AFME Securitisation Division Response to European Commission Consultation – Renewed Sustainable Finance Strategy

July 2020

1.1 General

AFME and its members welcome the opportunity to provide comments on the Commission Consultation Renewed Sustainable Finance Strategy (the "Commission Consultation Paper"). The responses set out below reflect the input to the Commission Consultation Paper from a securitisation perspective as we believe that the securitisation market has an important role to play in the development of sustainable finance.

Where questions relate specifically to green securitisation we have often referred in our responses to the wider concept of environmental, social and governance "ESG" securitisation as the considerations for green securitisations would generally apply as well to securitisations linked to social or governance principles. We anticipate that the social and governance aspects of ESG securitisation will be increasingly important in the post-COVID19 economic scenario.

We also note the Commission's work undertaken in respect of the Taxonomy Regulation[1] (as supplemented by the work of the Technical Expert Group), the proposed Disclosure Regulation[2] and the proposed Regulation on Low Carbon Benchmarks[3] (each of the proposed Taxonomy Regulation, the proposed Disclosure Regulation and the proposed Regulation on Low Carbon Benchmarks, the "Proposed Sustainable Investing Legislative Package").

We believe that the EU Taxonomy is particularly helpful as it provides a standardised approach to the measurement of the environmental impact of the economic activity supported by the investment being sought. We note that the Proposed Sustainable Investing Legislative Package does not apply directly to securitisation transactions (although may be of relevance indirectly to the extent investors in securitisations are caught by the regime) and that financial instruments issued pursuant to securitisation transactions are not 'financial products' as defined in the Disclosure Regulation. We broadly agree with this approach which is the same as the approach currently taken for EU Green Bonds[4]. While adequate disclosure of information will be key for the development of a market in sustainable investing, we note that a lot of work has already been undertaken to subject securitisation transactions to a high level of disclosure and due diligence requirements under the Securitisation Regulation such that European securitisation now has the highest such standards of any fixed income product.[5]

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[1] 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 http://data.europa.eu/eli/reg/2020/852/oj

[2] COM 2018 354 final, Proposal for a Regulation of the European Parliament and of the Council on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341

[3] COM (2018) 355 final, Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 2016/1011 on low carbon benchmarks and positive carbon impact benchmarks

[4] EU Technical Expert Group on Sustainable Finance, Proposal for an EU Green Bond Standard, June 2019

[5] Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017

As noted in our Position Paper "Principles for developing a green securitisation market in Europe" (the "Green Securitisation Position Paper"), (see Annex 1), the definition of green securitisation should be limited to transactions backed by green assets. The definition of green securitisation should not include securitisation transactions backed by brown assets regardless of whether the transaction may meet the EU Green Bond requirements for other reasons e.g. the application of the proceeds or capital or liquidity relief for green purposes or by virtue of the relevant originator having strong ESG credentials generally. However, as long as this is consistent with the EU Taxonomy or other applicable standards, transitional assets that look to achieve a minimum level of improvement should be classified as green (not brown) assets for such purposes, particularly given the lack of existing green collateral for securitisation transactions and the need to incentivise the market. The inclusion of transitional ESG assets may also lead to the development of a sustainability linked securitisation market where the structure of the transaction or terms of the bonds are more favourable if ESG KPIs related to or contained in the underlying assets are met.

Finally, where it can be demonstrated that securitisations of ESG assets show superior credit or liquidity performance it should be possible for ESG securitisation transactions to achieve differentiated treatment for regulatory capital purposes which recognises ESG criteria in line with our response to Question 88 and the work currently being undertaking by the EBA and the international fora. We also support the development at an international level of risk assessment methodologies that include a forward-looking perspective to better take into account the impact of ESG factors on the long-term risk profile of assets and related prudential treatment.

1.2 Responses to certain questions raised in Commission Consultation Paper

Below, we include responses to the questions in the Commission Consultation Paper which we have identified as being particularly relevant for the securitisation industry.

(A) Extracts from Section 1 of the Commission Consultation Paper - General Policy

Question 1: With the increased ambition of the European Green Deal and the urgency with which we need to act to tackle the climate and environmental-related challenges, do you think that (please select one of the following):

(1) **Major additional policy actions are needed to accelerate the systematic sustainability transition of the EU financial sector.**

(2) **Incremental additional actions may be needed in targeted areas, but existing actions implemented under the Action Plan on Financing Sustainable Growth are largely sufficient.**

(3) **No further policy action is needed for the time being.**

Incremental additional actions may be needed in targeted areas, but targeted actions implemented under the Action Plan on Financing Sustainable Growth published on 8 March 2018 (the "Action Plan") are largely sufficient.

