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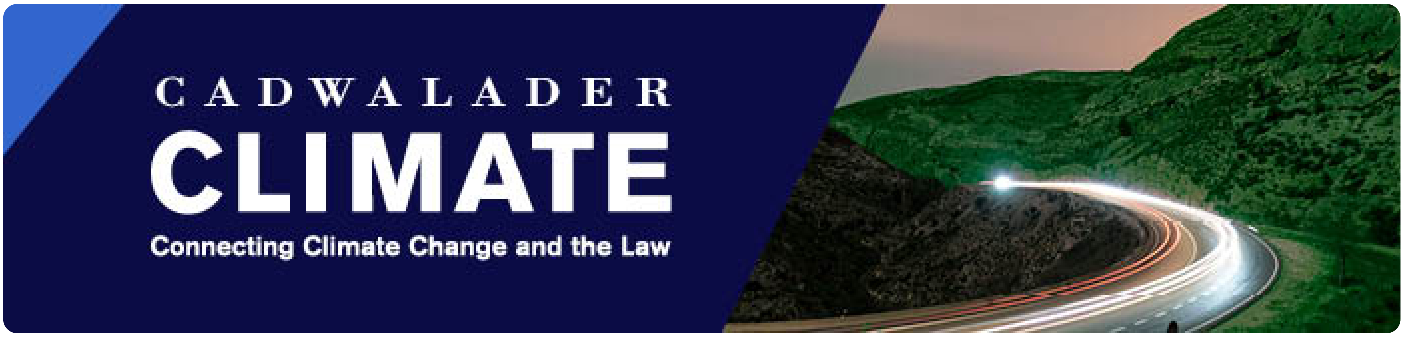

Structured Finance Industry Group Publishes ESG Best Practices for Auto ABS and RMBS Disclosures

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In September 2023, the Structured Finance Association (SFA) published its **ESG Best Practices for Auto Asset-Backed Securities (ABS) and Residential Mortgage-Backed Securities (RMBS) Disclosures**. The industry-wide working group spearheaded the development of principles-based approaches for securitization disclosures, reflecting consensus-based views from issuers, investors, rating agencies, data & analytics firms, and other securitization transaction parties. The SFA has been working on its ESG Disclosures Initiative to develop best practices for reporting decision-relevant ESG metrics across various asset classes since May 2022.

Industry-Wide Disclosures Principles

The SFA assessed existing environmental disclosures in Agency and non-Agency RMBS and ABS markets, and against established global environmental frameworks such as the UN Principles for Responsible Investment (PRI), Partnership for Carbon Accounting Financials (PCAF), International Capital Markets Association (ICMA), Sustainability Accounting Standards Board (SASB), and Task Force on Climate-Related Financial Disclosures (TCFD). Based on this analysis, the group **established a principles-based approach** (the “Principles”) whereby securitization disclosures should meet the following criteria:

- Relevant
- Objective
- Verifiable

- Measurable
- Comparable
- Accurate

These Principles aim to ensure uniformity, credibility, and transparency in ESG disclosures.

Asset Class—RMBS

In the RMBS Working Group, two broad categories, Energy Efficiency and Physical Risk, were identified as areas where the market could adopt disclosure best practices in the short term (Phase I) based on currently available standardized data. Metrics considered for disclosure within RMBS include:

- Home Energy Rating System (HERS) Score: Recommended for disclosure if HERS rating is a material criterion of a Green Bond program. Disclosure should cover the number of loans in the pool with HERS ratings and the HERS rating threshold within a Green Bond program.
- Green Building Certificates (GBC): Recommended for disclosure if GBC is a material criterion of a Green Bond program. Disclosure should cover the number of loans in the pool with certified GBCs, details of each certified GBC, and the methodology for approving GBCs.
- Green Mortgage Programs: Disclosure should follow program offering documents and adapt to programmatic changes.

Phase II considerations may include Physical Risk disclosures, particularly FEMA-derived data, dependent on market dynamics and member interest.

Asset Class—Auto ABS

In the Auto ABS Working Group, Clean Transportation was identified as an area for short-term (Phase I) disclosure. Specifically, the Concentration of Vehicle Propulsion Systems was identified as a disclosure metric that meets the Principles. This metric involves reporting the types of propulsion systems (Electric, Hybrid, Internal Combustion, Other) for each vehicle within the pool, presented in a stratification table in the prospectus document.

Additional disclosure fields, such as EPA GHG Score, EPA Average Tailpipe Emissions, EPA Vehicle Fuel Efficiency, and EPA Smog Rating, were considered, but concerns were raised about data availability and accuracy in the context of securitization disclosures.

The suggested implementation date for the Auto ESG disclosure metric is January 1, 2024, allowing issuers time to make necessary updates. Phase II disclosures will be considered based on member interest and market and regulatory dynamics.

Taking the Temperature: The SFA ESG Disclosure Initiative has produced proposed best practices for ESG disclosures within certain asset classes within the structured finance market, with a focus on environmental disclosures. Although the degree to which market participants will adopt the new best practices remains to be seen, the structured finance industry has been a focus of increasing disclosure guidance. As we reported earlier this year, the European Supervisory Authorities (ESAs) and the European Central Bank (ECB), published a Joint Statement on climate-related disclosure for structured finance

products. In describing the need for such guidance, the ESAs and ECB stated that "securitisation transactions are often backed by assets that could be directly exposed to physical or transition climate-related risks, such as real estate mortgages or auto loans. Since the value of these underlying assets could be affected by climate-related events, the ESAs and the ECB share the view that the reporting on existing climate-related metrics needs to improve, and that additional metrics are necessary. Additional climate-related data will allow investors to better identify climate change-related risks while avoiding overreliance on estimates from external sources." We also previously reported on the importance of securitization transactions to securing a portion of the massive financing necessary to fund efforts to transition to a green economy.