

In Practice

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The Draft RTS on ESG disclosures for STS securitisations: a hit or a miss?

Draft technical standards concerning sustainability disclosures aim to make STS securitisations more appealing from an ESG investment perspective. This In Practice article examines the proposed regime and identifies some practical shortcomings.

PROPOSED REGIME

Securitisations fall outside the Sustainable Finance Disclosures Regulation (SFDR) framework,¹ which excludes them from the definition of “financial products”. With investors increasingly focusing on disclosure of environmental, social and governance (ESG) impacts when implementing their investment strategies, it is essential to include structured debt products in the ESG regulatory regime. Draft regulatory technical standards concerning sustainability disclosures for STS securitisations (Draft RTS)² proposed under the EU Securitisation Regulation³ could present the first step towards standardising ESG disclosure for securitisations more generally, in an effort to making the industry more appealing from this perspective. However, the Draft RTS propose a burdensome layer of disclosures while offering limited benefits. This In Practice article examines the regime the Draft RTS propose, and identifies some practical shortcomings.

Currently, simple, transparent and standardised (STS) securitisations of auto loans and leases or residential loans are subject to standardised environmental disclosure requirements. Articles 22(4) and 26d(4) of the EU Securitisation Regulation require information relating to the environmental performance of the underlying assets to be made available as part of the Art 7(1)(a) disclosures for true-sale and synthetic securitisations backed by residential loans or auto loans/leases to be eligible for STS status.

The Draft RTS provide an alternative whereby originators can instead publish a statement on the principal adverse impacts (PAIs) on sustainability factors of the assets financed by the underlying exposures of their transaction, according to templates appended to the Draft RTS (the Templates). The Templates' metrics closely track their equivalent under the SFDR, Taxonomy Regulation and Non-Financial Reporting Directive and take the form of a stand-alone PAIs statement. However, the scope of the Draft RTS is much broader than under such other legislation as it covers all originators, including small and medium-sized enterprises (SMEs) and other new market entrants as well as financial institutions and large public-interest undertakings.

The Templates vary between residential loans and auto loans/leases and contain both mandatory and optional ESG indicators ranging from greenhouse gas emissions to waste. While not part of its compulsory mandate, the European Banking Authority (EBA) also included the option of disclosing PAIs in relation to other asset classes including trade receivables. Understandably, no templates have been included for credit card receivables and consumer loans given that the credit granting entity for these asset classes frequently does not know what asset is financed by the underlying exposure.

PRACTICAL SHORTCOMINGS

The proposed optional ESG disclosure obligations are a good initiative to try to cure the current lack of consistency in the securitisation market for originators who are already institutionally familiar with the requirements of other legislation. However, if made compulsory, the burden on smaller or newer originators that are neither acquainted with these obligations nor possess the required systems to meet them risks disincentivising the use of STS securitisation, especially if bank loans or other forms of secured instruments would not require such disclosure to finance assets. In addition, the Templates require a significant amount of information – for instance, there are 22 indicators for residential real estate assets if all optional indicators are filled. Originators might also not possess the data required to fill these metrics; for example, the unadjusted gender pay gap metric of the manufacturer of vehicles backing the assets in an auto asset-backed security transaction may not be known by the originator if this company is not party to the documentation and the information is not publicly available. Some metrics also seem superfluous, such as the non-green asset ratio that is not required under the SFDR. In respect of timing, the Draft RTS mention aiming to ensure that investors are in a position to make informed decisions concerning the sustainability impact of their investments; however, the Draft RTS also propose that the PAI statement be made available as part of Art 7(1)(a) disclosure. This would mean the statement would not be available when investors make their decisions but only a month after the first interest payment date on the transaction. Additionally, making the information available quarterly is a burden that might not be useful to investors since sustainability factors are likely to be stable in respect of a given asset within a static pool. It is also unclear that updates to the disclosure would not be required unless the originator becomes aware of updated information in the course of its ordinary business or interactions with an obligor and would therefore form part of the originator's quarterly reporting. Finally, the Draft RTS propose to use repositories for the disclosure required for public securitisations but do not clarify the means of disclosure for private transactions.

CONCLUSION

The EBA hinted that creating a market for sustainable securitisation will require ESG disclosures to be extended to non-STs transactions and other asset classes on a mandatory basis. The Draft RTS constitute an important first step in this direction; however, they create a heavy burden in terms of the amount, frequency and type of disclosure that would need to be simplified if it is to be applied more broadly, especially with regards to SMEs and new market players. ■

¹ Regulation (EU) 2019/2088.

² Draft Regulatory Technical Standards with regard to the content, methodologies and presentation of disclosures pursuant to Art 22(4) and 26d(4) of Regulation (EU) 2017/2402.

³ Regulation (EU) 2017/2402.