

Sustainability indicators for ABS
5 October 2021

Introduction: enhancing ESG transparency of securitised markets

Growing demands from asset owners and greater regulatory scrutiny are driving the investment industry. Clients require information not only on portfolio ESG performance, but are also asking for transparency on underlying assets, and if appropriate, stewardship. This extends across traditional and alternative investments.

Unlike for corporate bond and equity markets, the Asset-Backed Securities (ABS) investment universe (which includes mortgage-backed securities, commercial-backed securities, auto loan securitisations, collateralised loan obligations, whole business securitisation), often suffers from a paucity of relevant and standardised ESG information.

There are no third-party sources of ESG data for the ABS investment universe: rating agencies that provide credit assessments on ABS do not typically opine on ESG unless it materially impacts their credit assessment.

Lacking relevant and standardised data can make it difficult for investors to accurately and effectively appraise ESG risks. ABS are therefore penalised as an asset-class as regulators and clients set more sustainability-related requirements.

In the EU, we are slowly starting to see some improvements with environmental reporting for auto-loans and RMBS thanks to securitisation regulations. Regulation (EU) 2017/2402 requires originators and sponsors to disclose the available data on the environmental impact of assets underlying STS securitisations. However, it only applies to STS securitisation (30% of the market) and does not require environmental data to be made available for all deals but simply for it to be published if it is readily available.

The sustainability-related information published under ESMA's template and/or data loan tapes are therefore inconsistent from one deal to another. Information on the environmental performance of assets is not only needed to respond to the growing demands from asset owners to evaluate their ESG footprint but it is also imperative to allow the buy-side to comply with greater new regulatory disclosure requirements (such as SFDR).

Key performance indicators (KPIs) are not a silver bullet but they are essential. They can provide standardised raw information for further analysis by asset managers (i.e., collection of qualitative information and due diligence) to improve comparability of companies' or assets' performance. Adopting KPIs for each sub-asset class can also facilitate the reporting process and transparency on material sustainability issues to underlying investors.

Anticipating the formal adoption of the mandate given to the ESAs to develop sustainability indicators for securitised assets by 10 July 2021, AMIC members have reflected on a list of most needed KPIs for ABS. We hope the following proposal will help the ESAs achieve their mandate.

- (1) The characteristics of the asset class should reflect the choice of KPIs.** It's important to ensure that each sustainability indicator is actually relevant in the context of a specific ABS exposure and helpful to ESG investors and their clients. The EU Taxonomy criteria and SFDR 18 mandatory KPIs under the draft RTS might not always be the most appropriate set of sustainability metrics.
- (2) Auto-loans, RMBS and CMBS should be prioritised.** Unfortunately, personal loans and credit card receivables cannot be precisely assessed. Priority should therefore be given to auto-loans, RMBS and CMBS. For CLOs, although it would be helpful to have data points as soon as possible, it is probably preferable to wait for the finalisation of sustainability standards under CSRD, which hopefully will lead to the adoption of general and sectorial KPIs.
- (3) Mandatory KPIs should be based on readily available or indispensable data points as a first step.** Although from a buy-side perspective we would like to see ambitious KPIs covering various sustainability aspects, we acknowledge the need to strike the balance between investors' needs and originators/obligors' capability to collect and communicate relevant information. We need to avoid situations where some missing data deter or stop some originators from bringing deals to the market. It may therefore be helpful to identify, as a first step, mandatory KPIs based on readily available or indispensable data points and a list of desired/optional KPIs.
- (4) The KPIs should work across jurisdictions.** ABS investors and their clients invest globally via funds or discretionary portfolios. It's important to ensure that the KPIs work across jurisdictions to enable data reconciliation in order to assess the overall ESG footprint of a product.
- (5) ESG KPIs should be adopted for both STS and non-STs markets.** The STS market represents only 30% of the market. We would encourage the EC to expand the KPIs, soon to be identified by the ESAs, to the non-STs market.
- (6) Reporting should be updated:** The information needs to be updated on a regular basis (at least annually) to consider potential pool replenishment.
- (7) Reporting against the environmental KPIs needs to be done on a loan by loan basis,** reporting for social & governance KPIs can be either on an aggregate basis or loan by loan (depending on the KPI).
- (8) The information should be made available pre-issuance to inform investment decisions.**
- (9) The information to be reported should be centralised by the European Data Warehouse.**

- **Environmental aspects**

Regarding environmental aspects, many data points are of interest to the buy-side but in the short-term we recommend starting with the most basic yet crucial information, which is the average Co2 emissions of vehicles and the breakdown between the petrol, diesel, hybrid, fuel cell, other zero-emission and electric vehicles. Ideally, average well-to-wheel Co2 emissions of vehicles should be provided given that asset managers are expected to report on scope 1, 2 and 3 GHG emissions and the carbon footprint of all asset classes (including ABS) starting in 2023 (c.f. SFDR draft RTS). Lastly, car manufacturers and asset managers are supposed to report against the EU taxonomy starting in 2022. Originators/obligors should therefore be in a position to indicate whether vehicles are taxonomy aligned or not.

