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STRUCTURED FINANCE ASSOCIATION

ESG Market Sentiment Survey: Securitization Issuer & Investor Perspective

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SFA's 2nd Biennial ESG Market Sentiment Survey: Issuer and Investor Perspective

The Structured Finance Association surveyed structured finance market participants for our biennial survey, tracking the extent to which environmental, social and governance (ESG) disclosure metrics are incorporated, or being considered for incorporation, within the structured finance market both at the Enterprise level and at the Structured Finance Business Unit level. Additionally, comparing 2022 data to 2020 data, our results provide insight into how ESG disclosure and investment strategy alternatives have evolved over the past two years.

Survey Key Takeaways

ESG disclosure and investing within structured finance grew 15% in last 2 years
– led by the investor community

Issuer disclosure is growing thoughtfully
-40% providing some ESG reporting and
- another 40% seriously considering or evaluating it

Top ESG integration motivator for Issuers continues to be *"Ongoing Demand from Investors"*

ESG disclosure in the structured finance market has begun to incorporate a broader range of asset classes including RMBS, CMBS, Auto, Personal Loans, Data Center, PACE, Rail

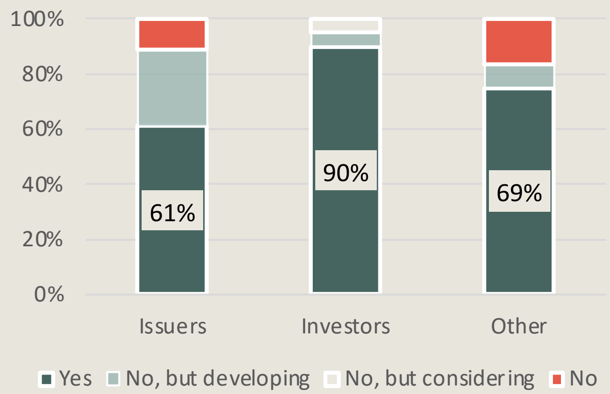
***"Client Demand"* and *"Alignment with Firm Values"* continue to be top ESG Investor motivators**

ESG investment strategies are shifting to meet underlying client demand - with *"ESG integration"* still leading the way and *"Impact Investing"* seeing a doubling

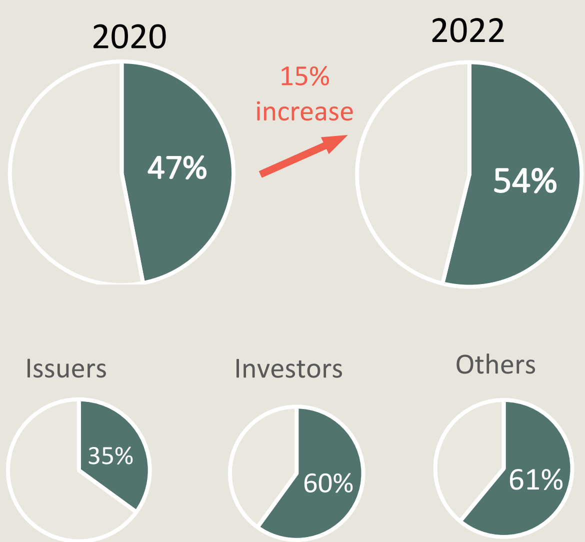
Disclosure is a fundamental imperative
– with collateral-level information being most important

ESG disclosure and investment strategies within structured finance grew 15% in last 2 years

ESG Program at *Corporate* Level
(2020 vs. 2022)



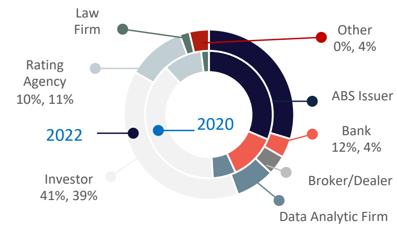
ESG Program at *Structured Finance* Level
(2020 vs. 2022)



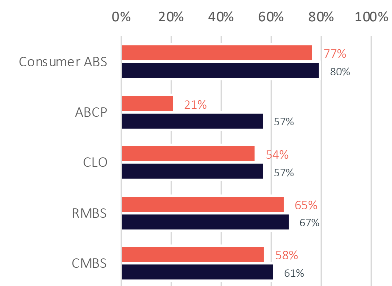
Survey Respondents

In the inaugural year of the SFA Bi-Annual ESG Industry Engagement Survey (2020), 49 firms responded—representing diverse perspectives across the securitization market—compared to 55 respondents in the second Bi-annual Survey (2022).

by Participant Type
(2020 vs 2022)



by Market Sectors Participation
(2020 v 2022)



Note: Survey participants voluntarily responded. Thus, there may be a self-selection bias in the results; the sentiments of those who responded to the survey may differ from the market as a whole.

In line with current global market trends, our 2022 survey results show that a **majority (73%) of the responding market participants have a defined ESG program at the corporate level with only 8% stating they do not.**

An additional **17% of overall respondents indicated their firm is taking steps to develop one.** Looking under the hood, significantly more institutional investors (90%) have Corporate ESG programs compared to a lower but still healthy number (61%) of structured finance issuers.

Two major factors leading to this difference are the:

1. comparably larger size of the typical institutional investment firm versus the size of the average structured finance issuers' firm
2. growth of ESG disclosure has been in large part driven by investors – as discussed further below

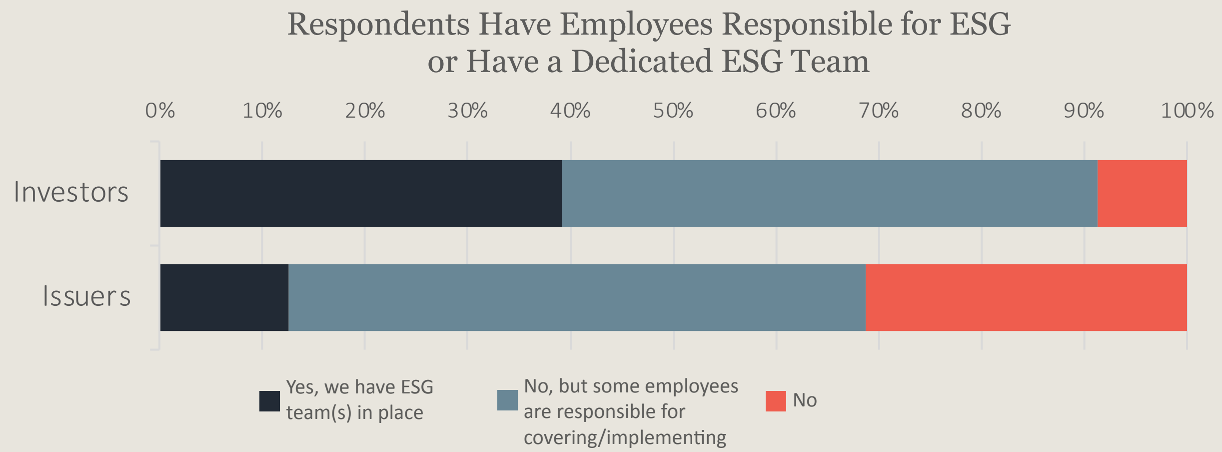
Investors are leading ESG evaluation in structured finance

