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European Green Securitisation Regulatory State of Play

Obstacles to growth and opportunities for leadership

December 2022

Association for Financial Markets in Europe
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Executive Summary

This report examines green securitisation in the context of sustainable finance and Europe's[1] broader sustainability goals. It provides AFME members with a comprehensive overview of the relevant European regulations and aims to show the key role green securitisation can play in assisting Europe's transition towards a more sustainable economy.

The report is structured in three parts. The first part, "Sustainable Securitisation Market Overview", links green securitisation to the EU Green Deal and shows that although Europe is a leading region for green and sustainable bonds, the European green securitisation market remains subdued and lags far behind other jurisdictions. For instance, between 2019 – 2022 green securitisation issuance represented only 1.4% of total European[2] green issuance, whereas it accounted for 8.1% in China and 32.3% in the US.

The second part is a state of play of the current regulatory landscape. This section provides a brief overview of the European political initiatives aiming to foster a sustainable economy. These are the European Commission's Renewed Sustainable Finance Strategy and the "Fit for 55" package as well as the UK's strategy "Greening Finance: A Roadmap to Sustainable Investing". It then presents the EU legislation (including legislative proposals under discussion) which affect securitisation both directly and indirectly.

The third part focuses on recent regulatory developments and discusses the current development of the EU Green Bond Standard and the importance of developing a framework for green synthetic securitisation.

Lastly, the Annex examines the potential scale of securitisable green lending by the end of 2030. It shows that, in respect of residential mortgage loans on energy-efficient properties, loans for green home renovations and electric vehicle financing, securitisable green lending could exceed €300 billion annually by 2030, showing the huge potential for securitisation to finance the green consumer transition through these three asset classes alone.

"Green securitisation can play a key role in assisting Europe's transition towards a more sustainable economy"

1 The EU and the UK.

2 European issuance includes both the EU and the UK.

Sustainable Securitisation Market Overview

What is a sustainable securitisation?

Environmental, social and governance (ESG) objectives currently embody the meaning of "sustainability". ESG factors are becoming increasingly meaningful to investors in the context of capital markets offerings, and policymakers frequently indicate how important these are in regulatory analysis. "Sustainability" has become an important aspect of securitisation, too.

When investors assess ESG factors in securitisations, they typically consider three criteria, namely the securitisation portfolio, the key transaction counterparties and the use of proceeds. Based on these criteria, a securitisation can be sustainable when the collateral has a positive impact on "sustainability" - for example, energy-efficient mortgages are environmentally friendly – when the securitising parties align with governance objectives[3] or when the proceeds raised by the transaction are going to refinance assets with ESG characteristics.

Although these three factors help evaluate the sustainability credentials of a transaction, there is currently no regulatory framework dedicated to securitisation to specify when and how the "ESG" label can be attributed to a securitisation deal. Sustainable securitisation can therefore include a broad range of transactions – please see Table 1 below - manifesting a certain level of interaction between these three elements.

The lack of a specific legal framework has led market participants to develop their own voluntary principles. For example, the International Capital Market Association (ICMA)[4] has developed the Green Bond Principles (GBP), the Social Bond Principles (SBP), the Sustainability Bond Guidelines (SBG) and the Sustainability-Linked Bond Principles (SLBP), all of which apply to securitisation bonds. In addition, the Climate Bonds Initiative (CBI)[5] also provides a green label for securitisation.

Green securitisation and general market overview

Green securitisation is part of the wider "sustainable securitisation" universe and has a key role to play in Europe's ambitious green goals. The European Commission's Green Deal plan aims to shift to a sustainable economy so that the European Union (EU) becomes "the first climate-neutral bloc in the world by 2050".[6] The scale of funding required is of course enormous, an estimated €350 billion in additional investment per year over this decade to meet the 2030 emissions-reduction target in energy systems alone, alongside the €130 billion Europe will need for other environmental goals.[7] To even hope to succeed in this ambitious project, it will be crucial for all sources of capital and liquidity to be deployed across the full array of financial products.

Securitisation is, in fact, perfectly designed to make a substantial contribution to these goals by facilitating banks both to free up regulatory capital and refinance lending to both wholesale and retail clients through access to the capital markets. As a result of these transactions, lenders may use freed up capital to reinvest in ESG lending, while capital markets investors may channel capital via securitisation directly to finance renewable lending. In this regard, the High Level Forum on the Capital Markets Union (CMU) noted in its June 2020 report that securitisation has an enormous potential "to advance the capital markets union and green finance".[8] Ensuring, therefore, that the securitisation market can flourish will be central to achieving the goal of growth in ESG projects and activities.

3 For a full list of "ESG" examples, please see this AFME discussion paper.

4 https://www.icmagroup.org/

5 https://www.climatebonds.net/policy/policy-areas/market-development

6 https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal/delivering-european-green-deal_en

7 Communication from the Commission to the European Parliament, the Council, the European Economic and Social committee and the Committee of the regions empty - Strategy for Financing the Transition to a Sustainable Economy, Strasbourg, 6.7.2021 - here.

8 https://ec.europa.eu/info/files/200610-cmu-high-level-forum-final-report_en

However, despite the fact that Europe is a leading region for green and sustainable bonds, it is currently a laggard with respect to green securitisation. The AFME Securitisation Data Report Q2 2022 depicts the current, low volumes of green and, more generally, ESG securitisation issuance.[9]

Figure 1: **European green securitisation issuance by asset class**

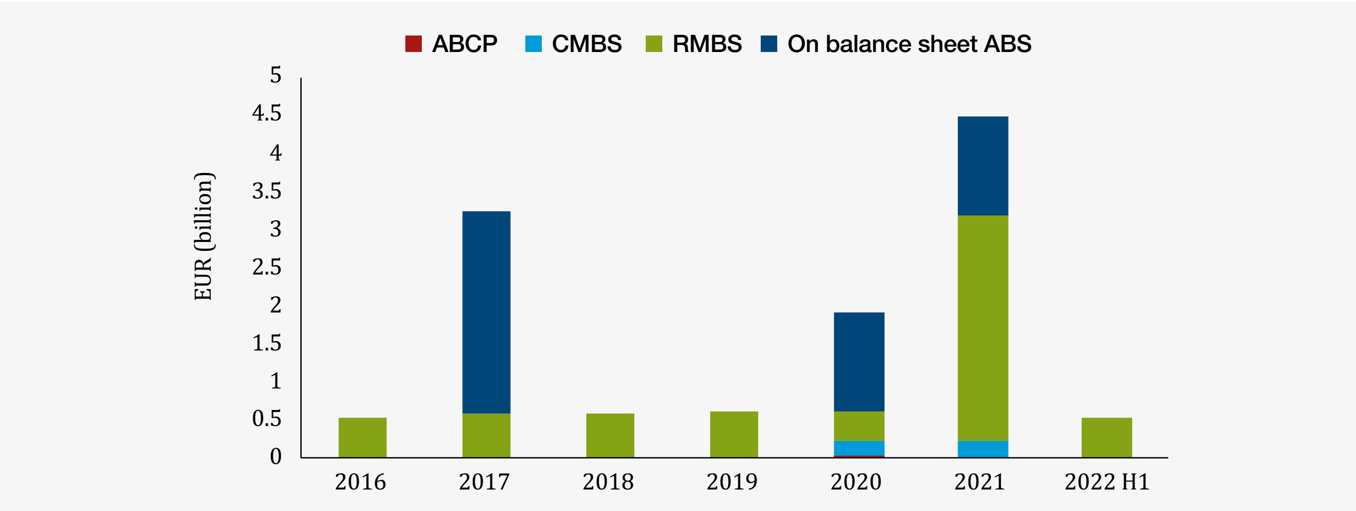
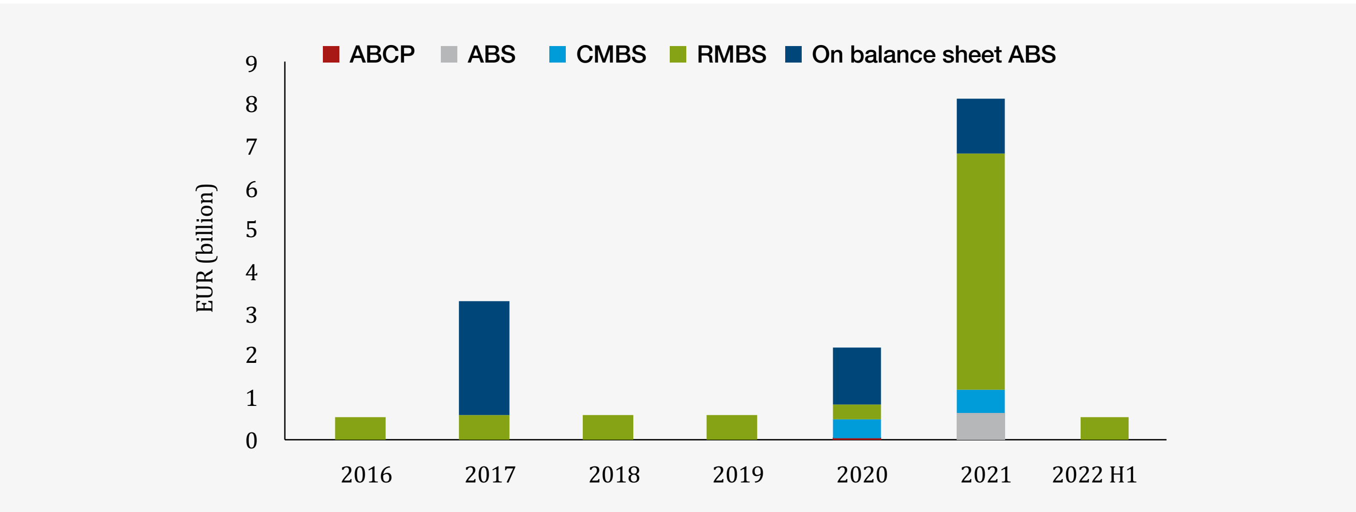


