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TranspArEEnS

ANALYSIS OF MARKET NEEDS FOR EE-ESG COVERED BOND DISCLOSURE

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TranspArEEnS

Mainstreaming Transparent Assessment of Energy Efficiency in Environmental Social Governance Ratings

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TABLE OF CONTENTS

1. Introduction 5
2. An overview of the Covered Bond Market 7
   2.1 The market for covered bonds 7
   2.2 The market for sustainable covered bonds 8
   2.3 Sustainable Covered Bonds Finance A Broad Variety Of Assets 8
3. A market based initiative – The Covered Bond Label 11
   3.1 Sustainable Covered Bonds on the Covered bond Label website – liability side 11
   3.2 Further need of data disclosure – asset side 14
4. Drivers of disclosure today 18
   4.1 Sustainable Finance & Disclsoure: Regulatory Framework, Supervisory Expectations & Monetary Policy 18
   4.2 Investor Community 19
   4.3 Rating Agency Methodologies 23
   4.4 Issuer Actions & Reactions 24
5. Conclusion 27
6. References 28

Executive Summary

The establishment of EE-ESG disclosure for SME financing can benefit from an in-depth analysis of how the covered bond market began to collect and disclose EE-ESG information. Sustainable covered bonds began to be issued in 2014 and, since then, have embarked on a path of continual growth, standing at around EUR 56 bn in June 2022, and with over EUR 60 bn registered on the Covered Bond Label website at the end of 2022.

Sustainable covered bonds finance a wide range of green and social loans, related to energy-efficient buildings, affordable housing and access to essential services, and are generally linked to Sustainable Development Goals laid down by the United Nations and to the outlines of the EU Taxonomy.

The sustainable covered bonds sector is benefitting from the current momentum in standardisation and the expansion of data granularity thanks to the growing interest from both investors and central banks in better assessing the degree of ESG-related information in cover pools, coupled with the increase in data reporting requirements and options through the Harmonised Transparency Template (HTT) of the Covered Bond Label.

Since 2017 the Covered Bond Label provides the possibility to flag, by way of a 'green leaf', covered bonds deemed to be sustainable according to a broad definition since refined by the EU-funded and EMF-ECBC-led Energy Efficient Mortgage Initiative (EEMI). In addition to this, in 2021 the HTT started offering specific sections and tabs where issuers may insert further information on their ESG strategies as well as ESG-related datapoints on the cover pool assets in question. A further exercise targeting mortgages focussed on Energy Efficiency and retrofitting is being advanced via the Energy Efficient Mortgage Label (EEML), launched in 2021, where the Harmonised Disclosure Template (HDT) is used by lenders to report relevant information.

In parallel, the move towards enhanced data disclosure is also being driven by the assertiveness of the EU with its Sustainable Finance Agenda and the EU Taxonomy as its centrepiece. This has had several ramifications in EU Law impacting on covered bond market practices, such as the Covered Bond Label, which recognised the importance of the provision of transparent and harmonised data for investors. Furthermore, this has resulted in an ongoing dialogue with investors which is delivering regular feedback to issuers on appetite and needs from a data perspective, both in general and specifically related to ESG considerations, and subsequently shaping issuers' disclosures accordingly. Finally, credit rating agencies are also playing a role in determining the kind of data that the market is collecting, processing and disclosing from an ESG perspective.

With the request in Art. 31(5) of the EU Covered Bond Directive for the EU Commission to draft a report by July 2024 on the potential introduction of the European Secured Note (ESN – an SME loan backed financial instrument inspired by covered bonds) asset class, the timing for reflection and designing harmonised reporting templates for ESG data for SMEs in the context of ESNs could not be better. A blueprint for this instrument has been developed by the ECBC ESN Task Force, drawing on the best practices presented by the Covered Bond Label. Further development of this blueprint, through a specific EE-ESG lens, will be the subject of the next stage in the TranspArEEns Project – to be reported on separately in due course - and will draw heavily on the EE-ESG best practices of the Covered Bond Label as reported here.

1. Introduction

As indicated in the first Report in this series[1], for a variety of reasons, SME financing can present a number of challenges, whether for the SMEs themselves wishing to access financing or for banks in their ability to provide it. At a time when all eyes are on mobilising long-term finance for energy efficiency projects as a way to drive the climate transition, the often-limited access of SMEs, as the engine of the EU economy, to financing in general and energy efficiency financing in particular is a problem that needs to be solved. The ability of banks to lend to SMEs is inherently linked to banks' own ability to raise finance on capital markets.

With the implementation of the recently adopted Covered Bond Directive[2], the EU has provided a strong legal framework for the covered bond market. While the Directive does not include SME loans as eligible collateral under Article 6, it does provide an 'opening' directly related to SME financing through the creation of a long-term dual recourse funding instrument, modelled on the covered bond product, known as European Secured Notes (ESN) in Article 31. Indeed, the value of a dual recourse instrument based on the covered bond instrument and deployed for the financing of non-traditional asset classes has already been recognised in Europe as a way of providing a supply of sustainable private finance to the real economy through a funding instrument which remains accessible in stress scenarios and acts as an anti-cyclical measure.

While the Covered Bond Directive limits the possibility of directly funding SMEs through the issuance of covered bonds as indicated above, covered bonds can nevertheless serve as a best practice example for the development of separate funding instruments, such as ESN. Indeed, the key characteristics of covered bonds, including the preferential claim of investors in the event of default to both the cover pool of financial assets and the balance sheet of the issuer, asset coverage, bankruptcy-remoteness and regulation, translate into reduced funding costs for banks and offer favourable conditions for investors.

As a result of the security features of covered bonds and their benefits for market participants, since 2015 and in the context of the Capital Markets Union (CMU) debate, there have been efforts at EU level, also supported by the EMF-ECBC[3], to promote the development of ESN as a complement to covered bonds and allowing for the financing of asset classes beyond the traditional covered bond collateral types, such as SME loans. As suggested above, this instrument is intended to combine existing covered bond techniques and markets' best practices for the establishment of a funding solution for lenders and a new product for institutional investors, which would also be accessible in a stress scenario, thereby acting as an anticyclical funding tool and providing support for the real economy.

In 2017, the European Commission issued a call for advice[4] to the European Banking Authority (EBA) on (i) whether a dual recourse instrument, similar to covered bonds, may provide a useful funding option to banks engaged in lending to SMEs and infrastructure projects and (ii) an appropriate EU framework and regulatory treatment for this instrument. The EBA models its proposed approach to designing ESNs on the European Covered Bond Framework and certain characteristics of the covered bond product, most notably its dual recourse nature.

With the overall objective of TranspArEENs in mind to improve access of SMEs to long-term finance for energy efficiency projects as the key to achieving the EU's climate targets, the first Report in this series

[1] TranspArEEns Project – Bertalot, L., Johnson, J. & Palladino, F. (EMF-ECBC) Deliverable 4.1 - Technical Report on key opportunities to enhance standardised disclosure of EE-ESG products
[2] Directive (EU) 2019/2162 on the issue of covered bonds and covered bond public supervision and amending Directives 2009/65/EC and 2014/59/EU
[3] Hypo.org < https://hypo.org/ecbc/market-initiative/european-secured-note/ >
[4] European Commission, Call for advice to the EBA on European Secured Notes, 2017

established that the TranspArEEns survey, database and EE-ESG rating has the potential to greatly enhance the availability of standardised and transparent information on SMEs' EE-ESG credentials, as a complement to information on their financial and economic performance, and therefore support analysis of the credit performance of SME loans. A more robust understanding of the profile of SMEs could in turn make an important contribution to unlocking the potential in general terms of ESNs, offering a wide range of benefits for issuers, investors, SMEs themselves and contributing to future growth.

In light of the specific EE-ESG perspective of TranspArEEns, there is also potential for the development of EE-ESG ESNs. Indeed, Latham & Watkins suggest that ESNs could, for example, attract a social label, through their focus on funding an economic sector that traditionally faces challenges in accessing credit and that *"depending on the issuing bank's underwriting strategy, SME ESNs may be welcomed as yet another sustainable finance instrument that could further leverage private capital for ESG aims"*[5]. With the innovation that TranspArEEns brings through its focus on EE and ESG, its infrastructure could be additionally supportive of ESN developments along a 'green' and 'social' pathway, supporting the climate transition, economic recovery and, also helping issuers meeting an increasingly complex regulatory agenda focussed on disclosure requirements.

It is against this background that developments and best practice in the covered bond market can help shape the design and development of ESN and, specifically of relevance in the context of the current Project, EE-ESG ESN. One of the key drivers behind the success of the covered bond product in more recent years has been the Covered Bond Label, which is recognised by market participants, issuers, investors and regulatory authorities alike, as being an indispensable mark of quality and transparency in the market. As will be described in more detail later on, the Covered Bond Label responds to a market-wide request for common qualitative and quantitative standards and for an enhanced level of transparency and comparability in the European covered bond market and therefore establishes a clear perimeter for the asset class and highlights the core standards and quality of covered bonds, increases transparency and access to information for market participants. At the heart of the Label are a robust governance structure, a Harmonised Transparency Template (HTT) and regular dialogue with market participants to ensure that the Label continues to lead from the front and anticipate market needs. Of particular relevance in the context of the development of EE-ESG ESN are the Covered Bond Label's definition of a sustainable covered bond and the sustainable disclosure requirements included in the HTT, which represent an important source of best practice in this area.