The latest trends point to continuing rapid evolution of the ESG space within the structured finance market. Survey results show progress, with **over half of respondents (54%) reporting that they have a defined ESG Program at the structured finance level**, a 15% increase from 2020 levels.

> **"The incorporation of ESG disclosure within structured finance has naturally followed behind the corporate and equity market given the differing nature of the issuance that is backed by a specific collateral pool."**

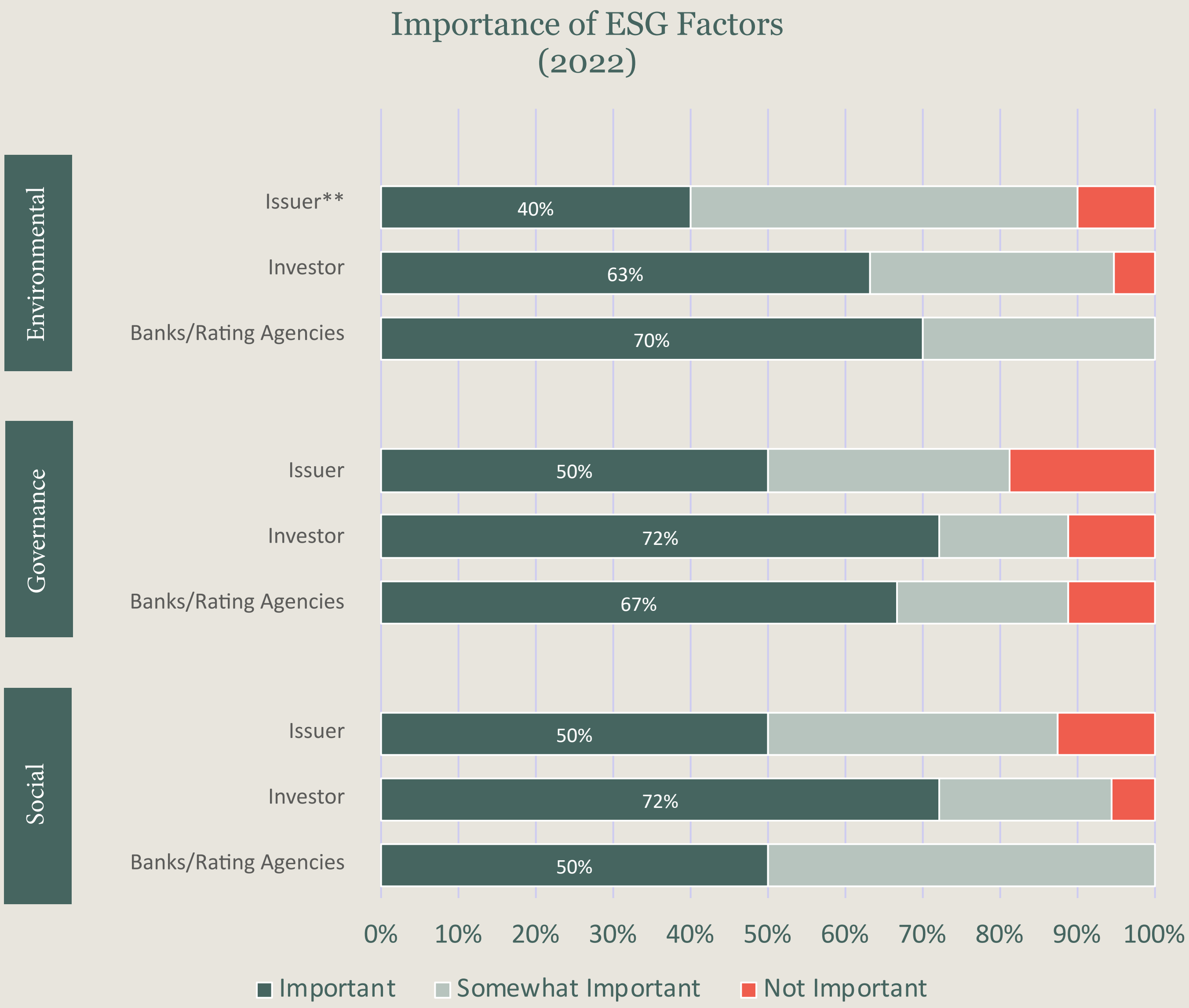
Kristi Leo
Structured Finance Association

In line with the growth of ESG disclosure, more firms are allocating resources to ESG programs with the majority of respondents (85%) stating they have full-time employees (FTEs)—either responsible for implementing ESG within their job functions or supporting an ESG program—at the structure finance level.



Environmental, Social and Governance are all important disclosure metrics

Similar to our 2020 survey result, the vast majority of structured finance investors, banks and rating agencies responding believe that environmental, social and governance **factors are important (versus somewhat important or not important) to evaluating structured finance investments. However, while only 10 – 20%** of issuer respondents answered that ESG is not important, there is a noticeably lower percent of issuers that find it important as compared to investors.