Figure 2: **European ESG securitisation issuance by asset class**



9 https://www.afme.eu/Portals/0/DispatchFeaturedImages/AFME%20Securitisation%20Report%20Q2%202022-2.pdf

Figure 3: **European ESG securitisation issuance by country**

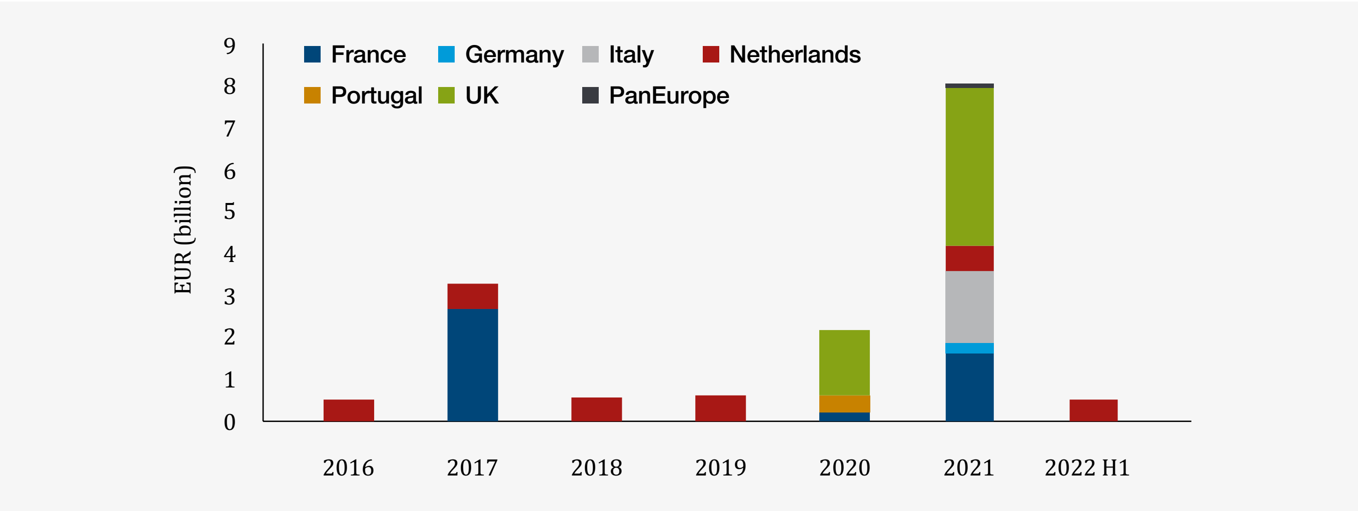


Figure 4: **European social and sustainable securitisation issuance by asset class**

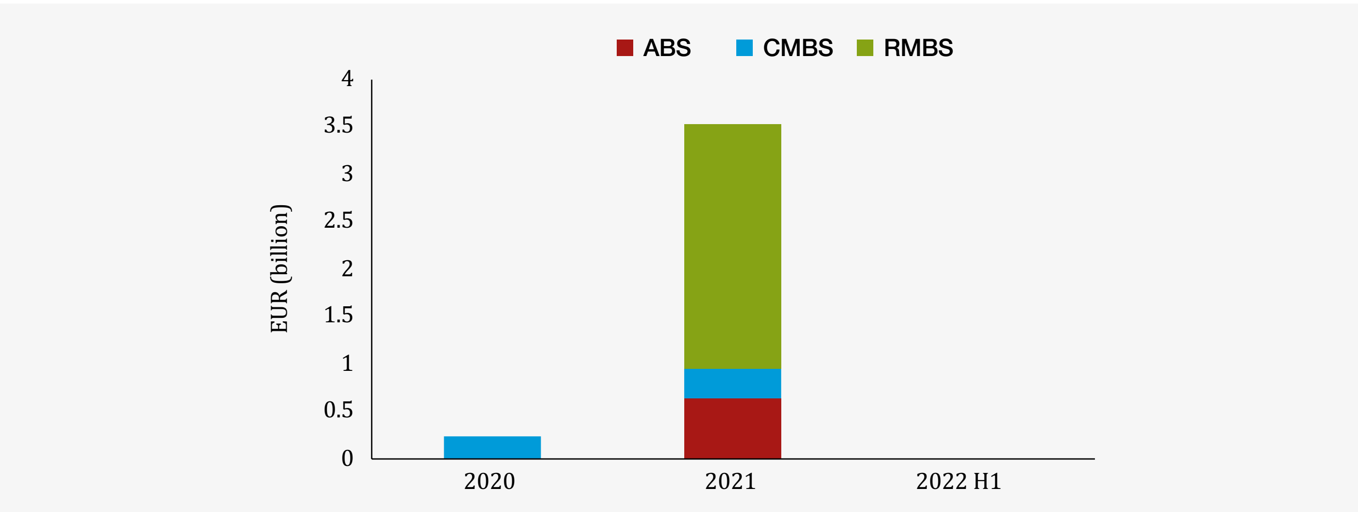


Table 1: **Type of ESG securitisation transactions by country, asset class and method**

The table below provides a brief overview of ESG securitisation transactions issued and/or originated in Europe, including the United Kingdom (UK), between 2016 and 2022H1.[10] In the course of five years, only 24 securitisation transactions with ESG characteristics have been issued. These include 10 green RMBS,[11] 4 green synthetic securitisations, 3 green CMBS,[12] 1 social and 1 sustainable CMBS, 1 green auto ABCP,[13] 2 social RMBS, 1 social ABS-consumer and 1 social ABS-receivables.[14] The market therefore seems to operate on the basis of different asset classes, with "green" currently prevailing over "social". In terms of the method used, most transactions seem to have combined sustainable collateral (either green or social) with sustainable (either green or social) use of proceeds.

Year	Name	Country	Amount	ABS type	Description
2016	Green Storm 2016	NL	EUR 526.2m	Green RMBS	**Green collateral/green proceeds:** Backed by portfolios entirely made up of energy-efficient mortgages and water use improvements, and the proceeds are used to (re)finance these loans.
2017	Green Storm 2017		EUR 594.2m		
2018	Green Storm 2018		EUR 587.8m		
2019	Green Storm 2019		EUR 600m		
2021	Green Storm 2021		EUR 595.9m		
2017	Premium Green 2017-2	FR	EUR 2660m	Green synthetic	**Green collateral/green proceeds:** Backed by a variety of loans, including project finance on renewable energy; freed up capital for green lending in diverse sectors.
2020	River Green Finance	FR	EUR 196m	Green CMBS	**Green collateral/green proceeds:** Backed by a single loan secured on an energy-efficient office building.
2020	Project Grasshopper SRT	UK	GBP 1100m	Green synthetic	Method used not known by AFME
2020	Green Belém No.1	PT	Class A: EUR 385m	Green RMBS	**Green collateral/green proceeds:** Backed by a pool of prime mortgage loans, and the proceeds are used to finance green building and sustainable finance projects. STS-compliant.
2020	La Fayette Asset Securitisation LLC	FR	EUR 21.8m	Green auto ABCP	**Green collateral/green proceeds:** Backed by designated green assets, either because the seller is active in green sectors or, as indicated by seller pool data, reports assets and proceeds are used to finance electric vehicles. Subsequent issues include financing for solar energy equipment loans and trade receivables.
2020	Funding No. 1 Plc	UK	GBP 242.4	Social CMBS	**Social collateral and social proceeds:** Backed by a portfolio of social housing units, and the proceeds are used to (re)finance social projects, such as affordable housing and the provision of homes for social and affordable rent.