Against this background, the present Report considers covered bond disclosure, with a focus on EE-ESG disclosure in more detail as best practice for disclosure of this kind in relation to other funding instruments, with a focus on ESN. To this end, the present Report: (1) provides an overview of the development of the covered bond market and sustainable covered bond market, (2) describes the ways in which the market has embraced developments by way of the Covered Bond Label and its tried-and-tested HTT and (3) considers the needs of different market participants based on feedback to a survey and a regulatory analysis. These insights will not only shape the further development of the Covered Bond Label but can offer valuable guidance for the development of ESN and EE-ESG ESN.

The best practice described in this Report will be taken forward and analysed in detail in the context of ESN specifically in a third Report in this series.

[5] Latham & Watkins, September 23, 2020, Number 2798, European Secured Notes – Coming to a Bank Near You?

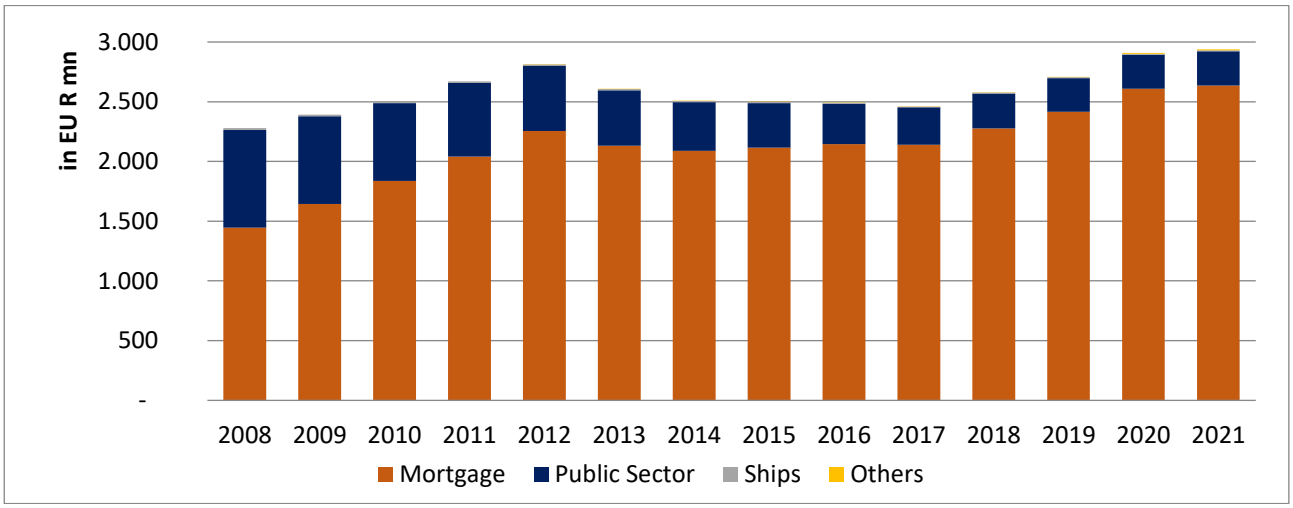
2. An overview of the Covered Bond Market

2.1 The market for covered bonds

Covered bonds[6] are debt instruments secured by a cover pool of mortgage loans (property as collateral) or public-sector debt to which investors have a preferential claim in the event of default. While the nature of this preferential claim, as well as other safety features (asset eligibility and coverage, bankruptcy-remoteness and regulation) depends on the specific framework under which a covered bond is issued, it is the safety aspect that is common to all covered bonds.

The covered bond is the oldest financial product in Europe originating in Prussia and Denmark during the second half of the 18th century[7]. Originally this product financed agriculture, but it later concentrated more on housing and commercial real estate. Currently the collateral for covered bonds are mostly residential and commercial mortgages (89.7%) followed by Public Sector (9.7%) and marginally shipping assets (0.3%) and other assets (0.3%).

Figure 1 - Outstanding covered bond - breakdown asset collateral



Source: ECBC Fact Book 2022

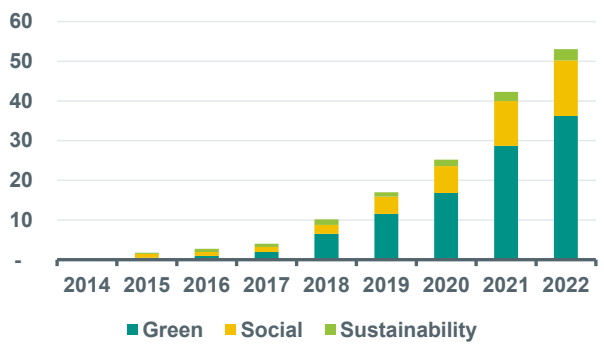
Over the past 20 years, the covered bond market has developed into the most important segment of privately issued bonds on Europe's capital markets, with volume outstanding as of end-2021 of EUR 2.9 trillion. Today, there are active covered bond markets in 30 different European countries. The covered bond market has also expanded beyond European borders to become a global product: countries such as Australia, Canada, New Zealand, Singapore, South Korea, Brazil have established covered bond legislation, and others (Morocco, US, Japan, Mexico, Chile, India, Thailand, Malaysia, China, Croatia) are looking to establish Covered Bond frameworks.

[6] Covered Bond Label – What is a Covered Bond? < https://www.coveredbondlabel.com/legislation/what-is-a-covered-bond >
[7] ECBC Fact Book (2022). Covered Bond Overview (P 135) https://hypo.org/ecbc/publications/fact-book/

2.2 The market for sustainable covered bonds

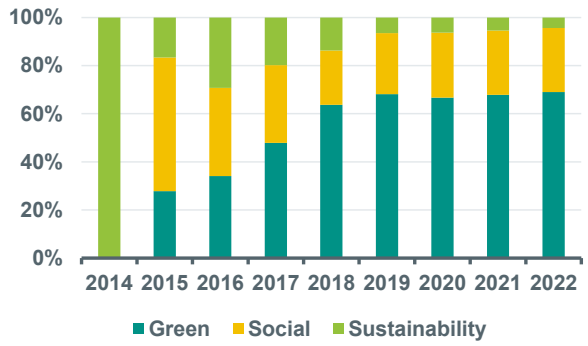
The first sustainable covered bond was issued in 2014 by Münchener Hypothekenbank. This was followed in 2015 by an inaugural green euro benchmark covered bond in 2015 from Berlin Hyp. As reported by Schuller, Costa & Beaumont in the 2022 ECBC Fact Book[8], since then, the market in sustainable covered bonds has continued to expand, with issuance gaining momentum in particular since 2018, when more than EUR 6bn of sustainable covered bonds were issued. The authors estimate that more than 70% of sustainable covered bonds are green covered bonds, with the proceeds being used to (re)finance green projects, which in the case of covered bonds are most often linked to energy efficient buildings, whereas 26% were social covered bonds and 5% sustainability covered bonds (see graph below right).

Figure 2: Outstanding amount of sustainable covered bonds, EUR bn



Source: ECBC, ABN AMRO, Bloomberg, 2022 data covers H1

Figure 3: Share of green, social and sustainable covered bonds in total, %



Source: ECBC, ABN AMRO, Bloomberg, 2022 data covers H1

The sustainable footprint of the covered bond market has grown over the years, with new supply having gained real momentum since 2018, setting new records every year. In 2021, more than EUR 19 bn of sustainable covered bonds were issued across different currencies, which was almost triple the volume of sustainable covered bond issuance in 2018. Year-to-date, new supply has already exceeded EUR 10 bn, suggesting that 2022 can become another record year. At the end of June 2022, the market for sustainable covered bonds amounted to a total outstanding of around EUR 54 bn.

2.3 Sustainable Covered Bonds Finance A Broad Variety Of Assets

Sustainable covered bonds have been issued in different formats, ranging from green, social, and sustainability covered bonds. The different flavours reflect the different use of proceeds of the bonds. In short, green covered bonds are mostly aligned with the ICMA's Green Bond Principles (GBP), and sometimes also already with the EU Taxonomy with the proceeds of the bonds being used to (re)finance green projects. In case of covered bonds these are often linked to energy-efficient buildings. Social covered bonds are mostly aligned with the ICMA's Social Bond Principles (SBP). The proceeds of the bonds are used to (re)finance social projects, which in case of covered bonds is largely related to affordable housing or public lending. Finally, sustainable covered bonds are aligned with the ICMA's Sustainability Bond Guidelines (SBG), which tends to be a mix of green and social projects, for instance, energy-efficiency as well as affordable housing. As far as

[8] ECBC Fact Book (2022) Sustainable Covered Bond Overview (P57) https://hypo.org/ecbc/publications/fact-book/

sustainability linked bonds (SLB) are concerned they have not yet been issued in covered bond format and are still considered a novelty in the banking segment.