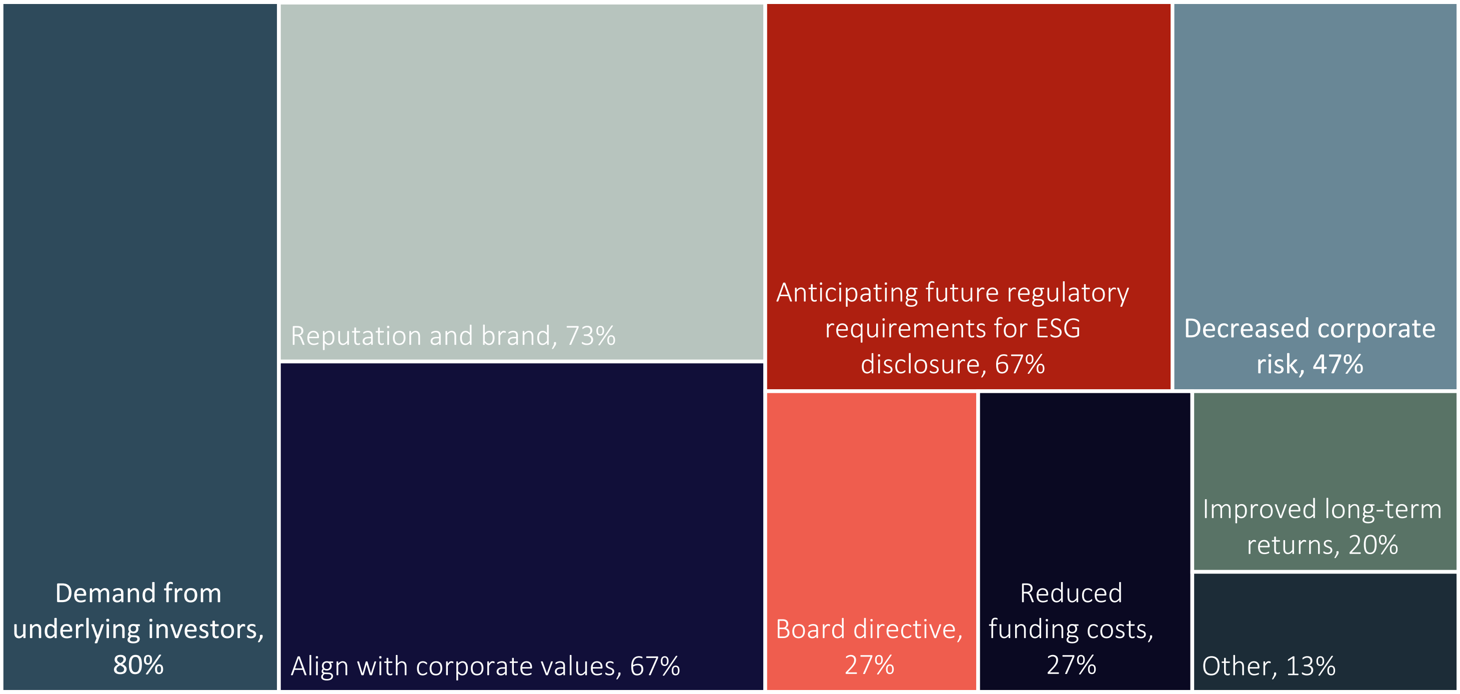
** Notes: We removed the Unsecured Consumer issuer respondents from this 'Environmental' chart so as to not skew the result. All of the Unsecured Consumer issuers responded that 'Environmental' factors are not important, most likely due to the lack of collateral. Based upon work of the SFA's ESG Disclosure Initiative, structured finance investors generally agree with the issuers that 'Environmental' factors are not important for unsecured consumer assets. However, investor respondents to this survey answered this question with various asset classes, not just unsecured consumer loans, in mind.

Issuer Participation is Growing Thoughtfully

Investor demand still top driver for issuers

Global investor demand for ESG disclosure continued to rise across all facets of the capital markets during 2022. **80% of securitization issuers report that the top motivator for ESG integration continues to be ongoing demand from underlying investors.** This was followed by more than **65%** stating that “alignment with corporate values” and “firm reputation” were strong motivators.

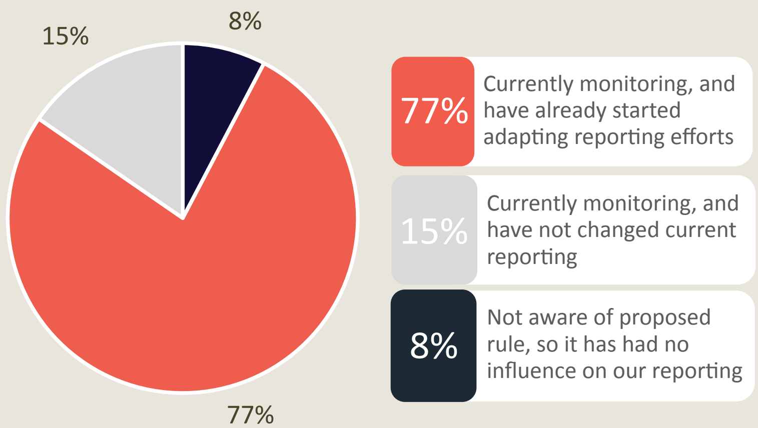
2022 Motivations for ESG Integration
(as % of total issuer respondents)



Issuers are carefully monitoring changing regulatory landscape

Since the publication of SFA's 2020 survey results, the Securities and Exchange Commission's (SEC) proposed rules for climate disclosure – and the issuer respondents are carefully monitoring this development. **Roughly 67% of issuers are reviewing ESG disclosure strategies amid the changing regulatory landscape and anticipate new disclosure requirements at the corporate level.**

SEC's proposed rule influenced your ESG reporting efforts (2022)



"We are continuing to evaluate industry disclosure trends and scope of information that would be meaningful and impactful for our securitization program."

