ESG Securitisation Awards

2023

SCI

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Roll of Honour

ESG SECURITISATION OF THE YEAR

Fortuna Consumer Loan ABS 2022-1 (auxmoney, Citi)

ESG INNOVATION OF THE YEAR

Intesa Sanpaolo

ESG CLO MANAGER OF THE YEAR

Fidelity International

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M&G Investments

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Obvion

ESG ARRANGER OF THE YEAR

Tramontana Asset Management

ESG LAW FIRM OF THE YEAR

Paul Hastings

ESG SERVICE PROVIDER OF THE YEAR

European DataWarehouse

London, April 2023

SCI's inaugural ESG Securitisation Awards come at a time of significant regulatory momentum for improving sustainability disclosures and definitions for securitised products. In Europe, there are RTS in the works for STS-compliant RMBS and auto ABS, whereby originators will be encouraged to disclose the principal adverse impacts on sustainability factors of the assets financed by their transactions. The EBA has also concluded that the EU Green Bond Standard is the most appropriate existing framework under which to regulate sustainable securitisations, while the European Supervisory Authorities more recently issued a call for improved climate data from securitisation issuers.

An AFME analysis from December 2022 suggests that European securitisable green lending in respect of residential mortgages on energy-efficient properties, loans for green home renovations and electric vehicle financing could exceed €300bn annually by 2030. However, the study points out that the lack of risk-sensitivity and proportionality in the European regulatory framework for securitisation is a substantial barrier to achieving these volumes. It further highlights the disconnect between the Capital Markets Union 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.

The paucity and lack of standardisation of data and metrics remains a broader issue. And growth of the European ESG securitisation market was – last year, at least – further constrained by market volatility caused by the war in Ukraine.

Against this backdrop, this year's SCI ESG Securitisation Awards celebrate the pioneers in the space – whether that is through extending credit to underserved borrowers, expanding the availability of energy-efficient mortgages or championing ESG positive approaches. Indeed, the awards roll of honour on page 2 of this special edition reflects the vibrancy, innovation and aspiration that the securitisation industry evidently contributes to ESG considerations.

Our congratulations to the deserving winners of the awards, as well as to those involved in ESG securitisation as a whole for their many achievements over the last year. The qualifying period for the awards was the twelve months to 31 December 2022.

We would also like to wholeheartedly thank everyone who submitted a nomination for the awards. Additionally, our thanks and appreciation go to our awards advisory board – comprising Max Bronzwaer of PCS, Margot d'Ancona-Roesink of Rabobank, Benjamin Bouchet of Scope Ratings and Elena Rinaldi of TwentyFour Asset Management (each of whom was recused from judging an award that they could be nominated for) – for its invaluable input. Final selections for the awards were made by the SCI editorial team, based on the pitches we received, colour from market participants and our own independent reporting.

Looking to the next 12 months, it will be interesting to see how supply and demand dynamics shape up for ESG securitisations, given the market had already seen a handful of such issuances at the time of writing. SCI will certainly continue to keep you abreast of these developments and more!

All the best for the year ahead,

Corinne Smith
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ESG SECURITISATION OF THE YEAR
WINNER: FORTUNA CONSUMER LOAN ABS 2022-1

The second social bond offering from German lender auxmoney has won SCI's ESG Securitisation of the Year Award. Dubbed Fortuna Consumer Loan ABS 2022-1, the €225m true sale securitisation of a static pool of unsecured consumer loans sold by auxmoney was arranged by Citi, which also served as joint lead manager alongside BNP Paribas.

Founded in 2007, the German loan originator has grown to establish itself as a leading digital-lending platform for consumer credit in Europe. Through unique risk models and truly digital processes, auxmoney is able to improve access to affordable credit while simultaneously reducing the risk and cost of lending. As of March 2023, auxmoney has originated loans to its customer base in excess of €4bn – of which close to €1bn were originated in 2022 alone.

Dedicated to lessening financing exclusion in the market, auxmoney lends to the self-employed, freelancers, entrepreneurs, employees in probationary periods, non-Germans, both the young (under 25 years) and the elderly (over 65 years), those whose household income is below €1,500 per month, as well as consumers with low credit bureau scores (such as Schufa E or lower).

Of the consumers in Fortuna 2022-1's highly granular portfolio, 77% meet at least one of these individual criterion, according to third-party opinion from ISS. Of the consumer loans granted to 25,054 entirely private individual borrowers in Germany in the portfolio, more than half (55%) were given to borrowers with a low credit bureau score.

Daniel Drummer, cfo at auxmoney, explains: "To us, the social aspect of this deal is not just a label, but at the heart of our business model. auxmoney strives to use best-in-class technology – not only to provide a superior user experience to all of our customers, but also to deliberately serve consumers who are underserved by traditional lenders. As a result, we are able to have a considerable social impact by giving people access to financial means – improving the lives of many."

Fortuna 2022-1's triple-A rated class A notes follow the standards defined in the International Capital Market Association's (ICMA) Social Bond Principles. Proceeds from the issuance are used to enable the financial inclusion of the relevant population groups, in line with auxmoney's own dedicated Social Bond Framework – which fosters the United Nations Sustainable Development Goal targets.

With a majority socially-linked portfolio, the second Fortuna transaction is also STS compliant, with the class A notes now eligible as collateral for ECB repo operations and LCR purposes.

SVI served as third-party verification agent for Fortuna, with the deal also benefitting from reporting made available through the European DataWarehouse and Bloomberg – with cashflow modelling received via Bloomberg (FORTA 2022-1 Mtge) and Intex (FRTNA221).

Boudewijn Dierick, md and country executive at auxmoney Investments, adds: "We keep the structure for investors consistent and transparent, using the same name and same programme for each transaction. This allows us to come in as a repeat issuer and build long-term relations with various investors."

delighted by the positive reception which we continue to receive from the capital markets and the direct impact this allows us to have on improving the lives of many borrowers."

Beyond its dedication to offering responsible lending and fostering financial inclusion in Germany, auxmoney also strives to reduce its carbon footprint and conduct business according to the highest ethical standards, with prudent risk management and corporate governance.

Despite broader macroeconomic pressures, ESG considerations continue to be at the core of auxmoney's business. On the impact of the macroeconomic environment on auxmoney, Dierick shared: "So far, we've seen the portfolio perform very resiliently. At the same time, we are thrilled by the impressive demand for our bond issuances, particularly when considering that the ABS market was basically shut for a few months before our transaction."

> "WE KEEP THE STRUCTURE FOR INVESTORS CONSISTENT AND TRANSPARENT, USING THE SAME NAME AND SAME PROGRAMME FOR EACH TRANSACTION"

In fact, at the time of writing, the second Fortuna transaction had already been succeeded by the firm's third and largest social bond offering so far – Fortuna Consumer Loan ABS 2023-1 – further cementing auxmoney's position as a reliable issuer in the ABS market.

Dierick comments: "Our latest deal was several times oversubscribed. We have been

Boudewijn Dierick, auxmoney Investments

In reopening the European consumer ABS market with its latest issuance, auxmoney may not just be proving the value of its own social bond offerings, but also setting the precedent for socially sustainable European ABS issuance going forward.

