ESG securitisation in Australia: ready for lift off?

Securitisation with a sustainable label has shown some promising signs of development in Australia but even its most ardent advocates would have a hard time claiming the asset class has truly taken flight. A group of market participants hosted by ASJ and **National Australia Bank** *acknowledged the particular challenges of aligning the securitisation asset class with the best sustainable finance practice – but also expressed confidence about the size and variety of the market in future.*

PARTICIPANTS

- **James Austin** Chief Financial Officer FIRSTMAC
- **Henry Cooke** Executive Director GRYPHON CAPITAL INVESTMENTS
- **Natasha Feder** Portfolio Manager and Structured Credit Analyst FIRST SENTIER INVESTORS
- **Lionel Koe** Director, Securitisation Originations NATIONAL AUSTRALIA BANK
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- **Michael Puli** Associate Director, Sustainable Finance S&P GLOBAL RATINGS
- **John Rohl** Chief Financial Officer BRIGHTE
- **Sarah Samson** Global Head of Securitisation Origination NATIONAL AUSTRALIA BANK

MODERATOR

- **Laurence Davison** Head of Content KANGANEWS

PROGRESS SO FAR

Davison *Should Australian securitisation market participants be happy with the progress made in developing environmental, social and governance (ESG) practice in the sector to date, or is it lagging?*

◆ **SAMSON** There has been a lot of progress but we are still just getting started. Although there has not been significant issuance yet, it is building in the background. The most pleasing piece of progress is the growth in the number of market participants that genuinely believe in the importance of ESG and do not just view it as a box to tick. They understand why it is important and also that there will be ramifications if they do not think about it.

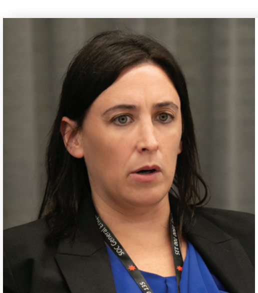
◆ **KOE** One of the main challenges is that there are still fundamental barriers to bringing deals to market, a lot of which are data related and limit the pool of eligible collateral. National Australia Bank (NAB) issued Australia's first green residential mortgage-backed securities (RMBS) in 2018, and while there has been interest ever since then it has taken time for momentum to build. This momentum has really accelerated in the last 18 months, however – so much so that we are fielding a steady stream of reverse enquiry asking for green collateral.

The reality is that ESG is the biggest theme in global markets today. We will see a lot more transactions – it really is just getting started in this sector. All things considered, it is quite an exciting time to be in this space.

◆ **ROHL** Brighte completed its debut public deal in October 2020, and with NAB's help we were very successful. As a first-time issuer we were very pleased with the appetite for the deal, and a lot of it was attributable to overwhelming interest in the ESG aspect. We have certainly seen the demand from debt investors increasing.

What we hear is that investors would like to write bigger cheques but there is a paucity of green assets. We are excited about what happens from here, based on what we have already seen in capital markets as well as the social mandate that is really going to drive evolution.

◆ **MOIR** We are just at the start of the ESG journey and while the evolution is accelerating we have a lot further to go, particularly on data. I suspect that within a five-year timeframe the market will have developed so much that what is currently on offer will look basic in comparison. Actually I hope this is the outcome,



"ALTHOUGH THERE HAS NOT BEEN SIGNIFICANT ISSUANCE YET, IT IS BUILDING IN THE BACKGROUND. THE MOST PLEASING PIECE OF PROGRESS IS THE GROWTH IN THE NUMBER OF MARKET PARTICIPANTS THAT GENUINELY BELIEVE IN THE IMPORTANCE OF ESG AND DO NOT JUST VIEW IT AS A BOX TO TICK."

SARAH SAMSON NATIONAL AUSTRALIA BANK

Issuer level considerations

THE FOUNDATIONAL CONCEPT OF SECURITISATION IS THAT CREDIT ANALYSIS FOCUSES ON ASSETS RATHER THAN ISSUER. BUT THIS IS NOT ENOUGH IN A WORLD WHERE ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) ASSESSMENT INCREASINGLY ANALYSES ISSUERS AS A WHOLE RATHER THAN INDIVIDUAL SECURITIES.

Davison *Securitisation has a specific challenge in the sense that investors traditionally look primarily at the collateral backing a deal whereas the ESG space requires much deeper understanding of the originator's credentials. How can the market align the two considerations?*

SAMSON An important point here is that it is not enough just to have an asset pool that ticks the boxes – it is also about the originator. This is why the issuer's rationale behind doing a green product is important. Some are further along the sustainability journey than others.