10 AFME data. Please also see the EBA report on developing a framework for sustainable securitisation.

11 Residential Mortgage-Backed Security

12 Commercial Mortgage-Backed Security

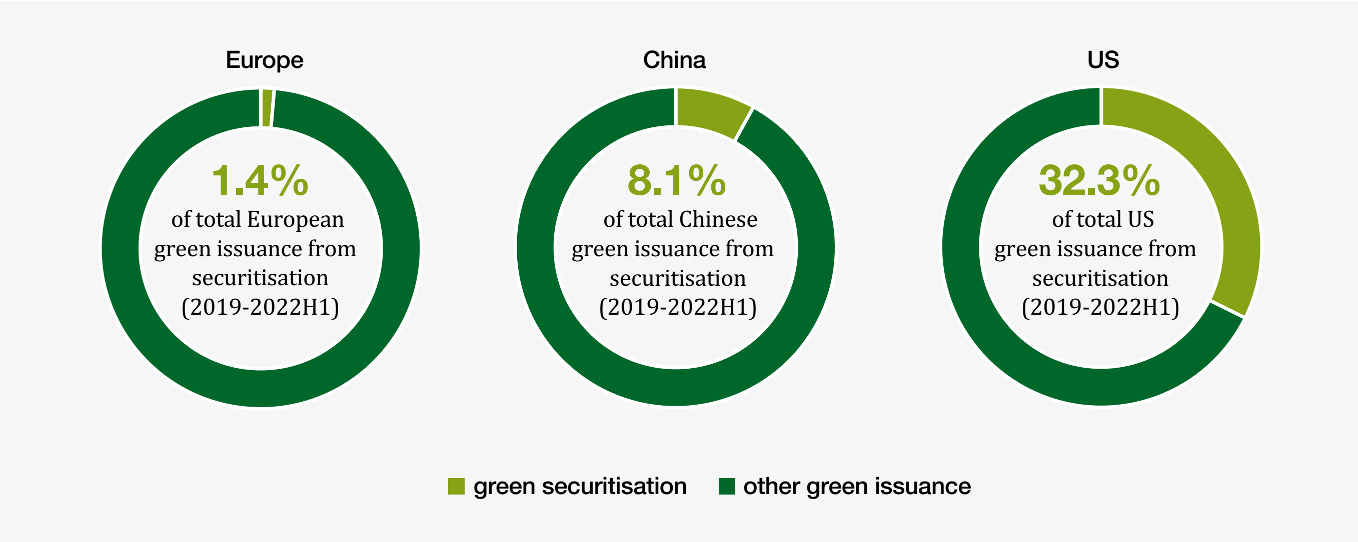
13 Asset-Backed Commercial Paper

14 Asset-Backed Security

Year	Name	Country	Amount	ABS type	Description
2021	Project Boquerón	ES	EUR 1.6bn	Green synthetic	**Green collateral/green proceeds/green sustainability-linked bond:** Backed by a portfolio of renewable energy efficiency financing. It includes a stepdown coupon upon meeting specified ESG/impact lending targets and capital relief redeployed to an area which directly cuts carbon emissions.
2021	Finsbury Square 2021-1 plc	UK	GBP 639m	Green RMBS	**Green proceeds:** The proceeds from the class A are used to finance part of the green collateral, and the remaining unallocated proceeds will be put towards new green mortgage lending over the next five years. STS compliant.
2021	Gemgarto 2021-1 PLC	UK	GBP 472m	Social RMBS	**Social collateral and social proceeds:** Backed by a pool of prime, performing, first-ranking mortgages and monies used to (re)finance owner-occupied mortgages to underserved borrowers with complex incomes, (self-employed, first-time buyers with limited credit history, contractors, retired and/ or younger borrowers).
2021	Brass No. 10	UK	GBP 1,724m	Social RMBS	**Social collateral and social proceeds:** Backed by a pool of mortgages targeted towards first time buyers, retired and self-employed borrowers. Part of the proceeds are to be used towards social projects including higher-rate savings products and/or competitively priced mortgage products to customers who may be underserved by other lenders in the market because of the complexity of their characteristics (for example, self-employed borrowers, contractors, first-time buyers and retired borrowers).
2021	GARC corp-3	Italy	EUR 1,300m	Green synthetic	Method used not known by AFME
2021	PMI100	Italy	EUR 383m	Social ABS – Receivables	Method used not known by AFME
2021	Fortuna 2021 - STS German Consumer ABS	Germany	EUR 250m	Social ABS – Consumer	Method used not known by AFME
2021	BPCE Home loans FCT 2021 Green UoP. Class A	France	EUR 1,500m	Green RMBS	Method used not known by AFME
2021	BPCE Home loans FCT 2021 Green UoP. Class B	France	EUR 120m	Green RMBS	Method used not known by AFME
2021	Frost CMBS 2021-1 DAC	UK	GBP 112m	Green CMBS	**Green collateral/green proceeds:** Backed by a portfolio of green mortgages, and the proceeds are used to refinance energy efficient warehouses.
2021	Frost CMBS 2021-1 DAC	Pan-Europe	EUR 92m	Green CMBS	**Green collateral/green proceeds:** Backed by a portfolio of green mortgages, and the proceeds are used to refinance energy efficient warehouses.
2021	Sage Ar Funding 2021 PLC	UK	GBP 280m	Sustainable CMBS	Method used not known by AFME
2022	Green STORM 2022	NL	EUR 531.6m	Green RMBS	**Green collateral/green proceeds:** Backed by portfolios entirely made up of energy-efficient mortgages, and the proceeds are used to (re)finance these loans.

And while numbers of ESG transactions in Europe are so low, outside Europe securitisation has already become an important tool to channel capital into green lending. In the United States (US) and China, for example, green securitisation represented in Q1 2021 more than 50% and 10% respectively of their overall green financing, whilst in Europe it stood only at 1%.[15] The difference is staggering if one also looks at data from a longer period. Figure 5 below compares green securitisation issuance between Europe, China and the US taking into account data from the period 2019-2022H1. Green securitisation issuance represents only 1.4% of total European green issuance, whereas it stands at 8.1% in China and 32.3% in the US.[16]

Figure 5: **Green securitisation (2019-2022H1)**



The contrast in growth shown above between the European green securitisation market and other jurisdictions is undoubtedly vast and inevitably leads one to wonder why. A lead factor is the state of the European securitisation market itself which still remains subdued.

The European green securitisation market will flourish only when regulatory impediments in the European securitisation product have been addressed

There is already a great deal of commentary and focus on the state of the European securitisation market, it is not a topic therefore we seek to cover in this report. Suffice to say, however, that it is the conviction of a growing universe of observers (both with and without a commercial interest in the product) that the lack of risk-sensitivity and proportionality in the European regulatory framework for securitisation substantially prevents the revival of issuance volumes in the product. At the heart of the problem is the disconnect between the CMU strategy, which recognises the value of securitisation to the economy and seeks to restore a well-functioning European market, and the direction of work undertaken at the more technical level. It is telling that over the years the European ABS market has declined in size. In 2008, its size (including the UK) was 75% that of the US, however it diminished to only 6% in 2020,[17] a year after the implementation of the EU securitisation framework. The divergence between ambition and outcome is therefore evident, and policy makers should be trying to close the gap, which becomes even more evident by looking at the current contrast between EU and US securitisation issuance levels.[18]

15 EBA report on developing a framework for sustainable securitisation - here.

16 European data includes the UK. US data includes agency issuance.

17 As noted in this blog by the European Stability Mechanism.

18 AFME Securitisation Data Report Q2 2022 - here.

Table 2: **Total European issuance by collateral in Q2 2022**[19]

	2022-Q1	2022-Q2	2021-Q1	2021-Q2	2021-Q3	2021-Q4	Total
ABS	8.7	10.1	14.4	16.5	10.3	21.1	**62.3**
CDO/CLO	10.7	6.4	6.6	8.1	8.8	20.2	**43.7**
CMBS	0.8	0.7	2.5	1.2	2.2	1.4	**7.3**
RMBS	43.7	17.4	21.9	10.1	25.7	29.0	**86.7**
SME	0.0	0.0	2.0	0.0	0.5	25.9	**28.4**
Corporate	0.0	0.0	1.6	0.3	0.0	2.9	**4.8**
Total	**63.9**	**34.5**	**48.9**	**36.4**	**47.6**	**100.2**	**233.1**

Table 3: **Total US issuance by collateral in Q2 2022**

	2022-Q1	2022-Q2	2021-Q1	2021-Q2	2021-Q3	2021-Q4	Total
ABS	58.3	61.8	60.8	68.8	73.2	67.2	**270.1**
CDO/CLO	18.4	11.0	58.1	43.2	46.6	74.8	**222.7**
Agency MBS	577.0	454.9	847.1	795.9	715.5	692.4	**3,050.9**
Non-Agency CMBS	13.5	12.1	17.0	25.6	28.2	46.0	**116.8**
Non-Agency RMBS	7.1	5.5	41.2	56.5	58.5	74.3	**230.6**
Total	**674.4**	**545.3**	**1,024.3**	**990.1**	**922.0**	**954.6**	**3,891.1**

Sizing the green securitisation market into the future

The comparisons made above against the Chinese and US securitisation markets indicate how much room there is for the European green securitisation market to expand.

In this regard, AFME partnered with S&P Global Ratings to form an assessment on the potential scale of future green securitisation issuance by 2030. The data research focuses on three types of securitisable green asset classes, namely residential mortgage loans on energy-efficient properties, lending for green home renovation and electric vehicle financing, and based on current data provides estimates of growth until the end of the decade. The findings are:

Residential mortgage loans on energy-efficient properties: Gross green mortgage lending could reach €125 billion annually across eight European RMBS markets, i.e. Belgium, France, Ireland, Italy, the Netherlands, Portugal, Spain and the UK.

Lending for green home renovation: If residential buildings reach a 3% renovation rate by 2030, this could generate an annual funding requirement of about €75 billion, which may partly be addressed by further mortgage advances that are securitisable. This figure assumes a fully-funded typical renovation cost of about €17,000 per property, and considers the same eight European RMBS markets mentioned above.

Electric auto financing: In respect of new battery electric vehicles, securitisable financing could reach €80 billion annually, while there could be a further €30 billion in annual financing required for used ones. These estimates concern only the five major European auto ABS markets, namely France, Germany, Italy, Spain and the UK.

To read the full assessment, please refer to the **Annex** - Potential Growth of Securitisable Green Lending by 2030.

19 Volumes in Tables 2 and 3 are in billions of EUR.

Regulatory Landscape Towards a Sustainable Economy

This part provides a brief overview of the key regulatory developments in the field of sustainable finance on an EU and UK level. Section 1.1. presents the EU and UK strategy, section 1.2. lists out the EU rules which have an indirect impact on securitisation and section 1.3 presents the EU rules which directly apply to securitisation.