With the success of this deal, auxmoney carries great optimism into not only its own social offering going forward, but also the growth of the social portion of the ESG securitisation market. "I do expect the social bond markets to grow further from here," considers Drummer. "We've noticed that more investors are focusing on ESG than ever before, with some of our investors telling us that they are deliberately investing in our deals because of this social element."

He concludes: "Irrespective of investor reception, ESG is a very important subject for us, and we are proactively furthering the ESG agenda – both internally and externally."

ESG INNOVATION OF THE YEAR
WINNER: INTESA SANPAOLO

Intesa Sanpaolo has won the Innovation of the Year category in SCI's ESG Securitisation Awards. The Italian lender stood out for its proprietary ESG scoring, which is embedded in important decision-making processes of the bank, including significant risk transfer transactions.

> "INTESA SANPAOLO'S PROPRIETARY ESG SCORING METHODOLOGY IS A QUANTITATIVE AND FACT-BASED APPROACH, COMBINING MULTIPLE INPUT SOURCES, AND COVERS BOTH CORPORATE AND SME BORROWERS"

Intesa Sanpaolo's proprietary ESG scoring methodology is a quantitative and fact-based approach, combining multiple input sources, and covers both corporate and SME borrowers. The scoring leverages direct access to clients to enrich and integrate ESG information. Further features include the use of advanced analytics, such as natural language processing (NLP).

The assessment occurs across more than 100 quantitative KPIs using 20-plus descriptors. For example, environmental factors cover carbon footprint, physical and transition risk, and natural resources and biodiversity. Social factors include human capital development and employee engagement, while governance factors cover board structure and remuneration, business ethics and political engagement, as well as business relationships.

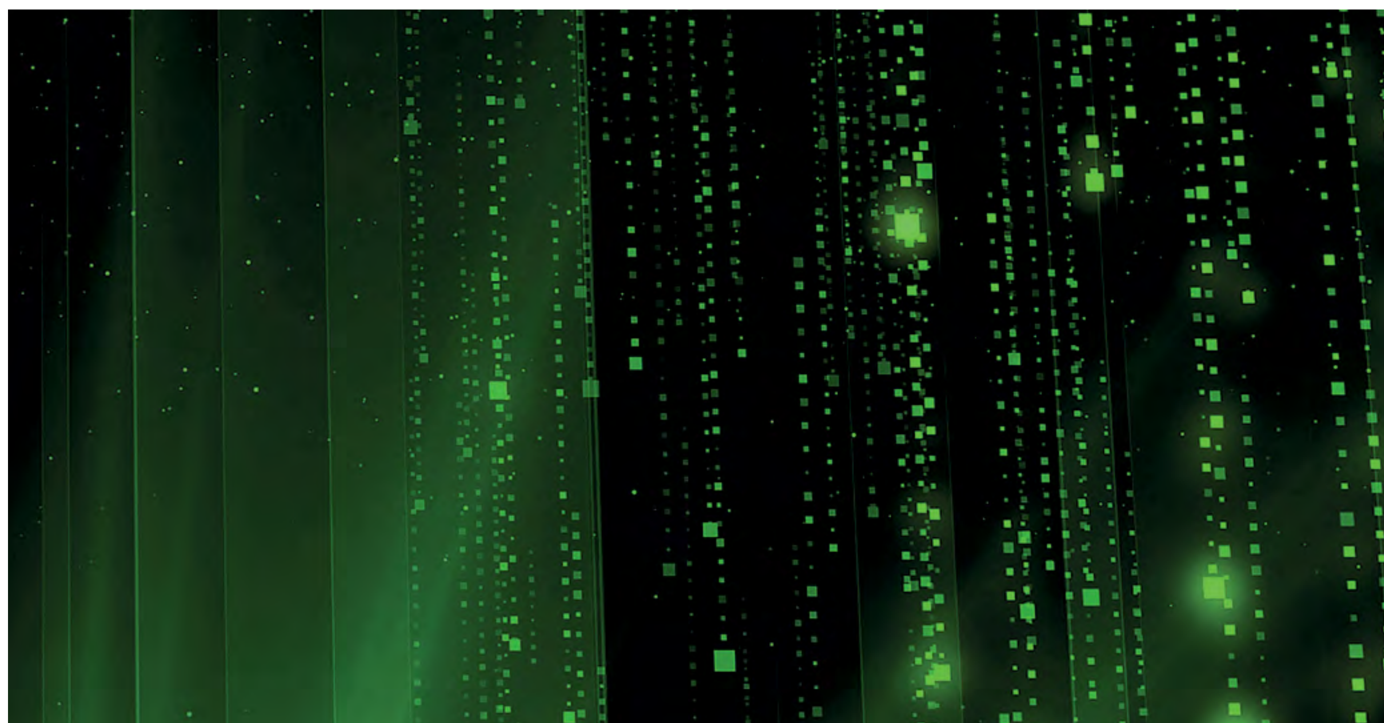
The ESG score can be utilised for various internal processes. First, it enables a better understanding of the client to support them in their ESG objectives and transition.

Second, ESG assessment is integrated to foster responsible credit decisions and it is an assessment that is complementary to credit ratings. Finally, it allows for targeted portfolio selection in risk transfer strategies and portfolio steering activities or new originations.

Regarding portfolio steering, Intesa Sanpaolo's credit strategies framework aims at steering origination towards the most attractive portfolio clusters through the selection of the best economic sectors and customers in terms of risk-returns, with KPIs including net operating margin, risk weighted asset and cost of risk. The sectoral attractiveness is evaluated by means of prospective trends in terms of ESG features of each sector.

The ESG scoring can also be utilised in risk transfer transactions, by limiting the contribution of part of the portfolio that is less 'ESG-friendly', while preserving the overall economic rationale. One case study is a combined €6.5bn cash and synthetic leasing securitisation, where Banca IMI acted as the arranger.

The target portfolio includes loans falling within the internal ESG scoring that incorporates EU taxonomy objectives. Around 70% of the rated portfolio has a 'not-RED' ESG score, which is above the thirtieth percentile of Intesa Sanpaolo's ESG class distribution. At least 40% of the portfolio has an A/B ESG score, which is above the seventieth percentile of the bank's ESG class distribution.



ESG CLO MANAGER OF THE YEAR
WINNER: FIDELITY INTERNATIONAL

Environmental, social and governance (ESG) concerns are increasingly coming into focus in the CLO market, driven by growing investor demand. Fidelity International is SCI's ESG CLO Manager of the Year in light of its dedication to the topic, its robust ESG positive approach and its unique sustainability framework.

One of the main differentiators of Fidelity International and its sustainability goals is its dedication in creating a unique ESG framework. "As a firm, we deeply care about sustainability and that has led us to develop an ESG framework, with our proprietary rating system first introduced in 2019," says Michael Curtis, head of private credit strategies at Fidelity International. "This was followed by a second iteration in 2021, which was launched across the equity, fixed income and private credit asset classes."

