ICMA International Capital Market Association

Green and sustainable finance: What is the role of the repo market?

An ERCC consultation paper

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Executive summary

The transition to a sustainable global economy requires scaling up the financing of investments that provide environmental and social benefits. ICMA has always been at the forefront of developments in sustainable finance through its support of the Green and Social Bond Principles and with its Sustainable Finance Committee[1]. This paper aims to explore potential green and sustainable advances in repo and collateral markets by assessing existing opportunities and potential risks. In particular, it explores three possible intersections between the repo market and sustainable finance: 1. Repo with green and sustainable collateral; 2. Repo with green and sustainable cash proceeds and 3. Repo between green and sustainable counterparties.

The paper is intended to serve as a starting point for promoting related discussions in the repo community and to explore what role, if any, the repo and collateral market can play in supporting the development of sustainable finance. It seeks purely to acknowledge the complexity of the subject and to assist the broader understanding of a variety of views. It is not a position paper in which ICMA is attempting to define green and sustainable repo or collateral. We welcome all interested stakeholders to respond to the consultation questions at the end of the document with their views on the topic.

1 https://www.icmagroup.org/sustainable-finance/icma-sustainable-finance-committee-sfc/

Introduction

The sustainable finance market has grown considerably in recent years as policymakers, regulators and market participants have shifted their attention to incorporating sustainability considerations into their policy decisions, regulatory frameworks and investment strategies. It has been forecast that by 2025 assets held in sustainable investment products in Europe will reach a value of €7.6 trillion[2], outstripping conventional funds, as new EU rules take shape and investors focus increasingly on sustainable economic activities and projects. As the primary and secondary markets for sustainable assets expand, ICMA's European Repo and Collateral Council (ERCC), as the principal representative body of the European repo and collateral market, not only recognises the growing importance of this market, but also embraces its responsibility to clarify and promote the role of repo in sustainable finance as part of ICMA's broader commitment to the transition to a sustainable global economy.

Today, sustainability is already being actively considered in many segments of the market - from securities lending[3] to ESG-related derivatives products[4]. This paper aims to explore potential sustainability aspects of repo and collateral by assessing existing opportunities and potential risks in this area. It will firstly examine the structure of the sustainable finance market before taking a closer look at the potential role for repo in this context and exploring what could be potentially considered as green and sustainable repo. It will then analyse the opportunities as well as the risks that arise from embedding sustainability into the repo market. This paper is intended to serve as a starting point for a deeper discussion among members and other stakeholders and will help to frame future ERCC workstreams.

2 https://www.ft.com/content/5cd6e923-81e0-4557-8cff-a02fb5e01d42
3 https://www.islaemea.org/wp-content/uploads/2021/03/ISLA_AO_Framing_Securities_Lending_for_the_Sustainability_Era.pdf
4 https://www.isda.org/a/qRpTE/Overview-of-ESG-related-Derivatives-Products-and-Transactions.pdf

The sustainable finance market

ESG Investing refers to strategies and practices that incorporate material environmental, social and governance (ESG) factors in investment decisions and active ownership with a view to minimise risks and maximise returns[5]. Both the private and the public sector have made their moves to promote and mainstream sustainable investment as it becomes increasingly important in allowing market participants to act in a responsible way and to encourage positive changes in day-to-day business.

Private sector initiatives

Many of the drivers behind the growth of ESG Investing come from investment managers who are taking an increasingly proactive role in the field. The Principles for Responsible Investment (PRI), which is a United Nations-supported international network of investors with over 3,000 investor signatories across the world, representing over USD 100 trillion assets under management (AuM), has adopted high-level principles for responsible investment. The signatories voluntarily commit to incorporate ESG into their investment analysis, decision-making processes, policies and practices; to seek appropriate disclosure on ESG issues from investees; to promote acceptance and implementation of the Principles; and to report on activities and progress towards implementation of the Principles. Other prominent investor-led initiatives or networks in the ESG space include Ceres, the Institutional Investors Group on Climate Change (IIGCC), the Transition Pathway Initiative (TPI), Climate 100+, the Global Impact Investing Network (GIIN) and others. In the euro area alone, according to the ECB's November 2020 Financial Stability Review[6], investors from almost all sectors increased their holdings of green bonds to a total of €197 billion by the end of 2020. Banks are also increasingly embedding ESG considerations into their business model, expanding the share of green bonds in their treasury portfolios and increasing their green bond issuance. For euro area banks, the share of green bonds increased from 4% to 13% of total issuance between the first quarter and the third quarter of 2020, providing new green financing opportunities to investors, including corporates and other clients that are traditionally loan-financed.