We further note that the Action Plan represents a strong step forward towards growth in the sector but emphasised that it could be expanded further to focus more on the Social and the Governance aspects in ESG, particularly in light of recent events, which have brought increased focus on social and governance considerations.

Where it can be demonstrated that securitisations of ESG assets show superior credit or liquidity performance it should be possible for ESG securitisation transactions to achieve differentiated treatment for regulatory capital purposes which recognises ESG criteria in line with our response to Question 88 and the work currently being undertaking by the EBA and the international fora. We also support the development at an international level of risk assessment methodologies that include a forward-looking perspective to better take into account the impact of ESG factors on the long-term risk profile of assets and related prudential treatment.

We welcome initiatives supporting the further development of a label for green mortgages (see Question 32 below). We also welcome the ICMA Sustainability-Linked Bond principles as they provide an alternative to a "use of proceeds" set of principles, and could therefore in theory be applied to securitisations where the structural features of the underlying assets (and the notes issued as part of the securitisation) vary according to certain ESG KPIs.

We note however, that major policy actions may need to be taken at national level in order to foster the transition to ESG finance in general and, in respect of securitisation, the development of a sufficiently large number of loans that are considered ESG assets (including auto loans and mortgage loans) to support a sustainable finance securitisation market, although it is appreciated that certain of such measures (e.g. fiscal measures) are the competence of the member states.

Question 6: What do you see as the three main challenges and three main opportunities for mainstreaming sustainability in the financial sector over the coming 10 years?

We have identified the following as key opportunities for mainstreaming sustainability in the financial sector:

1. increasing social and political focus on sustainability issues;

2. informing a trend in sustainability-linked consumer/investor choice; and

3. the development and implementation of technological solutions to resolve the data issues in tracking and reporting on sustainability factors.

We have also identified the following key challenges for mainstreaming sustainability in the financial sector as:

1. data collection by originators and reporting;

2. dealing with brown/transitioning assets;

3. enshrining with an ESG standard a universal definition of what an ESG bond is (we note however, that the EU Taxonomy is very helpful in this respect); and

4. focusing on securitisation origination - lack of availability of ESG asset portfolios to support ESG securitisations.

We also support the general AFME view on this question.

Question 66: In your view, does the EU financial system face market barriers and inefficiencies that prevent the uptake of sustainable investments?

The lack of availability of ESG assets in the EU continues to be a significant market barrier for the development of ESG securitisation. In this respect, the development of a public support scheme for ESG assets, such as the Property Assessed Clean Energy Loans (PACE) in the United States, might significantly bolster the availability of ESG assets and therefore facilitate an increase in the number of ESG transactions. We note that in the European Union a number of such initiatives might be the competence of member states. See also our responses to Questions 34 and 23.

(B) **<u>Extracts from Section 1 of the Commission Consultation Paper – Relating to Data Reporting, Disclosure and Labels</u>**

Question 14: In your opinion, should the EU take action to support the development of a common, publicly accessible, free-of-cost environmental data space for companies' ESG information, including data reported under the NFRD and other relevant ESG data?

We recognise the importance of data in the functioning of an efficient market for ESG assets and the development of a common, publicly accessible data space where such data can be posted and compared would be helpful to the development of ESG finance as a whole including in a securitisation context. In our Green Securitisation Position Paper, we note it is critical to the development of a sustainable securitisation market that originators and servicers record and track green data in detail and in a way that is easily extractable for the purpose of disclosure and ongoing reporting. The same principles would apply to ESG structures more broadly.

In respect of securitisation transactions, it should be noted that the data and reporting framework introduced by the Securitisation Regulation already provides for the reporting of certain information to investors at key milestones of the transaction or an ongoing basis. Certain of such information would be published on securitisation repositories (when the first repositories are authorised). It is important that the high level of disclosure already required under the Securitisation Regulation is maintained to enable investors to perform their due diligence and ongoing monitoring transactions, and only where necessary, this is supplemented by any relevant ESG data to enable investors to assess and monitor the ESG attributes of securitisation transactions.

Question 22: The TEG has recommended that verifiers of EU Green Bonds (green bonds using the EU GBS) should be subject to an accreditation or authorisation and supervision regime. Do you agree that verifiers of EU Green Bonds should be subject to some form of accreditation or authorisation and supervision?

While we agree in principle that having a form of accreditation, authorisation, and supervision of verifiers of EU Green Bonds would be beneficial, the premature introduction of substantial regulation may lead to market concentration in the number of verifiers. To this end, we would support allowing the market for verification service providers to develop and then introduce appropriate regulation following a 'stock-taking' exercise.

