obligations under the NFRD to disclose information on how and to what extent the undertaking's economic activities are associated with economic activities that qualify as environmentally sustainable under Articles 3 and 9 of the same Regulation
- The European Commission adopted a Delegated Act in July 2021 specifying the disclosure required under Article 8

CRR Article 449a

How does it link to securitisation?

Article 449a

Article 449a is a Pillar 3 CRR requirement that will apply to EU banks from June 2022

It applies to large banks with quoted shares

It requires:

- *The quantitative disclosure of ESG Risk*
- *The qualitative disclosure of ESG Risk*
- *The quantitative disclosure of physical climate risk*
- *The bank's ESG policies, KPIs and GAR*

The EBA published a consultation on art.449a disclosure on 1st March 2021 and a survey on 16th September 2021

NFRD, Taxonomy & CRR

"GAR" the common thread

A **key metric** proposed by the EBA for the **CRR Article 449a & NFRD** purposes is the

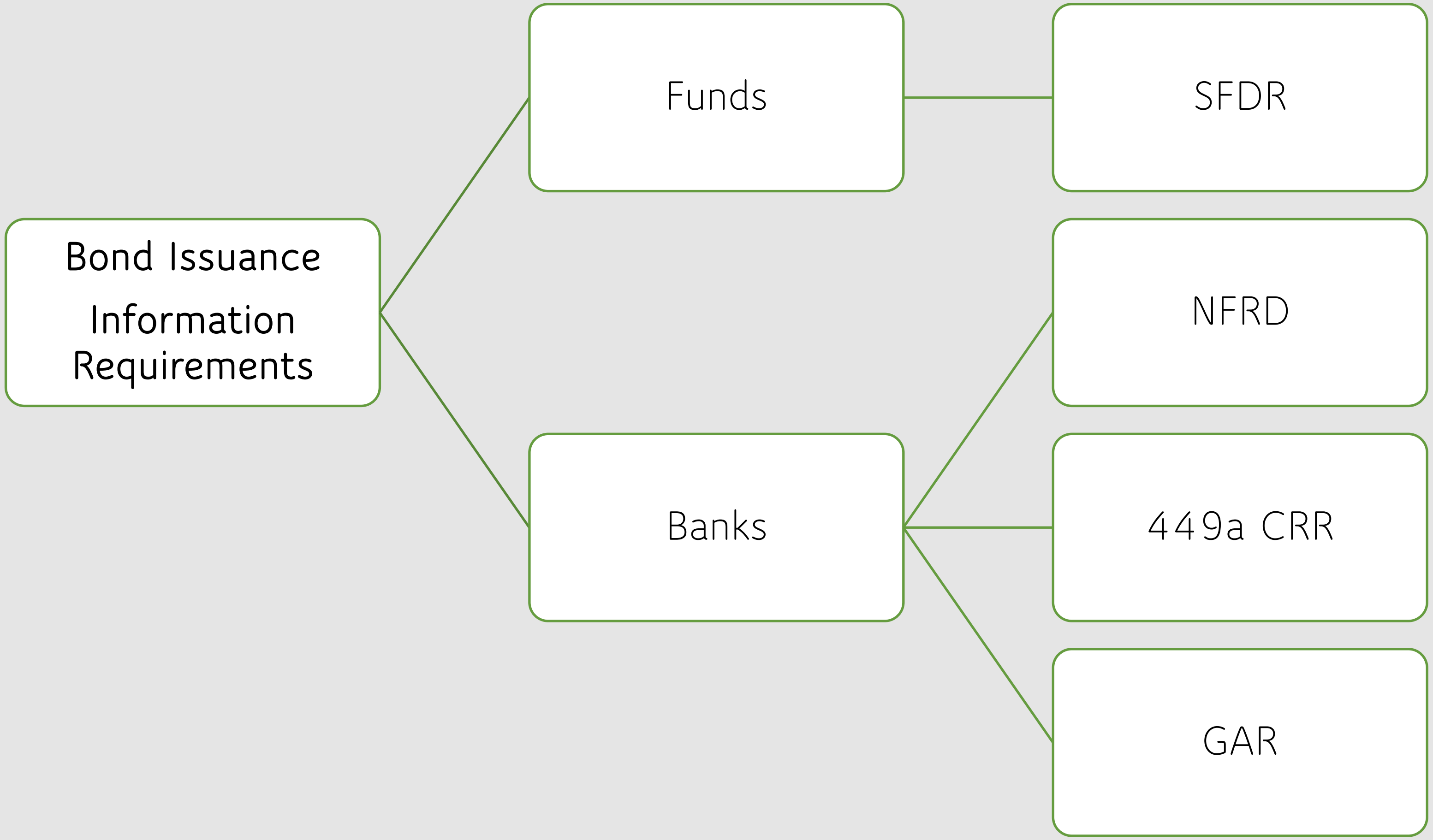
Green Asset Ratio ("GAR")

