STRUCTURED FINANCE ASSOCIATION

SFA Research Corner

Calls for Consistent, Comparable Climate-Related ESG Disclosures

March 2, 2021

WHAT WE'RE WATCHING

Managing financial risks associated with climate change are key points in the ESG discussion. The core challenge for regulators and financial markets is twofold - the lack of a systemic and broadly accepted method for analyzing, modeling, or pricing climate risks, and the absence of well-developed supervisory frameworks. These challenges make comparability difficult across institutions, industries and investment products, as noted by the Federal Advisory Council and Board of Governors.

COMING SOON: NEW EPISODE OF SFA'S *BRIGHT IDEAS* PODCAST

In this week's episode of *Bright Ideas*, SFA's CEO Michael Bright and President Kristi Leo sit down with dv01's CEO Perry Rahbar and Strategy Principal Charlie Oshman for a conversation on ESG and why it's taking the finance market by storm.

The new episode will be released on Wednesday and available on SFA's website and social media channels, LinkedIn & Twitter. Stay tuned!

Over the past few weeks, the Federal Reserve, the SEC and the House Committee on Financial Services have addressed these challenges directly. While these discussions have focused specifically on the equity markets and corporate governance, how these challenges are resolved in the broader markets will ultimately influence how the structured finance markets address its own unique ESG-related reporting challenges, an effort led by SFA and its membership.

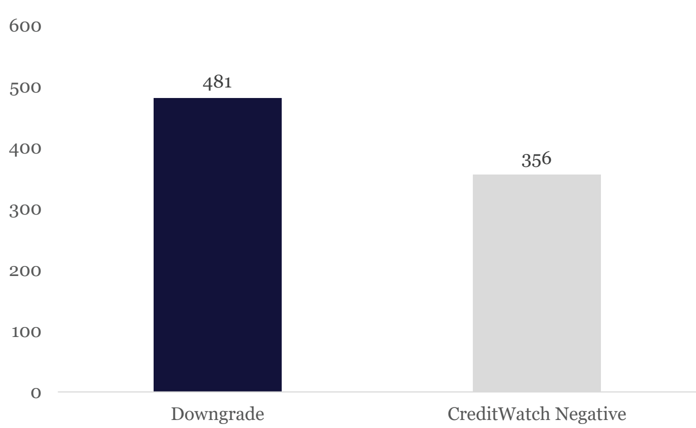
Speaking at the 2021 IIF U.S. Climate Finance Summit: Financing a Pro Growth Pro Markets Transition to a Sustainable, Low-Carbon Economy, Federal Reserve Governor Lael Brainard expressed her support of "standardized, reliable and mandatory disclosure" of climate risks. Although Governor Brainard lauded the importance of "industry-led" efforts such as the Financial Stability Board's Task Force on Climate-Related Financial Disclosures (TCFD) for their work towards "consistent" climate-related financial disclosures, she raised concerns around "variable quality, incompleteness, and a lack of actionable data" arising from voluntary disclosure practices. At the same event, Acting Director of the SEC's Division of Corporation Finance, John Coates, suggested that the SEC "should help lead" the creation of the disclosure system.

On February 24, acting SEC Chair Allison Herren Lee issued a public statement directing the Division of Corporation Finance to enhance its focus on climate-related disclosure in public company filings. The current focus will "review the extent to which public companies address the topics identified in the [SEC's] 2010 guidance, assess compliance with disclosure obligations under the federal securities laws, engage with public companies on these issues, and absorb critical lessons on how the market is currently managing climate-related risks." Insights gleaned will be used to update the 2010 guidance on climate change matters. "Ensuring compliance … and updating existing guidance are immediate steps the agency can take on the path to developing a more comprehensive framework that produces consistent, comparable, and reliable climate-related disclosures."

Climate-related disclosures was again addressed at the February 25 meeting held by the House Financial Services Subcommittee on Investor Protection, Entrepreneurship and Capital Markets. While all could agree that transparency was necessary to mitigate financial risk resulting from climate change investors, shareholders and taxpayers, some questioned whether mandated disclosures and prescriptive proposals could pose barriers to some businesses. Climate-related disclosures was also addressed by Chair Powell at a recent Senate Banking Monetary Policy hearing. Although Chair Powell did not commit to supporting mandatory disclosures during the hearing, he agreed that a move towards a standardized disclosure template was the goal over time.