If accreditation, authorisation and supervision of verifiers of EU Green Bonds is introduced the key principles thereof should include: independence, transparency of methodologies (including their analytical quality), the adoption of proportionate governance (including appropriate management of conflicts of interest) and global convergence. A regulatory regime for verifiers of EU Green Bonds should also recognise:

1. the dynamic nature of the market and need for innovation; and

2. the differences between ESG information and financial information.

The above views apply equally to verification of ESG securitisation and sustainability linked securitisations. Notwithstanding any verification service, it is important that the high level of disclosure already required under the Securitisation Regulation is maintained to enable investors to perform their due diligence and ongoing monitoring transactions, and only where necessary, this is supplemented by any relevant ESG data to enable investors to assess and monitor the ESG attributes of securitisation transactions.

We also support the general AFME view on this question.

Question 23: Should any action the Commission takes on verifiers of EU Green Bonds be linked to any potential future action to regulate the market for third-party service providers on sustainability data, ratings and research?

We note that certainty as to the quality and reliability of the data is critical for the development of an efficient market. There may be some logic in linking the regulation of the verifiers of EU Green Bonds with any regulatory regime for providers of sustainability data, ratings and research given the potential overlap between the two and to the extent the Commission expects many service providers will wish to provide both services. However, we do not consider that there needs to be a link between the two and we would expect the scope of the data, ratings and research to be much wider. Our comments in Question 22 above regarding the risks of introducing regulation prematurely (or, in this case, standards that are too narrow) and the key principles that should form part of any regulatory regime that is introduced apply equally to this question.

If the policy decision is not to regulate the market for third-party service providers on sustainability data, ratings and research, an alternative would be to have a framework setting out how sustainability data, ratings and research and third party service providers thereof should operate (including professional standards), for example, in terms of the type and format of data collected, to encourage certainty and consistency as to the quality, reliability, format and type of data available to the market, including for verification purposes by verifiers of EU Green Bonds.

The above views apply equally to verification of ESG securitisation. Notwithstanding any verification service, it is important that the high level of disclosure already required under the Securitisation Regulation is maintained to enable investors to perform their due diligence and ongoing monitoring transactions, and only where necessary, this is supplemented by any relevant ESG data to enable investors to assess and monitor the ESG attributes of securitisation transactions.

We also support the general AFME view on this question.

Question 25: In those cases where a prospectus has to be published, do you believe that requiring the disclosure of specific information on green bonds in the prospectus, which is a single binding document, would improve the consistency and comparability of information for such instruments and help fight greenwashing?

In respect of securitisation transactions, we strongly believe that the introduction of a specific mandatory disclosure regime for ESG information would be counterproductive and would not propose any additional new mandatory disclosure requirements (either in the prospectus or on an ongoing basis) over and above the general standard of disclosure that already applies to securitisation. A more effective way of combatting greenwashing would be the introduction of a verification regime as discussed above as this would enable the assessment of information being made at an in-depth level.

We also note that, as discussed in our Green Securitisation Position Paper, the Securitisation Regulation sets out the highest disclosure standards for securitisation anywhere in the world, including in Article 22(4) information related to the environmental performance of "residential loans or auto loans or leases". As a green or sustainable securitisation would be "green" or "sustainable" due to the sustainable nature of the underlying assets, we would expect disclosure of the sustainable aspects of the transaction in the prospectus in most cases to be limited to the description of the sustainability requirements of the eligibility criteria that underlying assets are required to meet, how such eligibility criteria meet the requirements of the ESG framework or taxonomy that has been applied to the transaction and details of any verification process carried out.

To the extent the proceeds of the securitisation will be used, or any capital or liquidity relief achieved on the transaction applied, for sustainable purposes, this additional information may also be disclosed but should not be required to be disclosed unless necessary to meet the general disclosure standards for prospectuses. However, some transactions may require additional disclosure, for example, if the terms of the underlying assets contain ongoing green obligations or if the collateral for the transaction is a significant commercial property specially designed or refurbished to achieve a green objective, additional detail around how such property complies with the relevant green principles or taxonomy may be needed. In addition, if a transaction does not qualify as an ESG securitisation because the underlying collateral is not ESG but has other ESG elements e.g. the proceeds are applied for ESG purposes or the purpose of the transaction is to provide funding to an originator with strong ESG credentials, although not relevant to the credit risk of the securitisation transaction, if a more general ESG or green bond label is being applied for, the issuer may want to include information about this in the prospectus and/or answer any likely investor queries about such arrangements via the arranger/manager due diligence questionnaire.