- The GAR is likely going to be very important for securitisations in the way the LCR eligibility has become
- A product that is not listed as "green" and therefore cannot count towards the GAR will be less attractive to banks

Summary

How it all fits together

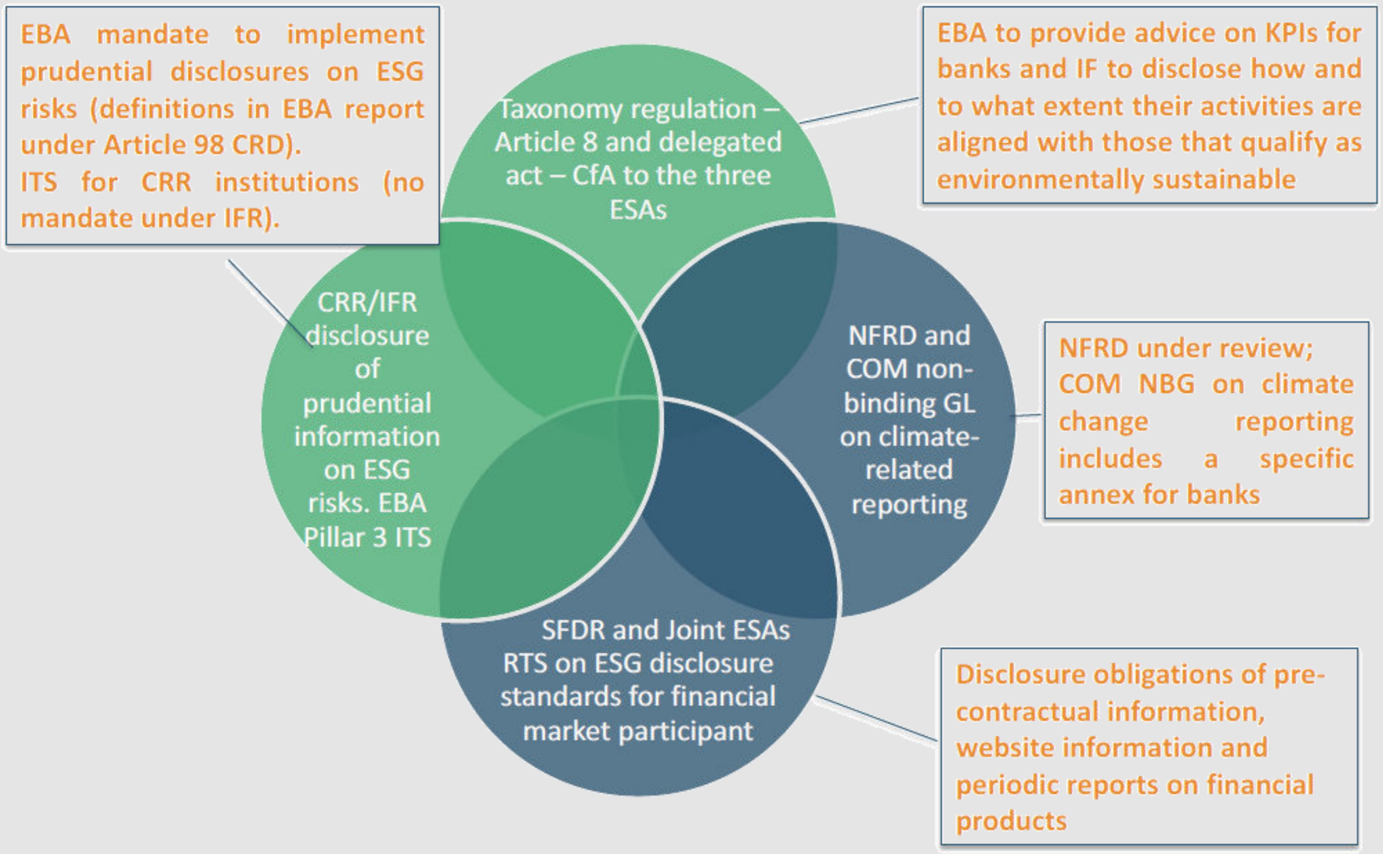
Are you thinking of issuing or purchasing a bond?