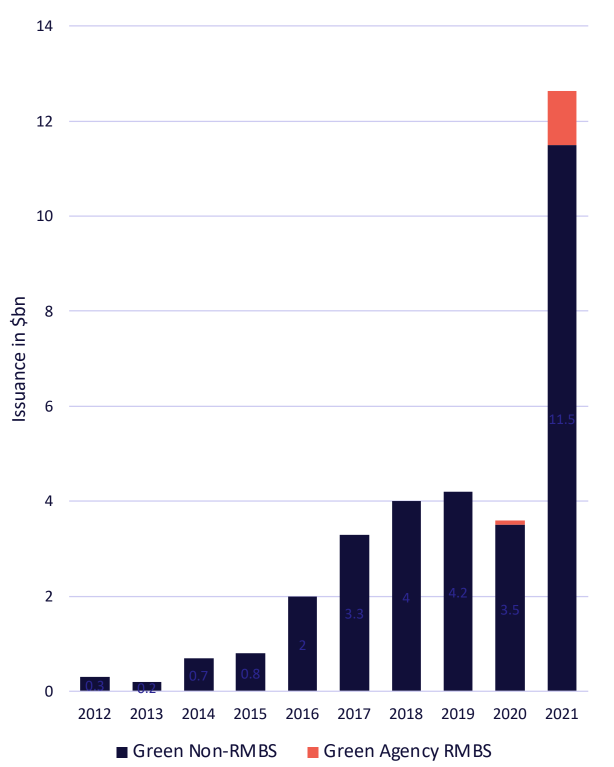
Julia Landes
Harley-Davidson

Significant green issuance growth in percent terms; remains small portion of overall market

Green bond issuance more than tripled in 2021, but remains a small percentage of the overall structured finance market. At just under $13bn, green issuance was a fraction of the $4.4tn total of structured finance issuance in 2021, which is also quite small compared to corporate green issuance at almost $400bn in 2021.

The largest asset class in structured finance green bonds is solar, with residential mortgages, led by the GSEs, adding a significant volume beginning in 2020. Other asset classes issuing in the space include autos, PACE, data centers, rail, and rate reduction bonds.

Green Issuance in Structured Finance (2012-2021)

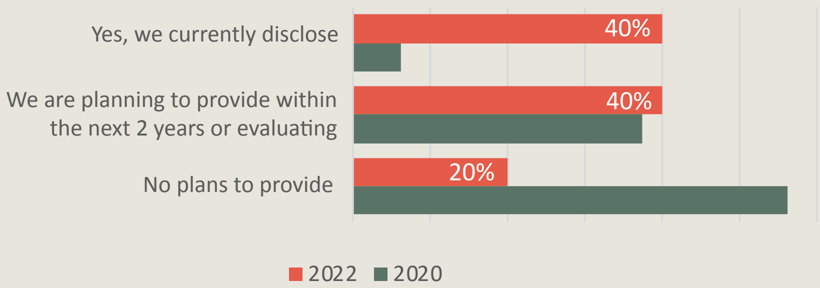


Source: SFA market compilation, Deutsche Bank, Fannie Mae, Freddie Mac

Disclosure is a fundamental imperative

Reporting of ESG information for securitization transactions has seen a significant increase since 2020. While just over a majority of issuer respondents do not have plans to issue sustainable securitization bonds, the vast majority are now providing (or are planning to provide) investors with ESG reporting: **40% of respondents are reporting this information** and **another ~40% are either evaluating or planning to provide within the next two years.**

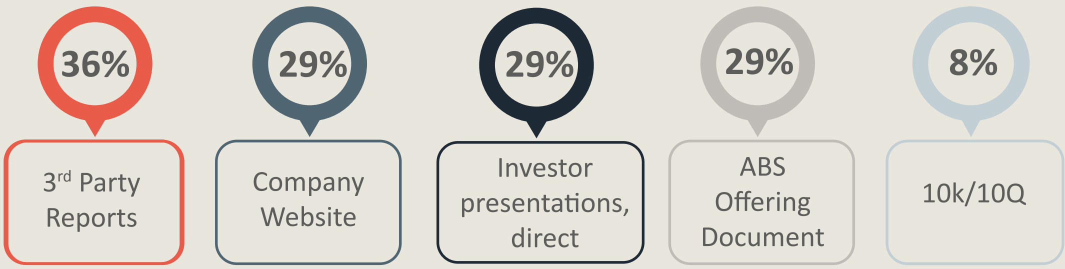
Issuers Disclose or Planning to Disclose
ESG Information for Securitization Transactions
(2020 vs. 2022)



ESG-related data reported across a broad range of document types

For firms who do not plan to provide ESG disclosure, the two main reasons cited were significant costs and the lack of a need to convey sustainability strategies via an ESG structured finance instrument.

