UPDATE

ESG – Sustainable Securitisation Report

One of the amendments to the EU Securitisation Regulation[1] which came into force in April 2021 required the European Banking Authority ("EBA") to publish a report on developing a sustainable securitisation framework to integrate sustainability-related transparency requirements into the EU Securitisation Regulation. The EBA published this report, *Developing a Framework for Sustainable Securitisation*, on 2 March 2022 (the "Report").

In terms of the overall state of the EU sustainable securitisation market, the Report concludes its development to date (compared to the US and Chinese markets) has been hampered by a lack of available sustainable assets and the absence of a definition, standards, and data to foster transparency and credibility in the market.

The Report particularly focuses on: (i) how the EU green bond standard ("GBS") can be applied to securitisations; (ii) the relevance of a dedicated framework for sustainable securitisation at this time; and (iii) the nature and content of sustainability-related disclosures for securitisation products.

EU GBS Regulation Applicability to Securitisations

One of the key areas that the EBA explores in the Report is the application of the EU GBS. As further described in our client update last year[2], the European Commission proposed the EU GBS regulation[3] to make the EU's financial system more sustainable by creating a voluntary 'gold standard' for green bonds. The focus of the EU GBS is to ensure that funds raised by the underlying bond are exclusively allocated to finance economic activities that are either environmentally sustainable projects or contribute to the transformation of activities to become environmentally sustainable.

The EBA recommends that the EU GBS should also apply to securitisation in order to ensure a level playing field across all types of green bond instruments. The Report recognises, however, that certain adjustments to the EU GBS will be necessary to make it appropriate for securitisation. Two such adjustments are:

a) The EU GBS requirements (including the use of proceeds, disclosures and sanctions) apply in the first instance to the bond issuer. However, in the securitisation context the Report recognises this should be switched to apply at the originator level. This would also allow a green securitisation to have non-green assets, so long as the use of proceeds by the originator qualifies. This is an important accommodation while the supply of green assets is built up in the real economy; and

[1] Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012

[2] European Commission Proposed Green Bond Standard, July 2021. https://maples.com/en/knowledge-centre/2021/7/european-commission-proposed-green-bond-standard

[3] 2021/0191 COD.

b) The reporting of the EU GBS disclosure framework should be adjusted to make it compatible with Article 7 of the Securitisation Regulation.

Dedicated Framework for Sustainable Securitisation

Given the EBA's recommendations with regard to the EU GBS, it is unsurprising that the Report finds that it is not appropriate to establish a specific framework for green securitisation at this time. The EBA's view is that it is premature to establish a dedicated framework in addition to the EU GBS when the EU GBS has not been adopted yet. The EBA also specifies that the EU green securitisation market is still at an early stage of development. Therefore, it is too early to develop a dedicated framework and indeed it might create risks by not being suited to the demands of investors and issuers. The Report envisages that a dedicated framework might become relevant in the future once more green assets are available and the market has developed.

Sustainability-Related Disclosures for Securitisation

The Report concludes by re-emphasising that investors need to be able to perform due diligence and issuers / originators need to be able to provide clear and transparent disclosure of ESG factors in order for the sustainable securitisation market to grow. The EBA advises that no additional investor ESG due diligence requirements are necessary for securitisation specifically. However, the Report does make several other recommendations, including that the application of principal adverse impact disclosures should be extended to non-STS securitisations.

Next Steps and Implications for CLOs

Based on the Report and the EBA's recommendations, the European Commission will submit its own report to the European Parliament and the EU Council on creating a sustainable securitisation framework. The publication of the EBA report is a welcome development, and both the Report and the anticipated report from the European Commission will generate further momentum in the growing EU sustainable securitisation market.

The implications for CLOs of extending the EU GBS rather than introducing a dedicated framework for sustainable securitisation remain to be seen. While the proposed adjustments to the EU GBS to accommodate securitisation generally are very welcome, they may not fit secondary market securitisation activity such as CLOs given the issuance proceeds do not flow to a single asset-level originator.

However, the CLO product has already made material progress towards sustainable securitisation objectives driven by both investor appetite and manager policy, initially by the adoption of ESG negative screening and latterly by the positive application of ESG manager methodology / scoring. Further, we anticipate some EU MiFID managers may in 2022 print the first Article 8 Sustainable Finance Disclosure Regulation compliant CLOs. Further, as the ESG asset supply increases over time CLOs will in turn naturally access sustainable securitisation frameworks and labels.

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