

# ESG Industry Engagement Survey 2020

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# ESG Industry Engagement Survey 2020

The Structured Finance Association surveyed structured finance market participants to assess the extent environmental, social and governance (ESG) principles are incorporated, or being considered to be incorporated, within the structured finance market both at the *Enterprise* level and at the *Structured Finance Business Unit* level. Our results provide insight into the levels and range of ESG engagement as well as the various approaches that issuers and investors take in executing their ESG strategies.<sup>1</sup>

## Key Takeaways

### Extensive ESG inclusion at corporate level in securitization market

- A vast majority of securitization market participants (86%) reported they have ESG programs in place at the Enterprise level.

### Increasing development of ESG programs at securitization level

- Nearly half (47%) of all market participants report an ESG program in place at the Structured Finance Business Unit level.

### “Client Demand” is #1 factor motivating ESG for Institutional Investors in securitization market

- Almost all investor respondents (95%) currently apply an ESG framework to **all** or **some** of their investment decisions.
  - 60% of investors apply an ESG framework to all investments and 35% apply it to certain managed funds, portfolios or client-directed funds.

### Top three motivations for issuers are “alignment with corporate values”, “reputation & brand” and “investor demand”

### Growing number of ABS issuers are developing ESG programs

- 81% of ABS issuers currently incorporate ESG in their overall business operations and 73% do so in their asset origination and underwriting practices.
- While currently only 13% of the issuer respondents sponsor an ESG-focused securitization program, 43% indicated they are developing one.<sup>1</sup>

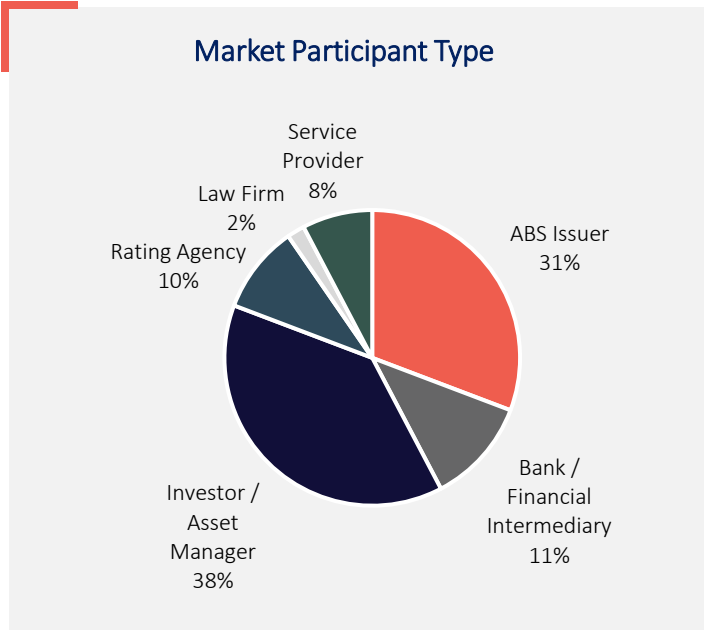
<sup>1</sup> Survey participants voluntarily responded. Thus, there may be a self-selection bias in the results leading to the potential that those that responded to the survey may differ from the overall market as a whole.

## Overall Results

### Respondent Profile: Market Role & Sector Involvement

Our survey, conducted in August and September of 2020, reflects input from 49 firms representing diverse perspectives across the securitization market, including institutional investors, securitization bond issuers, large diversified financial institutions, rating agencies, and other service providers. See Figure 1 for details.

Figure 1



- A majority of respondents (57%) participate solely in the U.S. markets, while slightly more than one-third of respondents (35%) participate both in the U.S. markets and abroad. The remaining 8% of respondents participate exclusively outside the U.S., in European or other markets.
- Respondents who indicated their participation in other non-U.S. markets noted their involvement in Canadian ABS, Australian ABS and RMBS and infrastructure-based receivables asset classes. See Figure 2 for details.

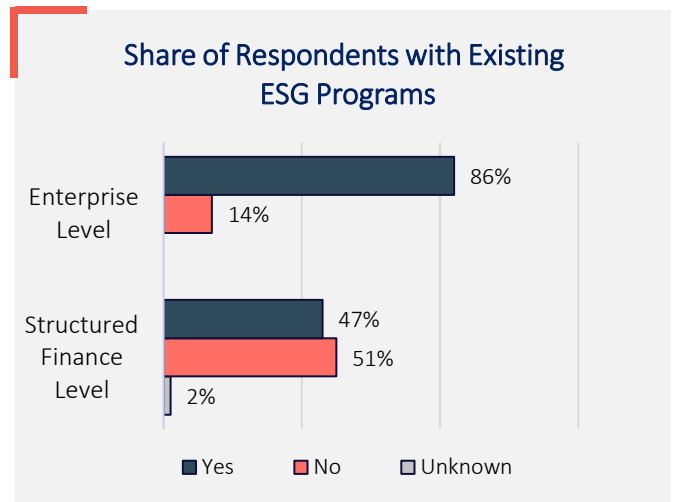
Figure 2



### ESG Programs, Resources and Goals

- Since ESG has been a hot topic in the U.S. equity market for almost a decade, it is not surprising that we found that ESG programs are currently more prevalent at the *Enterprise* level than at the *Structured Finance Business Unit* level. However, the securitization market is quickly gaining momentum.

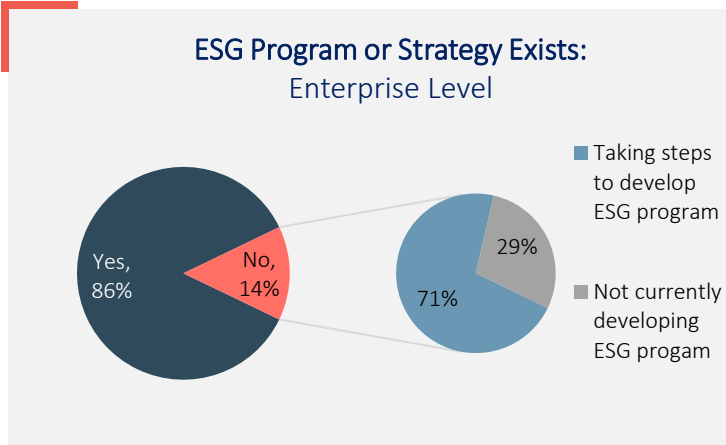
Figure 3



Further, we found that for those organizations without an ESG program in place, many are taking steps to develop a program.