As car manufacturers are already shifting massively towards EVs, having a KPI allowing clear distinction between EVs will very soon become essential. One of the clear environmental challenges associated with EV production is that it is commodity/mining intensive. The mining processes used to extract lithium typically require using significant amounts of water. Two other components, cobalt and nickel, have respectively raised human rights and environmental concerns. In that context, having information on the average recyclability of vehicles and battery pack would be very helpful.

- **Social aspects**

Some information on borrowers' profiles is currently provided via data tapes (income, deposit, employment status, APR). This may eventually be helpful to determinate if auto-loans ABS promote access to mobility. Completing these data points with the following information would allow investors to better appraise any negative or positive social impact and in particular to what extent the loan considers:

- **Accessibility:**
 - Does the borrower qualify under any underserved methodology (e.g. resident in an area of deprivation or in an area of affluence)? Methodologies should be disclosed with a numerical output.
 - Is the borrower a recipient of any social incentives or benefits (it could be based on any government programme)?
- **Affordability:**
 - Any scores and methodologies to show the level borrowers can absorb payments.
 - Details on the methodology, if any, to protect borrower from usurious costs to improve affordability
 - Additional social borrower protections (which may reduce recoveries).

Now considering vehicles and potential adverse impacts on society, communication of the average safety score of the fleet (e.g., NCAP, Euro NCAP) would be valuable to investors and should be readily available information.

To further appraise social impacts, asset managers may have to refer to the CSR reports of car manufacturers, which hopefully will be further improved and standardised when NFRD is reviewed. Transactions originated and serviced by unlisted originator-servicers (where no CSR report is published) should populate the relevant KPIs identified under the NFRD (and soon CSRD).

- **Governance aspects**

No transaction specific Governance KPIs were identified for auto-loans/leases ABS. Portfolio managers will have to refer to the obligors' practices and policies to appraise any risk or opportunity related to governance matters.

But, when relevant, originators/obligors should report against the governance KPIs identified under the SFDR draft RTS (until NFRD is reviewed):

- Compliance and process to control compliance with the UNGC principles or OECD Guidelines for Multinational Enterprises
- Unadjusted gender pay gap
- Board gender diversity

Transactions originated & serviced by unlisted originator-servicers should also populate relevant parts of [AFME Securitisation ESG Due Diligence Questionnaire](#).

KPIs recommended for RMBS/CMBS

Environmental aspects

Buildings account for 36% of global energy use through their construction and operation and 40% of the energy-related carbon dioxide emissions. Measuring, tracking/improving and comparing the environmental footprints of buildings are therefore essential to asset owners. Despite the existence of readily available information, due to the many industry standards (BREEAM, SKA, LEED, Fitwel, WELL) and regulatory obligations (EPC ratings) in place, this is not often passed on to RMBS investors. Information on basic but yet very important environment indicators are needed so that RMBS remain investable in an age when ESG investing is becoming the new norm.

Here are the most needed data points which we believe should be systematically communicated:

- **Scope 1, 2 and 3 GHG emissions** are needed to calculate other metrics such as carbon footprint of assets, conduct climate scenario analysis and to construct portfolios according to the temperature outcomes (e.g. Paris Agreement). It is also needed to comply with industry standards such as the GRESB and upcoming regulatory obligations (e.g. product disclosure under the proposed UK FCA enhanced climate-related disclosures). The ongoing energy consumption of buildings makes up for the majority share of building's overall carbon emissions profile. Calculating emissions can be complicated due to electricity multiple generating sources but can be estimated.
- **Energy Performance:** The **Primary Energy Demand (PED)** (which is the calculated amount of energy needed to meet the energy demand associated with the typical uses of a building expressed by a numeric indicator of total primary energy use in kWh/m² per year) and the **Energy Performance Certificate (EPC)** ratings are two valuable KPIs. These data points will be needed to report against one of the mandatory SFDR KPIs and should therefore also be mandatory. 'Inefficient real estate assets':

$$\frac{((\text{Value of real estate assets built before 31/12/2020 with EPC of C or below}) + (\text{Value of real estate assets built after 31/12/2020 with PED below NZEB in Directive 2010/31/EU}))}{\text{Value of real estate assets required to abide by EPC and NZEB rules}}$$

Other desired information on environmental aspects:

- **Energy performance:**
 - Details on any contractual changes linked to the energy performance of the property would also be valuable information (e.g. payment to borrowers or a change in the rate of interest).
 - Knowing if the property has energy generation capabilities, such as solar panels, other technologies promoting energy independence or any energy efficiency equipment.