Public sector actions

Beyond investment firms, the transition towards a greener and more sustainable economy has also become a major issue for governments and central banks around the world. The UN Sustainable Development Goals (SDGs) adopted by all UN member states in 2015 sets out a 15-year plan on shared social, environmental and economic development, based on its 17 policy objectives and 169 sub-targets, balancing economic growth with social and environmental issues. In the same year, the Pairs Agreement was accepted at the 21st Conference of the Parties (COP) where nations committed to limiting greenhouse gas emissions and global warming. The Agreement also stipulates that developed countries should assist developing countries with their mitigation and adaptation efforts by mobilising $100 billion annually from 2020 onwards.

Looking more closely at Europe, the European Green Deal presented by the European Commission in December 2019 established a roadmap for transitioning the EU to become climate neutral by 2050 with at least €1 trillion of sustainable investments to be mobilised over the next decade according to the European Green Deal Investment Plan[7]. Sustainable finance plays a key role in mobilising the capital needed to overcome the important climate and environmental challenges ahead and to meet the defined policy objectives.

In September 2020, following the example of a number of other European sovereigns, the German Federal Government launched a green Federal security for the first time[8], aligned with ICMA's Green Bond Principles[9]. A total volume of EUR 11.5 billion was issued in 2020, injecting momentum into sustainable bonds and encouraging more capital mobilisation for sustainable purposes. From a

5 See ICMA's High Level Definitions: https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/Sustainable-Finance-High-Level-Definitions-May-2020-051020.pdf
6 https://www.ecb.europa.eu/pub/financial-stability/fsr/focus/2020/html/ecb.fsrbox202011_07~12b8ddd530.en.html
7 https://ec.europa.eu/info/publications/200114-european-green-deal-investment-plan_en
8 https://www.deutsche-finanzagentur.de/en/institutional-investors/federal-securities/green-federal-securities/
9 https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/green-bond-principles-gbp/

social perspective, the European Commission has issued EUR 39.5 billion of ICMA aligned social bonds under its EU SURE bonds programme, supporting national short-term work schemes and similar measures to help contain unemployment under the COVID-19 pandemic.

Central banks such as the ECB may change the landscape of the sustainable finance market by looking at ‘greening’ their monetary policies and promoting funding of green bonds by adjusting eligibility criteria. In September 2020[10], the European Central Bank announced that it was making sustainability-linked bonds (i.e. bonds with coupon structures linked to certain sustainability performance targets) eligible as collateral for Eurosystem credit operations and outright purchases for monetary policy purposes, starting 1 January 2021. This not only broadens the pool of Eurosystem eligible assets but also indirectly promotes the issuance of sustainable-linked bonds, as a means of raising finance, in Europe.

Regulation also plays an increasingly important role in governments’ strategies to foster the growth of sustainable finance. In Europe, the EU’s securities markets regulator, ESMA, has taken sustainability factors into account across its rulebooks and supervision as part of its strategy[11]. This includes monitoring and assessing sustainability related market developments and related risks as well as the inclusion of environment related systemic risk in stress test scenarios. Some key regulatory frameworks include the Taxonomy Regulation[12] and the Disclosure Regulation[13]. Looking beyond Europe, other parts of the world, are also actively engaged in the developments to encourage market growth. ICMA’s Compendium of international policy initiatives & best market practice[14] summarises the most significant developments in sustainable finance globally. All of these actions help to create an environment for market participants, with either long-term or relatively short/medium-term investment strategies, to trade in a green and transparent marketplace, with high levels of credit quality and liquidity.

ICMA’s role in the sustainable finance market

ICMA plays a leading role in the development and stewardship of sustainable finance. It is at the forefront of the financial industry’s contribution to the development of sustainable finance and related standards. The Green Bond Principles (GBP), the Social Bond Principles (SBP), and the Sustainability Bond Guidelines (SBG) represent the global standard for sustainable bond issuance. These Principles are currently used by more than 95% of international sustainable bond issues (ex-China)[15]. In 2020, ICMA released, with the GBP SBP Executive Committee, guidance for Sustainability-Linked Bonds and a framework for the issuance of transition-themed bonds with the Climate Transition Finance Handbook. ICMA is also involved in the international regulatory and policy dialogue on sustainability through its responses to regulatory consultations and its engagement in policy fora. It is, among other things, a member of the European Platform on Sustainable Finance and the chair of the Bond Working Group of the Hong Kong Green Finance Association.