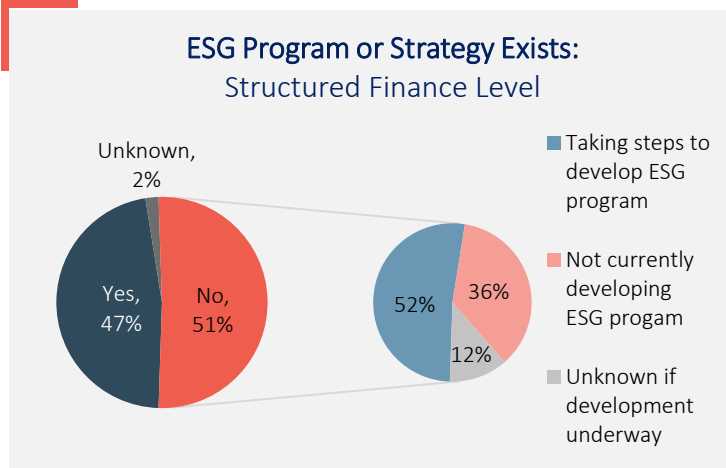
- In addition to **86%** of respondents indicating that their firm has a **defined ESG program or strategy** at the *Enterprise* level, an additional 10% of overall respondents indicated their firm is taking steps to develop one.

Figure 4



- That contrasts with **47%** of respondents indicating their firm has a **defined ESG program or strategy** at the *Structured Finance Business Unit* level and another 27% of all respondents are developing one.

Figure 5



## Goals & Timeline

- 55% of respondents with ESG programs at the *Enterprise* level reported they include target dates for the completion of certain goals, such as representation and make-up of board of directors and senior leadership representation, company operations, and guidelines on investment holdings.
  - Of these respondents, 30% are issuers and 39% are investors.
- By comparison, 43% of respondents with ESG programs at the *Structured Finance Business Unit* level reported having timelines for such goals.
  - Issuers and investors each make up 20% of these respondents.

Figure 6



Figure 7



## Budget and Resources

We found that of those market participants that indicated their organizations have an ESG program in place, they also reported that dedicated resources and budget are allocated to support the program.

- Twenty respondents (45%) report that their organizations have resources and budget dedicated to the *Enterprise* level ESG program, in addition to employees which are responsible for ESG.
- Seven respondents (16%) report that the ESG budget and resources is expected to increase in the next 5 years.





## Employees

Our survey results show that many respondents either have full time employees (FTEs) that are focused on ESG or have ESG teams in place. Additionally, organizations report that some employees are responsible for ESG as part of their job duties, both at the *Enterprise* and *Structured Finance* levels.

- The **majority** (72%) of respondents indicated that at the *Enterprise* level their organization has **ESG teams or FTEs** in place, and 24% of respondents indicated that some employees are responsible for ESG in their role. See Figure 8 for details.
- In contrast, at the *Structured Finance* level only **30%** of respondents indicated **ESG teams or FTEs** are in place, with 65% indicating that some employees are responsible for ESG in their role. See Figure 9 for details.

Figure 8

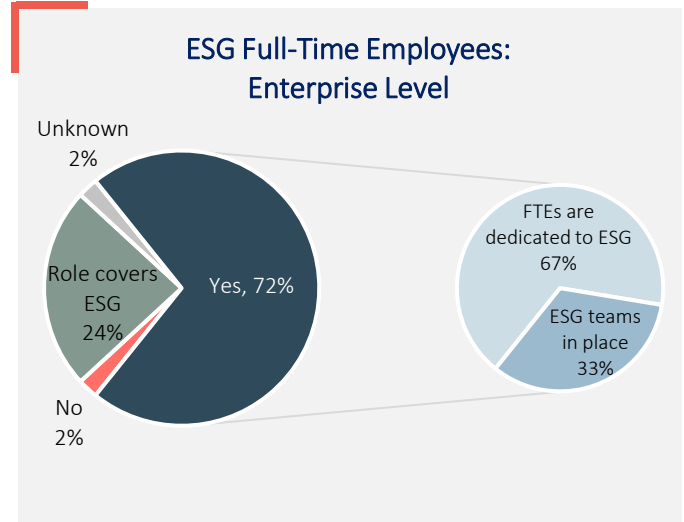
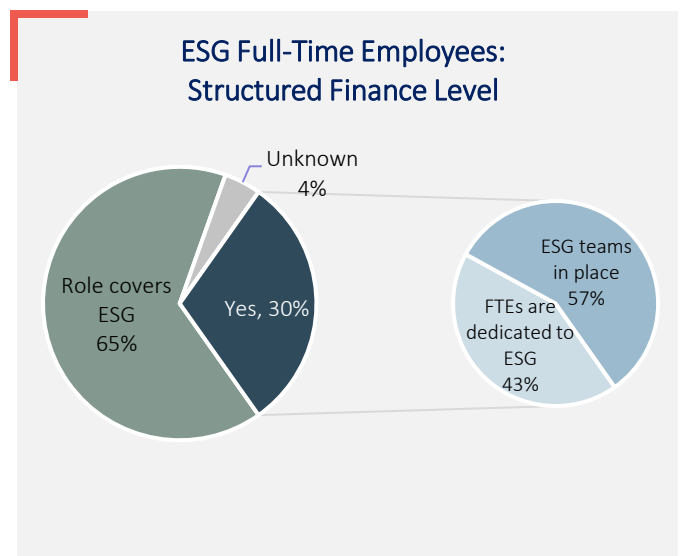