Figure 4 : Sustainable covered bonds seek alignment with the GBP, SBP and SBG

Four components of alignment

I	**Use of proceeds**				
	Green			**Social**	
1	Renewable energy	√	1	Affordable basic infrastructure	√
2	Energy efficiency	√	2	Access to essential services	√
3	Pollution prevention and control	√	3	**Affordable housing**	**√**
4	Environmentally sustainable management of living natural resources and land use	√	4	Employment generation, and programs designed to prevent and/or alleviate unemployment stemming from socioeconomic crises, including through the potential effect of SME financing and microfinance	√
5	Terrestrial and aquatic biodiversity	√			
6	Clean transportation	√			
7	Sustainable water and wastewater management	√			
8	Climate change adaptation	√	5	Food security and sustainable food systems	
9	Circular economy adapted products, production technologies and processes, and/or certified eco-efficient products	√	6	Socioeconomic advancement and empowerment	√
10	**Green buildings**	**√**			
II	**Process for project evaluation and selection**				
III	**Management of proceeds**				
IV	**Reporting**				
Key recommendations for heightened transparency					
i	Green, social or sustainability bond frameworks				
ii	External reviews				

Source: ICMA, ING

As the authors[9] highlight a key characteristic of use of proceeds bonds is that sustainable covered bonds (re)finance an earmarked portfolio of new or existing eligible green and/or social assets. This portfolio may have an overlap with eligible cover pool assets, but does not necessarily have to. As such, there are examples of sustainable covered bonds that allocate proceeds to a portfolio of sustainable loans that are not part of the cover pool. Separate from their use of proceeds, these sustainable covered bonds are secured by sufficient cover assets meeting the asset eligibility criteria stipulated by law and/or the bond programme documentation.

[9] ECBC Fact Book (2021) Sustainable Covered Bond Overview (P59) https://hypo.org/ecbc/publications/fact-book/

In general, the primary financing target of green mortgage covered bonds are energy-efficient commercial or residential buildings, with green residential real estate loans nowadays being the most important use of proceeds category. Instead, banks with mortgage cover pools (partly) comprised of social housing loans often issue social or sustainability mortgage covered bonds.

As far as sustainable public sector covered bonds are concerned the most important use of proceeds is the access to essential services, such as the financing of community projects in areas of healthcare and education. In 2019 the first green public sector covered bond focusing on sustainable water and sanitation, waste management, energy efficiency, renewable energy and territorial mobility/soft urban transport segments was issued and during the first half of 2022 another green public sector covered bond was issued (re)financing rail infrastructure and public transportation projects.

In 2020 in Luxembourg a renewable energy covered bond was issued. This issuance went beyond the usual mortgage and public sector covered bond segments and remains up until today the one single example of a sustainable covered bond issued under a dedicated legal framework for the issuance of green covered bonds.

The achievement of Sustainable Development Goals (SDG) drafted by the United Nations in 2015 are as well among the goals of sustainable covered bonds. Amongst the various SDGs the main target goal for sustainable covered bonds are Sustainable cities and communities (SDG 11), followed by Affordable and Clean Energy (SDG 7), Climate Action (SDG 13) and Industry innovation and infrastructure (SDG 9). More marginally also the other SDGs can be found with the exception of Gender equality (SDG 5) and Zero hunger (SDG 2).

Looking at the six environmental objective set by the EU Taxonomy, climate change mitigation objective is the most important one for Covered bonds with an environmentally sustainable use of proceeds.

In a nutshell, albeit starting from a niche market position the share of sustainable covered bonds has been growing every year. Sustainable covered bonds finance a wide range of green and social loans, related to energy-efficient buildings, affordable housing and access to essential services. Currently with the tight spread levels of covered bonds, the greenium, i.e. the price differential between sustainable and vanilla covered bonds, is still modest or not even visible. At the same time investors dispose of an increasing variety of tools to make a distinction between sustainable versus less sustainable investment alternatives. As an example, ESG criteria have been increasingly integrated in issuer and covered bond rating methodologies, while issuers also often obtain an external assessment of their green, social or sustainability bond process from external reviewers. Central banks as well have become more and more involved in climate-related issues. The prospect of taking into account climate considerations into any future market operation by central banks, such as future purchases, targeted lending operations or collateral eligibility initiatives, will by then only form a further positive incentive for investors to buy sustainable assets, including sustainable covered bonds. Finally, the more granular ESG data requirements for sustainable covered bond through the Harmonised Transparency Template of labelled covered bonds provides further data in order to assess the ESG criteria of certain issuances.

3. A market based initiative – The Covered Bond Label

The Covered Bond Label[10] is a quality Label which responds to a market-wide request for common qualitative and quantitative standards and for an enhanced level of transparency and comparability in the European covered bond market. The Label:

- Establishes a clear perimeter for the asset class and highlights the core standards and quality of covered bonds;
- Increases transparency;
- Improves access to information for investors, regulators and other market participants;
- Has the additional objective of improving liquidity in covered bonds;
- Positions the covered bond asset class with respect to regulatory challenges (CRD IV/CRR, Solvency II, redesign of ECB repo rules, etc.).

The Covered Bond Label Foundation (CBLF) was established by the EMF-ECBC in 2012 and was developed by the European issuer community, working in close cooperation with investors, regulators, and rating agencies and in consultation with all major stakeholders. The Label website became fully operational in January 2013, with the first Labels being granted from the onwards.

At the time of writing, visitors can find the Harmonised Transparency Template (HTT)[11], 125 issuer profiles and information on 158 labelled cover pools with issuance data on around 5,000 covered bonds amounting to a total face value of over EUR 2.0 tn.

The Label is based on the Covered Bond Label Convention[12] (the one currently in force is the 2023 Label Convention as described below), which defines the core characteristics required for a covered bond programme to qualify for the Label.

The HTT is the worldwide standardised, Excel-based form that issuers who have been granted the Covered Bond Label use to disclose information on their covered bond programmes. Definitions and format of the disclosed information are standardised to increase comparability and transparency between issuers and between jurisdictions.

Standardisation facilitates investors' due diligence, enhancing overall transparency in the Covered Bond market. The HTT, designed to be fully compliant with the current legislative environment undergoes constant review, stirred by the Covered Bond Label Committee and the Covered Bond Label Advisory Council, so to be always up-to-date with regulatory and market requirements.

3.1 Sustainable Covered Bonds on the Covered bond Label website – liability side

The first move towards sustainability of the Covered Bond Label came with the decision of the Covered Bond Label Committee of 5 April 2017 to introduce an IT feature on the Covered Bond Label website to signal Covered Bond Labelled Sustainable Covered Bonds to users of the website. Issuers labelling sustainable covered bonds can make use of a 'green leaf' next to their ISIN to highlight the issuance.

[10] Covered Bond Label Website - https://www.coveredbondlabel.com/
[11] Covered Bond Label Harmonised Transparency Template - https://www.coveredbondlabel.com/htt
[12] Covered Bond Label Convention - https://coveredbondlabel.com/about/18/convention

Figure 5: Screenshot of the Covered Bond Label Website with a selection of sustainable covered bonds indicated by the 'green leaf' logo.

ISIN	Issuer	of Issuance	Date		Face value[1]	Coupon	Syn.	Listed	Tapped	Mat.[2]	EEA[3]	LCR[4]
XS2556223233	Møre Boligkreditt AS	16/11/2022	16/11/2027	EUR	250,000,000	Fixed	Yes	Yes	No	SB	Yes	2A
CH1216400056	Korea Housing Finance Corporation	14/10/2022	14/10/2025	**EUR***	160,000,000	Fixed	Yes	Yes	No	HB	No	2A
CH1216400064	Korea Housing Finance Corporation	14/10/2022	14/10/2027	**EUR***	140,000,000	Fixed	Yes	Yes	No	HB	No	2A
DE000HV2AY12	UniCredit Bank AG	27/09/2022	27/04/2028	EUR	500,000,000	Fixed	Yes	Yes	No	SB	Yes	1
XS2536806289	Eika Boligkreditt AS	22/09/2022	22/09/2028	EUR	500,000,000	Fixed	No	Yes	No	SB	Yes	1
DK0006357744	DLR Kredit A/S	31/08/2022	01/01/2026	**EUR***	14,209,527	Floating	No	Yes	Yes	SB	Yes	No
DE000BHY0GK6	Berlin Hyp AG	25/08/2022	25/08/2025	EUR	1,000,000,000	Fixed	Yes	Yes	No	SB	Yes	1
DK0009538738	Nykredit Realkredit A/S	23/08/2022	01/10/2026	**EUR***	557,400,140	Floating	Yes	Yes	Yes	HB	Yes	1
CH1202242249	Berlin Hyp AG	04/08/2022	04/08/2026	**EUR***	200,000,000	Fixed	Yes	No	No	SB	Yes	N/A
DE000LB2ZV93	Landesbank Baden-Württemberg	28/07/2022	28/02/2028	EUR	1,000,000,000	Fixed	Yes	Yes	No	SB	Yes	1