There may be occasions where the contractual documentation also provides for additional ongoing reporting obligations. In such cases, it should be up to investors – who are professional investors (and not retail investors) – to determine what constitutes an adequate disclosure standard. Any legislative or regulatory action should only be undertaken once a clearer market practice has developed in order to ensure that the rules are proportionate to the intention of developing a market for sustainable financial instruments.

As the market develops it will become clearer to all market participants what ESG data need to be provided and this should drive issuers to provide the necessary disclosures for their specific transactions.

Any such disclosure as described above would be tailored to the specific features of the relevant transaction. A mandatory disclosure regime would not be suited to all structures.

Question 26: In those cases where a prospectus has to be published, to what extent do you agree with the following statement: "Issuers that adopt the EU GBS should include a link to that standard in the prospectus instead of being subject to specific disclosure requirements on green bonds in the prospectus."

The prospectus will need to include all information required under the Prospectus Regulation and we would expect all material information relating to the ESG elements of the transaction and how the requirements of the applicable standard are met to be specifically disclosed. We note, by way of an example, the prospectus for the recent CMBS transaction issued by River Green Finance 2020 DAC. However, the inclusion of a link to the standard in addition to such material information for further background or context would also be helpful.

Question 30: The market has recently seen the development of sustainability-linked bonds and loans, whose interest rates or returns are dependent on the company meeting pre-determined sustainability targets. This approach is different from regular green bonds, which have a green use-of-proceeds approach. Should the EU develop standards for these types of sustainability-linked bonds or loans?

Sustainability-linked issuance, as a non-use of proceeds standard, is more potentially relevant for securitisations of transitional assets. See our response to Question 31 below.

Question 31: Should such a potential standard for target-setting sustainability-linked bonds or loans make use of the EU Taxonomy as one of the key performance indicators?

Sustainability linked bonds are an extension of our observations above on transitional assets. In a securitisation context, a sustainability linked securitisation would be a securitisation where the underlying collateral are transitional assets but where in addition the structure of the transaction or terms of the bonds become more favourable if certain ESG KPIs related to or contained in such underlying collateral are met.

The EU Taxonomy envisages that assets can qualify as green where the activity results in a significant improvement in green performance (see answer to Question 34 below). The "significant improvement" in green performance in the EU Taxonomy could be one of the KPIs for sustainability linked securitisation but we should not rule out other potential standards also as the market develops.

Question 32: Several initiatives are currently ongoing in relation to energy-efficient mortgages and green loans more broadly. Should the EU develop standards or labels for these types of products?

It would be helpful for the taxonomy to apply to loans (including mortgage loans) as well as bonds on a voluntary basis and to cover social and governance targets as well as environmental issues. We note, however, that any standards should not be so specific as to fail to be universally applicable across the different countries of the EU. The mortgage market differs significantly between different EU countries and this should be taken into account.

Question 34: Beyond the possible standards and labels mentioned above (for bonds, retail investment products, investment funds for professional investors, loans and mortgages, benchmarks), do you see the need for any other kinds of standards or labels for sustainable finance?

As noted in our Green Securitisation Position Paper, the development of a consistent and simple definition of green securitisation is crucial to the expansion of the green securitisation market. We believe that:

(1) The label "Green Securitisation" should be reserved exclusively for transactions collateralised by green assets and should not apply to securitisations just by virtue of the use of proceeds raised or capital/liquidity relief generated being applied for green purposes and/or the originator having strong green credentials generally (although those transactions may qualify for the wider green bond label).

(2) We acknowledge however, that the market will only widen and strengthen if brown and transitioning issuers are engaged with and have a place in the market, as there is limited availability of existing green underlying collateral. The EU Taxonomy envisages that a project or economic activity can be green where the underlying activity results in a significant improvement in performance (we note the technical annex thereto suggests a 30% benchmark against baselines for renovations and other types of project). Clarity that a securitisation of loans aimed at improving ESG performance will qualify as an ESG securitisation and when they would qualify would be extremely helpful in this regard.

(3) Labels for collateralised bonds should clearly distinguish between securitisation and covered bonds.

The above conclusions apply equally to ESG securitisations and ESG assets.

A standard would provide certainty to the market as to what constitutes ESG securitisation, be a measure against which the performance of the securitisation can be compared and help standardise the verification and reporting process. The time at which the assets are required to comply with the requirements of the EU Taxonomy or other relevant standard in order for the securitisation to qualify as an ESG securitisation should be the point at which the assets are securitised (noting that a securitisation may contain a range of assets originated over a significant period of time). If a transaction complies with standards at this stage it should retain its ESG securitisation label for the life of the deal (assuming information provided on the ESG elements of the transaction is true and accurate) and be grandfathered to the extent standards or requirements change thereafter. A master trust or programmatic transaction would need to be retested on the date of each further issuance for the purposes of compliance for that issuance only.