Figure 9



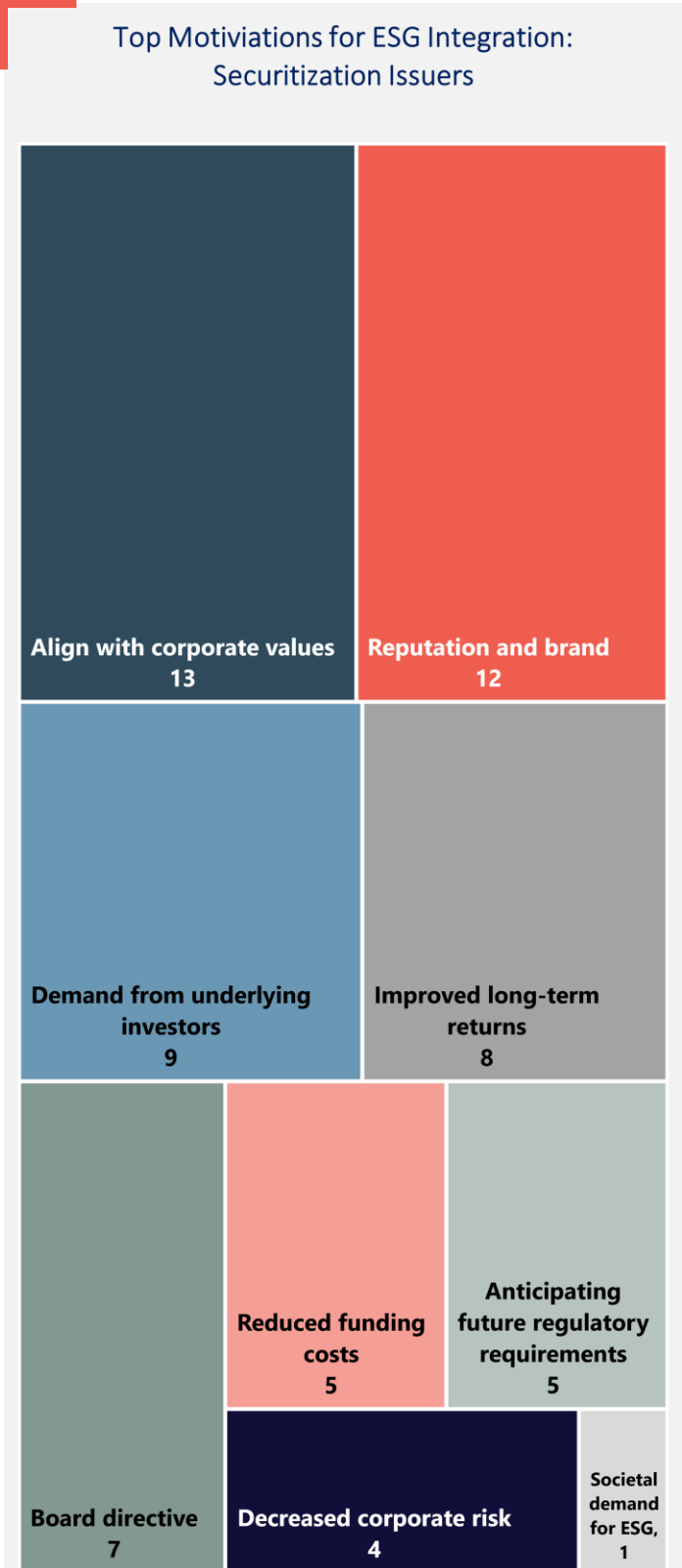
ESG Integration for Securitization Issuers

This section is focused on respondents that are issuers of securitizations. We sought to assess the various ways that ESG programs and frameworks are adopted at the parent level or in general business operations, and also the extent to which ESG strategies and practices are applied in the organization’s lending and securitization issuance activities.

Motivations for Implementing ESG Programs & Strategies

- Issuers cited the top two reasons for implementing ESG strategies are **corporate values alignment** and **reputation and brand**, followed closely by **demand from investors**.
- Over 50% of issuers also noted **improved long-term returns** and **board directive** as drivers to ESG implementation.
- Figure 10 shows the incidence of selection for factors on which issuers were asked to provide feedback.

Figure 10

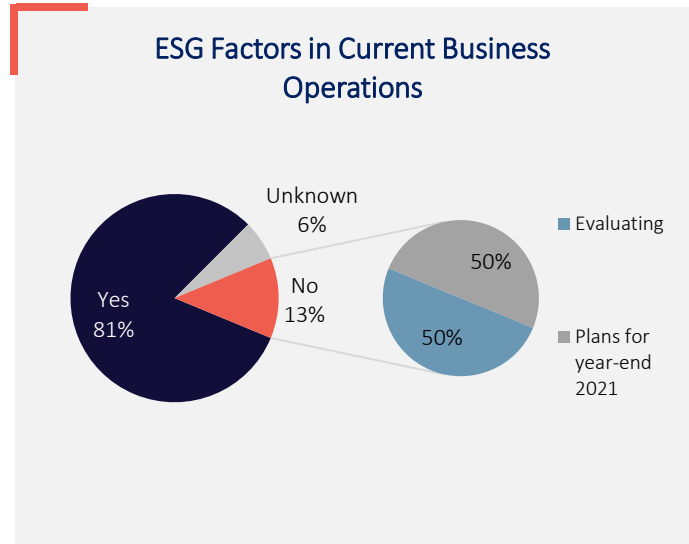


### ESG Considerations in Business Practices

Our survey found that among issuer respondents, significant consideration is given to ESG factors in their organization's overall business operations. Notably, for organizations that do not currently consider ESG factors, we sought feedback on their organization's evaluation of ESG considerations and whether there are plans for integration in the future. See Figure 11 for details.

- A **significant majority (81%)** of issuer organizations **currently incorporate ESG** into their business practices.
- For those who do not currently incorporate ESG, 50% are planning to do so by the end of 2021 and 50% are evaluating doing so.

Figure 11

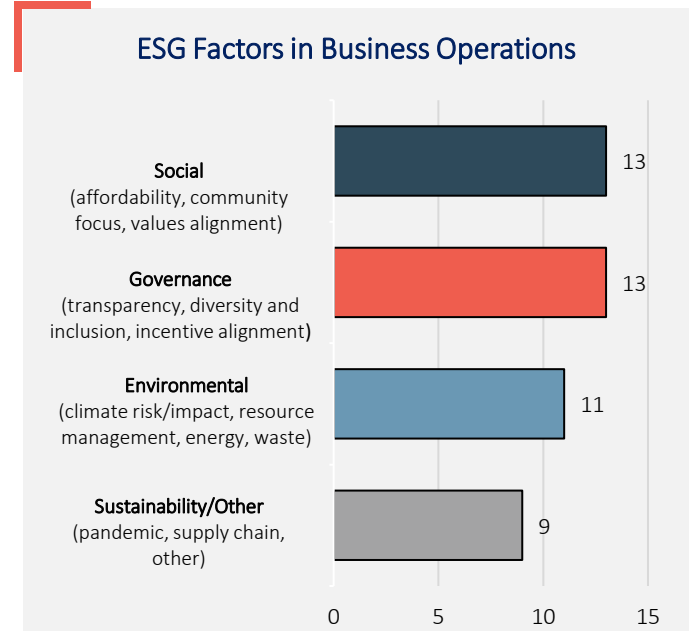


### ESG Factors: Which are Considered?

- Of the issuers that reported ESG factors are currently incorporated ESG into their business practices, **100%** indicated that both **Governance** and **Social** categories of ESG factors are considered in their business practices.
- Additionally, **Environmental** and **Sustainability** factors are considered by **85%** and **70%** of respondents, respectively, for incorporation into their business operations. SFA will follow these trends over the next year as we expect to see attention on both categories increase.