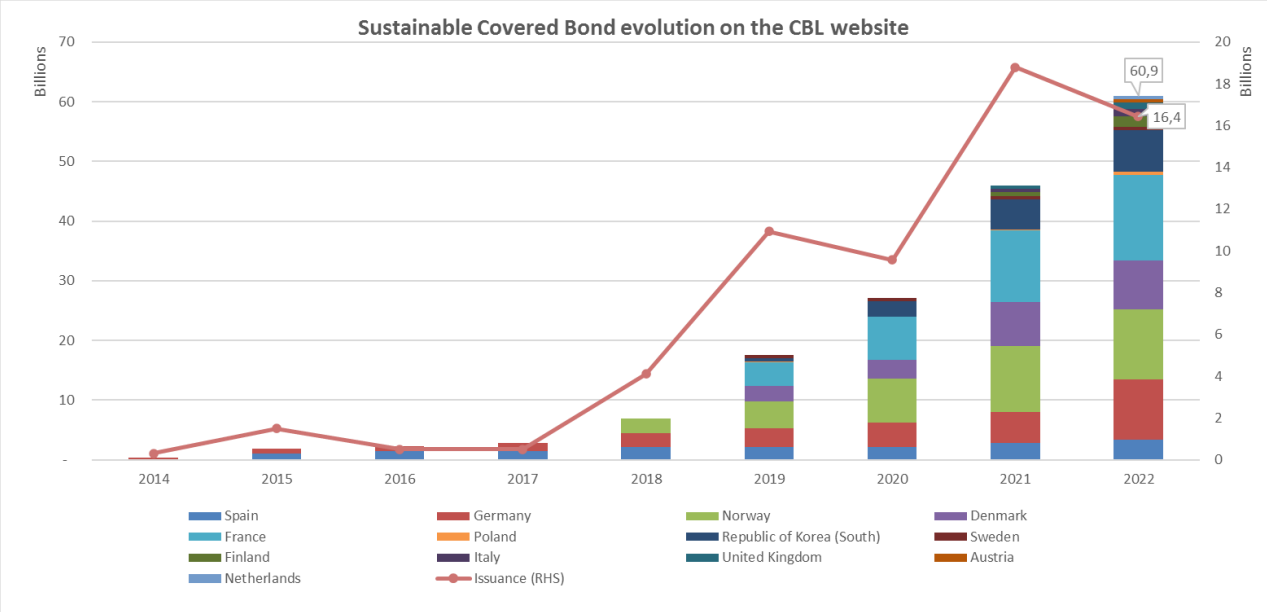
Source: Covered Bond Label

The definition of a sustainable covered bond was developed in cooperation with the EU-funded and EMF-ECBC led Energy Efficient Mortgage Initiative (EEMI) lending institutions and reads as follows:

A Covered Bond Labelled sustainable covered bond is a covered bond that is fully compliant with the Covered Bond Label Convention, and also includes a formal commitment by the issuer to use an amount equivalent to the proceeds of that same covered bond to (re)finance loans in clearly defined environmental (green), social or a combination of environmental and social (sustainable) criteria. Covered Bond Labelled sustainable covered bond programs are based on their issuer's sustainable bond framework which has been verified by an independent external assessment. The issuer strives, on a best efforts basis, to replace eligible assets that have matured or are redeemed before the maturity of the bond by other eligible assets.

Since then this feature has gained traction and is currently been used by 36 issuers in 13 countries totalling over 86 of covered bonds outstanding worth over EUR 58.5 bn.

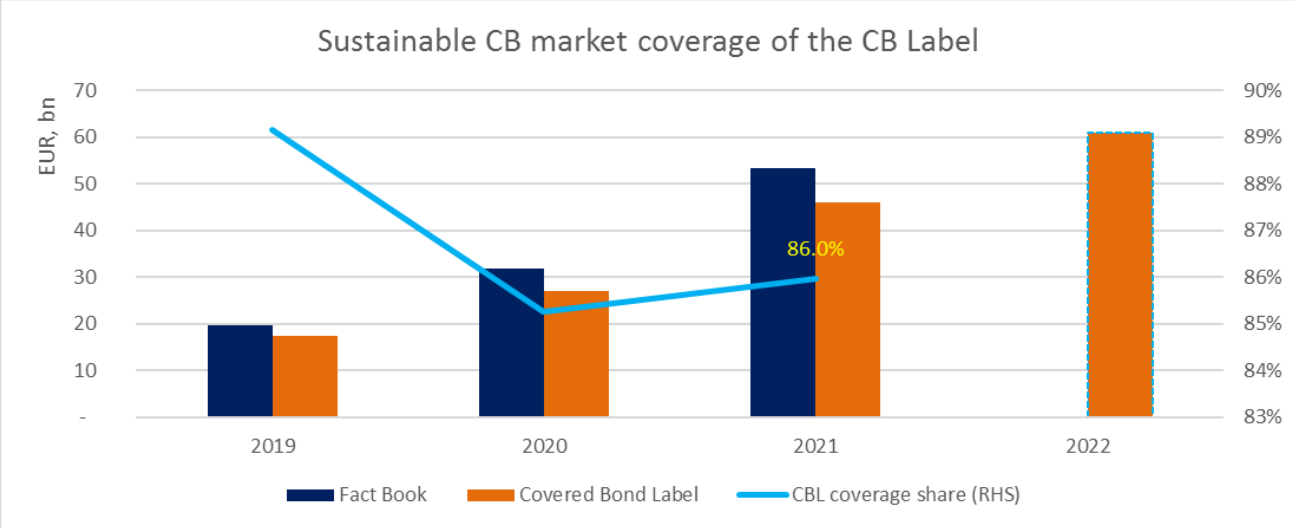
Figure 6: Sustainable Covered Bond evolution on the CBL website



Source: Covered Bond Label

Comparing the development with the sustainable covered bonds registered on the ECBC Fact Book over the years it can be concluded that the vast majority of sustainable covered bonds is captured under the Covered Bond Label, which can be considered as a significant standard-setter for the sustainable covered bond sector. It also evidences the value of disclosure of this kind and therefore represents best practice in this area for other funding instruments of this kind.

Figure 7: Sustainable CB market coverage of the CB Label



Source: Fact Book 2022, Covered Bond Label

3.2 Further need of data disclosure – asset side

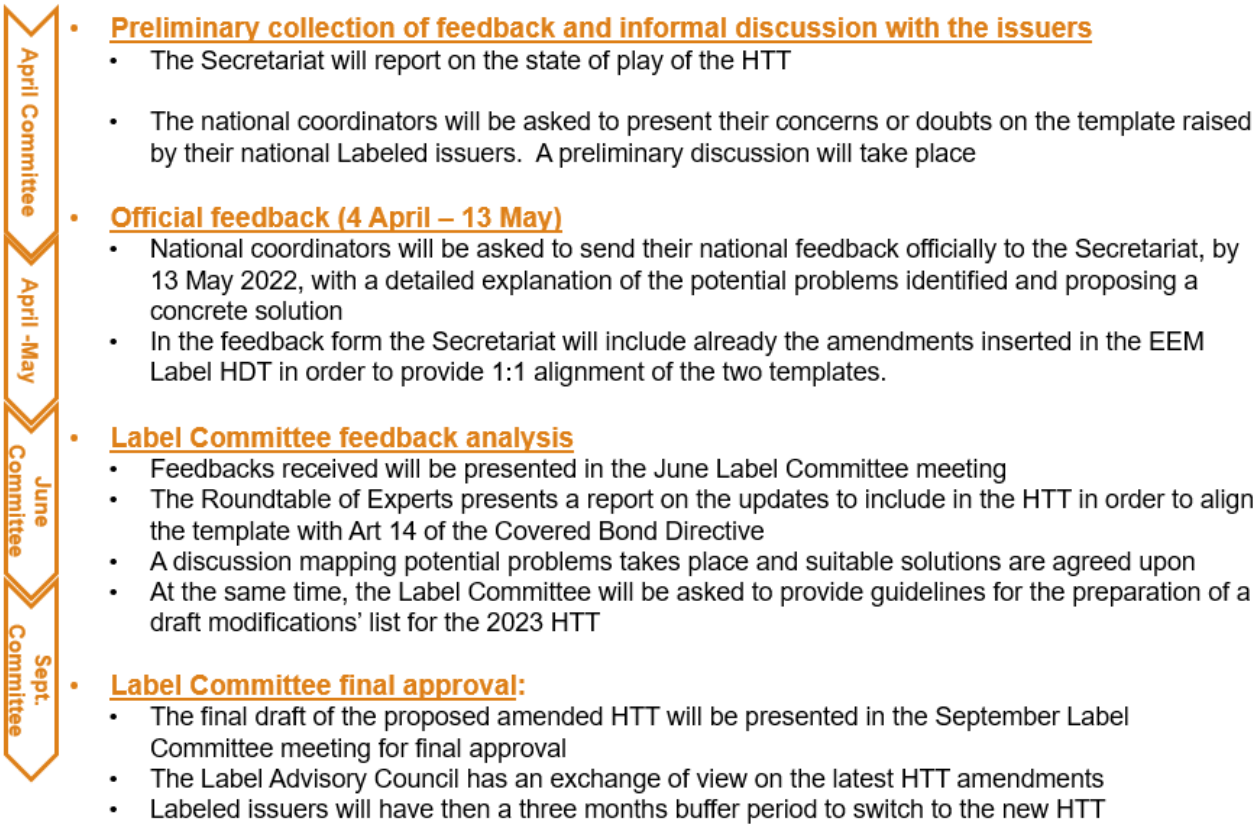
In parallel to the aforementioned momentum in sustainable covered bonds, there was also increasing awareness that simple self-certification of the issuer that a certain covered bond is sustainable would not be sufficient and could give rise to concerns of green-washing, thus damaging the reputation of the entire asset class. Against this background, the Covered Bond Label developed a new Optional Section in the HTT with which to collect and disclose information on the sustainable mortgages in the cover pools which are linked to sustainable covered bonds.