10 https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200922~482e4a5a90.en.html
11 https://www.esma.europa.eu/sites/default/files/library/esma22-105-1052_sustainable_finance_strategy.pdf
12 The establishment of an EU classification system (taxonomy) for sustainable economic investment which intended to serve as a common language for investors to identify projects and activities which have a positive impact on the environment. Entered into force on 12 July 2020.
13 The requirement for certain asset and fund managers/advisors to provide pre-contractual disclosures on ESG-related information both at the entity and product level to their clients in order for them to make informed investment decisions. The regulation will become effective from 10 March 2021.
14 https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/ICMA-Sustainable-finance-Compendium-of-international-policy-initiatives-best-market-practice-February-2020-200220.pdf
15 Environmental Finance Bond Database: https://www.bonddata.org/

The role of repo in sustainable finance

Although the repo market is aware of the rising number of green issuances and the increasing importance of sustainability more generally, with some early products emerging, there is still a lot of potential for further developments. As part of a discussion on green finance, the ECB's Money Market Contact Group (MMCG) discussed in their December 2020 meeting the launch of the Eurex Green GC basket but also cautioned that transaction volumes are still low and developments in other green money market instruments limited due to the short-term nature of these markets[16]. Nonetheless, MMCG members were hopeful that this might change with efforts to establish verifiable and consistent standards, ratings and controls, which could lead to green finance becoming the 'new normal' in the long run.

As the primary market for green and sustainable bonds continues to grow rapidly, the trading of these assets in the secondary market requires a liquid and functioning repo market. What is less obvious is whether there is any scope for repo to play a more active role in supporting sustainable finance beyond the funding of green and sustainable bonds, whether or not through a standard green bond basket. Does the concept of a green and sustainable repo make sense in practice? Should a repo transaction with some proportion of underlying green or sustainable collateral be classified as a sustainable repo? Does all the underlying collateral have to be considered, e.g. in the case of a GC basket? Should the cash proceeds be used to finance green initiatives? Or is it even the collateral and the cash that determine a sustainable repo? And finally, does the sustainability profile of the counterparty also need to be considered? Other areas such as how to treat interest and coupon payments or margin may also require further clarification.

Repo with green and sustainable collateral

A green repo market could be envisioned as one where buyers and sellers would only transfer bonds that are classified as green. The Green Bond GC Basket[17] launched by Eurex in November 2020 is one example of this type of 'green repo' and other CCPs and tri-party agents are likely to offer similar baskets in the future. This was confirmed at a recent meeting of ICMA's ERCC Committee[18], where a number of members, including tri-party agents confirmed that they are seeing a growing demand from clients and are actively looking at the opportunities in this domain. This type of repo[19] acts as a short-term funding vehicle for green assets, promoting secondary market liquidity and facilitating position-taking. One of the largest obstacles in green bond trading has historically been the lack of secondary market liquidity. This is often attributed to the sizeable gap between demand and supply for green bonds as well as green investors' tendency to hold green bonds to maturity.

According to the Climate Bond Initiative's (CBI)[20] pricing report for Q1-Q2 2020, green bonds in the euro market achieved a larger oversubscription than their vanilla equivalents, with an average 5.2-fold cover for green bonds compared to a 3.1-fold oversubscription for their vanilla equivalents. While this problem may have abated with the growth of green and sustainable bond stocks, it could still conflict with the Treasury Desk's main investment priority: namely liquidity. The development of a liquid repo market in green and sustainable assets could potentially encourage additional supply because repos provide an opportunity to temporarily convert those assets into cash, while maintaining the economic exposure, which might be less disruptive to investors' long-term sustainability goals than unwinding their green bond holdings. Another valuable feature is that repos facilitate market making and thereby support deeper and more transparent markets, consistent

16 https://www.ecb.europa.eu/paym/groups/pdf/mmcg/20201201/2020-12-01%20MMCG_meeting_summary_PUBLIC_final.pdf

17 The Basket consists of Euro-denominated debt securities that are issued in adherence with various Green Bond guidelines and classified as Green Bonds by the relevant data provider. It is worth noting that the basket filters for green bonds only and does not take into account wider sustainability considerations. This is the first standardised product that aims to provide a link between repo and sustainability and is an important step as it opens the discussion on the management of short-term cash in a sustainable manner.