As mentioned above, the potential standard should encompass criteria for transitioning assets as well as assets that already meet the minimum flat grade in terms of ESG criteria. We note in this regard that the taxonomy envisages that assets can qualify as green where the activity results in a significant improvement in green performance. We agree with this approach and see it as crucial in an ESG securitisation context to support the origination of sufficient assets to develop a functioning ESG securitisation market. It would also be helpful to clarify at what stage in the process of improvement transitional assets would qualify as "ESG". Our view is that the standard should look to the purpose of the asset and that such assets should qualify as being "ESG" at the time of the securitisation provided it can be demonstrated that the minimum level of improvement remains a legitimate aim. Given the limited availability of ESG assets it would not be helpful to reserve the ESG label only for transitioning assets that have already realised the minimum degree of improvement. Any subsequent refinancing of the assets which did not promote further improvement would likely lose the ESG label unless the flat minimum ESG standard had been reached. The inclusion of transitional

ESG assets could also lead to the development of a sustainability linked securitisation market where the structure of the transaction or terms of the bonds are more favourable if certain ESG KPIs related to or contained in the underlying assets are met. Sustainability linked bond terms may also help legitimise that the ESG KPIs constitute a genuine and achievable target for the relevant underlying loans.

(C) **Extracts from Section 1.5 of the Commission Consultation Paper - Capital markets infrastructure**

Question 35: Do you think the existing capital markets infrastructure sufficiently supports the issuance and liquidity of sustainable securities?

We think that the capital markets infrastructure would support the issuance and liquidity of sustainable securities however note that the market is yet in its infancy. In respect of securitisation transactions, the limited availability of ESG assets is an issue, as has been discussed above.

Question 36: In your opinion, should the EU foster the development of a sustainable finance-oriented exchange or trading segments that caters specifically to trading in sustainable finance securities and is better aligned with the needs of issuers?

ESG segments of stock exchanges are helpful as they allow investors to quickly identify issuers which have met certain standards and make investment decisions accordingly (for example, the green area of Euronext). However, it is important to list on an exchange that securitisation investors are familiar with and so this would only be useful if developed as a sub-segment of the exchanges commonly used for securitisation transactions and did not add significantly to the cost of the listing. In addition, the same benefit could be achieved via publicly accessible search functions and green labelling. Accordingly, members did not consider an ESG oriented exchange to be necessary for ESG securitisation at this stage.

(D) **Extracts from Section 2.5 of the Commission Consultation Paper - Green Securitisation**

Question 54: Do you think that green securitisation has a role to increase the capital allocated to sustainable projects and activities?

We strongly believe that ESG securitisation can play an important role in increasing capital allocated to ESG projects and activities. Securitisation allows for capital market investors to contribute to specific projects and activities in a risk-appropriate manner and it constitutes an important tool for financial institutions in managing capital, leverage and funding (whether the securitisation is a synthetic securitisation or a 'cash' securitisation). Securitisation provides banks and other originators with a tool for transferring assets out of their balance sheet, thus increasing their capacity for lending to ESG projects and by pooling together small ESG loans (such as mortgages, residential rooftop solar energy, small SME loans for energy efficiency projects, and small scale infrastructure projects) into more liquid assets, securitisation gives investors access to sustainable investments.

As discussed in our Green Securitisation Position Paper, demand for green (and ESG) securitisation bonds is increasing and the availability of a sufficient supply of ESG collateral to meet this growing demand will be critical. Many institutional investors have increased commitments to invest in ESG assets in line with policy objectives and we are seeing an increasing number of queries and investor demands for ESG securitisation, indicating that the appetite and interest are there and that this market has considerable potential to grow. We note the institutional and stakeholder support for green securitisation. In its report published on 10 June 2020, the High-Level Forum on the Capital Markets Union[6] notes that securitisation has an enormous potential "to advance capital markets union and green finance" and that "funding the ambitious EU Green Plan also needs a functioning securitisation market". However, we note the importance of shifting away from the narrower concept of green securitisation and to start focusing more on the wider concept of ESG securitisation.

Furthermore, there is potential for the growth of ESG securitisation in both 'cash' and in synthetic variants. Each variant has a key role in driving lending and investment decisions within firms and could be an important tool in creating positive incentives for the origination of green assets, in particular if differentiated markets for green securitisation develop and are well functioning/ regulated.

Question 55: Do the existing EU securitisation market and regulatory frameworks, including prudential treatment, create any barriers for securitising green assets and increasing growth in their secondary market?