1.1. EU and UK Strategy

a. European Commission's Renewed Sustainable Finance strategy – published on 6 July 2021

European regulators and policymakers have given strong indications that ESG considerations will be increasingly important in regulatory analysis and decision-making in the years to come. The EU, in particular, has been putting forward policies and regulations focused on environmental and social objectives underpinned by good governance, since the publication of the Sustainable Finance Action plan (2018),[20] the EU Green Deal (2019)[21] and more recently the EU Renewed Sustainable Finance Strategy (2021).[22]

The Renewed Sustainable Finance Strategy (RSFS) sets out over 50 legislative and non-legislative initiatives to be implemented in the EU to help improve the flow of money towards financing the transition to a sustainable economy. The RSFS groups these initiatives under six sets of action:

- Extend the existing sustainable finance toolbox to facilitate access to transition finance;
- Improve the inclusiveness of small and medium-sized enterprises (SMEs) and consumers by giving them the right tools and incentives to access transition finance;
- Enhance the resilience of the economic and financial system to sustainability risks;
- Increase the contribution of the financial sector to sustainability;
- Ensure the integrity of the EU financial system and monitor its orderly transition to sustainability; and
- Develop international sustainable finance initiatives and standards, and support EU partner countries.

The Commission will report on the RSFS's implementation by the end of 2023 and will support Member States in their efforts on sustainable finance.[23]

b. European Commission's "Fit for 55" package – published on 14 July 2021

The "Fit for 55" package is a set of proposals which aims to amend EU legislation and policy in order to ensure that the EU is able to meet its new climate targets, namely a 55% reduction in greenhouse gas emissions by 2030 and carbon neutrality by 2050.[24] It touches on most areas of the EU economy, however particular emphasis is put on decarbonising the power generation, transport and buildings sectors.

The package does not aim at sustainable finance directly, but it fleshes out the EU's overall policy and legislative framework for the bloc's transition to net zero. It therefore provides a roadmap of those areas of the economy which have significant investment potential and those ones which are at higher risk of stranded assets.

The "Fit for 55" package will need to be discussed and negotiated by the European Parliament and the Council, procedure which is likely to take several months, as the speed and progress of each separate proposal is largely independent of the other proposals in the package.

20 https://ec.europa.eu/commission/presscorner/detail/en/IP_18_1404

21 https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal_en

22 https://ec.europa.eu/info/publications/210706-sustainable-finance-strategy_en

23 https://www.europarl.europa.eu/legislative-train/carriage/renewed-sustainable-finance-strategy/report?sid=6301

24 https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021DC0550&from=EN

c. The UK's strategy: "Greening Finance: A Roadmap to Sustainable Investing" – published on 18 October 2021

"Greening Finance: A Roadmap to Sustainable Investing" outlines the legislative and regulatory changes that will be made in the UK in order to encourage consumers and investors to make more environmentally positive investment decisions.[25] The Roadmap lays out three key initiatives:

- Delivering Sustainability Disclosure Requirements (SDRs);
- Implementing a UK Green Taxonomy; and
- Setting out the UK Government's expectations in respect of investor stewardship.

In relation to the first initiative, the Task Force on Climate-Related Financial Disclosures (TCFD) has developed recommendations on how companies can disclose the ways they manage financial risks and opportunities created by climate change. TCFD-aligned disclosures (intended to become fully mandatory across the UK economy by 2025) are the basis upon which SDR is built on.[26] The proposals require companies, asset managers and creators of investment products to substantiate how sustainability is accounted for in governance, investment policies and strategies. The SDR will also require disclosure against minimum safeguards which promote sustainable investments, as also required by the UK Green Taxonomy.[27]

The UK's Green Taxonomy will set out the criteria that economic activities must satisfy to be considered "environmentally sustainable" and "Taxonomy-aligned". The advice of the UK's Green Technical Advisory Group (GTAG) indicates that the UK Green Taxonomy will aim to ensure interoperability with the EU framework by adopting the same principles and objectives underpinning the classification of economic activities. Thresholds and criteria, however, might have to be adapted to the specificities of the UK economy.

The Transition Plan Taskforce (TPT) was launched to develop a gold standard for transition plans. The TPT's work will help to drive decarbonisation by providing a framework and benchmark that helps financial institutions and companies to prepare rigorous transition plans. These plans will specify how entities can support the UK's net zero transition through disclosures on how they will achieve pledged targets and support economy-wide decarbonisation. These actions will support a "whole of economy transition" and help tackle greenwashing.

In respect of the third initiative, the UK Stewardship Code 2020 defines stewardship as "the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society".[28] According to the Roadmap, "stewardship can be a powerful vehicle to hold companies to account for the feasibility and credibility of their net-zero commitments and their transition strategies to align their business models with a net-zero economy". It is therefore important that the pensions and investment sectors - asset owners, asset managers and the service providers that support them – as stewards of capital, use the information generated by SDR and take ESG criteria into account in every aspect of their daily operations. The progress they make towards reaching the investor stewardship objectives are going to be assessed by the UK Government at the end of 2023.

Apart from the "Greening Finance: A Roadmap to Sustainable Investing" strategy, developments in the UK around sustainability have been limited so far.

25 https://www.gov.uk/government/publications/greening-finance-a-roadmap-to-sustainable-investing

26 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1031805/CCS0821102722-006_Green_Finance_Paper_2021_v6_Web_Accessible.pdf

27 In November 2021, the FCA published a Discussion Paper proposing further detail on the SDR regime and sustainable investment products labelling regime.

28 https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Final2.pdf

1.2. Sustainable Securitisation: EU rules affecting securitisation indirectly

The EU Renewed Sustainable Finance Strategy and the "Fit for 55" package cover the entire area of sustainable finance and are underpinned by the EU Taxonomy Regulation, the EU Sustainable Finance Disclosure Regulation (SFDR) and the Non-Financial Reporting Directive (NFRD), as amended by the forthcoming Corporate Sustainability Reporting Directive (CSRD). These are the pillars of the EU sustainability disclosures framework, whose purpose is to create consistency in the way sustainability information is shared throughout the financial chain.

Currently, neither the EU Taxonomy nor the SFDR apply to securitisation transactions directly. In respect of the former, the financial instruments issued pursuant to securitisation transactions do not fall under the definition of "financial product" included in Article 2 of the EU Taxonomy, while the parties involved in a securitisation deal are also not "financial market participants" for the purposes of the SFDR. However, rules set out in those two regulations may still be of relevance to securitisations to the extent that investors (and asset managers) in securitisations are caught by either regime, in which case they will be requiring sustainability related information from the originators in order to comply with their own obligations under these two regulations.

Additionally, in May 2022 the Joint Committee of the European Supervisory Authorities (ESAs) launched a consultation on their draft Regulatory Technical Standards (RTS) with regard to the content, methodologies and presentation of disclosures pursuant to Article 22(4) and 26d(4) of the Securitisation Regulation ((EU) 2017/2402),[29] by which they aimed to "ensure a high degree of consistency with the disclosure framework developed under SFDR and the associated RTS". (For greater detail on the consultation and AFME's response, please see section "Live Regulatory Issues" below.)

Consequently, even though the EU Taxonomy, SFDR and NFRD/CSRD do not target securitisation directly, they will affect securitisation deals and influence securitisation level 2 text measures. This report is therefore presenting them briefly below. For greater detail, please refer to AFME's report "Sustainable Finance in Europe: Regulatory State of Play".[30]

a. EU Taxonomy Regulation - in force since 12 July 2020

The Taxonomy Regulation ((EU) 2020/852)[31] (the "Regulation" in this section 1.2(a)) establishes the "EU Taxonomy", a classification system established by the EU in order to provide market participants and policymakers with appropriate definitions according to which economic activities can be considered environmentally sustainable. The Regulation establishes therefore the criteria according to which an economic activity can qualify as environmentally sustainable for the purposes of establishing whether an investment can be considered an environmentally sustainable one. Pursuant to Article 3 of the Regulation, an economic activity is environmentally sustainable when it contributes substantially to one or more of the environmental objectives specified in the Regulation, it does not significantly harm any of those objectives and complies with the Regulation's minimum safeguards and the Commission's relevant technical screening criteria.

The environmental objectives referred to above are (i) climate change mitigation, (ii) climate change adaptation, (iii) sustainable use and protection of water and marine resources, (iv) transition to a circular economy, (v) pollution prevention and control and (vi) protection and restoration of biodiversity and ecosystems. Each of these objectives must be defined by technical screening criteria established by the European Commission through delegated acts. For example, the Commission Delegated Regulation (EU) 2021/2139, published in the Official Journal of the EU on 9 December 2021[32] and applicable since January 2022, was the first published delegated act and covers the first two objectives.