See Figure 12 for details.

Figure 12

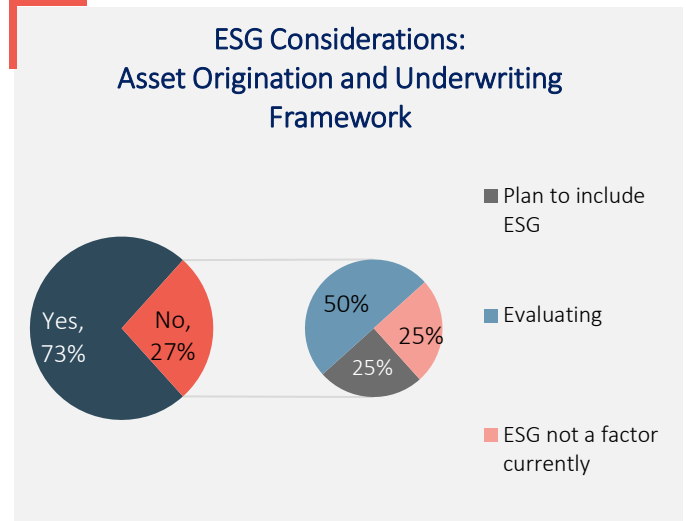




## ESG Considerations in Asset Origination & Underwriting Practices

- We drilled down further into how issuer respondents consider ESG factors. Specifically, we asked about the extent to which issuers consider ESG in their **asset origination** and **underwriting** frameworks.
  - Our issuer respondents originate a variety of asset types including RMBS and multifamily, and 73% of these issuer organizations currently incorporate ESG into their asset origination and underwriting frameworks.
  - For those who do not currently incorporate ESG factors, 50% report they are still evaluating incorporation and 25% plan to do so in the near future. Only one respondent indicated that ESG is not currently factored into their origination and underwriting.

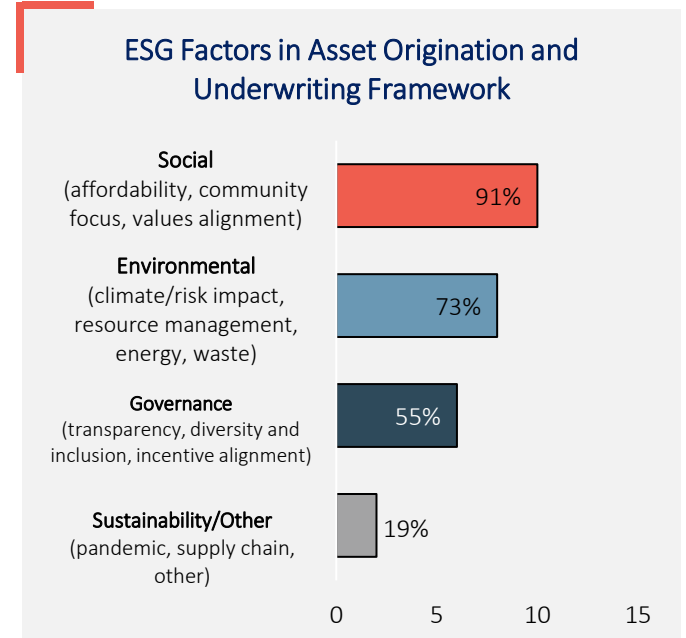
Figure 13



## ESG Factors in Asset Origination & Underwriting Practices

- We asked issuer respondents to indicate all of the broad categories of ESG considerations that they factor into their asset origination and underwriting practices.
  - Of the issuers that reported ESG factors are currently incorporated into their asset origination and underwriting, the top two categories they consider are **Social** (91%) and **Environmental** (73%).
  - More than half (55%) of respondents also consider **Governance** factors such as transparency, diversity and inclusion, and incentive alignment in origination and underwriting practices.

Figure 14



### Reporting of ESG Information: Parent Company

Our survey found that the majority (75%) of issuer respondents are either: currently providing parent company level ESG information to the public or investors, or they are evaluating or developing plans to do so:

- Reporting of ESG information is still a developing practice with just less than half of issuer respondents (44%) currently providing ESG data at the *Enterprise* level to the public or investors.
- The demands from the market is driving another one-third (31%) of issuers to evaluate or develop a plan to do so, and 50% of those respondents plan to do so in the next two years.
- Only 25% of respondents do not currently report parent company ESG data and have no plans or developments underway. See Figure 15 for details.
- Issuers that currently provide such ESG data furnish it in a number of formats, including:
  - Company website and corporate sustainability reports,
  - Investor presentations and direct investor engagement,
  - 10K or 10Q reports, and
  - Third-party reports such as rating agency reports.