NFRD, Taxonomy & CRR

"GAR" the common thread

Figure 1: EU legislative initiatives on ESG related disclosures



Source: EBA consultation

Securitisation Regulation

Current Disclosure Requirements

Article 46 – Environmental Performance

(for STS transactions)

Article 22.4 "In the case of a securitisation where the underlying exposures are residential loans or auto loans or leases, the originator and sponsor shall publish the available information related to the environmental performance of the assets financed by such residential loans or auto loans or leases…"

- Only for RMBS and Autos
- Only "available"
- EBA guidelines provide helpful definition of "available"

Securitisation Regulation

Future Disclosure Requirements

Article 26.d.6 – Sustainability Requirements

(for STS transactions)

Article 26.d.6. By 10 July 2021, the ESAs shall develop, through the Joint Committee of the European Supervisory Authorities, draft regulatory technical standards in accordance with Articles 10 to 14 of Regulations (EU) No 1093/2010, (EU) No 1094/2010 and (EU) No 1095/2010 on the content, methodologies and presentation of information referred to in the second subparagraph of paragraph 4 of this Article, in respect of the sustainability indicators in relation to adverse impacts on the climate and other environmental, social and governance-related adverse impacts.

- Under the new article 26.d.6 inserted in the Securitisation Regulation by the Synthetic STS Regulation, the ESAs working through the Joint Committee will have to propose a draft RTS on sustainability requirements for RMBS and auto loans and leases
- The law required the proposal to be presented to the Commission by 10th July 2021 but it is not yet out

Securitisation Regulation

Future Disclosure Requirements

Article 45a - Development of a sustainable securitisation framework

(for STS transactions)

Article 45.a.1. By 1 November 2021, EBA, in close cooperation with ESMA and EIOPA, shall publish a report on developing a specific sustainable securitisation framework for the purpose of integrating sustainability-related transparency requirements into this Regulation. That report shall duly assess in particular: (a) the implementation of proportionate disclosure and due diligence requirements relating to potential positive and adverse impacts of the assets financed by the underlying exposures on sustainability factors; (b) the content, methodologies and presentation of information in respect of sustainability factors in relation to positive and adverse impacts on environmental, social and governance-related matters; (c) how to establish a specific sustainable securitisation framework that mirrors or draws upon financial products covered under Articles 8 and 9 of Regulation (EU) 2019/2088 and takes into account, where appropriate, Regulation (EU) 2020/852 of the European Parliament and of the Council (*); (d) possible effects of a sustainable securitisation framework on financial stability, the scaling up of the Union securitisation market and of bank lending capacity.

- Under the new article 45a inserted in the Securitisation Regulation by the Synthetic STS Regulation, the EBA will have to propose a draft RTS on sustainability disclosure requirements for securitisations generally
- The law required the proposal to be presented to the Commission by 1st November 2021 but the EBA has indicated that it is prioritizing the STS disclosure work

The battlegrounds

Assets vs Proceeds

Maybe the most contentious issue on green securitisation

Is a green securitisation:

- a securitisation of green assets ?
- a securitisation whose proceeds go to fund green projects ?

The battlegrounds

Green Assets

Case for

- It’s simple
- It makes some intuitive sense
- It means investors are repaid out of “green cash”

The battlegrounds

Green Assets

Case against

It is inconsistent with the core definition of the EU Green Bond Standard

It requires, yet again, more of securitisations

than of any other capital market instrument, including on how investors are repaid

It requires for securitisation to wait for the completion of parts of the green transition and *refinance* these parts

Instead of being able to *finance* the ongoing and upcoming parts of the transition

It limits the amount of funding available in this time critical phase of the green transition

for no visible benefit

The battlegrounds

Level playing field

This is a general issue with the treatment of securitisation through the entire regulatory framework

Sustainability regulation could exacerbate this issue:

- On the definition of green (assets vs proceeds)
- On the disclosure requirements
- On the interaction of STS and green

The future of green rules

Where are my carrots & my sticks?

- The EUGBS is not mandatory
- Almost every aspect discussed so far (SFDR. Sec Reg, NFRD, GAR, CRR Article 449a) is about disclosure
- The EU has indicated that the aim of the EUGBS is to drive more finance towards meeting the EU Green Plan
- The EC has been extremely coy as to how, once the EUGBS is in place, it could be used to drive funding to the right places
- We wait for the other shoe…

Verified by PCS

Setting the Standard for Securitisation

Thank you for your attention

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