18 https://www.icmagroup.org/assets/documents/ERC/Minutes-from-repo-committee-meetings/2020-12-09-ERCC-Committee-meeting-final-minutes-280121.pdf

19 Note an extension of this type of repo could also consider pre-screened collateral based on sustainable criteria applying to the issuers. However, sustainability criteria may vary between firms. Currently there is neither agreement in the industry on the methodology for the choice of ESG criteria nor is there one on the source of the necessary ESG data, although relevant regulatory developments underway may provide possible solutions in the future.

20 https://www.climatebonds.net/system/tdf/reports/cbi-pricing-h1-2020-21092020.pdf?file=1&type=node&id=54353&force=0

with a long-term green and sustainability strategy[21]. Financing sales also allows investors to hedge their green and sustainability risk by influencing companies who fall short of their social responsibility expectations.

Although repo with green collateral supports the liquidity of green assets, it is not consistent with the existing market standards such as the Green Bond Principles or the Green Loan Principles where the cash proceeds should be used in eligible green projects. Therefore, should we really call this a 'green repo' or should it more accurately be referred to as a 'green collateral repo'? It is also questionable whether simply transferring green bonds in a repo really injects any additional capital into the green finance ecosystem. If an investor holds green assets and lends these assets in a repo transaction, should its counterparty now count the repo as its own green investment? Clear terminology matters and it is important to develop agreed definitions for product transparency as well as to avoid justified concerns related to the risk of greenwashing, which we further considered later in the paper.

Repo with green and sustainable cash proceeds

The second intersection between repo and green and sustainable finance focuses on the cash leg of the repo. Rather than considering the underlying collateral assets, a stricter definition of a green and sustainable repo might require the cash loaned in a repo transaction to be invested in green projects or activities – thereby directly boosting the sustainable finance ecosystem. Provided there is demand for such products, there may be scope for expanding the Green and Social Bond Principles or the Green Loan principles to incorporate these types of transactions. In contrast to the previously described repo using green assets as collateral, 'green repos' that focus on the use of cash proceeds are likely to be more bespoke and longer-term structures (at least one-year or possibly several years), and more akin to a securitised 'green loan'. These transactions are likely to be considered more impactful as they create real funds for specific green investments. While this type of 'green repo' would be in line with existing market principles on the use of proceeds, a further consideration is whether the underlying securities have to be 'green assets'. Should certain securities (e.g. brown assets) be excluded from such structures – or could it be seen as 'neutralising' them?

Repo between green and sustainable counterparties

A third dimension to be considered is the classification of the counterparties to the repo transaction, i.e., counterparties that meet certain sustainability criteria. Instead of determining specific green collateral or uses of proceeds, the borrower's and lender's sustainability performance or profile is the key here. Assessing a firm's sustainability profile involves ESG measurement, monitoring and disclosure against pre-set benchmarks or targets. These may include looking at the ESG financial products or services a firm offers, its ESG financing and investment strategies, ESG disclosures and client engagement as well as a dedicated governance and organisational structure to develop and implement its ESG policies and practices[22]. There are already a number of data providers who score firms by benchmarking their ESG performance across and within sectors and sub-industries, which could help investors to classify their counterparties. However, a question to consider here is whether it is reasonable to reconcile short-term financing with the intrinsically long-term nature of sustainable investment and a firm's overall sustainable objectives.

21 https://www.aima.org/sound-practices/industry-guides/short-selling-and-responsible-investment.html
22 https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/201214-interim-study-esg-factors-banking_en.pdf

Opportunities

In the previous section, the paper looked at the different possible intersections between repo and sustainable finance. Even though a standardised form of 'green repo' has not been developed, opportunities exist for all three types of structures described. A functioning repo market could support the broader sustainable finance agenda in the following ways:

Supporting liquidity for green assets

By fulfilling its traditional role, the repo market provides a secure, flexible and efficient place to finance green and sustainable bonds, and at the same time supports market making through cost-effective funding. Market infrastructures can play an important role in this context by facilitating the trading, clearing and settlement of these instruments[23]. The development of related products such as tri-party green bond baskets could further encourage holders to lend their green assets, thereby supporting liquidity in the market. As of now, it is probably fair to say that pricing has not been the main motivation to enter the sustainable investment. On one hand, there is increasing evidence that a pricing advantage ('greenium') for green bonds emerges compared to their mainstream equivalents since increased investor demand leads to spread compression. On the other hand, it could be argued that the lack of market depth in liquidity in secondary markets leads to a premium over mainstream equivalents[24]. Therefore, by developing a functional repo market and feeding liquidity in the secondary market, it may also help to foster price discovery by facilitating trading and arbitrage[25]. It is important to note, although a repo with green collateral is unlikely to be considered as truly 'green' because of its lack of additionality to the overall environmental objective, it still fulfils the role of supporting liquidity and collateral fluidity and contributes to the development of an efficient and transparent green finance market.