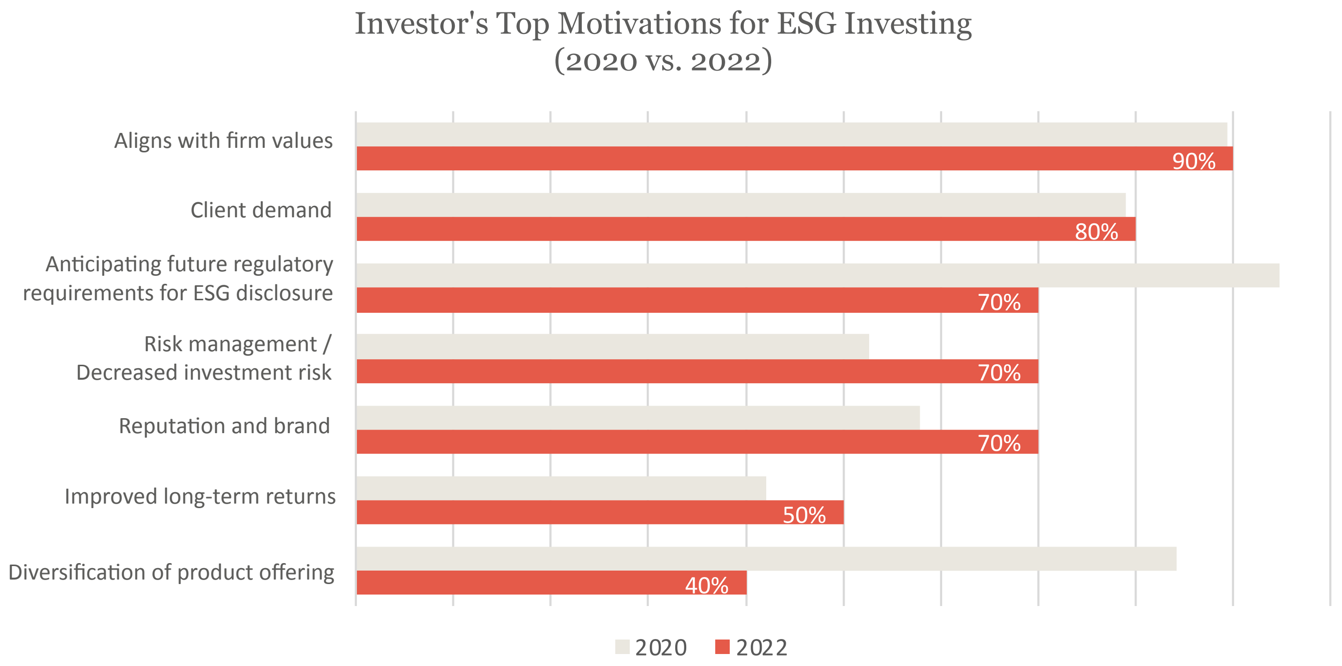
Where ESG Information is Reported Today



Investors Actively Seek ESG in Structured Finance

Client demand and firm values are leading investor motivators

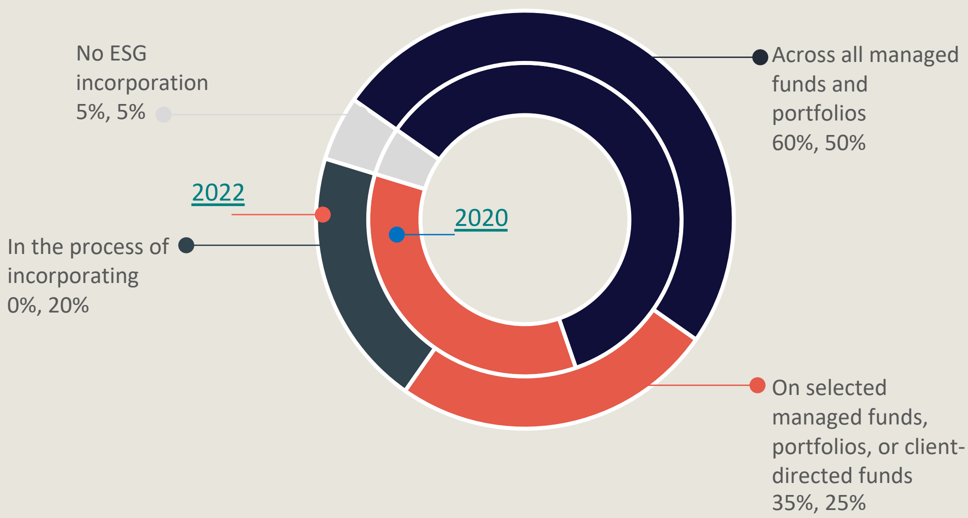
Institutional investors are increasingly looking to incorporate ESG investment strategy alternatives within the structured finance market. This is driven both by underlying client demand, the search for better long-term financial value, and a pursuit of better alignment with corporate values.



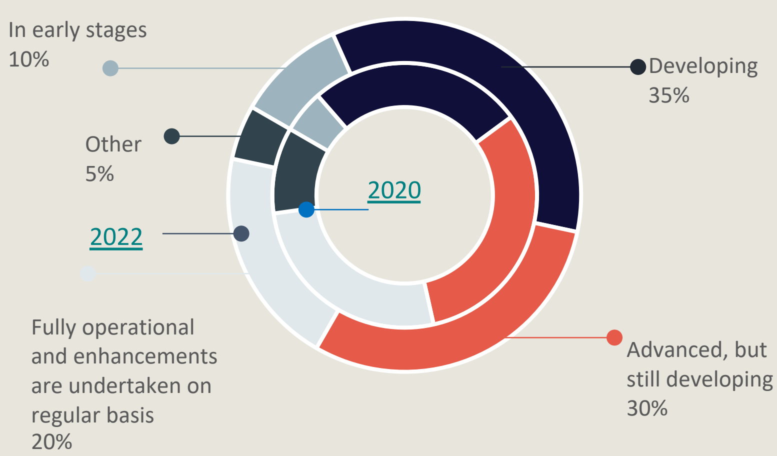
In SFA's 2022 survey, 90% of investors stated alignment with firm values is the top motivator compared to 79% who did in 2020. Client demand (80%) continues to be a catalyst for investors' decision to incorporate ESG investment strategy alternatives in structured finance.

Over half of investor respondents currently apply an ESG assessment framework to their investment decisions, either across a select number of managed funds and portfolios or across all, with many assigning internal ESG scores to funds. Furthermore, over 85% of investor respondents have either a fully operational ESG assessment framework or are in the midst of developing one, though this has not fluctuated from the 2020 SFA survey. However, consistent with 2020, investors overall continue to believe that there is a lack of uniformity in ESG disclosures within the securitization industry, making it difficult to adequately assess ESG factors.

Use of ESG Assessment Framework in Investment Decisions (2020 vs 2022)

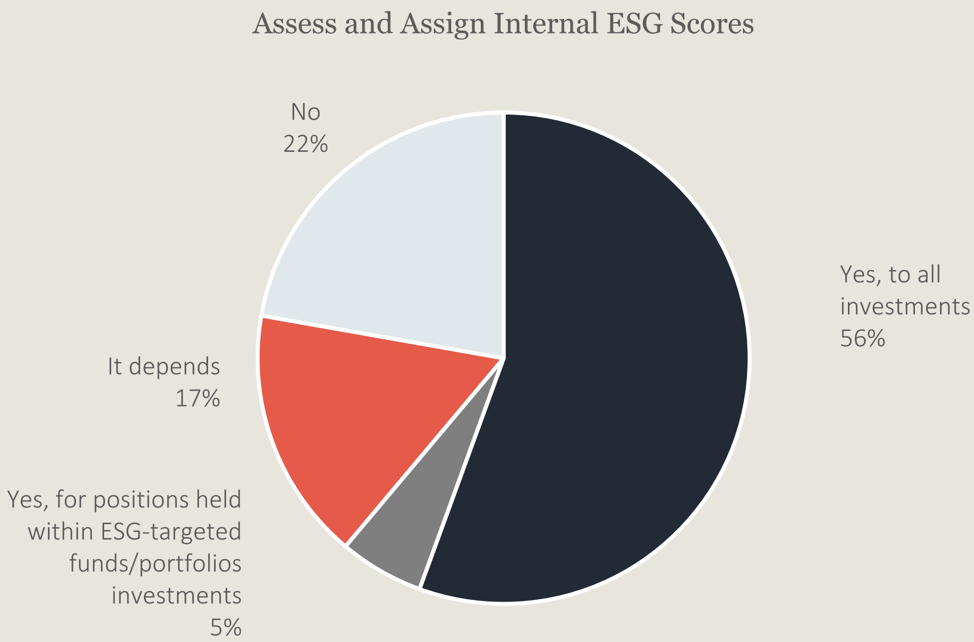


Nature of ESG Integration (2020 vs 2022)



Vast majority of investors assign internal ESG Scores

Our survey shows that over half of investor (56%) assess and assign internal ESG scores to all their investments.