He continues: "These ratings cover an absolute assessment of each company's sustainability characteristics across sectors and integrate third-party data points to complement our own analysis, research and engagement insights. This allows us to create our own model, and if we get data from MSCI or other providers, we can incorporate that into our assessment. However, we rely predominantly on our own research and data gathered through engagement, rather than third-party research."

Another differentiator for Fidelity is the way its ESG research is carried out. "Our ESG research is a fully integrated effort carried out by our internal research analysts, who directly engage with companies, leveraging existing management and key shareholder relationships. Those engagements are important to inform our view of the companies' sustainability credentials," Curtis says.

He adds: "Ultimately, the idea of our ratings is designed to generate a forward-looking and holistic assessment of an issuer's exposure to sustainability risks and principal adverse impacts. The fact that we integrate ESG into our investment process also improves our investment performance over the long term."

Fidelity's ESG model has 127 different sub-sectors, which enables the firm to tailor questions based on relevance, dependent on which sub-sector an issuer is categorised as.

> "OUR ESG RESEARCH IS A FULLY INTEGRATED EFFORT CARRIED OUT BY OUR INTERNAL RESEARCH ANALYSTS, WHO DIRECTLY ENGAGE WITH COMPANIES"

Curtis says: "We draw upon a very large data pool because we have 400 investment professionals at the firm across portfolio management, equity and fixed income. That group of people take part in over 15,000 meetings every year with companies and therefore the collection of that data improves and informs our ratings process. This firmwide integrated approach has allowed us to become the first manager to really implement and articulate an SFDR Article 8-aligned solution for CLOs."

Additionally, Curtis explains that there are different ways CLO managers can deliver value for investors. "One is reducing your risk, by reducing the probability of default and loss. When it comes to ESG, we think our returns overall on a net basis will be higher because we manage risk effectively," he says.

He continues: "If a company has an ambitious sustainability programme and agrees to have an independent holistic measurement of that plan over time, then we're happy to have an ESG margin ratchet linked to pre-defined targets that reduces the cost of capital if these targets are met. But that's no different from having a ratchet that has been common for decades, where if a company's credit profile improves – say, leverage reduces – it would tend to have a reduction in margin."

Michael Curtis, Fidelity International

Moving forward, the firm will continue to play an active role with the European Leveraged Finance Association (ELFA). "We're a co-chair of the ESG committee at ELFA and through that we are looking to collaborate with other member firms and establish best practices in order to encourage issuers to provide information to the market that we think is important," Curtis says.

He explains: "Our role at ELFA focuses on driving issuers' ESG adoption and also on data collection. ELFA has produced industry standard questionnaires that gather key information from issuers – not just data, but also qualitative information on the company's activities. So, we are working to enact change in that way."

At the same time, Fidelity is working to plug gaps in data, Curtis notes. "One of the big gaps the market has is collecting carbon emissions data, so we've been working on a solution. An increasing proportion of issuers are reporting carbon emissions, but we have been working on a solution for issuers that do not disclose. We have also developed a methodology where we can create estimates of a company's carbon emissions, working with a recognised industry body and based on the company's activities. Because those estimates are generally conservative, we would then use those figures as a base to re-engage with the borrower," he concludes.

ESG INVESTOR OF THE YEAR
WINNER: M&G INVESTMENTS

M&G has won the Investor of the Year category in SCI's inaugural ESG Securitisation Awards, following a year in which its dedication to engagement, fair and accurate ESG assessment of ABS deals and carbon emission modelling was evident. Building on over 20 years of experience in the ESG space, since the founding of its in-house ABS credit research team, M&G has consistently driven the industry forward in improving and standardising ESG analysis in structured finance. As one the largest investors in the UK and Europe, the firm is playing a significant role in developing a consistent methodology and standardised approach for ESG practices.

At the heart of M&G's ESG approach to ABS transactions stands a rigorous scoring process, fully integrated into its investment process. The scorecard consists of core factors supplemented by more bespoke factors for each specific asset class.

Last year alone, the firm scored over 150 deals using its proprietary framework, which analyses ESG risks within the transaction structure, asset pool and counterparty of a transaction. This results in specific ESG and overall scores for deals.

The ensuing scorecards generate a score which is comparable across securitised asset classes. It allows M&G to tackle the challenges and complexities around ESG analysis for ABS portfolios.

"Unlike general corporate ESG analysis, there is a lack of a recognised third-party provider of ESG metrics in the securitisation asset class," notes Anuj Babber, head of structured credit and private asset research at M&G. "Working in a constructive manner with issuers and trade bodies to form a framework that we think is fit for purpose and aspirational is something that we value in our approach. While we recognise that we are at the infancy of ESG analysis in securitisation, we believe that our scorecard evaluates a lot of the structural context and nuances around the securitisation asset class."

Cristina de Guzmán Esteban, M&G

M&G's ABS ESG scorecard (sample considerations)

← Analysis of environmental, social and governance (ESG) factors →

Sample considerations	Transaction	Assets	Counterparty
	Is the deal structured in line with the spirit of regulations or simply to the letter of the law?	Is there any indication of predatory lending within the asset pool?	How responsible are the originator's underwriting practices?
	Are appropriate governance features and controls in place?	How exposed are the assets to changing environmental conditions e.g. flood risk?	Is the servicer treating customers fairly? Is it empathetic to unexpected circumstances, such as Covid-19?
		How environmentally friendly are the assets in the collateral pool?	If originated by a corporate entity, what is our corporate analyst's view of the originator?
	Transaction score	Assets score	Counterparty score
	Overall ESG score		

Source: M&G

"SECURITISATION CAN PLAY A VERY BIG ROLE IN TRANSITIONING THE ECONOMY"

Cristina de Guzmán Esteban, ABS credit analyst at M&G, further highlights the firm's collaborative approach to ESG analysis. "A key point and differentiating factor in our approach is the collaboration with issuers, investors and trade associations, especially given the lack of regulatory guidance in structured finance. We are in continuous dialogue with different parties, which has been central to our framework design and allows us to be aligned with expectations of the market."

While the securitisation industry is still in the early stages of providing ESG transparency and disclosure, Babber argues that standardisation and consistency are central to its development and evolution. "Issuers are continually learning what the investment community is looking for in terms of data disclosure. Additionally, we are also seeing a more constructive framework from trade associations. The focus is sharpening; however, the market needs to move to a standardised disclosure approach, in order to make any sense out of the ESG data metrics that we are getting."

He adds: "The securitisation community recognises that we are on a journey. There is a lack of any third-party ESG score provider and therefore it is in everyone's advantage to work constructively together. There is increasing regulatory pressure to provide better ESG disclosure across all financial products and growing demands to integrate better ESG analysis in the investment process will provide the catalyst for better information."

Through its scorecard, M&G is building something that is purposely aspirational, while recognising that it is at the infancy of this journey. "It is important that we create something that works not just for today, but that also works for the disclosure we receive tomorrow," Babber notes.