Figure 15

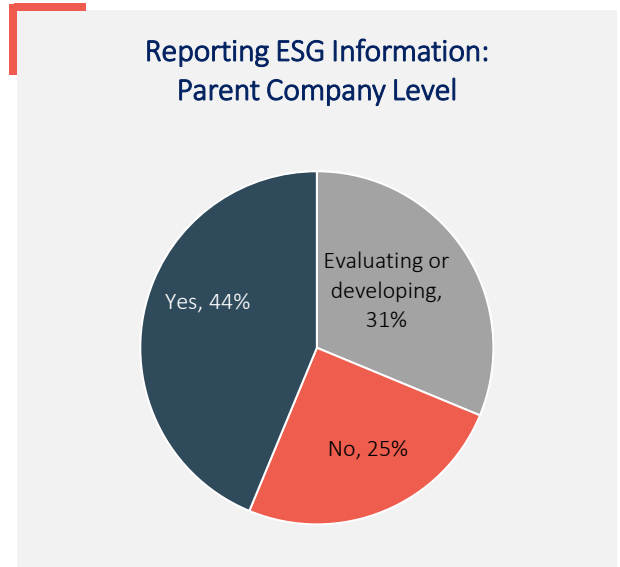
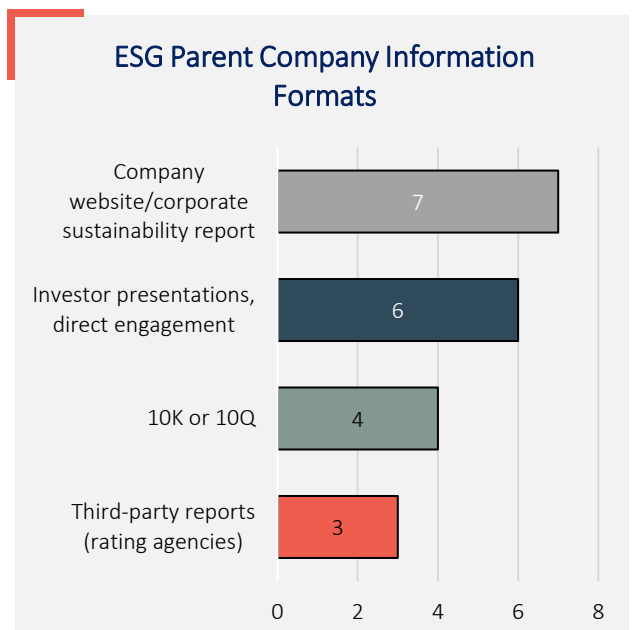


Figure 16



## ESG Information in Securitization Transaction Issuance & Reporting

Moving beyond issuers' practices on providing parent company level ESG data, we sought information relating to current practices for providing ESG information in documentation or reporting for securitization transactions.

- For securitization transactions only 6% of issuers currently provide ESG-related data.
- Most (94%) issuer respondents do not currently provide ESG-related data for their securitization transactions.
- However, more than one-third (38%) of respondents indicated that they are **evaluating or developing a plan to** provide ESG information for securitizations if they do not already do so.

See Figure 17 for details.

- Additionally, we found that issuers are evaluating and making plans to provide ESG-related information in their securitization transactions.
  - Issuers that are evaluating or developing a plan to provide ESG information expect to do so in the next two years.
  - These issuers also indicated that they plan to provide ESG data for securitization transactions in multiple formats.
  - The channel that is most popular for consideration is through **investor presentations and direct engagement**, followed by providing data on the **company website** or in **corporate sustainability reporting**.
  - However, those are only some of the channels by which information can be provided, with one respondent noting that they plan to disclose ESG data in the ABS offering document itself.

Figure 17

### Current Reporting of ESG Information for Securitizations

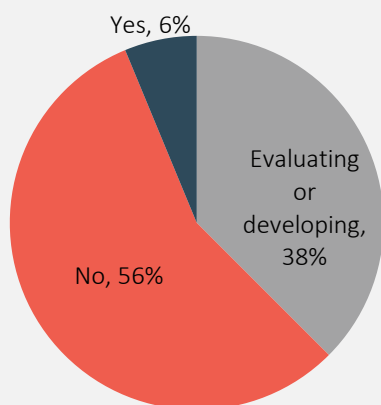
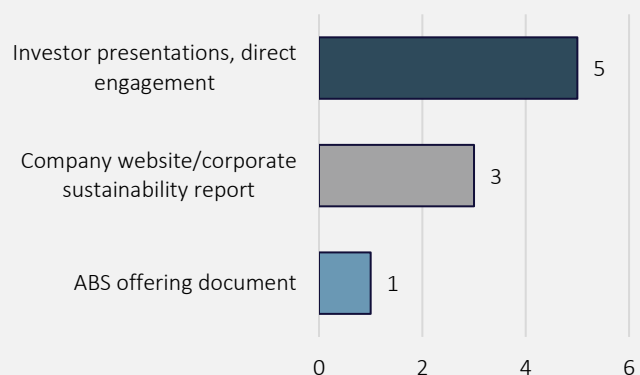


Figure 18

### Planned Formats to Provide ESG-related Data for Securitization Program

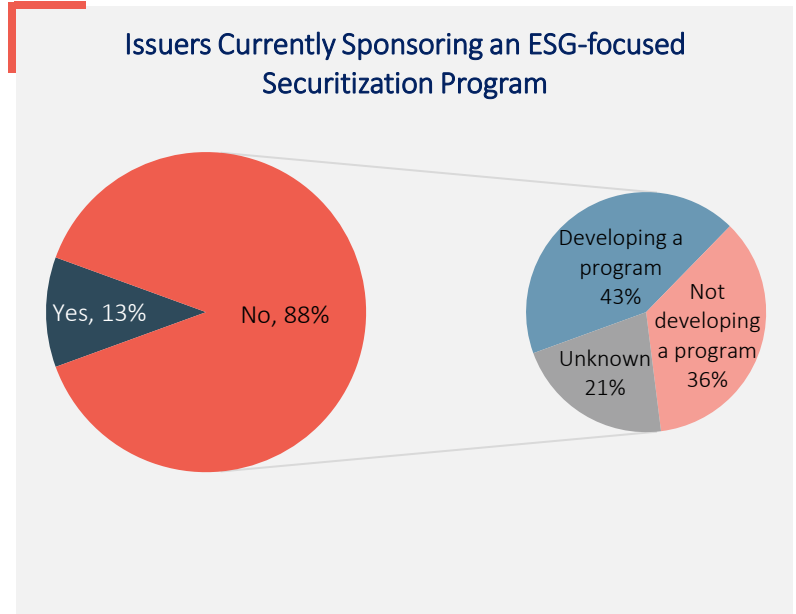


## ESG-Focused Securitization Platforms

In this section we share our findings on the development of securitization programs that are designed specifically with ESG considerations or targeted to ESG investors. Examples of this type of issuance program would include green, social, or sustainability bonds.