29 https://www.esma.europa.eu/sites/default/files/jc_2022_22_joint_consultation_paper_on_sustainability_disclosures_for_sts_securitisations_0.pdf

30 https://www.afme.eu/Portals/0/DispatchFeaturedImages/AFME_SustainableFinance2021_06_S.pdf

31 https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32020R0852&from=EN

32 https://eur-lex.europa.eu/eli/reg_del/2021/2139/oj

In respect of the remaining environmental objectives, technical screening criteria are still under development. The Platform on Sustainable Finance (the "Platform"), responsible for advising the Commission on the development of these criteria and the usability of the Regulation, reached the end of its 2-year mandate and published its recommendations on Data and Usability[33] as well as a supplementary report to the recommendations made by the Platform in March 2022 with additional technical screening criteria for the other four objectives ((iii) – (vi) above) under the Regulation.[34]

b. EU Sustainable Finance Disclosure Regulation – in force since 10 March 2020

Regulation (EU) 2019/2088[35] on sustainability-related disclosures in the financial services sector (SFDR) aims to enhance the availability and comparability of sustainability information to benefit end-investors interested in sustainable finance. Financial market participants (FMP), as defined in SFDR, (broadly speaking EU buyside firms such as fund managers, firms conducting MiFID investment management activities, pension schemes and insurers) and financial advisers (i.e. firms that conduct MiFID investment advisory activities or which advise on Insurance-Based Investment Products (IBIPs)) are required to provide product level and entity level disclosures. They are also required to classify their products based on their green ambitions and then comply with disclosure and product eligibility requirements that flow from such categorisation.

The level 1 text has been in force since 10 March 2021, however the mandatory disclosure obligations have only applied since 30 June 2021. The level 2 legislation and the relevant technical standards which specify how information should be presented are still being developed and are expected to come into force in July 2023. In the absence of level 2 provisions, the ESAs published on 25 February 2021 a joint supervisory statement[36] which clarifies how the SFDR level 1 rules will apply in the interim.

In general, SFDR rules are likely to result in buyside firms demanding ESG disclosures and information from broker-dealers/banks on their products e.g. debt instruments, derivatives and securitisations, so that they can comply with their entity and product level SFDR obligations. It is expected that they will also result in increased buyside demand for ESG products.[37]

c. Non-Financial Reporting Directive – adopted in 2014, in force since 2018

The Non-Financial Reporting Directive[38] (Directive 2014/95/EU, the NFRD) requires undertakings to disclose non-financial information, i.e. information in respect of human rights, environmental protection, anti-corruption and bribery, gender, education, profession and age diversity, social responsibility and the treatment of employees, in order to enable investors and consumers to assess the impact of businesses on society. It therefore aimed to encourage responsibility around social and environmental issues.

NFRD applies to large public-interest entities with an average number of employees in excess of 500, and to public-interest entities that are parent companies of a large group with an average number of employees in excess of 500 on a consolidated basis.[39] These companies are required to report on how sustainability issues affect their performance, position and development and on their impact on people and the environment – the "double materiality" principle.

33 https://finance.ec.europa.eu/system/files/2022-10/221011-sustainable-finance-platform-finance-report-usability_en_1.pdf

34 https://finance.ec.europa.eu/system/files/2022-11/221128-sustainable-finance-platform-technical-working-group_en.pdf

35 https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R2088&from=EN

36 https://www.esma.europa.eu/sites/default/files/library/jc_2021_06_joint_esas_supervisory_statement_-_sfdr.pdf

37 For greater detail, please refer to AFME's report "Sustainable Finance in Europe: Regulatory State of Play" - https://www.afme.eu/Portals/0/DispatchFeaturedImages/AFME_SustainableFinance2021_06_S.pdf

38 https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0095&from=EN

39 Public-interest entities are defined in the Accounting Directive as companies with securities listed in EU regulated markets, banks (whether listed or not), insurance companies (whether listed or not) and any other companies designated by Member States.

d. Corporate Sustainability Reporting Directive – adopted by the European Parliament and the Council in November 2022

The Corporate Sustainability Reporting Directive (CSRD) improves and enhances the current NFRD sustainability reporting requirements. While the NFRD applies to public interest entities only, the CSRD covers all large EU companies - even if not public interest entities - and all listed EU companies, with just listed micro-enterprises being currently exempted. In-scope entities will have to use the mandatory European sustainability reporting standards (ESRS) - currently developed by the European Financial Reporting Advisory Group (EFRAG)[40] - and the type of sustainability information required to be disclosed under the ESRS includes (among other things) the principal adverse impact key performance indicators (KPIs) required to be disclosed under the SFDR and the information required to be disclosed under the Taxonomy Regulation. In general, reported information should generally be comparable, reliable and easy for users to find and make use of with digital technologies.

The CSRD was adopted by the European Parliament on 10 November 2022[41] and by the Council on 28 November 2022.[42] It will enter into force 20 days after its publication in the Official Journal and it will start applying between 2024 and 2028:

- From 1 January 2024 for large public-interest companies (with over 500 employees) already subject to the NFRD, with reports due in 2025;
- From 1 January 2025 for large companies that are not presently subject to the NFRD (with more than 250 employees and/or €40 million in turnover and/or €20 million in total assets), with reports due in 2026;
- From 1 January 2026 for listed SMEs and other undertakings, with reports due in 2027. SMEs can opt-out until 2028.

1.3. Sustainable Securitisation: EU rules applicable to securitisations directly

The previous section provided an overview of the regulatory landscape surrounding sustainable finance in general. It indicated that securitisation does not fall directly in the scope of the relevant existing laws, they still however influence the securitisation market. This section will present the EU rules which apply to sustainable securitisation directly.

a. EU Securitisation Regulation as amended by the Capital Markets Recovery Package

The EU Securitisation Regulation ((EU) 2017/2402) was entered into force on 1 January 2019 and was partially amended in April 2021 by Regulation EU 2021/557,[43] which is part of the Capital Markets Recovery Package (CMRP),[44] from now on the "SECR". The SECR regulates all types of securitisation, namely both simple, transparent and standardised (STS) and non-STS securitisations, and compared to other regimes around the world, it establishes strict due diligence and disclosure requirements.[45]

40 EFRAG launched a public consultation (April – August 2022) on the draft ESRS exposure drafts which cover a full range of sustainability matters, namely environment, social, governance and cross-cutting standards. EFRAG is also in the process of developing a second set of draft ESRS that will cover sector-specific standards as well as sustainability reporting standards aimed at SMEs, but those are not yet available for consultation.

41 https://www.europarl.europa.eu/news/en/press-room/20221107IPR49611/sustainable-economy-parliament-adopts-new-reporting-rules-for-multinationals

42 https://www.consilium.europa.eu/en/press/press-releases/2022/11/28/council-gives-final-green-light-to-corporate-sustainability-reporting-directive/

43 https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32021R0557&from=EN

44 https://finance.ec.europa.eu/publications/coronavirus-response-how-capital-markets-union-can-support-europes-recovery_en

45 https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32017R2402

In respect of sustainability disclosures, Article 22(4) of the SECR contemplates disclosure by the originator and sponsor of an STS securitisation of information related to the environmental performance of three asset classes, namely residential loans, auto loans and leases. However, the second subparagraph of Article 22(4) and Article 26d(4) for on-balance-sheet securitisations[46] introduced new - under the CMRP – optional "principal adverse impacts" (PAI) disclosures. The articles read "[…] By way of derogation from the first subparagraph, originators may, from 1 June 2021, decide to publish the available information related to the principal adverse impacts of the assets financed by the underlying exposures on sustainability factors." Additionally, pursuant to the same Articles, the ESAs were mandated to deliver the relevant RTS which would specify the content, methodologies and presentation of such PAI disclosures. As briefly mentioned previously, the consultation was launched in May 2022, and publication of the final RTS is pending at the time of publication of this report. (The section "Live Regulatory Issues" below will present the consultation in greater detail.)

b. Proposal for a standard for European green bonds – adopted on 6 July 2021

On 6 July 2021 the European Commission published its legislative proposal for a regulation on a voluntary European Green Bond Standard (EuGBS).[47] The proposal is part of the EU's wider agenda on sustainable finance and lays out the foundation of a common framework of rules for green bond issuers (including the public and private sector, financial and non-financial undertakings, issuers located in and outside the EU) who wish to use the EuGBS designation.

According to the proposal, the proceeds raised by the green bond must be used exclusively for the purposes of financing EU Taxonomy aligned assets or projects, namely products which pursue the environmentally sustainable objectives set out by the EU Taxonomy Regulation (please see section 1.2(a) above). The allocation of proceeds must be reported in full transparency so to reduce the risk of greenwashing and ensure investors' protection. Issuers will also have to undergo a pre- and post-issuance review by an external reviewer who will verify compliance of the green bond with the EuGBS requirements and the Taxonomy Regulation. Such external reviewers will have to be registered with and supervised by the European Securities and Markets Authority (ESMA). The EuGBS therefore introduces a high standard of sustainability requirements and is envisaged to set a "gold standard".

True-sale securitisation is also meant to be covered by the framework, however the European Banking Authority's (EBA) report on sustainable securitisation (please also see below) suggested certain adjustments.[48] Firstly, the EuGBS requirements should apply at the originator level rather than at the level of the securitisation special purpose enterprise (SSPE) provided that the originator commits to using all the proceeds from the green bond for the generation of new green assets.[49] This is due to the role of the SSPE in a securitisation structure. The SSPE is normally set up to carry out a single transaction, namely the purchase of the portfolio of loans (e.g. mortgage loans, SME loans or auto loans) which are going to be securitised. If the "use of proceeds" requirement applied to the SSPE, the purchase itself of the securitisation portfolio would be seen as the allocation of proceeds for the purposes of obtaining the EuGBS designation. The underlying portfolio of assets would then need to be "green" itself, namely aligned with the EU Taxonomy Regulation and the relevant screening criteria. However, as there are currently few Taxonomy-aligned assets, such requirement would result in actually limiting the potential growth of the EU green securitisation market. On the contrary, applying the "use of proceeds" requirement at the originator level, as suggested by the EBA, would help build deeper pools of green collateral to securitise, which would ultimately also lead to a greener economy.