Reflecting on what the future holds for ESG in ABS, the team looks forward to the publication of the EU Green Bond Standard – which will include securitisation – while warning against the risks of green labelling. Although European green securitisations still only account for 1.4% of the total green issuance in Europe, De Guzmán Esteban describes the importance of sustainable ABS moving forward: "Securitisation can play a very big role in transitioning the economy towards a more sustainable future through supporting the finance of green assets. At M&G, we look forward to responsibly supporting this transition through active engagement with our counterparts."

ESG ISSUER OF THE YEAR
WINNER: OBVION

With a well-established but ever-evolving approach, combined with a strategy that not only encompasses new deal issuance but also the advancing of sustainability of all its customers, Obvion is SCI's ESG Securitisation Issuer of the Year. The firm's Green STORM RMBS platform began back in 2016 and continues to this day, with the most recent 2023 iteration falling outside the awards period, but yet again successfully pricing at the time of writing.

"We started Green STORM in 2016 because we had substantial funding needs and also saw an opportunity to couple the green assets we had to green investors, as a diversification next to our regular programme," recalls Sjoerd Humble, manager treasury at Obvion. "We then had the idea to set up a separate securitisation programme in order to be able to do so, targeting specific dark green investors."

From the outset, Green STORM transactions complied with the ICMA Green Bond Principles, had CBI certification and a second-party opinion from Morningstar Sustainalytics; and they continue to do so. However, Humble notes: "Over time, the collateral that we select has changed a bit because we have to tighten the rules from time to time, as the entire housing stock which is the reference portfolio that you're trying to beat in terms of sustainability also gets greener."

Indeed, Obvion's overall strategy has evolved over time as well. The lender has had less of a funding need in the last couple of years but has deliberately chosen to prioritise Green STORM issuance and only issue a regular RMBS if additional funding needs make it necessary. The firm's chief aim is to maintain its presence in the green RMBS space through the continuation and regular issuance from its programme and, by doing so, maintain its involvement in the green market and be able to contribute to the development of that market.

Sjoerd Humble, Obvion

"WE HAVE A SUFFICIENTLY LARGE BACK-BOOK TO PICK FROM AND DO COLLATERAL-BASED TRANSACTIONS, SO THAT'S MORE STRAIGHTFORWARD FOR US"

At the same time, sustainability has become an increasingly important part of the firm's mortgage business as a whole (see box for more).

That is not to say Obvion's issuance pattern is an easy one to replicate. "With green deals, collateral availability is always a concern," explains Humble. "We have a sufficiently large back-book to pick from and do collateral-based transactions, so that's more straightforward for us. But, for some new entrants to the lending market with smaller portfolios who are starting to use securitisation, it's more of an issue."

He continues: "Data availability is often a difficulty too. For us in the Netherlands, there is a register of energy labels that's public that we can use, but in other jurisdictions that's not the case."

However, Humble is hopeful that the situation will change and open up the market to more issuers. "Once more collateral becomes available and is green and once more data becomes available on greenness – which should happen because asset manager, pension funds and banks need to report, as of 2024, on their holdings and the energy efficiency of their holdings – you could potentially see more securitisations," he says.

Ultimately though, the goal is for green securitisations to cease to be anything unusual. "You're really issuing green bonds in order to make sure that in the future you can't issue green bonds anymore," Humble observes. "In the end, we're all planning towards the 2050 Paris Agreement and when we get there, then every portfolio should consist of Label A assets and every investment should be green."

He concludes: "I think for most investors that are looking specifically for green products, it's also about financing the transition, being part of the transition and playing a role in that transition. Once the transition is over, everything green will be the standard. But, of course, that's still a long way off."

SUSTAINABLE STRATEGY

As noted in the main text, sustainability is a strategic priority for Obvion, which is directly reflected in its mortgage business - whereby it offers its borrowers a range of incentives to invest in energy-saving measures. These include:

- Rate discounts: a sustainability-discount on mortgage interest rates (currently 5bp) if the mortgage loan is used to finance an energy-efficient house.
- Building deposits: borrowers can finance up to 106% of market value, if the part above 100% is used to invest in energy-saving measures. To encourage borrowers to do so, Obvion does not charge these borrowers a higher interest rate if they finance more than 100%.
- Additional loan: €9,000 to invest in energy-saving measures.
- Education: Obvion is a member of Sector Collectief DuurzaamWonen, an alliance of mortgage loan originators, intermediaries and educational institutions.
- Partnerships: Obvion cooperates with partners to make it easier for its borrowers to invest in energy-saving measures.

ESG ARRANGER OF THE YEAR
WINNER: TRAMONTANA ASSET MANAGEMENT

There are a lot of things that the ESG market needs to prosper and make a difference, but the most pressing of these is capital. For its contribution to bringing new capital to this market through technical expertise and new products, Tramontana Asset Management is SCI's choice as ESG Arranger of the Year.

"The broader energy transition requires enormous amounts of capital. The increase in energy prices means utilities and energy companies have found that their regular capital requirements have gone up, in addition to extra capital needed for transition," says Bharath Manium, md and co-founder of Tramontana.

The investment management firm was founded in 2014 by Manium and Paul Jackman, who previously ran the commodities investor business at Barclays. Based in London, it currently has 11 employees, chiefly drawn from the ranks of ex-colleagues at Barclays. But, as Manium concedes, it needs to hire more staff and not necessarily from the Barclays gene pool.

Tramontana currently has around US$5bn in assets under management, a number which grew "significantly" over 2022. Though Manium would be the first to admit that he and Jackman didn't start the firm in 2014 with a view to capitalising on the surge in interest in energy transition – which was no more than a gleam in the eye of an eco-zealot a decade ago – it has followed the market and is now regarded as one of the biggest arrangers and managers of carbon-backed financing in Europe.

One of the biggest contributions to the markets made by the EU has been tradable carbon certificates, the price of which has soared, as increasing numbers of firms have struggled to diminish their carbon footprints. However, despite the utility of the product, they are difficult to hold by institutions other than tier one banks for a host of accounting, regulatory and management concerns. Institutional money is shut out, depriving the sector of an important source of capital.

Bharath Manium, Tramontana

Tramontana has addressed the issue by repackaging energy transition assets into a standardised note form that can then be held in clearing systems like Euroclear and Clearstream. This makes them accessible to asset managers and opens a much deeper pool of investor capital, while also making the price discovery process more efficient and more transparent.

"What we try to do is to isolate the risk and give it those who understand it. A new financial partner might want to finance the asset but doesn't want to assume asset-specific risks. We structure it to isolate such risks and the investor is left with only the financing risk, which is what they want," explains Manium.

Tramontana has also added liquidity to the carbon hedging market. The most common instrument in this space is futures on the EU carbon allowances, or carbon credits, but liquidity is greatly diminished beyond the nearest December contract.

Paul Jackman, Tramontana

> "WHAT WE TRY TO DO IS TO ISOLATE THE RISK AND GIVE IT THOSE WHO UNDERSTAND IT"

So, Tramontana will buy the physical, hedge it with the nearest front contract and when that expires, hold it in a ring-fenced vehicle for delivery in five to seven years to whoever needs it. This means, of course, that the firm is exposed to the value of the physical, but hedging that type of risk is what Manium and Jackman did during their Barclays years.