FEDER For us, green is only the starting point. When we assess ESG, it is not just a focus on E or S or G – they are assessed together, and our minimum standards for each need to be met. One of the curiosities about the Australian market is that a lot of originators are private and quite small, which means they could struggle to meet our green criteria simply because of their structure and size. This poses some challenges.

Our process has always required an ESG assessment on every investment we make, and we tailored this assessment for securitisation before the industry even started thinking about it. On this basis, I have spent a lot of time trying to work out an internal approach that allows us to apply a standard corporate ESG analysis in the securitisation context.

In general, originators are starting to appreciate the concerns and take steps to try to alleviate some of the question marks we have had. This aspect is actually more of a black and white decision rather than shades of grey, simply because of the requirements of our investor base and what we need to produce.

SAMSON It could also be an opportunity for SPO [second-party opinion] providers and rating agencies. There is a servicer ranking concept, where they rank lenders on their ability to service. But there is also potentially a corporate ESG ranking that originators and servicers could seek, which would help investors to benchmark.

AUSTIN The 'S' and 'G' are also very important to where we are at. To that end we have developed a baseline ESG report, which is heavily focused on the social and governance aspects. A lot of it is about creating a benchmark so we have a flag in the sand and can measure evolution over time.

In previous years, this may have meant a few slides in an investor presentation. But we have moved this to being a 20 page ESG report on what we are doing as a company. This will be produced each year, at a minimum. As for what to measure, it can be almost anything – so it will be an evolving piece. But it is a start.

> *"It is worth noting that the early days of corporate ESG reporting typically produced a lot of very nice statements and lovely pictures, and not much data. Fortunately, these reports are evolving into more meaningful and useful measures of ESG progress."*
>
> **NATASHA FEDER** FIRST SENTIER INVESTORS

Samson *A lot of Australian loan originators are private companies. In this case, how do investors track that they are actually following their own ESG commitments?*

FEDER It is an unusual situation in the unlisted bank and nonbank originator cohort. This is where some of the challenge is going to be, and a working group from the Australian Securitisation

because it is what we are trying to deliver when we set up ESG programmes.

I would ideally like to see a change from product being either green or not green to being able to outline the full ESG credentials of a portfolio and report on its own merits. This would be real progress from what is something of a one size fits all approach at the moment.

◆ **AUSTIN** Transactions to date have clearly demonstrated that there is a lot of investor demand for anything ESG related. But I think we are still very much at the foundation stage, where data and measurement are very uncertain – particularly with mortgages and autos. As an industry, we have yet to set baselines on how we measure things and how we gather data. This will definitely evolve, because there is so much demand from investors.

◆ **COOKE** From an investor's perspective, we are absolutely feeling pressure on ESG and there is interest from everywhere. We get asked whether we are examining the ESG credentials of what we are investing in, whether what we are doing is good enough and how we are tracking it.

The market is evolving and we have put some systems in place to help us track and score. But securitisation is a complex beast involving many, many parties. We are not just analysing an individual loan: it is also necessary to look at the ESG credentials

Forum is aiming to encourage this group of unlisted originators to start putting in place more concrete reporting, including a way for us as investors to start measuring what is going on.

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COOKE We set up a system to track the ESG performance of the originators we invest in. We sent them a questionnaire to fill out, and most have been fully forthcoming. Some responses came back with the information we asked for and a note that it is all on their website anyway, while others were happy to provide it directly to us.

What is interesting is that there is not a lot of difference in our scoring between public and private nonbanks, with the biggest difference being between banks and nonbanks.

Overall, we were pleased to find that issuers were very forthcoming. They obviously felt it was worth doing and are not trying to hide anything, which is very promising.

FEDER I second this – at least in the sense that some originators have been very good. The caveat is that the smaller names, including smaller banks, do not have the staff or expertise.

Samson *Will the market get to a point where, labelled or not, investors will not buy a company's issuance of any type if it does not meet a minimum ESG standard?*

FEDER We are already doing it. It is a firm-wide policy across debt, equity and unlisted assets. We have lists of uninvestable assets that are designated as such for ESG reasons.

COOKE Absolutely. It has also happened for other criteria away from ESG. There are some originators we will not invest in for various reasons that may be specific to us or more generic.

Samson *Will the bar get higher or more difficult for issuers over time?*

FEDER I do not know about higher, but more nuanced. There are more requirements, but I do not think it will become more difficult.