46 The term means synthetic securitisation.

47 https://ec.europa.eu/commission/presscorner/detail/en/ip_21_3405

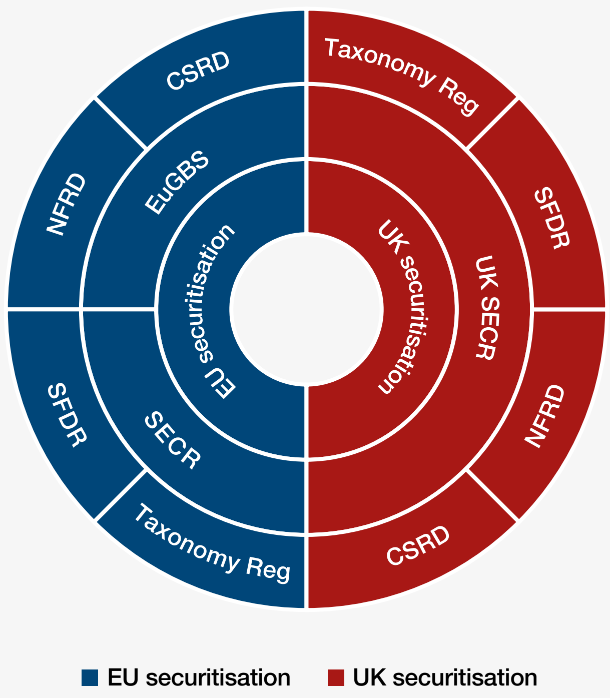
48 https://www.eba.europa.eu/eba-recommends-adjustments-proposed-eu-green-bond-standard-regards-securitisation-transactions

49 Please also see the Opinion of the European Central Bank of 5 November 2021 which states (in paragraph 3.1.5) that "For green transitional securitisations, obligations related to future taxonomy compliance are relevant for the originator, not for the issuer special purpose vehicle."

Secondly, the EBA suggested that EuGBS disclosure requirements should apply in order to ensure that investors are made aware of the green characteristics of the underlying securitised assets and to limit the risk of the "adverse green selection of assets". Such risk, in the EBA's view, may occur if originators are incentivised to invest in new assets which are significantly environmentally harmful with a view to securitising them through an EuGBS and to benefit from a positive pricing differential, and/or to sell off their legacy "brown" collateral to securitisation investors and to keep the "high-quality green" collateral on their balance sheet. According to the EBA, reporting under the EuGBS disclosure framework should also be adjusted to be compatible with Article 7 ("Transparency requirements for originators, sponsors and SSPEs") of the SECR, as this would ensure investors' access to all securitisation specific information. The proposed adjustments, as presented above, are seen by the EBA as an intermediate step which will allow the sustainable securitisation market to develop, until the EU economy, currently transitioning, becomes "greener". Logically, during this transition securitisations with green collateral pools would also qualify as green securitisations, as presumably intended at the end of the transition.

In respect of establishing a framework for green synthetic securitisation, the EBA acknowledged the benefits that synthetic securitisation could contribute to a more sustainable economy but noted that more time is needed in order to assess whether and how the specificities of synthetic securitisation could be reflected in a green framework. This is equally relevant to green private securitisations many of which also fall outside the EuGBS but are equally important in financing the green transition of the real economy. The EBA's suggestion that synthetic securitisation should be excluded – at least for now – from the scope of the EuGBS is further analysed in the following section.

Figure 6: **The regulatory landscape surrounding sustainable securitisation**



Live Regulatory Issues

This section aims to present the latest regulatory developments in respect of sustainable securitisation. These include the EBA report on developing a framework for sustainable securitisation, the joint consultation paper of the ESAs on STS sustainability disclosures, the European Commission's report on the functioning of the SECR and the ongoing trilogue negotiations[50] on the EuGBS. AFME views will also be presented.

EBA report on developing a framework for sustainable securitisation – published 2 March 2022

The CMRP introduced a mandate to the EBA to publish a report on developing a specific sustainable securitisation framework "for the purpose of integrating sustainability-related transparency requirements" into the SECR.[51] The EBA's report on sustainable securitisation was published on 2 March 2022,[52] and apart from the proposed adjustments to the EuGBS, as mentioned in section 1.3(b) above, it also assessed the implementation of proportionate disclosure and due diligence requirements relating to sustainability factors and how to give shape to a specific sustainable securitisation framework that mirrors or draws upon SFDR and the Taxonomy Regulation.

In relation to sustainability-related disclosures and due diligence, the EBA's overall view is that no additional mandatory ESG due diligence requirements are necessary for securitisation specifically, given that Articles 5 ("Due-diligence requirements for institutional investors") and 7 ("Transparency requirements for originators, sponsors and SSPEs") of the SECR already impose detailed due diligence requirements, and investors' ESG due diligence assessments will be further facilitated by the enhanced transparency regime which is meant to be introduced in the upcoming EuGBS. However, according to the EBA, the improved availability of standardised data on the PAI of securitisation investments on ESG factors is key to the transition of the EU securitisation market towards further sustainability, so the EBA proposed (i) the extension of PAI disclosures to non-STS securitisations, (ii) adjustments to the ESMA templates to ensure that the loan level data provided in these templates are relevant for the calculation of the PAI at transaction level for those transactions within the scope of the RTS and (iii) making PAI disclosures mandatory for all securitisation in the medium term once the EU sustainable securitisation market has further matured and more experience has been gained on the implementation of sustainability-related disclosures for securitisations.

Regarding the development of a sustainable securitisation framework, the EBA concluded that "it is too premature to establish a dedicated framework for green or social securitisation in addition to the EuGBS and that priority should be given to ensure a proper implementation of the EuGBS to securitisation". Further, a dedicated framework may be appropriate "once the EU economy has further transitioned, more green assets become available and the use of proceeds (UoP) approach becomes less relevant".

As also noted in section 1.3(b) above about green synthetic securitisation, the EBA has adopted a position of "wait and see". The report states that "more time would be needed to assess whether and how the specificities of synthetic securitisation should be reflected in a green framework, especially given that no green standard has been considered yet for any credit protection instrument. It is therefore proposed that the EBA is mandated to monitor the development of the EU green synthetic securitisation market and, if appropriate, further investigate the relevance and potential content of a framework for green synthetic securitisation".

50 Trilogues are tripartite meetings on legislative proposals between representatives of the European Parliament, the Council and the European Commission. Their purpose is to reach a provisional agreement on a text which will then need to be approved by both the Parliament and the Council. For more information, please see here.

51 Art.45a of the SECR as amended by CMRP.

52 https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Reports/2022/1027593/EBA%20report%20on%20sustainable%20securitisation.pdf

The challenges that the EBA posits in relation to the creation of a green synthetic securitisation framework centre on the following arguments:

- The synthetic securitisation market is mostly private and of a bespoke nature. Institutional investors with long-term horizons often require tailored conditions to invest in synthetic securitisation. These investors would also likely require their own ESG criteria to be reflected in the transaction before entering into a green synthetic deal.

AFME view: Investor requirements for assets to satisfy their own ESG screening criteria is as true for public as it is for private securitisations. Investors falling within the scope of SFDR will nevertheless need to report relevant holdings, and therefore exclusion of this important asset class will ensure that incomplete information is reported.

- Measuring and monitoring the redeployment of capital to green assets is difficult. In a green use of proceeds synthetic securitisation, the amount of assets generated by the transaction would be dependent on the credit risk associated with the green assets. As a result, to ensure proper monitoring of the green use of proceeds in the context of synthetic securitisation, the exact capital charges of the newly generated green assets would need to be known and disclosed.

AFME view: It will be incumbent upon banks to provide this information in time. There are already precedents in the public sector that use proxies to monitor such activity, e.g. originating banks partnering with the European Investment Fund (EIF) on funded and synthetic significant risk transfer (SRT) transactions which must report new originations based on a multiplier established on day one, depending on at what point in the capital structure the EIF is assuming risk.

- The prudential implications of green synthetic securitisation are uncertain at present due to the lack of evidence/data on the credit risk performance of green assets.

AFME view: This is equally the case for true-sale securitisations or indeed any financial instrument issued under the EuGBS.

- No green framework is currently envisaged for other types of credit protection instruments. Like true-sale green securitisation, before establishing a specific framework, a holistic view would need to be gained on the need and the design of a framework for green credit protection instruments, including credit derivatives and financial guarantees.