AFME very much supports the development of the STS Securitisation Framework set out in the Securitisation Regulation and the CRR and its objective to restart the securitisation market. Yet the potential of the framework and the ambition to promote a safe and expanded European securitisation market are so far not being fulfilled. This is in part due to an excessively complex regulatory framework and an overly conservative treatment of securitisation that continue to discourage a meaningful recovery of the European securitisation market. In this respect, the regulatory capital treatment of securitisation transactions under CRR, Solvency II as well as the LCR rules remain an area of concern. These elements may have an impact on the development of a market for ESG securitisation.

Question 56: Do you see the need for a dedicated regulatory and prudential framework for 'green securitisation'?

The Securitisation Regulation regulates all securitisations in Europe and should be the context for the development of principles and practices for ESG securitisation. Any dedicated regulatory framework for ESG securitisation should be developed in line with or within the existing Securitisation Regulation framework rather than independently to avoid duplication or inconsistency.

The introduction of differentiated capital treatment for ESG securitisation, which recognises ESG criteria in line with our response to Question 88 and the work currently being undertaking by the EBA and the international fora, may incentivise market participants and make a material difference to the growth of the ESG securitisation market. At this stage, there is limited evidence of a risk differential between ESG and non-ESG (or brown) assets. Accordingly the development at an international level of risk assessment methodologies that include a forward-looking perspective to better take into account the impact of ESG factors on the long-term risk profile of assets and related prudential treatment would be extremely helpful. Please see our response to Question 88 for further information.

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[6]https://ec.europa.eu/info/sites/info/files/business_economy_euro/growth_and_investment/documents/200610-cmu-high-level-forum-final-report_en.pdf

(E) **Extracts from Section 2.5 of the Commission Consultation Paper - Incentives to scale up sustainable investments**

Question 67: In your view, to what extent would potential public incentives for issuers and lenders boost the market for sustainable investments?

The introduction of tax, regulatory or other initiatives could help to support the growth of the ESG securitisation market.

Tax incentives would (for now) be matters for national governments to decide and would comprise a trade-off in policy objectives (tax revenues versus achieving broader ESG objectives) and might be easier to achieve. See also our response to Question 88 regarding the prudential treatment of ESG finance.

Other potential incentives to boost the market for ESG investments, either by incentivising a growth in the underlying assets or the financing thereof could include: (i) reduced hair-cuts for central bank eligibility schemes or dedicated asset purchase programmes to support liquidity and pricing; (ii) bespoke LCR limits; (iii) ongoing governmental and regulatory support by way of guarantees and the related regulatory benefit; (iv) subsidies for establishing new ESG projects; and (v) permitting ESG synthetic securitisations to qualify for the STS label.

We also note that the EIB has recently participated in a green Portuguese RMBS securitisation transaction. We would welcome any support the EIB and the EIF could provide to help promote the development of an ESG securitisation market in Europe, in particular, via the holding of mezzanine and junior positions.

Question 68: In your view, to what extent would potential incentives for investors (including retail investors) help create an attractive market for sustainable investments?

The investors in ESG securitisation are primarily investors within the scope of the definition set out in the Securitisation Regulation and are institutional investors. Several categories of such investors are subject to capital requirements. If the credit and liquidity performance would support the introduction of a differentiated capital treatment for ESG securitisation which recognises ESG criteria – in line with our response to Question 88 and the work currently being undertaking by the EBA – this would help spur demand for ESG securitisation.

Question 69: In your view, should the EU consider putting in place specific incentives that are aimed at facilitating access to finance for SMEs carrying out sustainable activities or those SMEs that wish to transition?

Our view in a securitisation context is that the focus should be on developing an ESG securitisation market generally without specific focus being given to any particular asset class.

In conclusion, we again thank the Commission for this opportunity to present our comments on the Consultation Paper. We are eager to engage in further dialogue with the Commission on matters related to ESG principles and green securitisation.

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Position Paper September 2019

Principles for developing a green securitisation market in Europe

Executive summary

On 1st January 2019 the new framework for securitisation in the EU (the "New Securitisation Framework")[1] came into force, setting common standards for all securitisations and defining criteria for "Simple Transparent and Standardised" or "STS" securitisations. This was one of the key achievements of the last EU legislative cycle.

In June 2019, the European Council confirmed in "A new strategic agenda 2019-2024" that "Europe needs inclusiveness and sustainability, embracing the changes brought about by the green transition, technological evolution and globalisation while making sure no-one is left behind. As the effects of climate change become more visible and pervasive, we urgently need to step up our action to manage this existential threat. The EU can and must lead the way, by engaging in an in-depth transformation of its own economy and society to achieve climate neutrality."