COOKE It depends how we define difficult. If we mean difficult in the sense of 'will it be hard work to respond and get the information out?' – possibly. If it is 'are issuers going to be asked more questions?' – absolutely. But it will become easier as the market evolves.

Davison *The Australian syndicated loan market has started to see some deployment of use-of-proceeds loans with sustainability-linked features attached. Is something similar possible in the securitisation space, as a means of tying together the collateral focus and growing interest in originators' ESG credentials?*

SAMSON It is possible and it would solve some of the data issues. It also speaks directly to the green-brown spectrum, so a transaction that links back to the corporate originator does not have to be 100 per cent green. It requires the originator to sign up to specific and meaningful KPIs. At the moment, this type of issuance would lend itself better to large, listed companies – though it is still a challenge there – because the KPIs have to be meaningful.

On the other hand, the whole theory of securitisation is that it is divorced from the originator. But I am sure securitisation structures can solve for this. The concept brings it back to the companies and their boards to sign up to meaningful KPIs.

KOE It is more holistic as well. It mitigates some of the risks we have discussed about use of proceeds where there is risk associated with collateral refinancing. Under a sustainability-linked structure, the issuer has a wider ability to ensure the covenanted KPIs are met than it does with a closed-pool securitisation. Such a structure also opens up the collateral pool.

FEDER I may be the cautious one here. Sustainability-linked loans and securitisation are not natural bedfellows due to the special purpose vehicle structure of securitisations and the supposed de-linkage from the originator. I am interested to see how anyone tries to solve the multitude of problems that are associated with it.

of all the parties involved in a securitisation transaction in order to come up with an overall score.

At this stage in market evolution, it is difficult to define whether an organisation or product is green or not – because definitions and standards are evolving rapidly. But we can examine how they rank on a relative basis and encourage continual improvement.

There seems to be a sense that Australia is lagging relative to the rest of the world, but I disagree with this. I think securitisation is perhaps lagging or struggling relative to other asset classes that may find ESG somewhat easier in the current circumstances. But the expectation on us to be monitoring and looking at ESG is immense. Data is an issue, but generally the market is responding to it very quickly.

◆ **FEDER** For an investment manager with clients looking for green or social investments, it is very hard for us to put our hand on our heart and say any individual securitisation is genuinely a good product.

The particular challenge comes in the sense of the product being labelled correctly with available data, and that every party in the transaction is doing the right thing to satisfy this labelling. This aspect of the market is very much a work in progress. Although what we have seen so far is a great start, many pieces of this puzzle still need improvement.

For us, a green labelled product needs to be green through and through. We want to assess all parties involved to ensure they tick the green box, and for this process to be repeated for the asset itself. Unfortunately, there is currently not enough information – across several categories – to be able to do this.

Davison *Bringing a labelled product to market clearly involves significant challenges even if – which is relatively rare in itself – one can assume the collateral will likely satisfy ESG standards. For a company like Brighte, what is the value in doing this work to get a certification on a pool that largely comprises solar assets anyway?*

◆ **ROHL** Brighte is a mission-led organisation and the company did a lot of early work to make sure we were aligned with all aspects of ESG as a core part of our DNA. This meant our early organisational structure 'overinvested' in the governance and risk assessment team. The social and sustainability mission filters through into everything we do.

Davison *How does the second-party opinion (SPO) process apply relative weight to collateral versus sponsor-level considerations when it comes to a prospective ESG securitisation transaction?*

◆ **PULI** It can depend on whether it is a use-of-proceeds (UOP) or sustainability-linked deal. UOP varies to some extent based on the framework being used, but we always focus on where the money is going. If it is a sustainability-linked deal, we get into a lot more detail on what the assets are trying to achieve.

The specific challenge with securitisation is the need to monitor a pool of assets for its whole life. The European Banking Authority has looked at this, and one of its recommendations is to move away from the special purpose vehicle (SPV) and instead assess the originator. I think this could be a clearer way to go, at least initially until the type of green asset monitoring needed is available to assess specific SPVs.

CAPTURING DATA

Davison *Securitisation has always been a data-oriented sector, which should lend itself to the requirements of ESG-labelled issuance. But there are clearly ongoing challenges, particularly in the mortgage space – where the type and level of data needed to support a vibrant green RMBS space simply does not exist, or at best is not being captured. How is the data aspect evolving?*

◆ **PULI** Securitisation is less developed than other asset classes, but actually I do not think this is a bad place to be. Being on the leading edge can be tumultuous so I think being able to take a step back and explore what practices are being used across

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ANTHONY MOIR PEPPER MONEY

different instruments and think about how they can be adopted is beneficial.