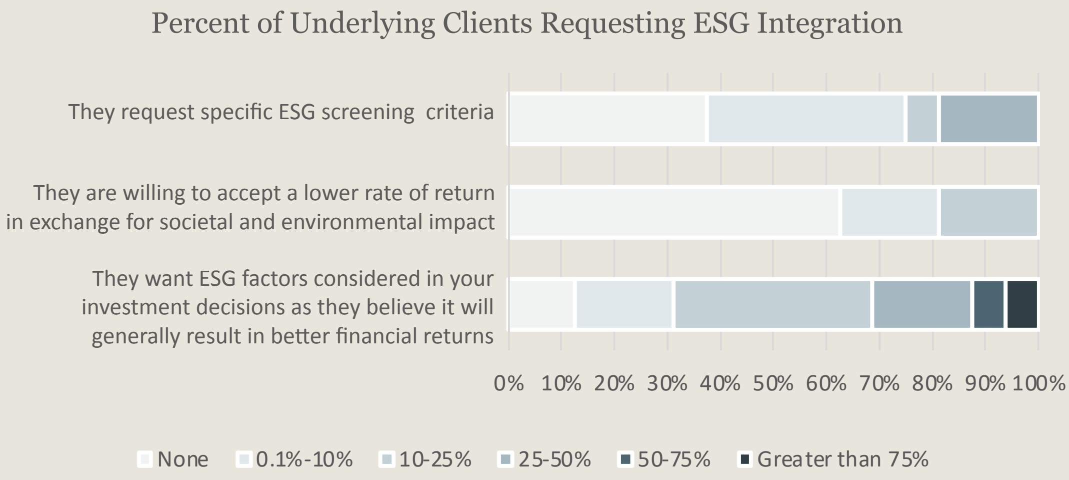


"We have developed proprietary scorecard methodologies for our corporate credit strategies. We also conduct a bottom-up assessment of structured credit instruments to assess the degree to which the underlying collateral is ESG-aligned."

Rob McDonough
Angel Oak Capital Advisors

Many asset management clients believe incorporating ESG credit metrics will result in better financial returns

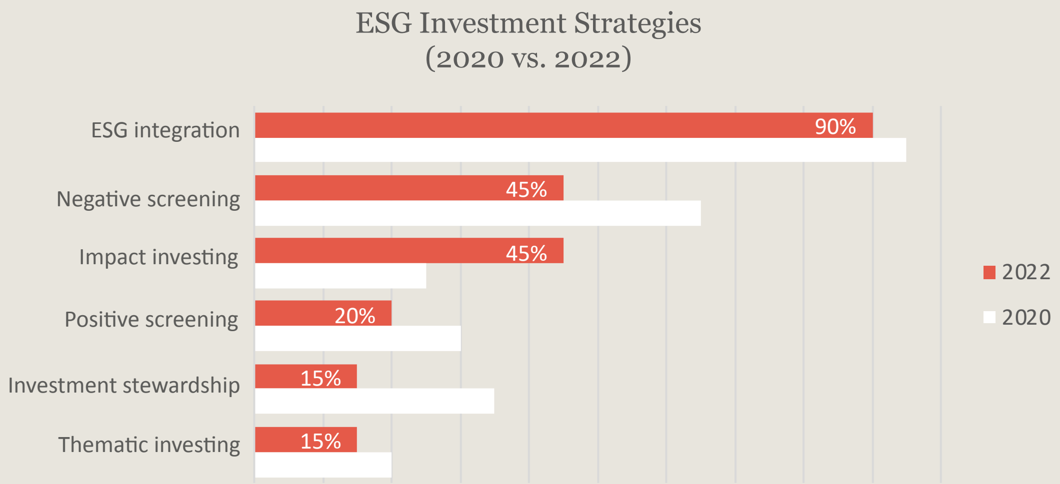
Investor respondents stated that roughly 25% of their clients want them to consider ESG factors in their investment decisions because they believe this approach will generally result in better financial returns. Additionally, the majority of clients request some type of ESG-specific screening criteria.



ESG investment strategies are being refined to meet underlying client demand

Investment managers continue to refine their approach to incorporating ESG in their investment decisions. An overwhelming **majority of investor respondents (62%) utilize ESG integration in their strategy** – which matched its significance in our 2020 survey.

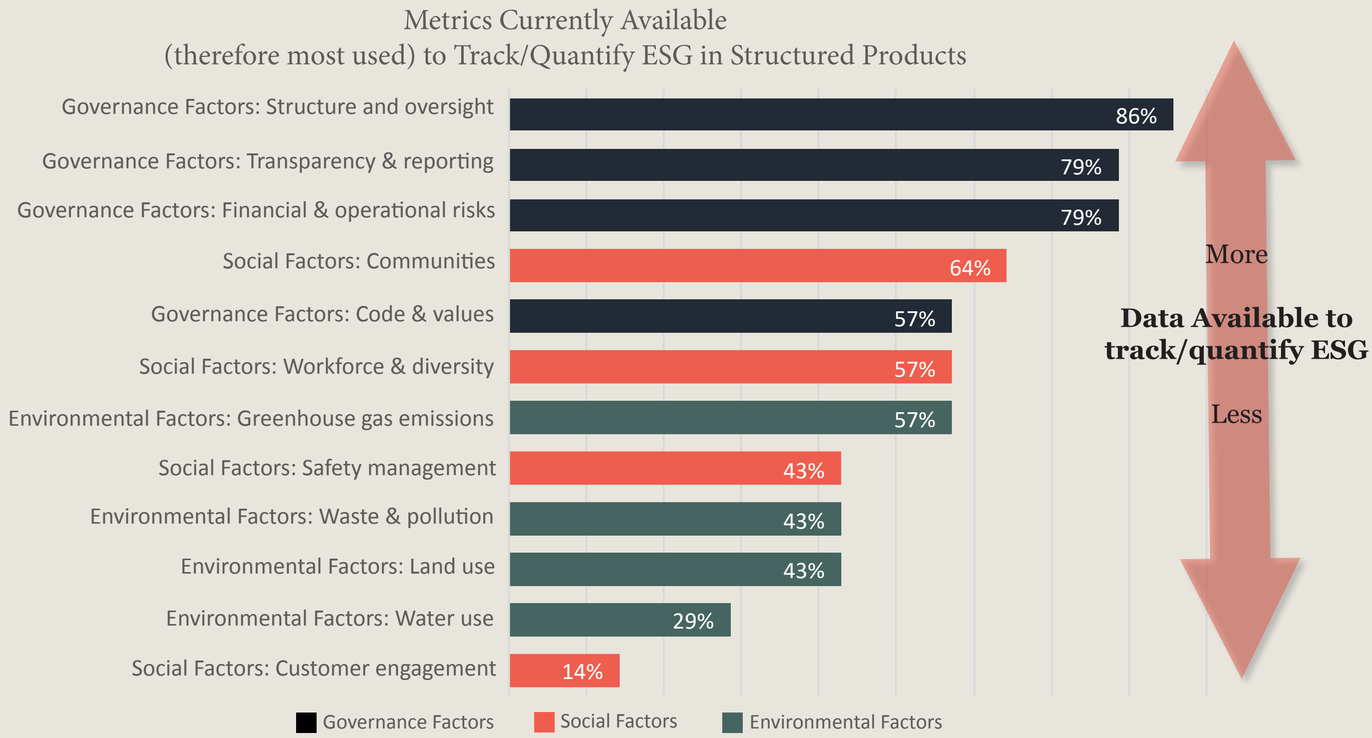
However, although not as prevalent as ESG integration, SFA survey data shows that roughly 50% of institutional investor respondents are providing "impact" investing options for their clients – representing a near doubling of use from 2020. This continued rise in sustainability-mandated investment demand across structured finance presents an opportunity for the market to consider disclosure requirements that support that demand.