- **Water Management:** Water management is identified as an important environmental KPI for buildings and is part of several reporting standards. For a building to qualify as sustainable under the EU Taxonomy, not only it needs to respect a certain level of energy performance, but its water appliances also need to meet certain quantitative requirements (water flow of taps, toilets, showers: x litres per minute). We have identified the communication of the water performance of buildings (e.g. SASB KPI: withdrawal data coverage as a percentage of total floor area) as a desired piece of information.
- **Physical risks due to climate change:** *“35% of REITs’ properties are exposed to climate hazards. Of these, 17% of properties are exposed to inland flood risk, 6% to sea level rise and coastal floods and 12% to hurricanes or typhoons.”*¹ Assessing climate risk is not only sound risk management but it will become a legal obligation under EU rules (SFDR, amendments to MiFID, UCITS, AIFMD, IDD). In that context and when it comes to RMBS, communication on area of properties located in regions subject to physical risks due to climate change would be desired (example SASB KPI: area of properties located in 100-year flood zones). If the above is not possible, servicers could develop a methodology to evaluate the physical climate risks on a regional basis as a proxy, which could then be disclosed.

Social aspects

Some information on borrowers’ profiles is usually provided via loan data tapes to appraise credit risk (income, deposit, employment status, APR). Completing these data points with the following information would allow investors to better appraise any negative or positive social impact and in particular to what extent the loan considers:

- **Accessibility:**
 - Does the borrower qualify under any underserved methodology (e.g. resident in an area of deprivation or in an area of affluence)? Methodologies should be disclosed with a numerical output.
 - Is the borrower a recipient of any social incentives or benefits (it could be based on any government programme)?
- **Affordability:**
 - Any scores and methodologies to show the level borrowers can absorb payments.
 - Details on the methodology, if any, to protect borrowers from usurious costs to improve affordability
 - Additional social borrower protections (which may reduce recoveries).

Governance aspects

No transaction specific Governance KPIs were identified for RMBS. But, when relevant, originators/obligors should report against the governance KPIs identified under the SFDR draft RTS (until NFRD is reviewed):

- Compliance and process to control compliance with the UNGC principles or OECD Guidelines for Multinational Enterprises
- Unadjusted gender pay gap
- Board gender diversity

Transactions originated & serviced by unlisted originator-servicers should also populate relevant parts of [AFME Securitisation ESG Due Diligence Questionnaire](#).

¹ <https://427mt.com/2018/10/11/climate-risk-real-estate-investment-trusts/>

Summary table: recommended sustainability KPIs

Auto-loans		
Environment	Social	Governance
Average Co2 emissions of vehicles	Accessibility	No transaction specific Governance KPIs were identified for auto-loans/leases ABS. But <u>when</u> relevant originators/obligors should report against the governance KPIs identified under the SFDR draft RTS (until NFRD is reviewed): <ul style="list-style-type: none"> ○ Compliance and process to control compliance with the UNGC principles or OECD Guidelines for Multinational Enterprises ○ Unadjusted gender pay gap ○ Board gender diversity Transactions originated & serviced by unlisted originator-servicers should also populate relevant parts of AFME Securitisation ESG Due Diligence Questionnaire .
Average well-to-wheel Co2 emissions of vehicles		
% petrol, diesel, hybrid, fuel cell, other zero-emission and electric		
Taxonomy alignment of vehicle/loan	Affordability	
% Recyclability of vehicles or batteries if EV	Average safety score of vehicles	
RMBS/CMBS		
Environment	Social	Governance
Primary Energy Demand	Accessibility (only for RMBS)	No transaction specific Governance KPIs were identified for RMBS/CMBS. But <u>when</u> relevant originators/obligors should report against the governance KPIs identified under the SFDR draft RTS (until NFRD is reviewed): <ul style="list-style-type: none"> ○ Compliance and process to control compliance with the UNGC principles or OECD Guidelines for Multinational Enterprises ○ Unadjusted gender pay gap ○ Board gender diversity Transactions originated & serviced by unlisted originator-servicers should also populate relevant parts of AFME Securitisation ESG Due Diligence Questionnaire .
Energy Performance Certificate		
Scope 1, 2 and 3 GHG emissions	Affordability (only for RMBS)	
Withdrawal data coverage as a percentage of total floor area		
Water flow of taps, toilets, showers: x litres per minute		
Physical risks due to climate change		

KPI's highlighted in 'bold' should be considered as necessary/mandatory. Other KPIs are desired/optional

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