When we are looking at different instruments and companies, it is through the lens of understanding that this is a transition period. Our SPO framework considers alignment to certain principles, as well as to what degree a company is advanced in these practices relative to others.

A lot of this comes down to data. Some companies are more advanced in embedding an ESG culture within their organisations, so we give them better marks for that. If they do not have this, they can still be aligned if they meet minimum requirements. But highlighting the extra steps some companies are taking is what we are trying to focus on.

Davison *Firstmac printed its first green RMBS in 2021 using proxy criteria for home emissions, as it is still building a pool of labelled green mortgages of sufficient scale to make a securitisation feasible. What gave Firstmac confidence it would get investor support for issuance while the data piece is still clearly a work in progress?*

◆ **AUSTIN** As a general rule, most investors are not very specific about requirements and are just keen to get products that are labelled green. In my experience – and I should say we have not worked with the provider at this discussion – SPOs have also been underwhelming. What we have seen does not look into any of the data or collateral criteria.

We described our transaction as a combination of light green and dark green. The light green part refers to building standards in New South Wales, Victoria and Tasmania that effectively qualify any house built since 2005 – which is pretty pathetic, to be frank. The dark green is just getting started, but we defined it as a house with a NatHERS [Nationwide House Energy Rating Scheme] measure of seven or above.

The problem with NatHERS ratings is they are very difficult to get. The data is all there, but it is with CSIRO [Commonwealth Scientific and Industrial Research Organisation] – which will not release it, on privacy grounds. I believe this is the key to a flourishing industry. We are recording NatHERS, but we can effectively only get it on new builds. We are recording the score, whether it is brown or green, for all new construction – but this is as far as it goes.

Of course we will need to label certain tranches as green to meet investor mandates. But I believe something we should all be getting to as an industry is reporting where every asset is on the spectrum, whether dirty brown or shining green. This means recording the data for every asset.

If CSIRO would release the data it would be a big help. But there are things we can do ourselves. In autos, every single vehicle has a CO_2 tailpipe emission that is quite easy to obtain.

We will do our first auto transaction in July and release the CO_2 on every vehicle – not to paint it as green but because providing this information is important, we believe. We will probably still include standalone tranches or deals to satisfy particular mandates.

Davison *Does the answer to the question of asset scale in the mortgage space require a solution for emissions data on existing homes – not just new builds?*

◆ **AUSTIN** We have to solve for the CSIRO release since this is where the data is kept. There are a few initiatives going on, including some private enterprises trying to partner with CSIRO. I just don't have any visibility of whether this will go anywhere, though. At the moment it is snagged on privacy concerns.

While the data release is essential to have mortgages flourishing, the latest proposed update to Climate Bonds Initiative (CBI) standards – which involves a combination of solar, postcode, number of bedrooms, gas, pools and the like – is a good approach.

We take a view that something is only green if it is improving carbon emissions. A house that is already built does not achieve much, but if we are offering discounted lending for a borrower to raise their home's NatHERS score from 6.5 to seven, we – and they – have achieved something. It is similar in autos, though I guess the market will evolve so that only electric vehicles (EVs) and, perhaps, hybrids are considered green.

◆ **MOIR** Coming back to what I said before, really the data aspect has not evolved – and we need it to. Data capture, and the analytics to understand and drive it, are the most critical components. Here, I would say we are still in the same place as we were a few years ago.

◆ **KOE** The information is there, but unfortunately it is not readily available due to privacy concerns. A number of institutions are working to get access to the data and this, if successful,

"DATA IS VERY IMPORTANT TO THIS. TO TAKE A SIMPLE EXAMPLE, IT COULD BE THAT ALL THE GREEN LOANS IN AN RMBS POOL GET PREPAID AND IT BECOMES A BROWN POOL OVER TIME THROUGH NATURAL SELECTION. THIS IS SOMETHING WE WANT TO BE ABLE TO MONITOR, BECAUSE IT WILL ULTIMATELY AFFECT THE SECURITY'S VALUE AND RISK."