Green financing aims to enable and develop the key role that debt markets can play in funding projects that contribute to environmental stability.

AFME and its members strongly support the development of a green securitisation market in Europe and welcome voluntary measures to promote its development. By leveraging green lending capabilities, green securitisation can play an important role in helping to close the yearly investment gap of almost EUR 180 billion to achieve EU climate and energy targets by 2030[2]. The New Securitisation Framework, along with the existing Green Bond Principles ("GBP")[3], set the context to develop principles and practices for "green" securitisation.

Although demand for green securitisation bonds remains relatively low at present, many institutional investors (including sovereign wealth funds, sovereigns and supranationals such as multilateral development banks) have increased their commitments to invest in green assets in line with their policy objectives. AFME's members are also seeing an increasing number of queries and reverse enquiries around green securitisations and believe the market has considerable potential to grow.

In this paper, we highlight key voluntary principles that AFME believes policymakers and market participants should support to help promote green securitisation. These include:

- The importance of defining green securitisation simply and clearly.

[1] Regulation (EU) 2017/2402
[2] European Commission Sustainable Finance Action Plan, March 2018.
[3] 3 https://www.icmagroup.org/green-social-and-sustainability-bonds/green-bond-principles-gbp/

- The need for political support and financial or regulatory incentives to promote the development of the green securitisation market.

- Consideration of the key contractual provisions that will need to be contained in a green securitisation transaction (e.g. eligibility criteria and triggers).

- The need to consider and address the impact of the evolution of green technologies and standards over time on long-term programmes and the secondary market.

Key Points

Definition of Green Securitisation and Labelling

- The development of a consistent and simple definition of green securitisation is crucial to the expansion of the green securitisation market.

- The New Securitisation Framework should provide the starting point and overall context.

- The GBP define "Green Securitised Bond" as "a bond collateralised by one or more specific Green Projects (as defined in the GBP), including but not limited to covered bonds, ABS, MBS, and other structures; and aligned with the GBP. The first source of repayment is generally the cashflows of the assets." We believe this definition, which was drafted some time ago, needs some refining: for example, to reflect the limited recourse nature of most securitisations. In addition, although both securitisations and covered bonds are collateralised by Green Projects (being the focus of the GBP criteria) covered bonds are different from securitisations in other respects and should perhaps be defined separately.

- AFME believes that the term "Green Securitisation" should be reserved *exclusively* for transactions collateralised by green assets (for example, mortgages to finance energy-efficient homes, electric vehicle loans/leases, solar leases and SME loans to fund environmental projects, etc.). We do not agree that if the underlying collateral is not green the securitisation should be classified as a green securitisation simply because the proceeds of the securitisation were applied towards, or regulatory capital or liquidity relief achieved allocated to, Green Projects. While some green investors may have more flexibility, many will only have a mandate to invest in securitisations collateralised *exclusively* by green assets. This definition will also promote simplicity while the Green Securitisation market is still developing.

- AFME notes that a securitisation transaction with non-green underlying collateral where the proceeds are invested in, or regulatory or liquidity capital relief allocated to, Green Projects, could still qualify as a Green Bond - just not as Green Securitisation.

- While seeking further engagement, AFME broadly welcomes the work of the EU Technical Expert Group on Sustainable Finance in the development of the EU Taxonomy of environmentally sustainable economic activities (the "EU Taxonomy") and an EU Green Bond Standard (the "EU GBS") as well as the more granular rating agency green criteria that provide a scale of greenness from light to dark. However, to promote simplicity, the "degree of greenness" should not be a matter for the definition of "Green Securitisation" which should simply provide for a transaction either to be green or not.

- AFME considers the GBP requirements relating to the "process of project selection" and "specifying the use of proceeds" to be satisfied upfront on a Green Securitisation transaction by virtue of the proceeds being applied to acquire collateral that complies with eligibility criteria meeting the requirements of the applicable green principles or taxonomy. By way of example, the eligibility criteria on a green RMBS transaction would typically include the minimum requirements relating to Energy Performance Certification (EPC) and on an auto loan transaction the minimum requirements relating to emissions standards. AFME believes no further evidence of the "process of project selection" or "specifying the use of proceeds" should typically be required in addition to the current market standard disclosure in the prospectus and/or purpose of proceeds provision of the bonds or loan which states that the proceeds will be applied by the issuer or borrower for the purpose of acquiring the eligible receivables.

Incentives for Green Securitisation Transactions

- AFME believes that the introduction of tax, regulatory or other initiatives could help to support the growth of the Green Securitisation market.

- Tax incentives would (for now) be matters for national governments to decide and would comprise a trade-off in policy objectives (tax revenues versus achieving broader green objectives) and might be easier to achieve.