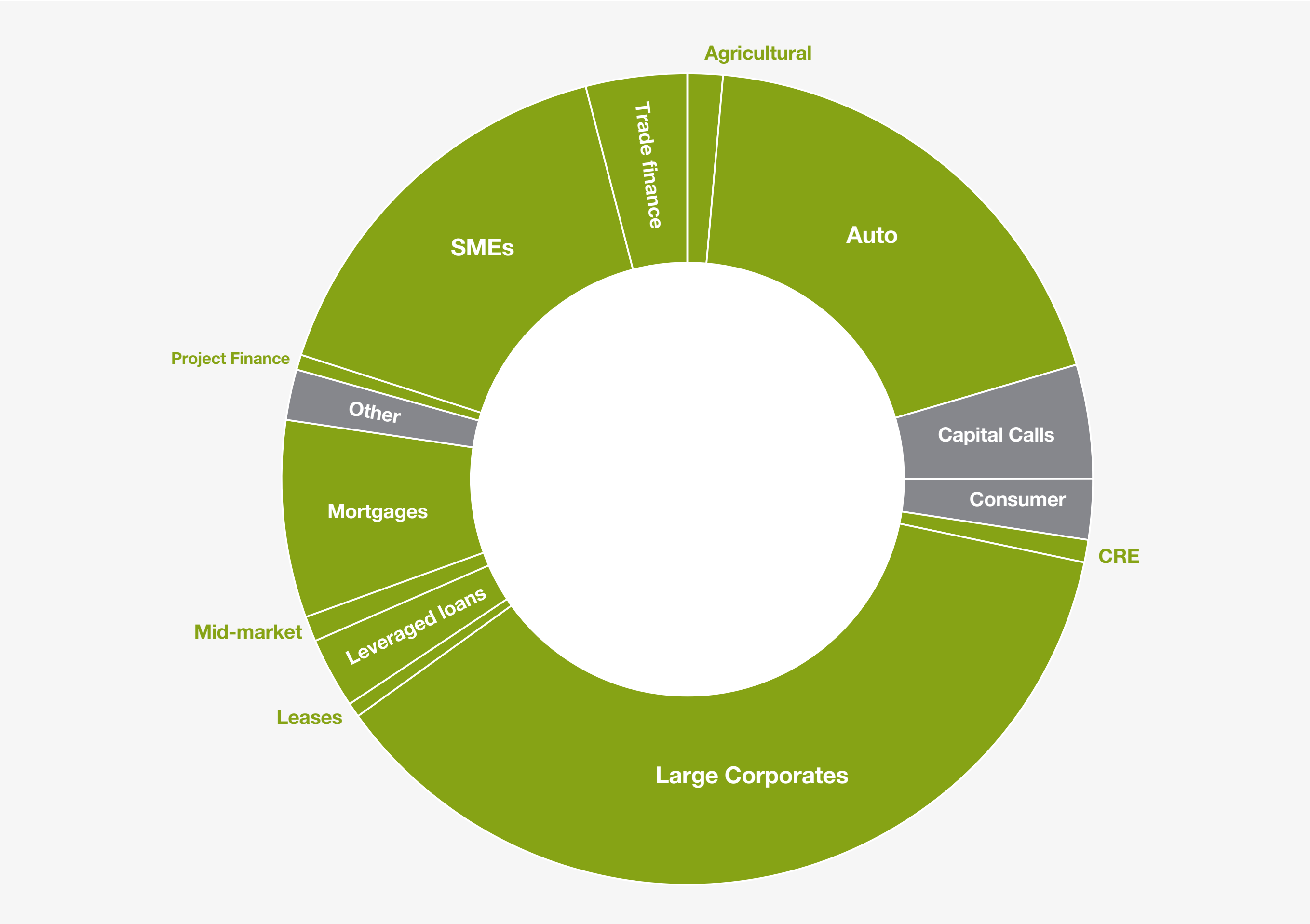
AFME view: Many synthetic securitisations take the form of credit-linked bonds issued by the originator bank itself, from a legal standpoint therefore they are very similar to other green bonds issued by banks.

"A framework for green synthetic securitisation is very relevant for the growth of the green securitisation market. Its exclusion from the scope of the EuGBS comes at the cost of the market itself"

In AFME's view, a framework for green synthetic securitisation is very relevant for the growth of the green securitisation market. Synthetic securitisation is a particularly useful tool in transferring credit risk from the banking sector and recycling bank capital into new lending, which is particularly the case for ESG lending. Additionally, certain asset classes, such as project/infrastructure finance and SME lending, are better suited for synthetic securitisation than true-sale securitisation given the challenges that arise in the latter around asset transfer to a special purpose vehicle (SPV). The importance of SME lending as part of the CMU project and the prolific use of project finance to fund renewable developments, such as photovoltaic and wind farms, highlight the relevance of synthetic securitisation to the purpose of the EuGBS which is to help finance sustainable investments.

The following chart provides an overview of the European SRT securitisation market in 2021,[53] and the asset classes which have been marked green are those who can be used in synthetic SRT deals for green purposes. Loans to large corporates, auto loans, loans to SMEs and mortgage loans represent the largest part of the market followed by trade finance, leveraged loans, agricultural loans, mid-market loans, commercial real estate loans, project finance and leases. Consequently, synthetic securitisation's exclusion from the scope of the EuGBS comes at the cost of the market itself. It doesn't allow it to grow and reach its full potential. In 2021, capital supporting €70 billion of banks' assets was recycled through synthetic SRT transactions. Based on the above deductions, 85% of assets referenced may be eligible as green.

Figure 7: **Green asset classes in synthetic SRT transactions**



53 SCI data.

Joint Consultation Paper: STS securitisations-related sustainability disclosures (2 May 2022 – 2 July 2022)

On 2 May 2022, the ESAs published a consultation paper which sets out draft RTS (the "Draft RTS") on the content, methodologies and presentation of information in respect of the sustainability indicators in relation to adverse impacts on the climate and other environmental, social and governance-related adverse impacts.[54] As per above, this is linked to the optional PAI disclosure provisions for STS securitisations introduced in the SECR by the CMRP.

The consultation paper makes clear that the objective of the RTS is not to establish a framework for "sustainable securitisation" but rather to ensure a high degree of consistency with the disclosure framework developed under the SFDR. The draft RTS cover STS non-ABCP traditional securitisations and synthetic securitisations where the underlying exposures are residential loans, auto loans and leases, but the consultation paper also aimed to solicit market participants' feedback on whether the disclosure requirements should be extended to other asset classes, such as commercial real estate, SME loans, corporate debt and trade receivables as well as credit card debt and consumer loans.

AFME's response[55] to the consultation paper pointed out a number of areas which could prove problematic for market participants and made certain suggestions for the improvement of the proposed level 2 text. For example, aligning the metrics required to be disclosed under the SECR and the draft RTS to their equivalents already defined in the SFDR or NFRD is a good instinct, it is only helpful however when those reporting under the SECR are already familiar with those other regulations/directives, either because they already have regulatory reporting obligations under them or because they have already built the required systems in order to satisfy the demands of their investors.

As noted in the previous section, SFDR generally imposes reporting responsibilities on "financial market participants" (as defined therein) and NFRD mainly imposes ESG reporting obligations on "large undertakings" which are "public-interest entities" (as those terms are defined in NFRD) exceeding an average of 500 employees during the financial year or public-interest entities which are parent undertakings of a large group meeting the same 500-employee criterion.

While these definitions mean that a significant number of market participants representing a large proportion of market volumes will need to be familiar with this type of reporting at an institutional level, this familiarity is broadly limited (at the moment) to the largest undertakings who have the most sophisticated reporting systems and are best able to bear those burdens. SMEs and new market entrants tend to be excluded from these reporting requirements. Imposing, therefore, significant additional detailed reporting requirements on originators who are not already institutionally familiar with the requirements of other legislation can actually disincentivise the financing of those assets via STS securitisation, especially if equivalent ESG reporting would not be required, if those assets were financed in other ways (e.g. bank loans or covered bonds/other forms of secured instruments).

Additionally, the Draft RTS require the relevant information to be disclosed quarterly starting a month after the first interest payment date on the transaction which is too late for investors in the primary markets who would need this information along with the initial offering documents if they are to use it to inform their investment decisions. From a market utility point of view, this information should be made available prior to pricing and it should thereafter be updated at most annually, particularly since the sustainability factors required to be reported on are likely to be extremely stable in respect of a given asset, and therefore unlikely to change materially over the life of a transaction with a static pool.

54 https://www.esma.europa.eu/sites/default/files/jc_2022_22_joint_consultation_paper_on_sustainability_disclosures_for_sts_securitisations_0.pdf

55 AFME's full response to the consultation is available on AFME's website – here.

In respect of supervision, the consultation paper states that the responsibility of supervising the ESG disclosures on securitisations should be kept separated from the supervision of certain provisions of the SECR, it does not, however, clarify how the supervision of ESG disclosures should operate. Since the disclosures provided for under the Draft RTS are required only of STS securitisations, supervision of these disclosures should be coordinated with the supervision of STS more generally, but ESG disclosure should be separate from, and supplemental to, Article 7(1)(a) disclosures of the SECR. National competent authorities designated for the purpose of supervising STS matters should therefore also supervise compliance with the requirements to be introduced under the Draft RTS, and since the disclosures contemplated under the Draft RTS are very largely derived from other legislation with separate supervision mechanisms, it would be appropriate to ensure there is a requirement for the relevant supervisors (e.g. those appointed to supervise compliance with the Draft RTS, and those referred to in Article 14 of SFDR) to coordinate to ensure consistent interpretation of equivalent requirements.

In respect of the means of disclosure, the Draft RTS "build[s] on the existing infrastructure for the disclosure of public securitisation information foreseen in Article 7 of the Securitisation Regulation, namely the Securitisation Repositories". While, broadly speaking, this is a sensible approach, the consultation paper fails to clarify the means of disclosure required for private securitisations.

Lastly, the draft RTS contains no transitional provisions which would allow sufficient time for originators to prepare until the final RTS is finalised. Considering the need for originators to put in place systems to collect and accurately report the requested information, a minimum of six months or longer between the publication of the final RTS in the Official Journal and its application would be appropriate. If this extra time to prepare is not provided, a significant portion of the market may simply opt not to provide the information contemplated by the Draft RTS, preferring to continue complying with the requirement to "publish the available information related to the environmental performance of the assets" as part of the Article 7(1)(a) SECR reporting instead. Realistically, market participants are likely to make the judgment that the resulting additional and unnecessary friction in the market would be undesirable, but nonetheless preferrable to possible regulatory liability for failing to properly comply with the Draft RTS.

