

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 2030². 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 <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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