- The introduction of preferential regulatory capital treatment for Green Securitisation would likely make a material difference to the growth of the market, although of course to meet prudential requirements such treatment would need to be based on evidence of superior credit or liquidity performance. Such incentives could help promote Green Securitisation to all securitisation investors not only those with a green mandate.

- Other potential incentives could include: (i) reduced hair-cuts for central bank eligibility schemes; (ii) bespoke LCR limits; (iii) ongoing governmental and regulatory support by way of guarantees and the related regulatory benefit; and (iv) subsidies for establishing new green projects.

- AFME encourages regulators and policymakers to establish a dialogue with market participants to consider such potential incentives in both the short and long term.

Disclosure, Ongoing Reporting and Underlying Data

- The New Securitisation Framework already sets out the highest disclosure standards for securitisation anywhere in the world, including in Article 22(4) information related to environmental performance of "residential loans or auto loans or leases". Market participants are currently undergoing a process of adjustment to these relatively new requirements. Although the GBP recommend impact monitoring and reporting on green bond transactions the proposed EU GBS envisage this being mandatory. AFME does not consider additional impact monitoring and reporting to be necessary for many Green Securitisation transactions for the reasons set out below. Accordingly, it is not our intention to propose additional new mandatory disclosure requirements over and above the general standard of disclosure that already applies to securitisations.

- On most public Green Securitisation transactions AFME would expect the green requirements to be tested only on the closing date (or, on a revolving pool, on each date of transfer) by the application of the eligibility criteria for the transaction. This would be the case for any transaction where the green aspects of the deal cannot change over time and therefore only need to be tested once. Any RMBS transaction or auto loan transaction where the relevant EPC certificate or emissions standard is certified upfront are good examples. Disclosure of the green aspects of the transaction in the prospectus would be limited to the description of the eligibility criteria in the ordinary course and no bespoke green triggers or default events would be required.

- On other types of public securitisation transaction additional disclosure may be required. If the underlying collateral contains ongoing green obligations (for example, key deadlines for achieving a minimum energy efficiency improvement), details of these ongoing obligations will likely need to be included in the prospectus. Another example is a transaction secured on one or a few very large commercial properties specially designed or refurbished to achieve a green objective, in which case additional detail around how such property complies with the relevant green principles or taxonomy may be needed.

- To the extent the originator or issuer wishes to include additional disclosure in the prospectus on any green aspects of the transaction that are unconnected with the green nature of the collateral, for example, relating to the use of proceeds or regulatory capital or liquidity relief made available, such disclosure should be voluntary.

- We encourage originators to record and track the green data on the underlying collateral necessary to determine whether the requirements of the GBP or relevant green taxonomy are met on a systemic basis. It may also be possible to extract this information from existing data based on the year a property is built (as standards change for new developments) or the particular model and year of a vehicle.

Eligibility Criteria and Trigger Events

- On any transaction where the green aspects of the underlying collateral are only required to be tested once on the closing date (or, for a revolving pool, each date of transfer) AFME would expect the green elements of the transaction to be met by establishing eligibility criteria that comply with the relevant green principles or taxonomy. The repercussions of any breach of a green asset warranty would be limited to the usual repurchase obligations of an originator and the ongoing reporting would be no different from that of a standard securitisation transaction.

- AFME would expect additional green trigger or default events to be required in some circumstances. Where the underlying collateral contains ongoing green obligations (as mentioned above) the transaction would need to consider what the repercussions would be of any breach of an ongoing obligation by the underlying borrower and how this should be reflected in any reporting.

Evolution of Technology

- As standards evolve over time a transaction originally considered to be green could cease to meet the requirements of the relevant green principles or taxonomy, potentially impacting on pricing and liquidity in the secondary market. Ongoing reporting and transparency where standards have changed on legacy transactions will therefore be important.

- Long-term securitisation structures such as master trusts may require flexibility to evolve over time in order to remain current as green standards develop and become more stringent.

- In relation to incentives, any regulatory capital or similar incentive introduced for green securitisations should include grandfathering for legacy transactions that have ceased to be considered green (or have become less green) over time as a result solely of the evolution of technology. Grandfathering will help to mitigate any material and sudden detrimental impact on pricing and liquidity in the secondary market. This may be less of an issue for tax incentives the benefit of which is typically upfront.

- It would also be helpful to consider whether the appropriate green bond criteria and/or taxonomy requirements against which a portfolio is tested should be those that applied on the date the relevant receivable was originated. This would ensure that where a legacy green portfolio is refinanced the new transaction could still qualify as a Green Securitisation.

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