In 2022, the firm executed a series of carbon-backed securities transactions to a total value of €1.5bn. Once again, this represented a significant increase over 2021.

It also witnessed several transactions mature last year, which had been initially executed in 2019 and 2020. "It's always good to see the full lifecycle of a deal happening smoothly," says Manium.

While the AUM has swollen over the past year, so has the type of client on the roster. Initially, Tramontana targeted the professional and experienced client, who was, for example, familiar with derivative instruments and the operational weight of carrying these types of risks. But this clearly limits the amount of capital that can be brought into the space, and what the ESG market needs more than anything is more capital.

In addition, corporates at the moment like Tramontana's structures as they help diversify their sources of funding away from traditional banks – which is particularly pertinent, given market turmoil currently affecting several well-known European banks, adds Manium.

So, in 2022, Tramontana onboarded several new clients with an appetite for buying carbon assets but without the expertise to handle price and delivery risk. The increase in the number of investors has raised the size of the typical transaction to over €300m.

Manium is aware that the sector faces a great many difficulties. There is the ever-present problem of greenwashing, and there is growing scepticism in many quarters that the comparative cheapness of traditional sources of energy makes the attainment of net zero by 2050 – or anything like it – hugely challenging.

But, points out Manium, the debate shouldn't be binary. "It's not all or nothing. You make some changes, and it will make an impact. We are beginning to make a difference, and this is what makes us most proud," he concludes.

ESG LAW FIRM OF THE YEAR
WINNER: PAUL HASTINGS

The winner of SCI's ESG Law Firm of the Year Award is Paul Hastings, for its deep expertise in the ESG field and its pioneering work to incorporate ESG factors into securitisation transactions.

Paul Hastings has worked over the years with a range of clients active in the structured finance space, such as LiveMore Capital – a sustainable lender founded with a social mission to provide mortgage finance for people in later life – and Kensington Mortgages, a more mainstream UK lender that issued the UK's first green RMBS and the UK's first social RMBS. Paul Hastings has also been at the forefront of ESG developments impacting European CLOs. Most notably, the law firm helped the CLO market make a step-change in its approach to ESG, with the Fidelity Grand Harbour 2021-1 deal.

The law firm has since continued to adapt and develop its ESG-related legal advice across the European and US markets, as ESG factors become increasingly part of the daily workflow of investors and CLO managers. "2022 was a year of incremental advancements, compared with the more substantive shift we saw in 2021," comments Paul Hastings partner and CLO specialist Blake Jones. "2022 saw the tightening and expansion of ESG exclusion lists, with a number of investors now having expanded the criteria to be included in exclusions lists and developing more sophisticated house positions on the assets to be excluded."

However, 2019 was a key milestone in the law firm's ESG journey, when it worked with Swiss-based responsAbility Investments (now part of M&G). That year the impact asset manager securitised US$175m of loans to microfinance and SME finance institutions in emerging markets.

Blake Jones, Paul Hastings

> "2022 SAW THE TIGHTENING AND EXPANSION OF ESG EXCLUSION LISTS"

The CLO transaction, structured by JPMorgan, comprised three tranches (senior, mezzanine and junior) in a listed, transferable bond format. The underlying pool of assets were 26 newly issued senior loans to fast-growing microfinance institutions and SME banks of 17 different countries in Latin America, Africa and Asia, which on-lent the proceeds to 30,000 SME clients and 5.6 million microfinance borrowers, 81% of whom are women.

In 2021, Paul Hastings again advised responsAbility on a US$177.5m single-tranche social bond that bundled loans to companies which operate in the financial inclusion, healthcare and WASH (water, sanitation, hygiene) sectors, and that have a measurable, positive social impact. This bond had a broad impact across multiple Sustainable Development Goals contained in the United Nations' Agenda 2030. The transaction was structured with a partial guarantee from the Swedish government that protected the issuer against the risk of loan defaults.

In the leveraged loan CLO sector, meanwhile, Paul Hastings was manager counsel on Fidelity Grand Harbour CLO 2021-1 and Fidelity Grand Harbour CLO 2022-1 – two transactions that broke the CLO ESG mold. Until these deals, CLO managers operated within a relatively limited framework, where the focus was mostly on which type of assets would be unsuitable to form the collateral of a CLO.

Fidelity Grand Harbour 2021-1, priced in November 2021, included ESG positive screening and was also structured to be the first deal in the CLO market to be "aligned" to Article 8 of the EU's Sustainable Finance Disclosure Regulation (SFDR). "It included significantly more extensive ESG criteria than seen in the market up to that point, including being the first European CLO to include positive ESG metrics through scoring of assets and applying a minimum concentration limitation on the portfolio for assets with a certain ESG scoring," explains Paul Hastings' Jones.

Fidelity Grand Harbour CLO 2022-1, priced in August, replicated these ESG provisions. Paul Hastings has also assisted Neuberger Berman, Partners Group, PGIM and others in designing their ESG screening criteria for CLOs and credit funds. It was also the first law firm to be invited to join a CLO manager working group

Victoria Morton, Paul Hastings

on devising a market approach to producing principal adverse sustainability impact reporting, in line with guidance in respect of Article 4 of the SFDR, which is a contractual obligation incorporated into some CLOs.

In the RMBS sector, Paul Hastings has advised multiple other mortgage lender clients on ESG requirements. With Kensington Mortgages, for example, the firm was again at the forefront of ESG developments.

Kensington's Finsbury Square 2021-1 Green RMBS was a first, as it was aligned with the ICMA Green Bond Principles of 2018 and contributed towards meeting the UN Sustainable Development Goals. With the proceeds of Finsbury Square 2021-1 Green's class A-Green notes, Kensington committed to originate £570m of green loans to fund the purchase of properties with a high energy performance rating. In the case of Gemgarto 2021-1, Kensington brought to market the first UK social RMBS, a transaction aligned to the ICMA Social Bond Principles.

Paul Hastings also works with LiveMore Capital, a lender founded in 2020 that provides mortgage finance for borrowers aged 50 and over. People in later life are too often underserved by high street lenders, note Paul Hastings' partners Paul Severs and Victoria Morton. "This has been particularly material for clients that are earlier in the life cycle of their origination platform, where there is considerable scope for advice relating to the establishment of an ESG framework for reporting and tracking mortgage loans," notes Morton.

ESG SERVICE PROVIDER OF THE YEAR
WINNER: EUROPEAN DATAWAREHOUSE

European DataWarehouse (EDW) has won the Service Provider of the Year category in SCI's inaugural ESG Securitisation Awards. The company has garnered industry acclaim for its involvement in a number of recent ESG initiatives, including the Green Auto Securitisation (GAS) and Engage for ESG Activation Investments (ENGAGE) projects.

Established by the market for the market in 2012, EDW was the first Securitisation Repository in Europe to facilitate the collection, validation and download of standardised loan-level data for ABS and private whole loan portfolios. At its core, the company's mission is to increase transparency and restore confidence in the European securitisation market.