HENRY COOKE GRYPHON CAPITAL INVESTMENTS

Social securitisation offers opportunities but hurdles to clear

IN SOME WAYS, SOCIAL RESIDENTIAL MORTGAGE SECURITISATION COULD IN THEORY BE AN EASIER PRODUCT FOR WHICH TO FIND QUALIFYING ASSETS THAN GREEN. BUT ITS CHALLENGES ARE JUST AS SIGNIFICANT, IF NOT GREATER.

Davison *What is the potential for social securitisation and on what basis might it be offered?*

SAMSON It is very plausible. Kensington Mortgages did a deal in the UK that National Australia Bank was part of. Like green mortgages, ensuring standards are set at an appropriate level is key. If deal parties can demonstrate they are putting someone in a significantly better financial position – for instance that they would not otherwise be able to buy a home – there is definitely a place for social securitisation.

Davison *What are the considerations on social securitisation from a second-party opinion (SPO) perspective?*

PULI Social securitisation is less developed, which means we have a close focus on definitions. Some originators use very high-level definitions and we have to bear down on exactly what they mean when they say they are providing a social good. For example, this could mean exploring their definition of affordable housing.

Davison *Will social securitisation in Australia be defined by affordable housing or by the nature of borrowers?*

SAMSON I think it will be both. The Kensington transaction was focused on the borrower. Kensington provided a mortgage that these borrowers could not get from anywhere else. But affordable housing social securitisation is definitely a possibility as well.

On the Kensington deal specifically, there was some focus on the definition of who qualifies for the lending product. But I think it would be difficult to argue that someone refinancing a million dollar property is socially disadvantaged. This is why I say social securitisation has to show how originators are actually helping people in a way that not many others would be willing to.

Austin *Would a qualifying loan have to be at a discounted rate so it is not considered to be nonconforming?*

SAMSON Not necessarily. One of the criteria under the Social Bond Principles is that the borrower cannot access mainstream financing. But there is clearly a lot of crossover between nonconforming and the type of loan that could qualify for social funding.

KOE Within the breakdown of prime and nonconforming loans, we can filter and exclude certain attributes such as credit impairment, large loan sizes and investment loans. This process helps define what the boundaries of social securitisation look like.

SAMSON The pricing discount piece is one argument. The other side is that the nonconforming market is very small and its borrowers would not be able to seek finance from a bank. Maybe eventually we get to a place where the rate has to reduce over time as borrowers trend toward mainstream. But we are at the start of this journey.

The most important thing at the moment is the integrity of the criteria used to demonstrate that originators are helping borrowers. As I say, there is a huge overlap between nonconforming and social lending – in many ways the latter is a subset. Originators are helping these borrowers in a way that banks will not.

Davison *If the investors here were soft sounded on a social securitisation transaction, what sort of things would they want to know about first?*

COOKE It would be about the definitions – whether it is bringing something additional to the table for borrowers. We are struggling with definitions at the moment and they need to evolve. Fundamentally, borrowers have to be ready, willing and able to pay their loan. Social securitisation has to fit in with this – and the definitions today are lacking.

FEDER For us, it is absolutely critical that the borrower is assessed as a viable lending option for the originator. The social concept is nice but we would be more concerned about the origination being done properly – which is a component of the S part of environmental, social and governance. The definition of social securitisation remains a curious concept for us.

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LIONEL KOE NATIONAL AUSTRALIA BANK

would significantly increase the access to eligible and compliant collateral in the market.

There is certainly potential for issuers to disclose a lot more data, subject to bolstering existing data capture processes. Issuers and the industry are beginning to capture this, which is encouraging and will be a positive development for the sector and investors.

I envisage that, over time, issuers may be able to report on the thermal efficiency of a house and its offsets, and CO_2 emissions in the case of cars. When it comes to mortgages, I am confident that, with the growing traction in ESG, the industry will be able to obtain a redacted version of data needed to facilitate future green RMBS issuance.

Until then, however, we are limited to certain states and geographic concentrations. Very extensive data mining would be needed to see green RMBS flourish in the absence of some other means of getting data.

I think the auto sector will be interesting, with leading manufactures already terminating internal combustion engine (ICE) vehicles in favour of hybrids or pure EVs. Stock is limited in Australia at the moment but in time I believe growth will be strong.

POOL EVOLUTION

Davison *The market seems – hopefully – to be close to entering a phase of rapid evolution when it comes to the quantity and nature of available data. If this proves to be the case, what happens to securities that were 'good enough' when investors bought them but where standards have subsequently evolved? More generally, what are investors' hopes on the delivery of the kind of data that has been discussed?*

◆ **COOKE** When we look at ratings, we also consider where they might move to in future and incorporate this in our analysis. I see the same happening with ESG criteria, where we would look at whether the trend is positive, neutral or negative.