- Most issuer respondents (88%) do not currently sponsor a securitization issuance program that is targeted to ESG investors or that funds an ESG-focused asset origination program.
- The issuer respondents with such programs already in existence are in the housing finance asset classes.
- An important sign of the developing growth of ESG-focused issuance programs, 43% of issuers without an existing program report that they are developing one. This may not be representative of the broader securitization market given the likely correlation between issuers that respond to an ESG survey also being more likely to have plans for an ESG program.

Figure 19



## ESG Investing Strategies & Practices

This portion of the report provides insight into ESG programs, strategies and analysis of investments in structured products. Our questions aim to assess the various approaches that investors have for integrating ESG practices into their investing approach for structured products. The topics covered in this section include:

- Nature of existing ESG frameworks,
- Motivations for and approach to ESG investing,
- Prioritization of ESG factors,
- How ESG factors are analyzed and incorporated
- The role of Credit Rating Agencies

### Nature of Existing ESG Frameworks

The majority of investors (60%) indicated that their firm applies an **ESG framework to all investments**.

- In addition, more than one-third of respondents (35%) apply an ESG framework **to certain managed funds, portfolios, or client-directed funds**.
- Notably, the one firm without an ESG framework in place noted that the **top barrier** to ESG integration is the **cost of technology and operational integration**.

In addition to assessing how many investors apply ESG considerations in their investment decisions, we sought to understand the various stages of development for investors' ESG frameworks, overall and in the structured finance market.

- **58%** of investor respondents have ESG frameworks that are either **fully operational** (26%) or **advanced and still developing** (32%).
- Another 26% have ESG programs in existence that are still developing.
- Notably, one respondent reported that the status for their ESG program is in the early stages for structured finance but developing for other sectors.

Figure 20

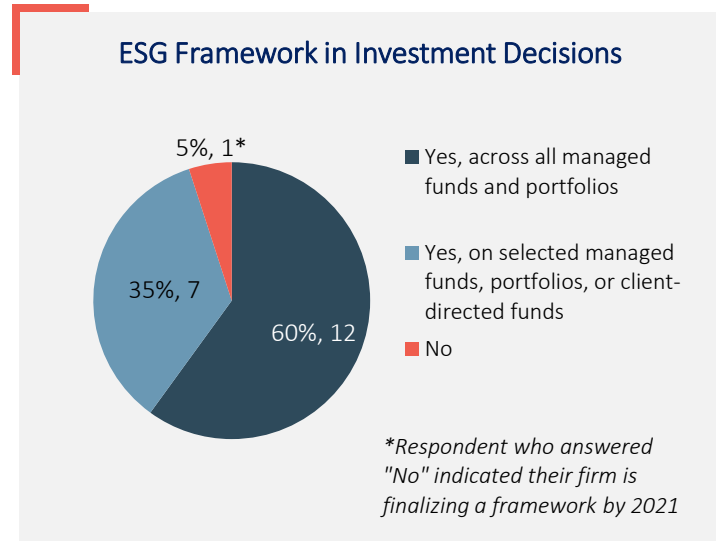
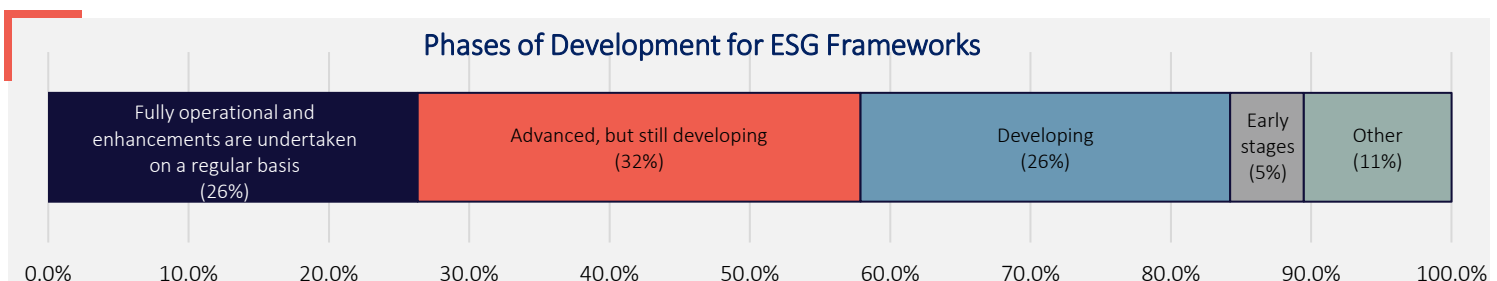


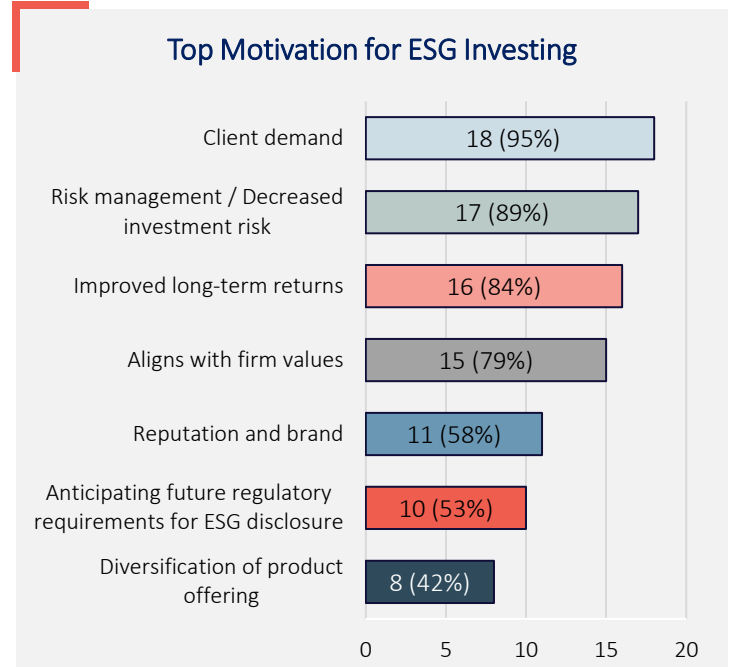
Figure 21



### Motivations for ESG Investing

- Nearly all investors (95%) indicated that **client demand** was a motivating factor for ESG investing, and 89% stated that **risk management** was a motivation.
- Improved long-term returns** (84%) and **alignment with firm values** (79%) were also key drivers for investors in implementing ESG investing.
- Less common motivations that were identified by **more than half** of respondents were **reputation and brand** (58%) and **anticipating future regulatory requirements** (53%).