Creating additional funding for green projects

Integrating sustainability into the repo market is not straightforward as sustainability is viewed as less relevant by investors with a short investment horizon. This might raise the question as to whether enabling sustainability factors to become more short term and persuading investors with short term strategies to embrace sustainability integration is appropriate. This is why defining a sustainable repo standard becomes particularly important to avoid misconception which may lead to charges of 'greenwashing' in particular relate to the simple transfer of green collateral. However, if the focus is on the cash leg, this is in line with the existing market principles in which the proceeds of cash in a repo transaction are invested in designated green projects. Compared to the simple transfer of green and sustainable collateral among market participants, a repo with green and sustainable cash proceeds injects additional funding into the sustainable finance ecosystem. The funding is used to address broader environmental and social challenges, leads to external benefits for a wider group of stakeholders and potentially the general public. Additionally, it also promotes accountability, transparency and better disclosure as the proceeds would be monitored and reported.

23 See for example LCH's announcement in relation to the clearing of EU SURE bonds: https://www.lch.com/resources/news/lch-sa-clear-eus-sure-bonds
24 https://www.icmagroup.org/executive-education/courses/introduction-to-green-social-and-sustainability-gss-bonds/
25 https://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/repo-and-collateral-markets/icma-ercc-publications/frequently-asked-questions-on-repo/3-what-is-the-role-of-repo-in-the-financial-markets/

Benefits for users of green and sustainable repos

Although the return on sustainable investment remains a controversial topic and the specific trade economics are relatively uncertain for any concept of green and sustainable repo, there are still some concrete benefits for market participants:

Reputation and client demand

Like any other sustainable investment, reputational benefits could be one of the top-ranking motivations for market participants to develop and trade green and sustainable repo products[26]. Engaging in sustainable investments sends a signal to the world that the firm is open to and supportive of green business, enhancing brand image and attracting and retaining clients. Additionally, companies who are proactively embedding environmental and social considerations into their investment strategies or risk models usually face lower regulatory and legal risks as regulations become stricter, which means lower long-term risk.

Transition of business models

Most companies are naturally exposed to climate risks and as climate risks translate to financial risks, firms will need to gradually transition from 'brown' to green financing at some point. Sustainable finance can help with this transition process[27]. According to the 2020 Green Bond Treasurer Survey[28], integrating sustainability as part of the risk management leads to closer collaboration internally. The preparation of the framework consolidates the internal position on sustainability, spreading understanding across various departments and forcing people to think about future projects with a sustainable mindset, which may in turn contribute to a change in priorities and strategy.

First mover advantage

As the transition towards a climate-neutral society proceeds, in the near future, there will be a significant reallocation of capital. There are likely some first mover advantages if firms have already incorporated sustainable financing and its related provisions into their processes across the board prior to tougher rules and regulations coming into effect. Early adopters could also help to define and encourage better standards in green and sustainable repo trading. The question is whether the first mover advantage is sufficiently large and whether the disadvantages of 'playing catch up' outweigh potential benefits for investors from waiting until the market grows larger and more investment products become available.

26 https://www.climatebonds.net/resources/reports/green-bond-treasurer-survey-2020
27 The ICMA Climate Transition Finance Handbook seeks to provide clear guidance and common expectations to capital markets participants on the practices, actions and disclosures to be made available when raising funds in debt markets for climate transition-related purposes. Issuers are encouraged to incorporate the recommendations outlined in the Handbook in their climate transition strategies.
28 https://www.climatebonds.net/resources/reports/green-bond-treasurer-survey-2020

Potential risks

While there is certainly ample potential for the repo market in Europe to support the ascent of green and sustainable finance, there are still some potential risks that the market needs to address and balance as it develops:

Greenwashing[29]