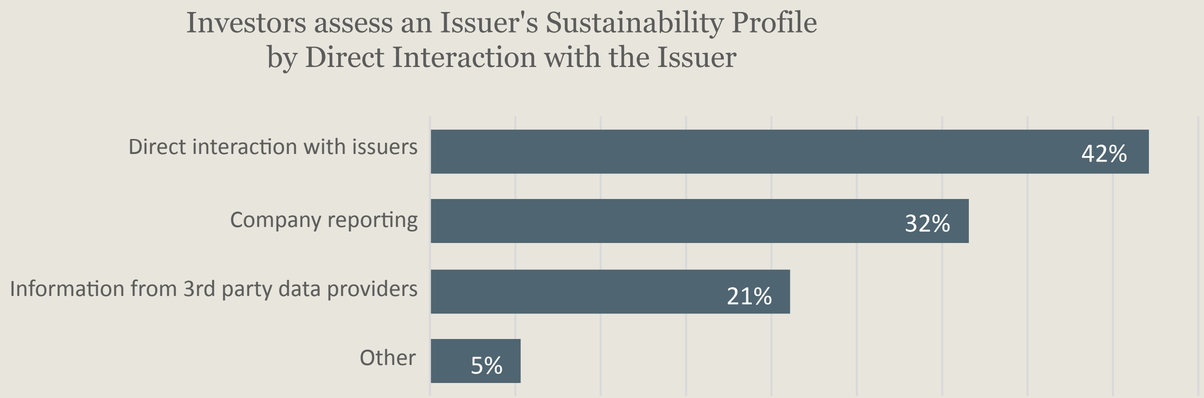
Governance metrics are most available to investors today

62% of investor respondents report that client business related to ESG matters has increased in the last two years. To keep up with client demand, many respondents are launching products that assess sustainability factors against the defined investment strategy.

When it comes to assessing ESG metrics in structured products, SFA's survey found that investors are currently overwhelmingly focused on the governance or "G" pillar – in large part because this is the data that is most available to them. The most common governance metric available to investors is the factor of structure and oversight (86%), followed by both transparency/reporting (79%) and financial & operational risks factors (79%).



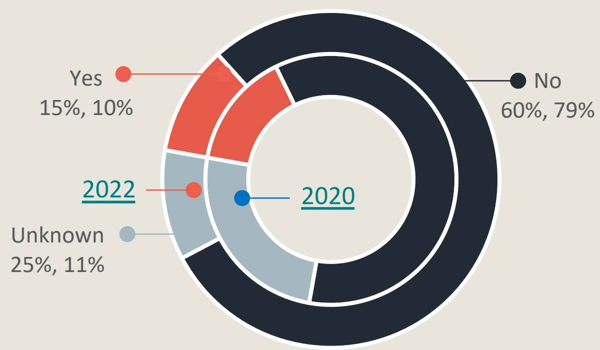
Most investors (42%) rely on direct engagement with issuers as their main source of information when it comes to assessing a securitization issuer's sustainability profile. This is followed by publication of an annual corporate ESG report or public information available on a company's website.



Disclosures improving, but still further advancements needed

While the securitization industry has seen advancements for disclosing and accessing ESG data, survey results indicate that there is room for improvement. The supermajority of investors (79%) believe existing credit rating criteria does not adequately address related risks and opportunities for structured products. An important contributing factor to this is investors' belief that there is not sufficient quantifying data and instead wide variability across agencies. Additionally, an overwhelming majority of investors do not believe rating agencies provide sufficient information on how ESG factors are incorporated in the credit ratings specifically for structured products. This sentiment among the investor community increased dramatically from 35% to 63% compared to 2020.

Sufficient information to determine how credit ratings incorporate ESG factors in structured products? (2020 vs 2022)



"Credit rating agencies have just recently started incorporating ESG considerations within the securitized sector. These considerations are, appropriately, focused on assessing the credit impact of ESG risks and are still evolving as more data becomes available. These are not necessarily covering the environmental or social themes that some clients are looking for in their investments."