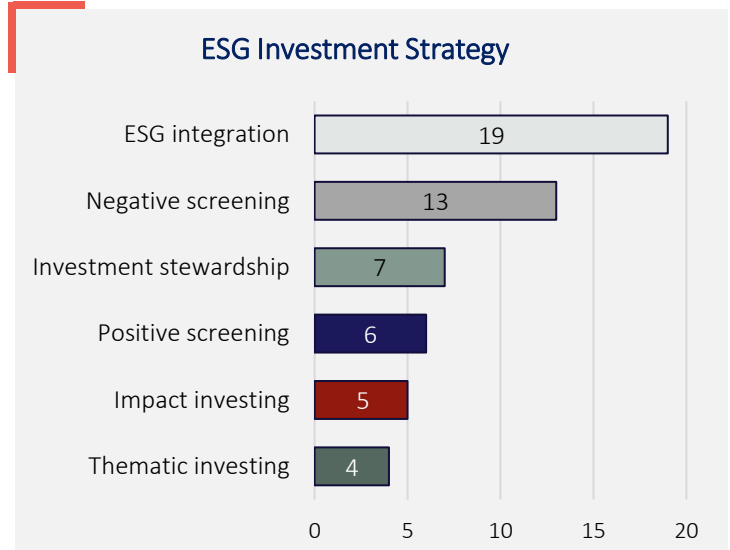
Figure 22



### Approach to ESG Investing

- The most common approach for applying ESG in their investment decisions is **broad ESG integration**, with **95%** of investor respondents indicating use of this strategy.
- The second most common approach to ESG investing is **negative screening** (65%).
- Less than half of respondents indicated that **investment stewardship** (35%), **positive screening** (30%), **impact investing** (25%) and **thematic investing** (20%) are part of their strategy.

Figure 23





### Prioritization of ESG Factors

Securitization investors currently focus on a myriad of metrics within each category of **Environmental, Social and Governance** factors to assess ESG within structured products.

- Of the metrics we polled, the Governance factors dominate other categories that investors incorporate into their analysis, with **structure & oversight** considered by **93%** of respondents.
  - As a close second, **87%** of investor respondents look at **financial & operational** risks as well as **transparency & reporting** factors.
- Of Social factors, more than half (**53%**) of investor respondents look at **workforce & diversity** and **inclusion of all communities** in their analysis.
- By far, the top factor in the Environmental category is **greenhouse gas emissions** with a majority of investor respondents (**67%**) assessing that factor.

Figure 24 on the following page details the popularity of these factors for investors that provided feedback.



Figure 24

ESG Evaluation Factors for Investments in Structured Products

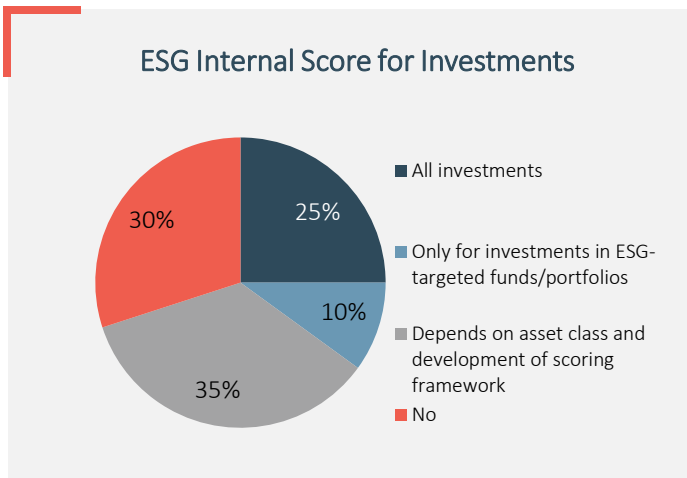


### Approach for Incorporating ESG factors

Our findings show that investors' use of **internal ESG scores** to evaluate investments varies considerably.

- **25%** of survey respondents assign an internal ESG score to **all investments**, and 10% do so only for investments that are included in ESG-targeted funds.
- Of the remaining 65% of investors, 35% assign ESG scores on a case by case basis, which for the most part is dependent upon the type of investment (equity, fixed income, or structured products).
- 30% of investors currently do not apply internal ESG scores when evaluating investments.

Figure 25



Additionally, we asked investors to identify their approach for utilizing data and information sources to evaluate structured products from an ESG perspective.

- More than a two-thirds majority (**68%**) of investors take a **comprehensive approach utilizing multiple data sources** to make an ESG assessment for investments in structured products.