Before entering into further details on the process and the technical specificities of the sustainable dimension of the HTT, it is worth providing a brief introduction to and description of the Template. The starting points for the HTT was actually National Transparency Templates, designed to address the different reporting templates which existed not only at country level, but also within each country, therefore making comparisons and analyses among different covered bonds cumbersome and time-consuming. Subsequently, in 2015, the Covered Bond Label developed the HTT, at the heart of which is a harmonised structure for the reporting of cover pool data for all labelled issuers. The phase-in period of switching from the NTT to the HTT was not set, but the usage of HTT was highly encouraged. Ultimately, a combination of first movers which exerted peer pressure, as well as positive signals from the investor community and rating agencies, provided the momentum for the labelled issuers to switch entirely to the HTT for the regular reporting of their cover pool information. The HTT is based on an Excel File with a blocked structure which prevents issuers from making changes to rows and columns. The first HTT consisted of the following Worksheets:

- **Worksheet A1. HTT general** – which focuses on general information of the cover pool and the related covered bonds, such as regulatory compliance, currency and maturity structure, substitute assets and presence of swaps.
- **Worksheet B1. HTT Mortgage Assets** – which focuses on the Mortgage assets on the cover pool.
- **Worksheet B2. HTT Public Sector Assets** - which focuses on the Public Sector assets on the cover pool.
- **Worksheet B3. HTT Shipping Sector Assets** - which focuses on the Shipping assets on the cover pool.
- **Worksheet C. HTT Harmonised Glossary** – which provides a space where issuers can insert further qualitative information and definitions to better explain the data provided.
- **Worksheet D. NTTs** – this is an empty tab where issuers are allowed to insert their National Transparency Templates should these provide further more nation -specific information not present elsewhere in the HTT.

In order to provide a stable and predictable Template, the HTT undergoes a well-defined and clear revision process which starts in March/April in a given year, with the official request for feedback to all labelled issuers and their respective national coordinators up until September when the new HTT is formally approved and when the official phase-in adoption period starts. The following is a schematic timeline of the 2022 revision process:

Figure 8: Timeline HTT revision process



Source: Covered Bond Label

With this revision process in mind, the original HTT structure was enhanced in 2017 with the addition of the **Worksheet. E Optional ECB-ECAIs Data**, a voluntary addendum to respond to the introduction by the European Central Bank (ECB) of minimum disclosure requirements for covered bond ratings. Through this addition, the HTT facilitates timely data disclosure in this area and ensures a homogeneous format across countries and institutions. In 2020, a voluntary worksheet "Temp. COVID-19", was introduced in order to monitor mortgage repayment moratoria due to the COVID Pandemic. This worksheet has since been renamed **"G1. Crisis mortgage holidays"** in order to provide a dedicated section for issuers to report on payment holidays resulting from significant crises, be it natural, political, social or economic. Currently the Covered Bond Label is monitoring the evolution of potential reactions to energy price evolutions in the form of payment holidays by governments or industry associations.

In 2020, against the background described in the first paragraph of this section, during the annual revision process of the HTT the Covered Bond Label Committee inserted the first sections for the disclosure of ESG related information. Considering that over 90% of the cover pool assets of covered bonds are mortgage loans and that during that period most analysis was focused on the "E" in the ESG acronym, these first sections focused on environmental impact data points linked to residential and commercial real estate. Leaning on the work developed under the EEMI[13], the sections added to the HTT in the B1. Worksheet were the following:

- Energy Performance Certificate

[13] EeDaPP – Pilot Phase Database (D4.4), Data Protocol and technical concept (D4.5)

- Type of Dwelling
- New or Existing Building
- House Age Structure
- Energy Demand (kWh/m2/year)
- CO2 impact (added in the 2021 revision process)

Besides these additions, a new section was inserted in Worksheet A. HTT General for the disclosure of information on whether the cover pool is linked to any sustainable/special purpose strategy and, if so, whether this strategy is a future commitment or already undertaken. Furthermore, the section provides a space where issuers can indicate the actual criteria and provide a link to their websites. Future potential considerations focus on the potential inclusion of a line on use of proceeds and an explicit link to Second Party Opinions.

For each of these entries, the data availability at jurisdiction level has varied significantly and it soon became clear that completion of this information did not necessarily depend on the issuer's willingness to report, but that there were exogenous bottlenecks link to problems of availability and accessibility of EPC datasets, alleged GDPR impediments, or simply lack of collected data, especially concerning the bulk of existing mortgages for which there is no EPC for the underlying collateral. In this context the Label Committee, in order not to discourage issuers from providing this data and to rather encourage the start of the data-collection, has kept these sections as optional and has also inserted a "no data" field which can be completed if no data for this section is available. Besides providing information to the user of the HTT regarding the level of data availability, this field also acts as a driver to improve the data collection by the issuer providing the HTT.

Besides the development of these new sections which are linked to all the mortgages in the cover pool, in 2020 a further development took place in the HTT, namely a new optional Tab on Sustainable Mortgage Assets. The underlying idea was to set up a worksheet which was focusing on exclusively the mortgage assets which the issuer used to issue sustainable covered bonds and using as a report structure the same as the one in Worksheet B1.

Following on from the last due diligence performed by the Secretariat in November 2022 out of 123 labelled issuers 36 were using the sustainable covered bond leaf and 16 were reporting information in the F1. Worksheet, representing a share of 53% sustainable labelled covered bond issuers. Against this background during the last revision process of the HTT the Label Committee decided to automatically require those labelled covered bond issuers which are tagging a sustainable covered bond with a 'green leaf' to insert information in the F1 worksheet starting from at the latest cut-off date of March 2023.

In order to further support issuers in their data collection, the Covered Bond Label also produces an HTT completion guideline for all sections in the HTT (ESG and non).

This exercise of providing transparent, comparable and reliable data on sustainable covered bonds is further supported by the Energy Efficient Mortgage Label (EEM Label) which focuses exclusively on data disclosure for energy efficient mortgages. This Label, which was set up in early 2021 is based on the EEM Label Convention[14] which lays down a comprehensive definition of an energy efficient mortgage as follows:

Energy Efficiency Mortgage (EEM) are intended to finance the purchase/construction and/or renovation of both residential (single family & multi-family) and commercial buildings where there is evidence of: (1) energy

[14] EEM Label – Convention - https://www.energy-efficient-mortgage-label.org/about-us/convention

performance which meets or exceeds relevant market best practice standards in line with current EU legislative requirements; and/or (2) an improvement in energy performance of at least 30%.

This evidence should be provided by way of a recent Energy Performance Certificate (EPC) rating or score, complemented by an estimation of the value of the property according to the standards required under existing EU legislation. It should specifically detail the existing energy efficiency measures in line with the EEM Valuation & Energy Efficiency Checklist.

Lending institutions are committed to providing regular information enabling investors to analyse the Energy Efficient Mortgage products, following the Harmonised Disclosure Template.

The EEM Label is intended as a quality benchmark for consumers, lenders and investors, with the aim of supporting recognition of and confidence in energy efficient mortgages through the disclosure of relevant, quality, and transparent information for potential borrowers, regulators, and other market participants. In addition, the Label aims to facilitate a process of standardisation to secure and enhance overall regulatory recognition of the asset class.

Before the official launch of the Label, the Energy Efficient Mortgages Initiative (EEMI) designed its core elements, including a IT platform and legal texts. The Label is built around the EEM Label Convention and a process of self-certification, both of which are overseen by the Label governance structure consisting of: the Label Committee, the Label Secretariat and the Label Advisory Council.

The EEM Label has been developed using the Covered Bond Label as a blue-print which has a 10-year track record of success. Indeed, the Covered Bond Label has established itself as the global reference point and data collection benchmark for the nearly EUR 3 tn. outstanding covered bond asset class. It is the intention that the EEM Label emulates this goal in the field of energy efficient mortgages and in the wider field of financing of energy efficient renovation, scaling-up volumes and best practices in relation to both retail and funding activities in the ESG sector.

The EEM Label comes at a pivotal point in time, in which efforts are underway at EU level to redesign the regulatory and monetary policy framework to address climate change and transition risks. As of August 2022, 38 pioneering lending institutions from 14 countries have adopted the EEM Label, covering the four corners of the Old Continent, large and small lending institutions, traditional banks and FinTech platforms.

The combined efforts of both Labels through their templates, the HTT and the HDT, deliver a virtuous circle, according to which experts of the (sustainable) covered bond market and the energy efficient market are able to discuss, exchange views and decide on how to best report ESG-related data of relevant assets, mindful of the requirements of the policy landscape as well as the data-related capabilities of issuers at the current time. This provides the preconditions to be able to deliver an ambitious yet realistic approach to data disclosure of the ESG dimension in relation to mortgage and covered bond markets.

4. Drivers of disclosure today

Disclosure practices in the financial sector, including the covered bond market, are being driven by a combination of factors. Firstly, the Sustainable Finance agenda is placing huge emphasis on ESG reporting and disclosure to market participants, including regulatory authorities and investors, from both a supervisory and funding perspective. Indeed, it is increasingly being recognised in the financial sector and beyond that environmental, social and governance (ESG) factors will impact households, corporates and financial institutions, both positively and negatively. As the EBA reports, *"scientific evidence suggests that climate change and environmental degradation, and the associated need to transition towards an environmentally sustainable economy, will lead to changes in the real economy that will in turn impact the financial sector through new risks and opportunities".*[15]

The EBA goes on to note that through their core business activities, i.e. their lending and investment activities, banks and investment companies can be impacted by ESG risks through their counterparties or invested assets. For example, counterparties can be affected by environmental risks through physical events, such as increased flooding as a consequence of climate change impacting properties, or through transition risks, such as policy implementation, technological advancement and changing market sentiment leading to certain economic activities being phased out. Similarly, social factors – such as inequality, health or labour relations – and governance factors – such as executive leadership or bribery and corruption – can have negative financial impacts on counterparties, and in turn on financial institutions.[16]

The subsequent Sustainable Finance agenda which has emerged since 2018 to address these dynamics is requiring huge efforts from banks to understand specific disclosure and therefore data requirements, identify potential data sources, benchmark existing and new financial products against the requirements, address gaps and move towards disclosure.