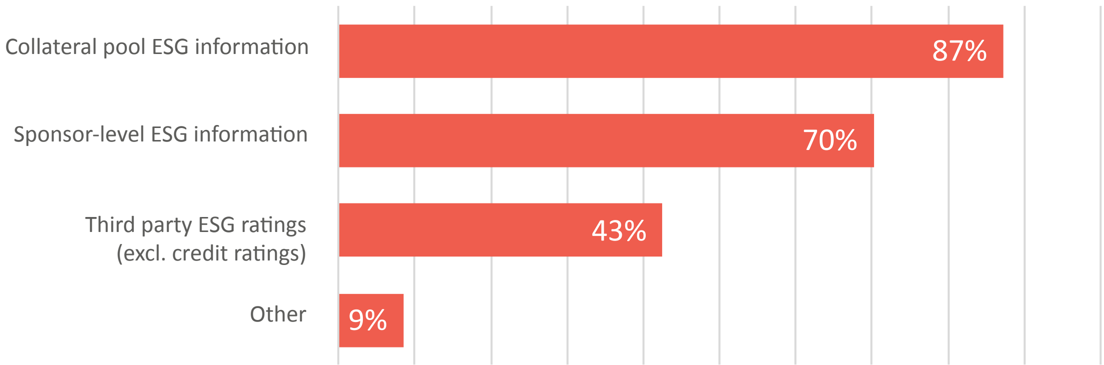
Allison Walsh
Income Research + Management

Disclosure Improvement Needed – But Not Through Regulatory Mandate

Collateral information is most important

Collateral pool ESG information for securitizations is considered to be the most relevant to ESG evaluations among the survey respondents (87%), followed by sponsor-level ESG information (70%) and then third party ESG ratings (42.5%).

Inputs most relevant for
ESG evaluations of structured products



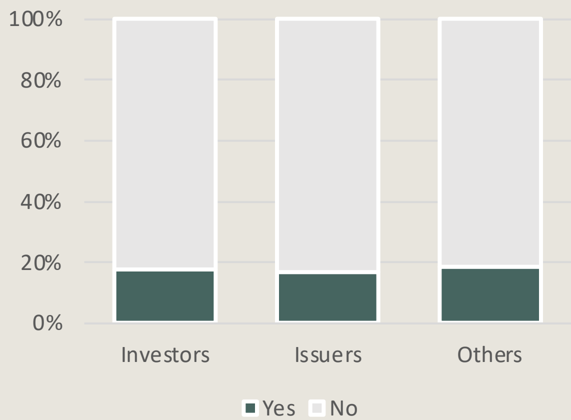
"If a securitization is to be judged, it should be evaluated based on the assets in the deal only. Having the sponsor-level information runs counter to the idea of a separated entity in the SPV."

Patrick Kim
Finance of America

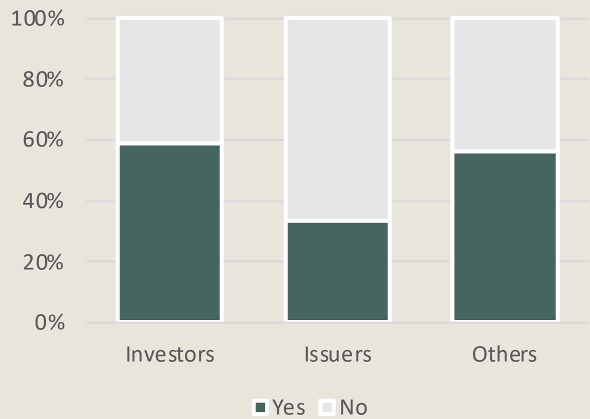
Overwhelming market consensus that the current SEC climate disclosure proposal should not apply to Securitization

On March 21, 2022, the Securities and Exchange Commission (SEC) proposed new rules that would require public companies to disclose mandatory climate risk-related information in annual financial reports and registration statements for corporate issuers. The proposed disclosures are similar to certain global climate disclosure frameworks, such as the Taskforce for Climate Financial Disclosures and the Greenhouse Gas Protocol. **At this time, the proposed rules do not apply to asset-backed issuers.** However, the SEC stated it is continuing to evaluate climate-related disclosures with respect to asset-backed securities and raised a series of questions relevant to ABS in their proposed rules.

Should the *current* proposed SEC climate-related disclosure apply to ABS Issuers?



Should the SEC require ABS Issuers to provide climate-related disclosure *in the future?*



Survey respondents were asked whether the proposed SEC rules should apply to ABS. An overwhelming **81%** **of respondents believe the SEC's current proposed rule for climate disclosure should not apply to ABS issuers.**

"The SEC's proposal is fairly broad and the ESG measurements are also disputable. Anything forced upon the industry has the risk of providing misleading data to investors."

Patrick Kim
Finance of America

"The market first needs to develop securitization-specific standards."

Francisco Paez
Metlife

However, respondents were split on the notion for future requirements with 60% of investors saying yes to a possible future disclosure regime. Overall, there is general market consensus that additional work needs to be conducted within the industry so that participants can work together to gain a better understanding of ESG and its implication for structured finance as well as what relevant data is available in a consistent, reliable and verifiable manner.

This is in line with most of the respondents who believe the current quality of ESG reporting in the structured finance market is poor (61%). Many in the industry have pointed to a need for greater clarity and validation of reported measurements and data.

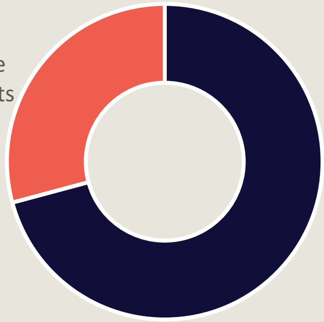
> **"I do think that much of the information would be useful in the near future, but recognize that this would be a significant burden for the space and that time is needed to develop the reports and information requested."**

Allison Walsh
Income Research + Research

Market believes principle-based disclosure is appropriate and most workable for securitization

In line with ongoing market and SFA member feedback, the vast majority of the industry respondents support a principle-based disclosure regime and not a prescriptive one with mandated disclosure fields.

If the SEC required climate disclosure for ABS, should the disclosure be principle-based or prescriptive?



Join SFA's ESG Disclosure Initiative

SFA's ESG Disclosure Initiative aims to develop an industry-consensus best practices for ESG disclosure to promote investor transparency that the industry can adopt globally. This includes collaborating to create an ESG disclosure framework specific to the structured finance market along with underlying reporting standards for each asset class. To achieve this, the Disclosure Initiative has established asset class working groups starting with the largest sectors of the market including Auto ABS, RMBS, CMBS, CLO, and Unsecured Consumer ABS. Participants represent every facet of the market — issuers, investors, rating agencies, data analytic firms, and law firms.

SFA members interested in joining the effort can do so by registering **here.**

To learn more about SFA's work on ESG visit our website: **ESG Disclosure Initiative - Structured Finance Association**

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