In fact, EDW views the converting of data into market trust as a social mission. By supporting the development of capital markets and promoting the circulation of safe credit, the company is contributing to economic growth and social value creation.

"EDW is a neutral platform for collecting data and making it available to the market. As such, the aggregation and dissemination of standardised information in the sustainability space is a natural extension of our role," says Christian Thun, ceo, European DataWarehouse.

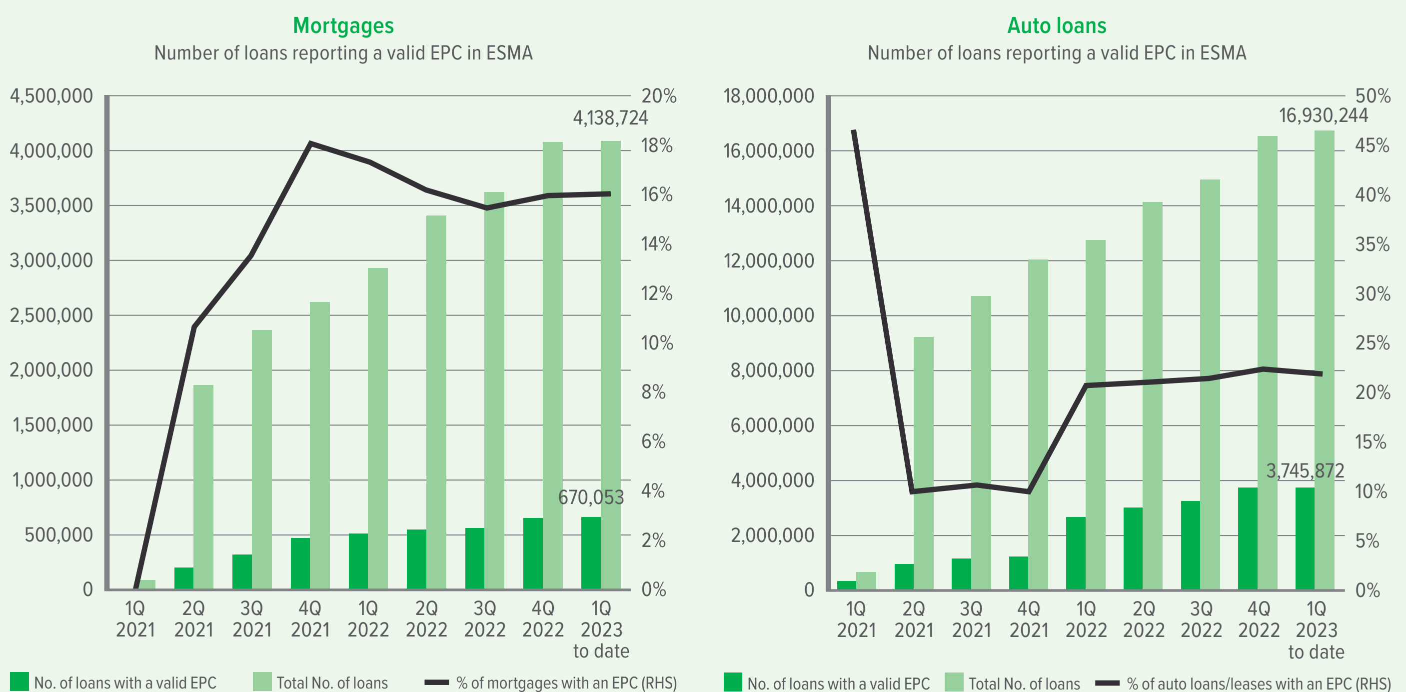
> "THE AGGREGATION AND DISSEMINATION OF STANDARDISED INFORMATION IN THE SUSTAINABILITY SPACE IS A NATURAL EXTENSION OF OUR ROLE"

Thanks to the ESMA and FCA exposure templates, EDW's sustainable finance dataset – including energy performance certificates (EPCs) – comprises more than 3.7 million records for auto loans and more than 670,000 records for mortgages, as of March 2023 (see Exhibit 1). However, the company goes a step further in this mission by also providing unique insights from analysing the information it collates, with the aim of highlighting opportunities for improvements and innovation within the ESG securitisation sector.

For example, in early 2022, EDW analysed over 500,000 real estate loans from five European countries for which an EPC was available to

Christian Thun, European DataWarehouse

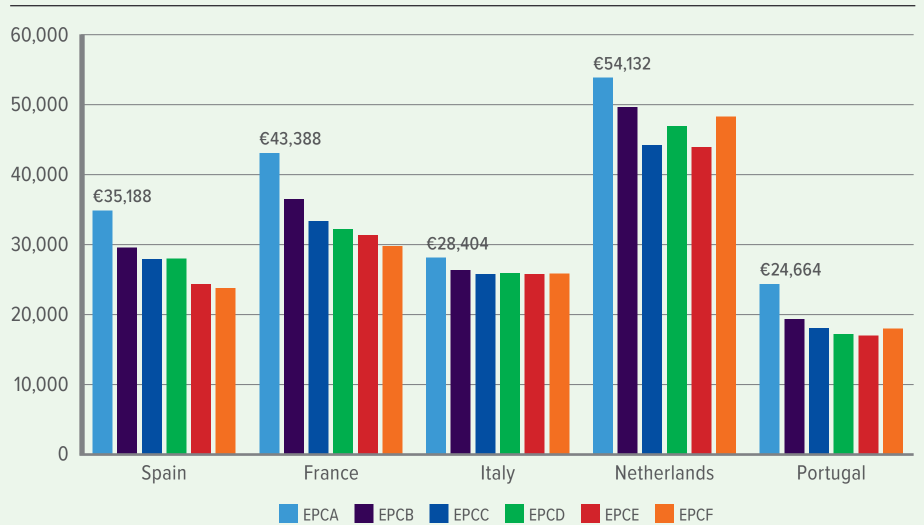
Exhibit 1: Energy Performance Certificates – how much data is available?



Source: European DataWarehouse

observe the relationship between the EPC of the financed property and the income of the borrowers (see Exhibit 2). A clear pattern emerged: borrowers whose properties had the best energy efficiency (expressed as EPC) had the highest incomes.

Exhibit 2: Borrower income by country vs EPC of mortgaged property



Source: European DataWarehouse

According to the analysis, borrowers in Spain with an EPC 'A' property earned an average of €35,188 per annum, while borrowers with an EPC 'F' property earned an average of €24,089. In France, the income difference between EPC 'A' and EPC 'F' householders was more than €13,300. In contrast, in Italy, the difference was €2,350.

"The findings suggest that older houses need more heating, but they are often occupied by poorer households that can't afford high heating bills. In such cases, the 'E' in ESG bleeds into the 'S'," notes Thun.

He argues that robust data helps to identify shortcomings and provides the foundation for evidence-based discussion and proper decision-making, rather than the conversation being driven by emotional responses. "The data proves that it is important that lower-income segments of the population are also able to afford energy-efficient real estate – or vehicles. Securitisation can be harnessed to create a lending environment that is conducive to this process. At the moment, society is leaving many behind on its ESG journey; if they continue to be left behind, the journey is unlikely to be completed."