Data is very important to this. To take a simple example, it could be that all the green loans in an RMBS pool get prepaid and it becomes a brown pool over time through natural selection. This is something we want to be able to monitor, because it will ultimately affect the security's value and risk. This will develop over time.

We have been struggling with similar issues in the UK, but it now has energy performance certificate (EPC) ratings – which involve someone going to a house that has already been built and assessing how good it is from an emissions perspective. The data is coming.

◆ **KOE** As an industry, we started with CBI criteria for green RMBS – which always had the notion that the target end goal was zero emissions by 2050 and that the criteria will be tightened periodically over time to get there. We always knew the market would continue to develop to these benchmarks.

◆ **SAMSON** Doing so will require corporates, from the top to the bottom, to be completely aligned – because otherwise they are not going to pass the test for a lot of investors.

I think the SPO providers are going to play a critical role, alongside investors, in being very clear about the standards they require and holding themselves to these standards to make sure there is consistency. Users can rely on the rating agencies if they are credible. I think this is where we will end up with SPO providers, too.

Davison *How helpful is this sort of third-party information in the securitisation market? Let's say an investor is offered an RMBS pool in which 80 per cent of the loans have an EPC rating: would this be sufficient due diligence or is it more complicated?*

◆ **COOKE** It depends. Some form of certificate is very useful information, and we can look at the pool to assess whether there is enough of this type of coverage and whether it is improving or getting worse. In some assessments this is an acceptable level – it can be as simple as that. But it is only one aspect of a transaction.

Davison *What would be an acceptable attachment point for investors when it comes to the quality of data available on home loans?*

◆ **FEDER** I would start with Utopia and move backwards. The age of a building alone is a woeful criterion, but how much better can we get if CSIRO does not hand over its data? To be honest, at the moment we are happy to wait it out. There is no need for us to rush in and buy something just because it has a green RMBS label.

The interesting thing about the EPC or a NatHERS rating is that it is the starting point for the pool, but it leaves open the question of how things evolve from there. The loans refinanced out of an RMBS pool may be the good ones, or on the other hand borrowers might upgrade their homes without mortgage lenders being aware of it. The pool could upgrade itself, in other words – but how will we know this, as investors?

There are data features the industry is yet to grapple with. How do we know when someone has put in water tanks or installed solar panels? Do we only find out once they have refinanced and got a cheaper mortgage elsewhere?

Davison *How can securitisation structures account for these challenges?*

◆ **KOE** Green notes need to be backed by at least an equal quantum of green receivables and we always ensure there is a sufficient overcollateralisation buffer of green assets relative to the liabilities.

To the extent we are finding different prepayment rates on certain mortgages, data reporting is integral. I think issuers have

done a good job in reporting this on a monthly basis so investors can readily identify the quantum of green receivables relative to green notes.

Certain issuers are already providing subsidised or lower rates to borrowers for green mortgages, and it will be interesting to see if new builds will provide a greater take-up for this product.

Ultimately, it comes down to pricing as well, including whether the market develops to a stage where we can see a pricing gap between green and nongreen tranches. At the moment it is pretty flat, so we will need to manage and monitor market development.

◆ **FEDER** At present the problem is that once the pool is out there it becomes the investor's problem. If the pool loses its green assets, whatever they happen to be, it is up to the investor to make a decision – and, depending on mandates or our house view, we might end up needing to exit such assets.

This would be time consuming and expensive, which is not in the best interest of our clients – who are, ultimately, the end investors.

◆ **KOE** This is a fair point, and it is something we have always considered. The first NAB green RMBS deal was 1.5 times overcollateralised and only the senior note was certified green. Even under stressed prepayment rates, there would be a healthy buffer of green overcollateralisation.

Structurally, the senior notes benefited from a sequential principal waterfall that inherently built on existing overcollaterlisation until the pro rata tests were met, and thereafter overcollateralisation would be maintained – all things being equal.

◆ **SAMSON** It is still an issue, though, because we cannot track everything accurately – for instance the point that homes might be upgraded when there is not an established method to capture the benefit of this.

It might be a while away, but I am sure there is some sort of technological solution to these issues. Perhaps lenders could encourage borrowers to self-report through a portal, for instance. I am sure it will be solved eventually, but I think it is a while away and we need to do our best in the interim.