The consultation period closed on 2 July 2022 and the publication of the final RTS is pending.

Report from the Commission to the European Parliament and the Council on the functioning of the Securitisation Regulation – published on 10 October 2022

The European Commission's report on the functioning of the SECR presented (amongst others) the Commission's position on sustainable securitisation. The Commission's assessment took into account the EBA report mentioned above and its relevant proposals with regards to both sustainability disclosures and the EuGBS.

The Commission agreed with the EBA that given the low amount of green assets available to be securitised, there is no scope at present for creating a dedicated sustainability label for securitisations, the European Parliament and the Council were therefore invited to take into account the EBA's recommendations in the context of the ongoing negotiations on the EuGBS (please see below).

In respect of sustainability disclosures, the Commission recognised the need for principal adverse impact disclosures and noted that the scope of the upcoming RTS from the ESAs should be as wide as possible, meaning that disclosure requirements should be extended to securitisations where the underlying exposures are not residential loans, auto loans or leases.

The report also invited ESMA to review the disclosure templates in order to "address possible technical difficulties in completing the information required in certain fields, remove possibly unnecessary fields and align them more closely with investors' needs". ESMA was also encouraged to draw up a single, simplified template for private securitisations and specifically consider whether information on a loanby loan basis is useful and proportionate to investors' needs for all types of securitisations. The ESMA review started in October 2022.

"The Commission agreed with the EBA that given the low amount of green assets available to be securitised, there is no scope at present for creating a dedicated sustainability label for securitisations"

Ongoing discussions on the EU Green Bond Standard

As noted above, the EuGBS is a voluntary standard proposed by the European Commission in order to "help scale up and raise the environmental ambitions of the green bond market". The EBA's report highlighted the importance of the EuGBS for the growth of the green securitisation market and recommended that the EuGBS requirements should apply to the originator of a securitisation rather than to the SSPE. This recommendation was also supported by the Commission, and co-legislators were invited to take it into account in the context of the ongoing political negotiations.[56]

Under the UoP approach, suggested by the EBA and under consideration by EU legislators at the time of writing, the originator will have to show that it uses the proceeds from the securitisation for 100% Taxonomy-aligned assets in the time following the issuance of the bond. At the same time, it will have to provide information concerning the green characteristics of the underlying portfolio, information that investors may not be receiving currently according to the disclosure requirements for securitisations under the SECR. The main advantages therefore of this approach is that it is conducive to the development of the securitisation market (for the reasons outlined in section 1.3(b) above) and offers increased transparency on the underlying assets which - where available - will allow for informed investment decisions. However, as the ESMA disclosure templates are under review at the time of publication of this report, the right balance must be found in terms of disclosure requirements. If the ESMA templates are going to be simplified, as anticipated by market participants given the Commission's assessments in its report (mentioned above), this should be taken into consideration in the design of reporting obligations under the EuGBS.

In addition, the green transition, as contemplated by the EBA report (mentioned above), may entail challenges that the EU policymakers will need to consider after the EuGBS has been adopted. These relate to asset class specificities, country specificities and availability of data, as further explained below:

- **Asset class specificities:** Securitisation is a tool to finance a broad array of asset classes, for example, residential mortgages, consumer loans, auto loans, leases, SME loans, accounts receivable, leveraged loans, commercial mortgages, project finance/ infrastructure loans, corporate loans etc. Multiple metrics may be used to measure taxonomy compliance across these asset classes. Levels of preparedness of industries and levels of maturity of these markets in relation to ESG will vary by asset class meaning that the rate of development will also vary substantially.

- **Country specificities:** Metric inputs and metrics used within member states vary substantially such that the same loan in one country may have a very different "green score", for example, to that in another country. The lack of standardisation needs to be addressed for a meaningful interjurisdictional comparison to be made.

- **Availability of data:** There remains significant lack of data across asset classes and jurisdictions, and availability of data varies substantially across both factors. Until such time there is robust available data, the envisaged transition to a greener economy is of limited value.

56 Trilogues dates are: 12 July 2022, 18 October 2022, 16 November 2022 and 14 December 2022.

Annex – Potential Growth of Securitisable Green Lending by 2030

Securitisable Green Lending To Households In Major European Markets Could Exceed €300 Billion Annually By 2030

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The potential scale of future green securitisation issuance is intrinsically linked to the future volume of underlying green collateral origination. In this article, we develop plausible scenarios based on current information and high level assumptions to estimate the possible annual origination volume by 2030 for three types of securitisable green assets: residential mortgage loans on energy-efficient properties, mortgage further advances for green renovation, and electric vehicle financing. We caution that 2030 is a distant horizon given the significant remaining uncertainty around the pace of energy transition, so these scenarios could be subject to change. We only consider countries with an active securitisation market.

Residential mortgage loans for energy-efficient properties

Although the first green-labelled European residential mortgage-backed securities (RMBS) issuance was as long ago as 2016, volumes have never taken off. One reason commonly cited for this is the perceived lack of underlying green mortgage loan collateral. However, recent regulatory developments could help bring greater clarity, leading to a significant portion of mortgage lending on existing residential properties being considered green.

At the beginning of 2022, new EU rules came into effect, establishing technical screening criteria (TSC) for the climate change adaptation and mitigation objectives that are part of the EU's wider taxonomy for environmentally sustainable activities. According to these criteria, the acquisition and ownership of residential buildings constructed before 2021 contributes to climate change mitigation if the building has an Energy Performance Certificate (EPC) of at least class A or is within the most energy-efficient 15% of the relevant residential building stock.

The low share of buildings with a class A EPC may be restrictive for green mortgage origination in some securitisation markets. (In England and Wales, for example, only 0.2% of the domestic properties with an EPC achieve the highest energy efficiency score, according to the U.K. government's EPC database.) However, the alternative "top 15%" requirement would by definition mean that a significant proportion of mortgage lending could be in line with the TSC of the EU Taxonomy.

Across eight key European RMBS markets—Belgium, France, Ireland, Italy, the Netherlands, Portugal, Spain, and the U.K.—we estimate that there could already be **€125 billion** annually in gross green mortgage lending, and we assume this remains broadly flat through 2030. This figure is based on 15% of overall mortgage origination volumes and assumes that annual financing requirements for energy-efficient properties follow similar patterns to the market average. It substantially exceeds recent volumes of about €40 billion per year for all investor-placed European RMBS, let alone the muted €3 billion in green RMBS issued in 2021.

However, using a more liberal definition of green mortgage lending means that the roadblocks to further green RMBS issuance lie in originators' ability to identify this pool of underlying collateral and evidence that it meets the required standards. In the years leading to 2030, increased penetration and harmonization of EPC schemes across Europe could help to unlock more of this collateral as an input for green RMBS.

Lending for green home renovation

According to the European Commission, buildings account for 40% of EU energy consumption and more than one-third of greenhouse gas emissions (see "In Focus: Energy Efficiency In Buildings", published Feb. 17, 2020). As authorities commit to emissions reduction targets, European homeowners will likely have increasing incentives to undertake home improvements that improve the energy efficiency of their property and reduce its carbon footprint.

Launched in 2020, the EU's Renovation Wave strategy outlined an action plan to at least double the current 1% rate at which the existing building stock is being renovated to foster greater energy efficiency. Proposed changes to the Energy Efficiency Directive call for the authorities to lead the way with a 3% annual renovation rate on public sector buildings.

National authorities may adopt a variety of policies to increase the renovation rate in this way, to create incentives beyond homeowners' projected long-term savings on energy bills. Individual countries may also adopt different models that mix public and private sector funding to facilitate this work. However, it seems likely that a portion of renovation costs will be self-funded by homeowners, and many mortgage lenders are currently developing and launching loan products to capitalize on the anticipated boom in energy renovation-related borrowing.

Considering the same eight European RMBS markets mentioned above, we estimate that a 3% renovation rate of the residential building stock by 2030 could generate an annual funding requirement of about **€75 billion**, which may partly be addressed by further mortgage advances that are securitisable. This figure assumes a fully-funded typical renovation cost of about €17,000 per property.

Electric auto financing

The electrification of the European light vehicle fleet will likely also be a strong source of growth in origination volumes of securitisable green collateral. As little as three years ago, auto financing secured on battery electric vehicles (BEVs) was a rarity in European auto ABS collateral pools, given that BEVs' share of new vehicle registrations was only around 1%-2% in most European markets. This has quickly changed, however, and we are now seeing European auto ABS with more than 10% of the collateral pool secured on BEVs. Although vehicles with hybrid electric and internal combustion engine transmissions have also accounted for a significant share of sales in recent years, from 2025 the standard for green cars (based on the TSC in the EU Taxonomy) will be for zero carbon dioxide tailpipe emissions, so we focus here only on the financing of fully-electric BEVs.

Industry projections suggest that new BEV sales could grow at a compounded annual rate of 20%-30% this decade, resulting in around 10 million annual unit sales by 2030. Considering only the five major European auto ABS markets—France, Germany, Italy, Spain, and the U.K.—we estimate that this would correspond to €80 billion in securitisable financing per year on new BEVs alone. This figure assumes that new BEV prices converge toward the current average of about €35,000 across these countries, and that funding patterns are unchanged. By the end of the decade, as the BEV market matures, there could be a further €30 billion in annual financing required for used BEVs—a market which is so far relatively under-developed.

Notes

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