At the same time and pre-dating the regulatory agenda, the market itself, as we have seen above in the case of covered bonds, recognised the importance of the provision of transparent and harmonised data to investors. This has resulted in an ongoing dialogue with investors which is delivering regular feedback to issuers on appetite and needs from a data perspective, both in general and specifically related to ESG considerations, and subsequently shaping disclosure accordingly. Finally, rating agencies are also determining the kind of ESG data that the market is collecting, processing and disclosing from an ESG perspective.

In the next section, we consider these drivers in more detail and illustrate how the covered bond issuer community is pre-empting and responding to these, providing best practice which can be deployed in the context of other funding instruments, including ESN.

4.1 Sustainable Finance & Disclosure: Regulatory Framework, Supervisory Expectations & Monetary Policy

As indicated above, at EU level, the Sustainable Finance agenda has given significant attention to ESG related disclosure. At the heart of this agenda is the EU Taxonomy[17] which establishes a common language for sustainable finance based on a standardised classification and well-aligned benchmarks for what assets can be considered as significantly contributing to environmental goals. In turn, the EU Taxonomy has significant

[15]https://www.eba.europa.eu/sites/default/documents/files/document_library/News%20and%20Press/Communication%20materials/Factsheets/1015657/ESG%20risk%20Factsheet.pdf
[16] See footnote 15.
[17] European Commission – EU Taxonomy for sustainable activities - https://finance.ec.europa.eu/sustainable-finance/tools-and-standards/eu-taxonomy-sustainable-activities_en

implications for other pieces of legislation, including the recently adopted Corporate Sustainability Reporting Directive[18] (CSRD) and the Sustainable Finance Disclosure Regulation (SFDR)[19]. At the same time, several mandates were extended to the European Banking Authority (EBA) under the Banking Regulatory Framework (CRR2/CRD5) to assess how to include ESG risks into the three pillars of the banking prudential framework. The result has been the publication of a Report on ESG risks management and supervision[20] and final draft implementing technical standards (ITS) on Pillar 3 disclosures on ESG risks[21].

We reported extensively on these requirements and their implications for financial institutions, particularly from an SME lending perspective, in the first report in this series[22]. We also reported on the ECB's climate-change related activities, including its 2020 Guide on climate-related and environmental risks[23] and its plans to integrate climate change considerations into monetary policy operations[24]. To recall, the 2020 Guide sets out not only what the ECB understands as the safe and prudent management of climate-related and environmental risks under the current prudential framework, as well as the ECB's expectations vis-à-vis financial institutions in respect of climate-related and environmental risks in the context of their business strategy and governance and risk management frameworks, but also explains how the ECB expects institutions to enhance their climate-related and environmental disclosures and thus enhance their overall transparency. As far as its monetary policy operations are concerned and of particular interest in the present context are plans to introduce climate-related disclosure requirements for credit institutions using private sector assets as collateral in ECB monetary policy operations and for private sector asset purchases.

For a fuller analysis, readers can consult our Report on meeting regulatory requirements using the TranspArEEns infrastructure, as indicated above. Suffice to recall here that, all in all, these disclosure requirements will, on the one hand, result in financial institutions being subject to greater scrutiny from market participants, including investors and regulatory authorities, on the sustainability of their activities, whilst on the other hand they will potentially impact banks' access to the ECB's collateral framework and the eligibility of their instruments for asset purchases. Together these developments are making alignment of current and future ESG disclosure efforts with this agenda of paramount importance.

4.2 Investor Community

The ECBC Covered Bond Fact Book 2021 and specifically the article entitled *"The Investor's Perspective"* written by Cristina Costa, Société Générale and Sabrina Miehs, Helaba[25], provide valuable insights into investor demand for EE-ESG covered bonds and the needs of the community. The authors surveyed 40 investors anonymously in April and May 2021 on a wide range of topics, including ESG considerations.

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[18] https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/company-reporting-and-auditing/company-reporting/corporate-sustainability-reporting_en

[19] https://finance.ec.europa.eu/sustainable-finance/disclosures/sustainability-related-disclosure-financial-services-sector_en

[20]https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Reports/2021/1015656/EBA%20Report%20on%20ESG%20risks%20management%20and%20supervision.pdf

[21]https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Draft%20Technical%20Standards/2022/1026171/EBA%20draft%20ITS%20on%20Pillar%203%20disclosures%20on%20ESG%20risks.pdf

[22] TranspArEEns Project – Deliverable 4.1 - Technical Report on key opportunities to enhance standardised disclosure of EE-ESG products

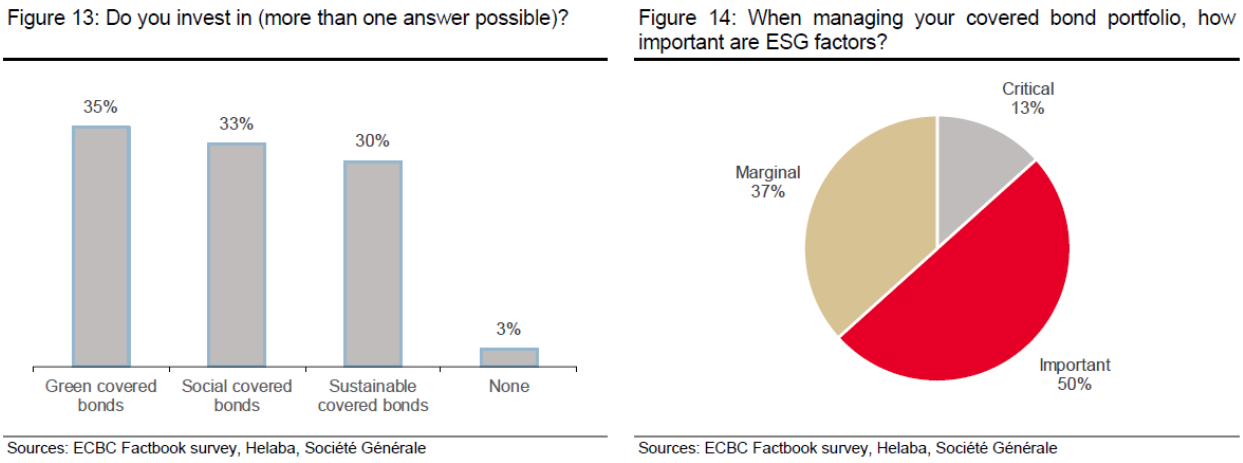
[23]https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.202011finalguideonclimate-relatedandenvironmentalrisks~58213f6564.en.pdf

[24] https://www.ecb.europa.eu/press/pr/date/2021/html/ecb.pr210708_1~f104919225.en.html

[25] ECBC Covered Bond Fact Book 2021 – "The Investor Perspective" - https://hypo.org/ecbc/publications/fact-book/

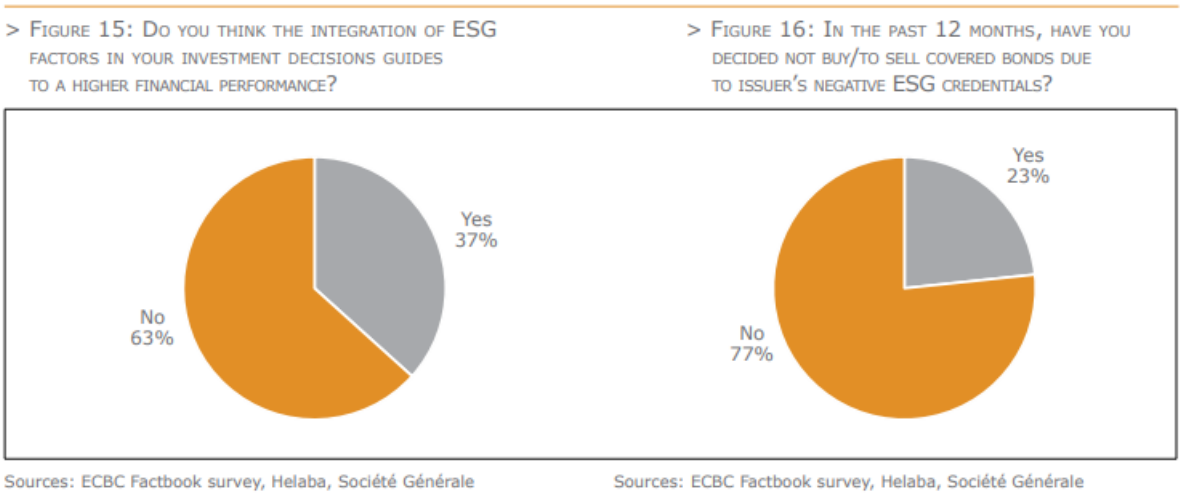
The survey results suggest that ESG factors are increasingly coming to the forefront and almost all investors surveyed invest in green, social and/or sustainable bonds and covered bonds. As indicated in figure 9, when managing the covered bond portfolio, 50% mentioned ESG factors were important, and a further 13% said they were critical investment drivers for their funds.

Figure 9: Replies to Questionnaire on ESG investor demand for EE-ESG covered bonds (1)



While a majority of investors surveyed indicated that the integration of ESG factors in investment decisions does not automatically lead to higher returns at the current time, a third of interviewees did however point to better financial performance, as outlined in figure 10. Significantly, some investors indicated that negative issuer ESG scores could actually result in investors deciding not to buy the covered bonds in question.