Last October, the German Federal Ministry for Education and Research awarded a grant for the GAS project to EDW, in collaboration with the Leibniz Institute for Financial Research SAFE. The three-year project seeks to create meaningful incentives for the automotive industry to establish a framework for a green finance mechanism that supports the financing of low-emission vehicles (LEVs) through bank lending. The resulting database would enable the reporting of ESG-related information at a single exposure level and the enrichment of loan- and lease-level data with manufacturers' ESG ratings and details on car emissions and characteristics such as fuel type.

Meanwhile, the ENGAGE consortium – comprising Dexai-Etica Artificiale, Unión de Créditos Inmobiliarios (UCI), EDW, Hypoport, Università Ca' Foscari Venezia and Woonnu – received a grant in November 2022 from the European Climate, Infrastructure and Environment Executive Agency (CINEA) under the EU's LIFE programme. The three-year project aims to create a future-proof data and innovative funding framework for energy efficient mortgage and renovation financing, as well as a standardised energy efficiency data disclosure template, which will be operationalised through the Green Investment Portal. The framework will provide for the application of the relevant sections of the EU Taxonomy Regulation into the Dutch and Spanish national building and mortgage-lending practices that will ultimately contribute to the standardisation of innovative and decarbonisation-targeted capital markets financing transactions.

"Investor appetite is growing for information about how 'green' a portfolio is and, at the same time, the ESG regulatory burden is growing. So, there is a need to create solutions that help end-users to comply with these demands – especially in relation to the EU Taxonomy Regulation," observes Marco Angheben, head of business development and regulatory affairs at European DataWarehouse.

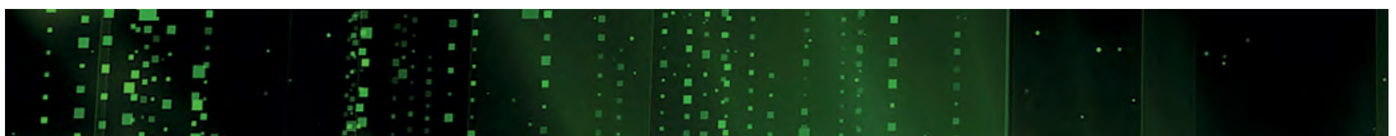
Marco Angheben, European DataWarehouse

He continues: "The big challenge is that the necessary data, such as the EPCs, isn't generally available – especially in the housing sector – due to data protection rules. A further challenge is that databases in different jurisdictions have varying degrees of accessibility and information quality."

Angheben suggests that a shift is needed from the current 'one-to-one' regulation aimed at a property buyer or tenant to the kind of open access to information that EDW espouses. "This begins with helping lenders collect, aggregate and digitise sustainable information. Loan-level data should comprise ESG documentation at the macro level, plus detailed information at the micro level. The GAS and ENGAGE initiatives are trying to drive progress not only in terms of green loans, but also in terms of helping the green transition."

EDW's values as a company also speak to its commitment to advancing initiatives across all ESG areas. From an environmental perspective, its goal is to be carbon-neutral across its entire business by adapting, innovating and investing to combat climate change through green practices. For example, EDW plants a tree for each ABS transaction that is created on its platform.

From a social perspective, EDW endeavours to create an inclusive and diverse work environment and to respect the fundamental human rights of its employees and clients. Finally, the company's corporate governance framework promotes principled actions, informed and effective decision-making and appropriate monitoring of compliance and performance.



Subjective issue

CLO managers are increasingly investing in their own methodologies and disclosure processes to provide investors with helpful ESG information. However, as **Corinne Smith** reports, the subjective nature of this data remains an issue.

The SFDR RTS and TCFD reporting for large UK asset managers and asset owners both became mandatory on 1 January 2023. In the case of CLO investments, investors rely on CLO managers to provide the information necessary for them to comply with their obligations under the rules. However, while some CLO managers have invested in their own methodologies and disclosure processes to provide investors with helpful ESG information, the subjective nature of this data remains an issue.

The SFDR applies to 'financial market participants' that offer 'financial products' and 'financial advisers', while the TCFD rules apply to FCA-authorised asset managers. "Investors are caught by these rules and therefore have to adhere to certain reporting requirements, including how they integrate sustainability risks into investment decision-making and how they consider principal adverse impacts of their investments on sustainability factors. In the case of CLO investments, investors rely on CLO managers to provide the information necessary for them to be able to comply with their obligations," says Jennifer Ellis, counsel at Linklaters.

With investor demand for ESG disclosures rising, more and more CLO managers are implementing investment guidelines and procedures that take ESG considerations into account. Some CLO managers are opting to go further and develop specific ESG policies and their own internal scoring methodologies,

Jennifer Ellis, Linklaters

whereby an asset must have a minimum ESG score at the time of acquisition to be eligible for inclusion in the portfolio.

Ellis notes that in some recent deals, CLO managers have also agreed to comply with certain initial and ongoing ESG due diligence requirements. These typically include an obligation on the CLO manager to use commercially reasonable efforts when selecting assets for investment to review due diligence materials, attend investor presentations or conduct management meetings and examine publicly available third-party information. For assets already in the portfolio, CLO managers are obliged to attend management meetings, conference calls or other events relating to the relevant obligor and monitor on an ongoing basis the industry and sector trends relating to that obligor.

In terms of investment guidelines, CLOs can incorporate ESG-related provisions focused on negative screening of obligors via the eligibility criteria and some are moving towards positive screening through the inclusion of ESG-related portfolio profile tests *(SCI 11 February 2022)*. Positive screening frameworks can either require a certain percentage of the portfolio to be comprised of ESG assets or employ a more thematic investment approach, whereby the CLO manager invests in assets that provide exposure to specific sustainability themes.

In terms of ESG reporting, an increasing number of managers are providing principal adverse sustainability impact (PASI) statements, in line with the SFDR RTS. This approach involves quantitative disclosures – including data on 14 key indicators (nine relating to the environment and five relating to social factors) for assessing adverse sustainability impacts across a range of ESG factors – and qualitative disclosures, including information about policies on the identification and prioritisation of PASIs, information on engagement policies and policies relating to reducing principal adverse impact (PAIs), and reference to adherence to responsible business conduct codes.

Denis Struc, portfolio manager at Janus Henderson Investors, views certain PAIs and their recommended measures as somewhat "aspirational" for a number of fixed income strategies, given the scarcity of information available to assess them. He points out that the PAIs range from matters of sustainability that can be reasonably quantified to others that are much harder to measure at the present time.

"A number of measures address carbon-related risks and are broadly aligned with other recommendations, such as TCFD, but there is a paucity of data for others that makes them more challenging to assess. This doesn't mean they don't need to be addressed – we're advocates of sustainability and use our leverage as investors to influence change – but finding the right data to accurately measure outcomes can be very difficult for many strategies," Struc argues.