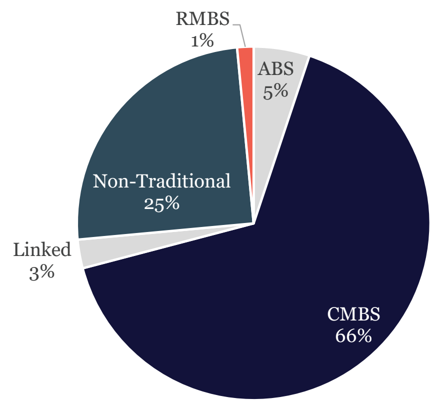
For S&P Global, environmental factors have yet to contribute to a rating action in structured finance. Between April and December 2020, S&P Global downgraded 481 structured finance ratings and placed another 356 ratings on CreditWatch Negative. All were attributed to pandemic-related Health and Safety ESG factors. "Roughly 70% of all actions were concentrated in (mainly U.S.) commercial mortgage-backed securities (CMBS), with a further 24% in nontraditional structured finance asset classes (such as wholesale business, aircraft, container, railcar, timeshare, small."

S&P: COVID-Related Health and Safety ESG Factors Led to Negative Rating Actions



Source: S&P Global Ratings

Rating Actions Related to ESG Factors Concentrated in U.S. CMBS



Source: S&P Global Ratings

Data and disclosure challenges notwithstanding, rating agencies have increased transparency around the application of ESG credit factors to structured finance (For more details see Moody's, Fitch, S&P, DBRS Morningstar, and KBRA.) Recently, S&P announced that they will publish ESG report cards on major structured finance sectors which will "list ESG factors that may have a more positive or negative influence on transaction credit quality and establish a benchmark for the relative ESG exposures in each asset class."

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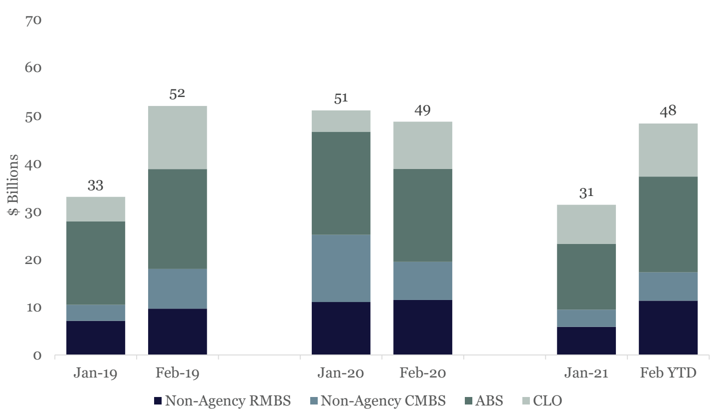
MARKET SUMMARY

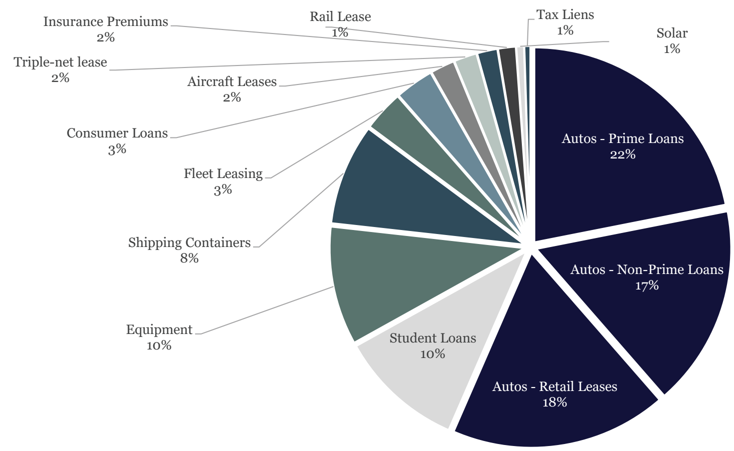
Over $48 billion of non-agency RMBS and CMBS, ABS and CLOs came to market in February, bringing year-to-date totals to $79 billion. Steady demand kept prices in the secondary market firm, and bid-ask spreads for the most liquid, benchmark products broadly unchanged. We have included Ginnie Mae REMIC transactions to our SOFR data library; SOFR-based securitizations to-date near $19 billion.