Davison *Is there a role for SPO providers here? The comparison would be a conventional credit rating, which does not begin and end when a deal gets priced. Can providers play a role in ongoing monitoring of data and reflect this in the content of SPOs?*

◆ **PULI** Our SPO is a point in time so we have a look for attributes when we rate. I think part of the hesitation on our side is the potential browning of assets, and from a data perspective we rely a lot on companies and their collection mechanisms.

Regarding tracking, perhaps having smart meters or the like tied into assets could be useful in the long term. The other element is that some certifications expire after five years, so the question we are grappling with is to what degree to bake in a certificate that only lasts for part of a 30-year mortgage.

This challenge can be tackled by defining green characteristics that will be less likely to expire. For example, there are taxonomies, like CBI, that provide criteria that take into consideration the tenor of the instrument and thus avoid green qualities expiring during the life of the note.

◆ **KOE** Alternatively, the market could evolve to tracking at originator level instead of the SPV and assets in the pool. This would enable the issuer more effectively to manage and maintain covenanted asset coverage ratios. It would be great to see the domestic market evolve further, including adopting a sustainability-linked style of issuance.

◆ **MOIR** We are focusing on capturing data and developing the analytics to support and report, and on how we can do so in an efficient way.

◆ **AUSTIN** Indeed: data is difficult. We are collecting it on home construction but this is a small percentage of loans. How we

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JOHN ROHL BRIGHTE

get to the nirvana of a rating on every single asset comes back to CSIRO. We are – or we should be – already there with autos because the CO_2 tailpipe is available. But in green it is very difficult.

ASSET GROWTH

Davison *What is the growth potential in naturally green-aligned assets like household solar and energy storage? What does the growth trajectory mean for funding needs?*

◆ **ROHL** In Australia, the latest data suggest 3.5 million homes have solar and a million of those have a really small amount. There are about 10 million homes in total, meanwhile, and probably eight million of those are solar eligible. This means five or six million homes will need solar. There has been continued growth, apart from this last year – which was badly affected by rain and COVID-19.

The adoption rate continues to be driven by economics, and engagement with sustainability in the home is moving from the early adopter to the mass market. It is the same with EVs: early adopters bought A$100,000 (US$75,000) cars but we are now seeing the first wave of A$40,000 cars.

There is also the affordability drive. A home in 2030 that has sustainable assets is likely to save anywhere between A$3,000 and A$5,000 per year.

Ultimately, this means 5-6 million homes will likely introduce solar and EV, which is A$30,000-100,000 worth of equipment that needs to move from opex to capex. This is A$500 billion that needs to be spent.

The pace will be the interesting thing, and batteries have been an interesting case study. Our market has a 10 per cent battery attachment rate versus 90 per cent in the EU. The EU has higher expenses and energy usage so there is more of an imperative, but we will get there.

It is difficult to forecast the next two years but it is easier to look at the next seven. A million cars are sold every year and by 2030 ICE manufacturing will be close to zero. This is the trajectory we are most excited about. The more assets a household needs, the bigger the ticket size and the longer they need to pay off those assets. These types of trends tend to push into loan product, and therefore the share of sustainability assets that needs to be securitised is likely to increase.

◆ **AUSTIN** Last year, EVs comprised 2 per cent of all cars sold in Australia. This is still pretty low, but it is gaining traction. Hybrids are a little more popular – they comprise around 5 per cent of sales. There is an open question as to whether hybrids are green, though. High petrol prices now may hasten the uptake of EVs and new models are becoming cheaper.

The other thing I will say is on homes and new construction. To really crack this for new origination it is the large national builders that we need to get engaged. There is a gap between a 40 basis point mortgage discount for a green home versus the cost of upgrading the home so it achieves a seven NatHERs rating.

Of course, there are all the benefits that come with a home being more energy efficient and having lower cooling and fuel costs in future. However, it really comes down to the upfront decision of whether we collectively can convince builders to focus on emissions efficiency when they just want to sell a lot of product.

It is a real challenge, especially bearing in mind that the 40 basis points is pretty much coming out of the loan originator's pocket. There are a lot of relationship benefits from investors but there is certainly no cost of funds benefit from issuing green at this point.

◆ **MOIR** We are a leading originator of EV loans but trying to get to scale in the product is very difficult, mainly because of the low availability of stock. But we view it as a promising programme for us at some stage in the future.