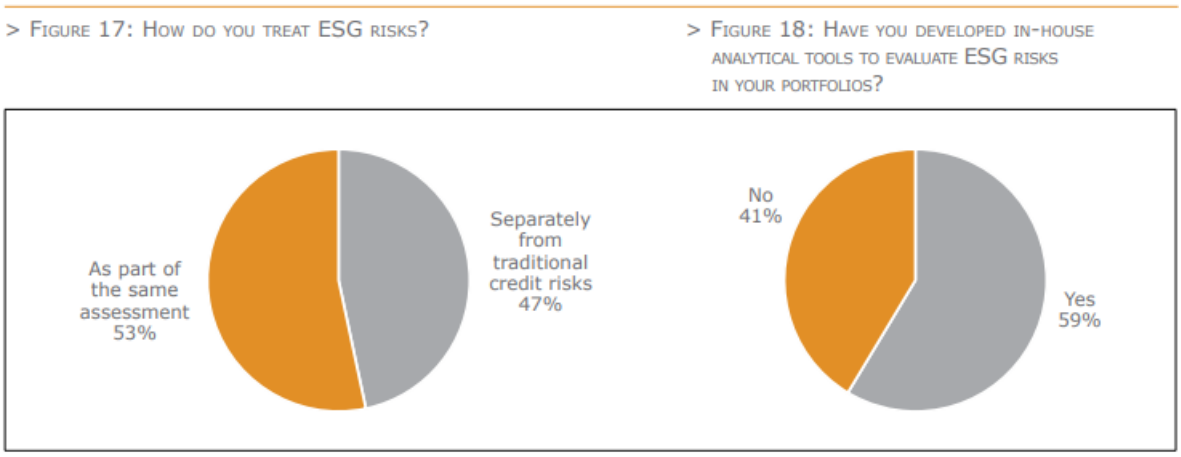
Figure 10: Replies to Questionnaire on ESG investor demand for EE-ESG covered bonds (2)



As indicated in figure 11 below, 53% of the investors surveyed stated they treat ESG risks as part of the same assessment (i.e. incorporated in the traditional credit analysis), and close to 60% say that although they do look at second party opinions on ESG/sustainability, they evaluate ESG risks based on in-house

developed analytical tools.

Figure 11: Replies to Questionnaire on ESG investor demand for EE-ESG covered bonds (3)



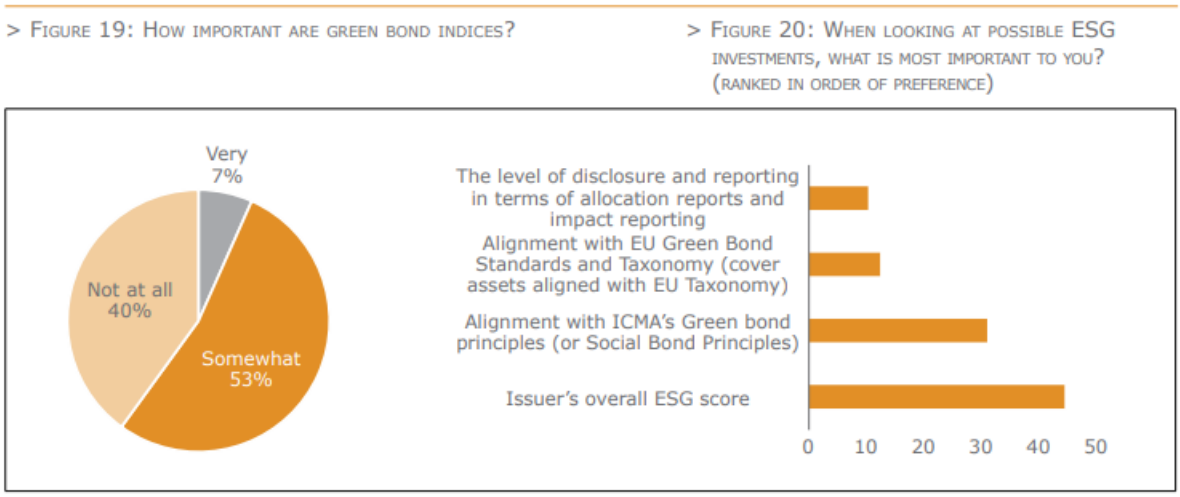
Sources: ECBC Factbook survey, Helaba, Société Générale

Sources: ECBC Factbook survey, Helaba, Société Générale

Lastly and as indicated in figure 12 below, it appears that green bond indices are considered useful for investors to monitor green bond performance and to make comparisons with other investments. Indeed, 60% (53% "important" plus 7% "very") replied that green bond indices are relevant for them. On the other hand, however, 40% stated this is not the case for them. This could be because the investment in green covered bonds is part of an aggregated fund, and not necessarily a pure ESG fund.

When asked about the main ESG investment drivers, most investors surveyed cited the issuer's overall ESG score as the main factor, followed by alignment with ICMA's Green Bond Principles. Alignment with the EU Green Bond Principles and Taxonomy was not that highly ranked, although it can be expected this factor to become more important going forward.

Figure 12: Replies to Questionnaire on ESG investor demand for EE-ESG covered bonds (4)



Sources: ECBC Factbook survey, Helaba, Société Générale

Sources: ECBC Factbook survey, Helaba, Société Générale

As a parenthesis on this topic inspired by the 2021 ECBC Fact Book article on green covered bonds[26], available deal data on new issuances reinforce the widely held assumption that green/ESG covered bonds are attracting a broader investor base. In fact, data compiled by Bond Radar[27] show that in 2020 sustainability covered bonds attracted, on average, 103 different accounts, compared to 72 accounts for traditional covered bonds. For 2018 and 2019, with 58 to 60 and 85 to 87 accounts, respectively, both types attracted almost the same number of accounts. This leads to two possible conclusions, namely that (1) the ESG investor base has grown, and since 2020, ESG deals have attracted more investors or that (2), alternatively, in times of severe stress like the COVID-19 pandemic, the ESG investor base is still active and can be relied upon to help issuers place deals.

EMF-ECBC Survey

In the light of current market and regulatory developments, the ECBC has been undertaking efforts to build a platform to facilitate a structured dialogue between and add value for investors and issuers, referred to as the ECBC Investor Task Force. The aim is to share knowledge and information, discuss developments and consider and respond to due diligence requirements from the investor community, and in this way, ensure an alignment between the priorities of investors, issuers and policymakers in the current regulatory environment.

In 2021 and 2022 and by way of this Task Force, the EMF-ECBC conducted a series of interviews with leading investors to establish their appetite for and needs in relation to EE-ESG covered bonds, with a view to aligning the Covered Bond Label and market developments with market dynamics and extracting valuable insights for the development of EE-ESG ESN.

Beyond insights into the level of interest and involvement in EE-ESG related activities, which coincide largely with the findings presented in the Covered Bond Fact Book, valuable additional feedback was received in relation to disclosure which not only helps to orient developments with regard to the Covered Bond Label but also point to potential value of future standardised disclosure in relation to EE-ESG ESN.

Overall, feedback received from almost half of investors surveyed point to a need for more information, whether this be from data and statistics or through events and roundtable discussion. Indeed, investors indicate that they receive many requests from third parties for further information on the ESG aspects of covered bonds but they do not possess sufficient knowledge about debates across countries on sustainable and ESG issues as well as on green/ESG cover pools. This feedback coincides with feedback from almost half of the investors surveyed on the importance of the ECBC in this context and the value in the ECBC taking a more prominent role in this area. An additional, recurring theme during the course of the sessions was concerns related to a lack of harmonisation and transparency in relation to disclosure of EE-ESG related information.

In this respect and on several occasions, investors interviewed pointed to the value of the Covered Bond Label 's Harmonised Transparency Template (HTT) as well as the Harmonised Disclosure Template (HDT) of the Energy Efficient Mortgage Label.

The combination of growing demand for green and sustainable covered bonds, coupled with positive feedback on the Covered Bond and Energy Efficient Mortgage Labels and their HTT and HDT respectively as well as requests for a more prominent role for the ECBC in relation to green/ESG covered bonds, points to

[26] ECBC Covered Bond Fact Book 2021 – "Sustainable covered bonds: market overview" - https://hypo.org/ecbc/publications/fact-book/
[27] Bond Radar website - https://www.bondradar.com/

the overall value of market-led initiatives of this kind and continued efforts to maintain and improve transparency towards investors moving-forward. This points to a robust case for adopting similar activities and actions in relation to other funding instruments, including ESN and EE-ESG ESN.

4.3 Rating Agency Methodologies

As suggested above, another key category of stakeholders within the context of green and sustainable covered bond disclosure is rating agencies which are increasingly integrating ESG criteria in their rating of issuers and covered bonds.

Covered bonds could be impacted by several ESG considerations identified in the rating agencies' ESG methodology categories. These factors are risks that range from environmental, carbon transition, climate to social, demographic changes, housing demand, data security as well as governance-related, regulatory compliance and transaction control mechanisms.

Rating agencies establish ESG credit factors as key aspects able to influence creditworthiness of entities or issues and help agencies to expand the number of criteria to include when a credit rating analysis is made. This process leads to a material collection which, when sufficient, affects the view of creditworthiness, and credit ratings get influenced by these ESG credit factors.

In practice, the collateral support analysis, the Investor Confidence Rating (ICR) of the issuing entity as well as the quality of the asset in the cover pool are what these ESG credit factors mostly influence.