Issuance for Non-Agency RMBS and CMBS, ABS, and CLO 2021 YTD ($79 Billion) Versus 2019, 2020



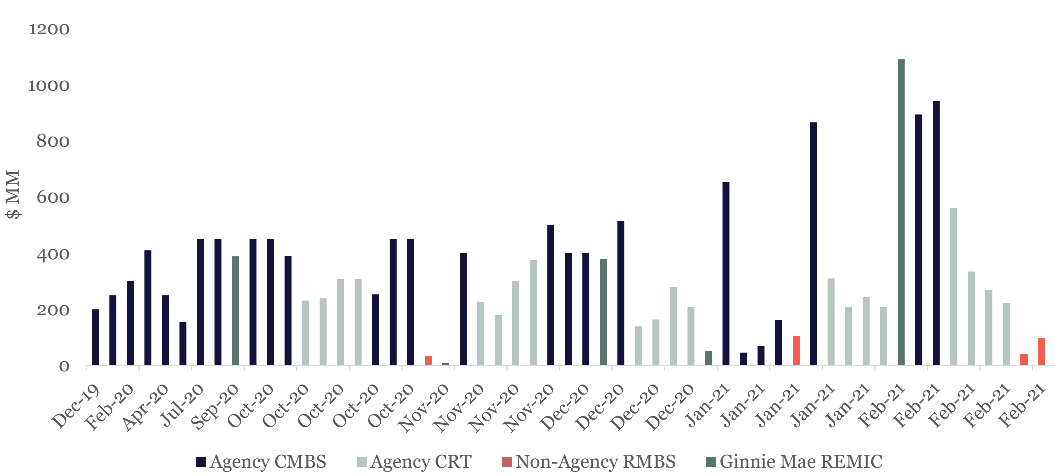
Source: Market Compilation

ABS Only 2021 YTD ($32.8 Billion)



Source: Market Compilation

SOFR-Based Structured Finance New-Issue Volume 2019 to 2021 YTD: $18.9 Billion



Source: Market Compilation

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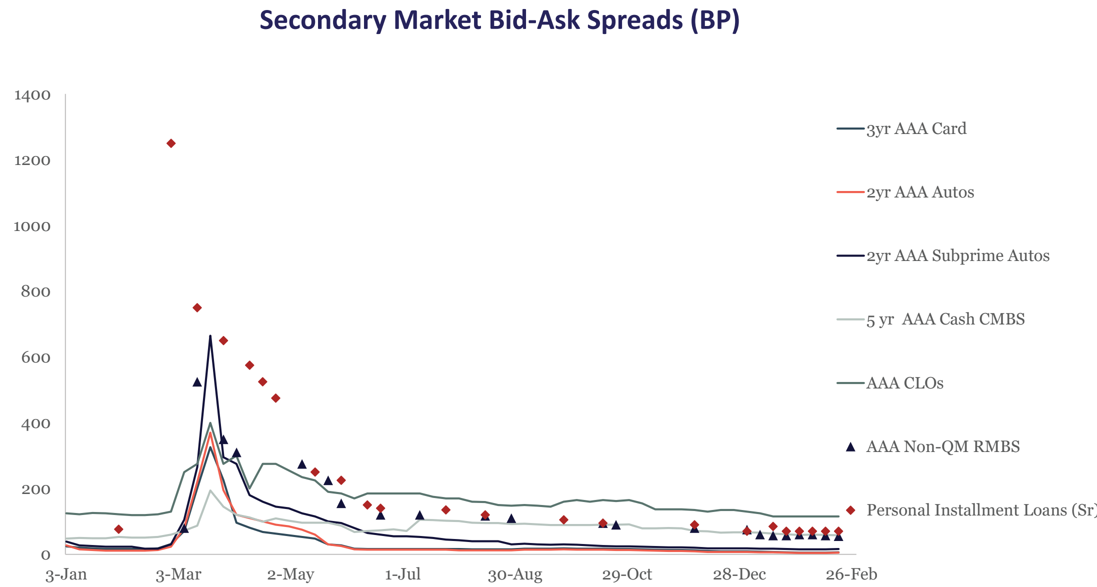

Source: Market Compilation

Secondary Market Bid-Ask Spreads		
(bps)	19-Feb	12-Feb
3yr AAA Card	6	5
2yr AAA Prime Autos	5	4
2yr AAA Subprime Autos	16	15
5yr AAA Cash CMBS	58	59
AAA CLOs	115	115