> "A NUMBER OF MEASURES ADDRESS CARBON-RELATED RISKS AND ARE BROADLY ALIGNED WITH OTHER RECOMMENDATIONS"

He cites biodiversity as an example. "I am not sure we have a clear understanding of what counts as 'biosensitive' or what counts as having a negative effect on biosensitivity. Without data, where do you start in terms of plausibly developing these definitions? Unlike for carbon, there remains a steep education curve in terms of understanding the metric and what counts as 'good' or 'bad'. As such, it makes sense that there is greater focus on carbon in the first instance, as it is more quantifiable."

Denis Struc, Janus Henderson Investors

Meanwhile, Ellis suggests that the latest trend to emerge in the CLO ESG space is additional periodic reporting. She cites Fidelity Grand Harbour CLO 2022-1 as an example, the documentation of which includes a requirement to report periodically on the average ESG score (reflecting an obligor's overall adherence to certain ESG factors) of the portfolio, as well as the obligors that have been added or removed from the portfolio as a result of their compliance with certain ESG factors.

"Currently, this level of reporting is still very much provided at the CLO manager's discretion and only a handful of managers have elected to do it so far. However, we do expect this activity to grow, due to the availability of ESG scores," Ellis observes.

Broadly, three streams of ESG CLOs appear to be emerging: those with standard exclusionary lists, or 'ESG negative' transactions; those

with ESG scoring and reporting provisions, whereby deals report an ESG score but there is no obligation to meet or achieve a certain minimum score; and those with an 'ESG positive' approach, where a contractual minimum ESG positive metric for the portfolio is set out, which the manager uses reasonable endeavours to achieve. Anecdotally, Fidelity International is one CLO manager that stands out for its ESG positive approach.

Although some CLO managers have invested heavily in their own methodologies to provide investors with helpful ESG data, the subjective nature of this data remains an issue, according to Ellis. "Data points differ from one manager to another, which makes it difficult for investors to compare different deals. It is likely more managers will look to start utilising third-party ESG score providers, in response to investor demand and to enable investors to more easily compare deals in the market from an ESG perspective."

CLO document review service Review Port recently introduced a CLO ESG provisions screening system, based on the quality and consistency of CLO manager ESG provisions in offering documentation. "In most cases, definitions of what constitutes ESG for a given CLO are determined solely by the CLO manager, which means it is impossible to monitor without subsequently offering reporting on ESG considerations. The idea behind the Review Port CLO ESG provisions screening is to allow investors to compare and differentiate between managers' ESG provisions, including noting if there are any internal ESG scoring, reporting requirements or due diligence procedures pre- and after-purchase of collateral obligations," explains Daniel Kakonge, founder and research director at the firm.

He adds: "The challenge is offering reporting across the market, as some managers still get away without offering any ESG reporting, which makes it harder for investors to track ESG consideration progress. For instance, with reporting requirements or due diligence procedures pre- and after-purchase of collateral obligations, if a credit becomes non-compliant with a manager's ESG investment policy, the credit can be disclosed in a report. We're seeing more and more investors requesting for reporting or due diligence procedures, with the documentation being redrafted accordingly."

Similar to the climate PAIs set out in the SFDR RTS, the FCA encourages in-scope firms to consider making disclosures available to clients via TCFD product reports. Each report should contain portfolio level disclosure on these mandatory metrics: Scope 1 and 2 GHG emissions; Scope 3 GHG emissions (disclosure for Scope 3 is delayed until 30 June 2024); total carbon emissions; carbon footprint; and weighted average carbon intensity (WACI).

> "IN MOST CASES, DEFINITIONS OF WHAT CONSTITUTES ESG FOR A GIVEN CLO ARE DETERMINED SOLELY BY THE CLO MANAGER"

Struc points to the variety of recommendations in sustainability reporting under various regimes and the number of different angles that investors have to be aware of, all of which require robust data in order to be adhered to. "The FCA is seeking to clarify the regime for labelling funds – it seems with a focus on core objectives and outcomes – while current EU regulations seem to be more quantitative in their approach, certainly for Article 8 funds," he observes.

Pursuant to the SFDR, Article 8 funds are defined as "promoting environmental or social characteristics", while an Article 9 fund has "sustainable investment as its objective" and a higher threshold for compliance. To date, a handful of European CLOs have been marketed as being "aligned" with Article 8.

In contrast, 307 Article 9 funds – representing a combined AUM value of €170.1bn – were downgraded to Article 8 in 4Q22, according to Morningstar data. The firm suggests that this migration to a less stringent category is being driven by uncertainty about how sustainable investments are defined.

At present, Struc suggests that it's more realistic to look at sustainability related to CLO managers rather than their portfolios. "It's an immediate win to look at aspects like talent development and inclusive hiring practices. On a relative basis, you can place managers above or below the average and then engage with the managers below that bar to create a constructive dialogue in terms of the path they're intending to follow."

CLO investors can also overcome the information barrier to an extent by asking the right questions of CLO managers. ELFA's CLO Manager ESG Diligence Questionnaire – which aims to improve the quality of reporting and data around the carbon footprint, governance and diversity of managers, as well as underlying obligors *(SCI 26 October 2022)* – is proving helpful in this regard.

"The questionnaire provides direction in terms of what matters to investors in connection with sustainability. The next step is to encourage widespread adoption of it: the questionnaires were deliberately designed to cater for various CLO managers, from those who are quite advanced and ready to provide comprehensive information to those who are at the early stages on their sustainability path," Struc observes.

He suggests that the CLO industry has the potential to lead the rest of the fixed income market in terms of ESG disclosure. "Once a dataset is created off the back of responses to the questionnaires, it enables comparisons to be made across a range of sustainability measures that can best be analysed on a relative basis. The end goal is to push for change, but first we need to understand what we mean by change."

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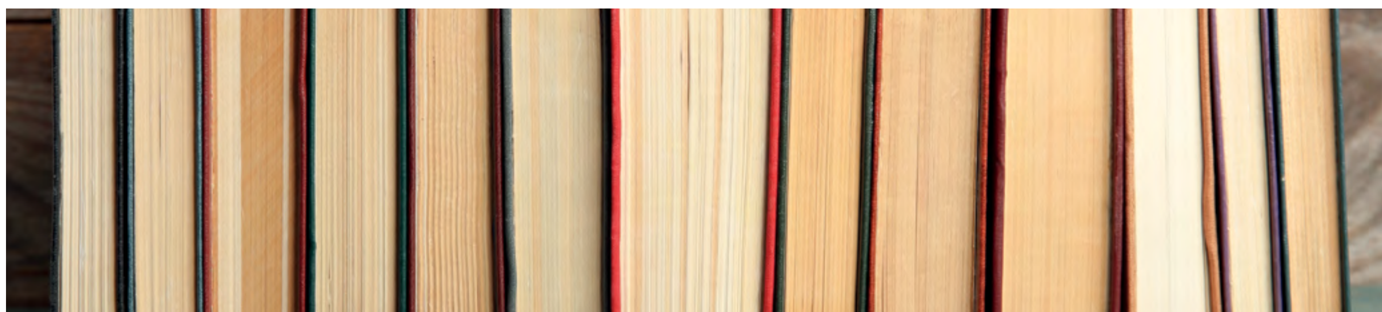

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