Figure 26

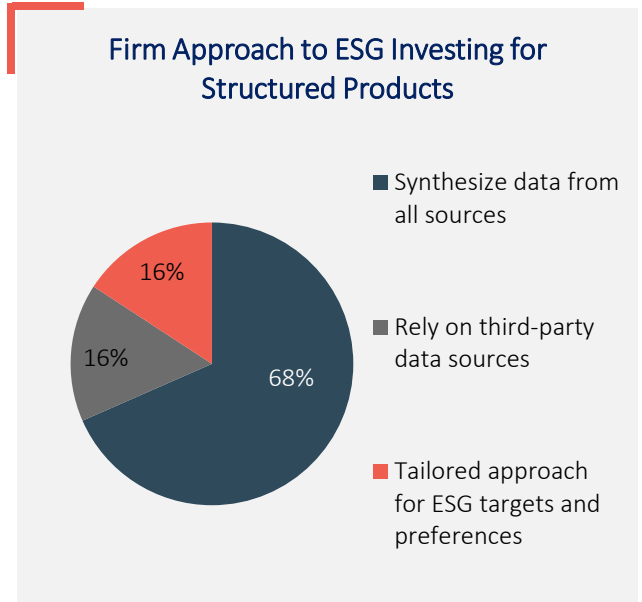
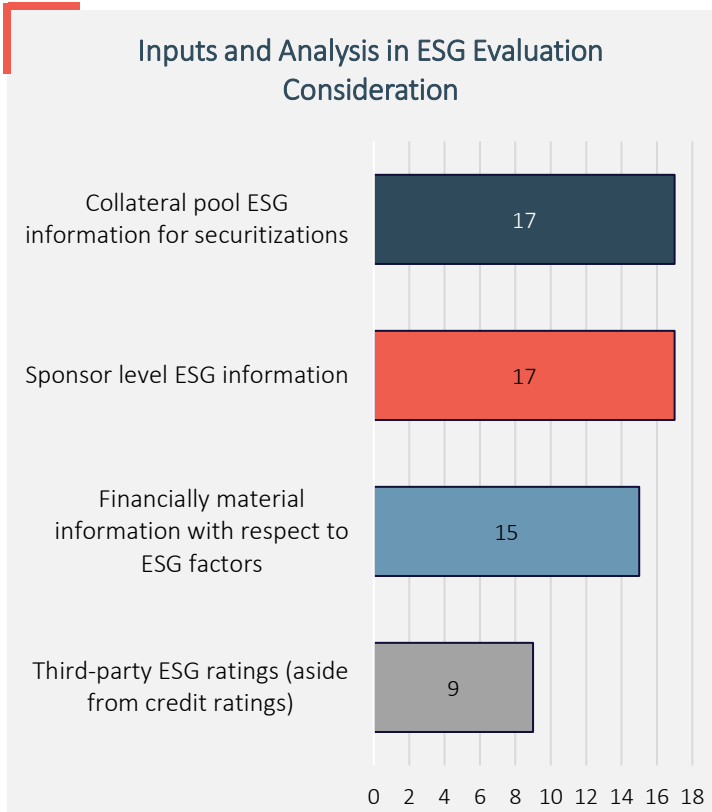
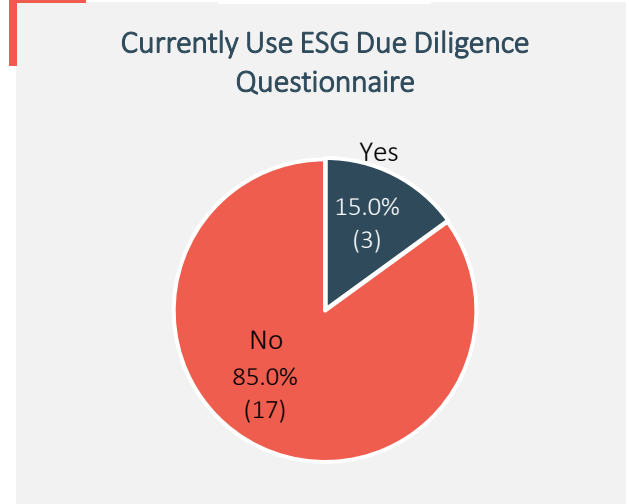


Figure 27



- 85% of investors use both **collateral pool** data and **sponsor** information in their ESG analysis of structured products.
- 75% of investors consider ESG factors that are **financially material**.
- The use of **third-party ESG ratings** is currently far less prevalent for structured finance, with just shy of half (45%) of investors utilizing such ratings.
- Notably, 30% of respondents use all four of these inputs in their assessment.

Figure 28



- Corresponding closely to the fact that only 8% of issuer respondents currently provide ESG reporting for structured finance transactions, a small minority of investors (15%) currently send an ESG questionnaire to issuers in order to gather data as part of their ESG evaluation.

### Role of Credit Rating Agencies

- 60% of investor respondents expressed the opinion that credit rating agency criteria does not adequately address ESG factors for structured products.
- Further, over one-third (35%) of investors do not believe rating agencies provide sufficient information on how ESG factors are incorporated in the credit ratings for structured products.
- A majority of investor respondents (60%) indicated that credit rating agencies should not assess ESG factors beyond credit quality for structured products.
- However, a greater majority of investors (75%) believe there is a need for a separate ESG impact score for structured finance transactions.
- See Figures 29 - 32 on the next page for a visualization of investor respondent feedback.

Figure 29

Credit Rating Agencies Adequately Address ESG Risks and Opportunities

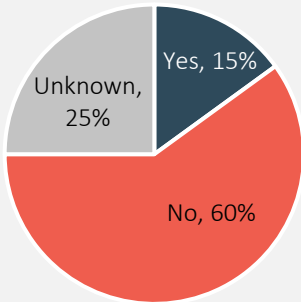


Figure 30

Credit Rating Agencies Provide Sufficient Information on ESG Factors in Credit Ratings

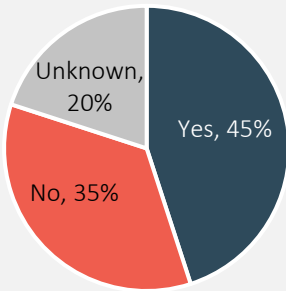


Figure 31

ESG Score Needed for Structured Products

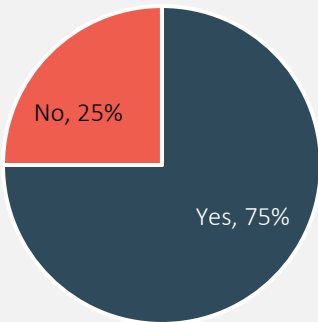
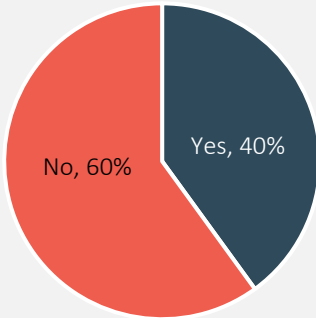


Figure 32

Credit Rating Agencies Should Assess ESG Beyond Credit Quality



## Next Steps for ESG in Structured Products

- SFA's ESG Task Force will continue to engage with market participants to advance industry engagement on ESG applications for structured products. That engagement will take the form of:
  - broad ESG topics impacting our market, such as regulatory and legislative developments, and
  - exploring the development of an ESG disclosure framework.
- SFA polled market participants on their preferences for the direction and scope of a disclosure framework for ESG in structured products. 59% of respondents indicated an interest in a general disclosure framework, with 41% of respondents indicating a preference for an asset-class specific disclosure framework.
- Of those interested in an asset class specific framework, 62% of respondents chose a framework for **commercial real estate**, 57% requested a **residential mortgages** framework, and 48% chose an **auto lease/loan** framework. Somewhat predictably, the top four preferred asset types for the development of an ESG disclosure framework aligns with the asset classes with the top four issuance volumes. See Figure 33 for details.
- If you would like to get involved in these efforts, click here for more informaton about [SFA's ESG initiative](#).

Figure 33