"THERE ARE COMPANIES SPECIFICALLY BUILDING GREEN HOMES BUT IT IS ALL ABOUT MOVING PRODUCT FOR THE VOLUME-DRIVEN, MASS BUILDERS. THEY WILL WEIGH UP THE INCENTIVES AVAILABLE TO THEM AND THE COST OF DELIVERING ENERGY EFFICIENCY. WE NEED A GREATER INCENTIVE TO CHANGE THIS EQUATION."

JAMES AUSTIN FIRSTMAC

"SECURITISATION IS LESS DEVELOPED THAN OTHER ASSET CLASSES, BUT ACTUALLY I DO NOT THINK THIS IS A BAD PLACE TO BE. BEING ON THE LEADING EDGE CAN BE TUMULTUOUS SO I THINK BEING ABLE TO TAKE A STEP BACK AND EXPLORE WHAT PRACTICES ARE BEING USED ACROSS DIFFERENT INSTRUMENTS AND THINK ABOUT HOW THEY CAN BE ADOPTED IS BENEFICIAL."

MICHAEL PULI S&P GLOBAL RATINGS

When it comes to housing and mortgages, Pepper Money and Firstmac are looking at the definition of a green asset in a similar way. We want to contribute to improving the energy efficiency of the home. Rather than just capturing data on the status of the of the house itself, our main goal is to capture data, assess the house and offer incentives to up-scale energy efficiency.

Davison *Picking up on the point about engaging home builders, does this imperative suggest the green mortgage product is not hitting the right target – in the sense that all the financial incentive goes to the home buyer not the home builder?*

◆ **AUSTIN** The decision is being taken by mass builders – it is not driven by the individual at this point. Yes, there are companies specifically building green homes but it is all about moving product for the volume-driven, mass builders. They will weigh up the incentives available to them and the cost of delivering energy efficiency. We need a greater incentive to change this equation.

If an individual wants to conduct an accredited NatHERs assessor, it means quite a reasonable sum that is possibly equivalent to a full home evaluation – around A$200-400. Mass builders' surveyors will do an evaluation as a freebie. It is all about the cost equation.

Even though we try to promote to the borrower to look at the benefits over time, it still comes back to the builder.

◆ **SAMSON** Linked to this – although more so for the borrower – I believe some of the European regulators have been looking at risk weights for green mortgages. The idea is that banks could hold slightly less capital for green assets. It would be another big incentive and would flow through to securitisation and APS 120 as well, so potentially we as a bank could offer cheaper funding for green loans.

Davison *Markets have been challenging for any type of issuance since February. We often talk about the idea of securities with strong ESG credentials nowadays – whether they are labelled or not – being able to unlock incremental liquidity. What role do market participants believe ESG credentials have in adding liquidity to a market that has not got as much of it as it did as recently as a year ago?*

◆ **FEDER** I do not think it will. However, high quality ESG originators and servicers – even those that do not necessarily have green-labelled assets – should theoretically find it easier to continue issuing because they are a better quality originator and servicer.

◆ **AUSTIN** I agree. What I would add to this is the experience from the green deal we did last year, which was more so after the deal. It is not about price, but the relationship benefits and the wider funding that can flow if we are able to deliver ESG assets is significant. This is the driving goal – broader funding, as opposed to getting better pricing.

◆ **ROHL** From our perspective, we saw first time investors into the securitisation market because of our origination. I do not think this answers the wider liquidity question, but it is an example of increased demand at the margin. It also demonstrates that liquidity can come from different parts of the portfolio allocation that would not otherwise have been involved in the securitisation asset class.

◆ **PULI** From a ratings perspective, what I am hearing a lot from different stakeholders is essentially that they are trying to build the experience to get ESG-aligned product out the door because they know it is the future. They know they will have to do it, so getting the experience now is of vital importance to them. Also, green labels open the door to diversification of investors. As mentioned already, this may lead to better financing conditions for the issuer.

◆ **SAMSON** I absolutely agree with Natasha Feder – we want higher quality issuers to do better, and everyone else can strive to meet their higher standards. But I also believe there is a bit more liquidity out there for those that are able to deliver labelled product. We get reverse enquiry quite often for specifically green product and no interest in anything else.

◆ **KOE** We are not talking about the pool of dark green investors here – it is more the traditional fund managers that now have an increasing allocation to ESG within their investment mandates.

These fund managers are already very familiar with and regularly invest in securitisation transactions. However, ESG has become a growing focus of investment mandates and this is driving incremental liquidity and demand. This phenomenon is expected to become more prominent and, if it does, it will be an important development for the market. ■