Against this background, here below are presented all relevant facets of five key rating agencies' methodologies as laid out in the relevant section of the ECBC Fact Book edition of 2022.[28]

DBRS Morningstar

In its rating analysis, DBRS Morningstar takes into consideration a total of 17 ESG risk factors which are enclosed in its specific ESG assessment framework. There are three categories into which these risk factors are divided, namely Environmental, Social, and Governance. These categories correspond to the main considerations analysed during ESG assessment by the rating agency. DBRS takes particularly under consideration they way ESG risks affect the issuer and transaction-specific ratings during the life of the transaction/rating. Conversely, in its structured finance and covered bond rating analysis, only 8 of the 17 are being used. Furthermore, investors may be exposed to other ESG risk factors based on whether the reference obligor or guarantor or counterparty is a government, corporate, or financial institutions entity. ESG considerations generally are due to one of the following: the collateral backing the covered bonds, from the transaction's counterparties or from the covered bond structure.

Fitch

ESG Relevance Scores (ESG.RS) is normally assigned by Fitch to debt instruments including covered bonds. This index reveals whether an ESG factor is relevant to the credit rating. More precisely, a set of scores was established to evaluate the direct impact on the rating on a standalone basis. These scores range from '5' to '1', where A score '5' stands for high impact whereas A score '1' refers to factors without credit impact or not relevant to the sector and the programme from a credit perspective. Another aspect to mention is that

[28] ECBC Covered Bond Fact Book 2022 – Chapter 4 Rating Agencies & Methodologies
https://hypo.org/ecbc/publications/fact-book/

ESG Ratings are independent from credit ratings. In fact, the former are assigned by Sustainable Fitch to assess an entity's or debt instrument's ESG performance and commitment.

Moody's

There are two frameworks used by Moody in its ESG methodology. The first one, the Issuer Profile Score (IPS), analyses ESG exposures of an issuer or transaction on a numeric scale from E-1/S-1/G-1 (Positive) to E-5/S-5/G-5 (Very Highly Negative) where E and S scores incorporate asset-level mitigants, whereas G scores incorporate both asset and transaction level mitigants. The second framework assesses credit impacts through the Credit Impact Score (CIS) and aims at explaining the impact of ESG considerations on the rating of a given issuer or transaction and is expressed on a scale of 1 to 5, indicating materiality and modification of rating in case of no exposure to ESG risks.

Scope

The ESG-D factors are used by Scope to assess banks' long-term sustainability and digital transition preparedness and can either notch-up or down the initial anchor rating. The agency then determines the maximum achievable covered bond rating from an analysis of jurisdictional and cover pool-specific factors. Therefore, the issuer's ESG factors constitute the starting point for the assessment of the ESG factors affecting rated covered bond programs. Furthermore, when rating a covered bond, Scope gives relevance to governance factors (qualitative) as well as social and environmental factors (quantitative).

S&P Global Ratings

The approach applied by S&P is to assign each covered bond programme with an environmental, a social and a governance credit indicator – these indicators reflect the rating agency's opinion of how material (on a 1 to 5 scale) the influence of ESG factors is on the specific programme and are assessed on a net basis, meaning that both the exposure and any related mitigating factor are taken into account. In addition, ESG factors can also impact S&P's cover pool support analysis from a qualitative and quantitative angle.

It could also be included energy efficiency considerations and their potential impact on the default probability of the borrowers and recovery values of the collateral. Similarly, the beneficial increase in liquidity and demand for ESG covered bonds ('greenium') could, for instance, positively impact secondary market prices of the supporting collateral and ultimately require lower levels of supporting over-collateralisation.

4.4 Issuer Actions & Reactions

Against the background described above of extensive regulatory reporting and disclosure requirements and expectations, constantly evolving investor needs and the increasingly systematic integration of ESG factors in rating methodologies, there is pressure on banks and therefore covered bond issuers to anticipate and achieve compliance with these requirements and expectations. As indicated earlier, the Covered Bond Label and its HTT are important market-led initiatives to support this compliance, as well as the broader ECBC governance structure and network of experts.

The HTT through an ESG lens

In April 2022, during the HTT revision process and with a special focus on the ESG sections of the HTT, the EMF-ECBC launched a survey of Covered Bond Label issuers and the Covered Bond Label Advisory Council with a view to understanding the actual needs of issuers and to align the disclosure requirements of the HTT around sustainable mortgage datapoints with actual data availability. The replies received highlighted the

main challenges as relating to a lack of available data and a lack of clear definitions for consistent reporting. A further challenge encountered by respondents was a lack of real data that needs to be substituted by estimations which have been calculated using data models.

Considering as indicated above that currently the information on sustainable covered bonds in the HTT mainly focuses on mortgage assets, the questionnaire also sought to establish whether it would be appropriate to capture additional further data-points in a future HTT revision. Against a background where there are three categories of eligible assets for the Covered Bond Label (mortgages, public sector and shipping assets) and there are three dimensions related to ESG considerations, the Covered Bond Label has drawn up a 3x3 matrix in order to record existing data points for energy efficient mortgages for real estate and track suggestions from issuers for the other dimensions:

Figure 13: ESG, cover pool asset matrix

	Environmental	**Social**	**Governance**
Mortgages RRE and CRE	**EPC** **Energy Demand** **Building Age structure** **Type of Dwelling** **New/Existing Building** **CO2 Emission**	Borrower type (first time buyers/home-mover/remortgage etc.)	
Public Sector			
Shipping			

Source: Covered Bond Label

The feedback received from the issuers will provide necessary input to the upcoming HTT revision process which will kick-start in March/April 2023 and which, among others, will focus on improve the data collection on ESG disclosure on the assets in the labelled cover pools.

ECBC ESG Bond Task Force

With the last revision process of the HTT focusing on its alignment with the requirements of the Covered Bond Directive, the next one will most probably focus among others on a more detailed and clearer inclusion of ESG related data in the cover pools. This trend will be supported by the newly established ECBC ESG Bond Task Force, which focuses on how the ESG discussion has an impact on the Covered Bond asset class. The TF is structured around four Work Streams:

- WS1 Information and Library.
    - Collection of the various available information necessary to understand the impact of ESG policy actions on the covered bonds both at EEA, national and extra-EEA level
    - Proposal of the outline of a new ESG-related section on the ECBC website (hypo.org) where the above-mentioned information is stored.
    - Draft of simplified Fact Sheets summarising the key points of complex pieces of legislation such as the EU Taxonomy and its delegated acts.
    - Draft of a Brochure on market and regulatory considerations on ESG and covered bonds
- WS2 Disclosure
    - Proposal of update suggestions to improve the ESG-related data-disclosure on the HTT
    - Revision of the definition of sustainable/green residential mortgage

  - Discussion on disclosure also for Social Covered Bonds
  - Discussion on the use of estimated vs actual values
  - Discussion on corporate level disclosure and covered bond disclosure
- WS3 Technical Issues
  - Discussion on use of proceeds and sustainable collateral approach
  - Discussion on (re)finance assets and on risk of double-counting sustainable collateral
  - Discussion on Grandfathering of existing sustainable covered bonds
  - Discussion on LCR treatment (development of checklist to keep HQLA level)
  - Analysis of alternative structural funding (CB vs Senior Unsecured)

- WS4 Legislative Issues
  - Overview of the ICMA requirements (GBP, SBP) and study of the ICMA label
  - Overview of the EU Green Bond Standard
  - ECB Requirement on green finance
  - EBA Report on Use of Proceeds

The objective of this TF is to provide the Covered Bond community with a clear overview and the right tools to understand the impact of ESG in the covered bond space and to develop the right understanding on how issuers can concretely provide the necessary data disclosure by supporting the development of relevant and effective suggestions to the Label Committee regarding the updates of the HTT on ESG matters. A further objective is to establish further insights into the characteristics of a sustainable covered bond and to broaden the horizon to other initiatives in order not to duplicate efforts.

5. Conclusion

The experience gathered in 10 years of the Covered Bond Label offers a wealth of best practice examples relating to the governance, data disclosure and reporting architecture for harmonised ESG reporting related to other funding instruments, and in particular European Secured Notes (ESN), with a focus on exposures to Small and Medium Enterprises.

With the start of ESG reporting of the cover pool in 2020 with a dedicated section on the HTT, the Covered Bond market took the initiative to start a data collection exercise which is continuing now with concrete considerations on how to include in the reporting information to secure compliance with the broader regulatory agenda, as under discussion the ECBC ESG Bond Task Force. This proactive approach of the market in providing concrete reporting solutions ahead of the legislator as well as the ability to communicate the needs and challenges of the market in a coordinated and effective fashion has enabled the Covered Bond Label community to ensure an appropriate calibration of dedicated pieces of legislation, such as the EU Covered Bond Directive.

The timing for reflecting and designing harmonised reporting templates for ESG data for SMEs in the context of ESN could not be better considering that, as indicated in the introduction to this analysis, Article 31(5) of the EU Covered Bond Directive requires the European Commission to draft a report by July 2024 on the possibility of introducing ESN. A blueprint for this instrument has been developed by the ECBC ESN Task Force, drawing on the best practice presented by the Covered Bond Label. Further development of this blueprint, through a specific EE-ESG lens, will be the subject of the next stage in the TranspArEEns Project – to be reported on separately in due course - and will draw heavily on the EE-ESG best practice of the Covered Bond Label as reported here.

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