As already discussed, the short-term nature of repo may conflict with investors' longer-term green or social projects, and therefore might be considered unsuitable for the purpose of green and sustainable finance. As a result, it is particularly important to properly define the relevant terms and clarify whether the concept of green and sustainable repo makes sense and, if it does, what exactly this is. An overly broad definition of green and sustainable repo may be susceptible to claims of 'greenwashing' in the absence of clear standards. In this context, the simple use of green and sustainable collateral may not be sufficient to qualify a repo as green and/or sustainable. For example, if counterparties trade in overnight repos with green and sustainable collateral, to what extent would this really contribute to a firm's sustainability goals and allowing the firm to benefit from improved reputation or internal transition towards a more sustainable-driven business model as mentioned in the prior section. If such a product is marketed as green and sustainable, there is a risk that this could be considered as 'greenwashing' which in turn could undermine the credibility of sustainable finance more broadly.

Collateral eligibility

The further evolution and importance of sustainability for the repo market also critically depends on the approach taken by regulators and central banks, in particular, on how actively they decide to encourage the use of green assets as collateral through either regulatory treatment or monetary policy. If the pool of eligible collateral is limited by regulators or central banks in the future, and non-ESG investment collateral is deemed less preferable, what is the impact of such stricter criteria on the collateral fluidity and liquidity and efficiency in the overall market?

Collateral quality

Repo, as a key funding instrument, has some unique advantages: cheap borrowing and safe investment as the cash is secured against the asset provided as collateral. However, green does not necessarily mean better credit, since it is the credit profile of the issuer that determines the quality of the collateral. While green and sustainable bonds could be perceived as better-quality collateral as a consequence of their label, the risk characteristics should not differ from a conventional bond, noting that green bonds are serviced from the cash flows of the entire operations of the issuer – not just the green/sustainable project[30]. Takers of green collateral will therefore need to balance any preference for green securities with inherent credit quality of the collateral they receive.

Documentation

Repo is often documented under a legal agreement such as the Global Master Repurchase Agreement[31] (GMRA). From a documentation perspective, the necessity for standardised documentation amendments will depend on the green and sustainable features that are being introduced, i.e., whether it is about collateral eligibility or use of proceeds. For vanilla repos with green bonds, the master agreement would less likely be affected. However, for repos that require proceeds to be monitored, there might be a request to develop a green Annex to the GRMA with bespoke provisions. At this early stage of development, while the industry is still exploring what a green and sustainable repo is conceptually, it is difficult to determine the impact on a contractual level.

29 The process where firms convey a false impression or make exaggerated claims about their green credentials.
30 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3042378
31 https://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/repo-and-collateral-markets/legal-documentation/global-master-repurchase-agreement-gmra/

Data quality and availability

Data quality and availability may still often be viewed as a major concern in the field. There is a perception in the market around multi-standards and inconsistencies, for example, what flags as green or sustainable can vary significantly for firms due to the various criteria and standards they use. However, with the emergence of new regulations and ongoing updates of market guidelines illustrated by ICMA's Green and Social Bond Principles, the definition of green and sustainable bonds has already become clearer. The European Commission's work on the EU Taxonomy, and other taxonomy initiatives internationally, aim to address this concern by promoting consistency in green and sustainable definitions. Therefore, the question is less about the absence of standards, but more about how market participants and data providers think about the existing standards and incorporate them into their systems and processes related to repo and collateral management.

Operational cost

Cost may also be perceived as a barrier to trading. Trading in green and sustainable bonds could result in higher fees due to ongoing administrative costs such as research, screening, labelling and disclosure. From an operational and implementation perspective, the management of green assets, including the identification and transformation of green bonds in firms' internal systems could also lead to further costs. However, as the sustainable finance market matures and as more investors enter the market, these costs may become less of a barrier as investments become more streamlined based on the experience already gained. The underlying objectives of building on the green segment of the business remain economically viable – whether it is to reduce risks and improve on reputation or to respond to customer demands and increase competitiveness.

Next steps for ICMA

Sustainability is rapidly evolving into a mainstream feature of the international capital market and its importance is set to increase further. Despite the uncertainties and challenges, there are undoubtedly many opportunities that come from embracing the concept of green and sustainable financing. Issuance and trading of green bonds have already seen impressive growth over the recent years and the repo market has an important role to play in facilitating issuance in the primary market and supporting liquidity in the secondary market. There is undoubtedly potential to more actively embrace the concept of green and sustainable finance in repo markets. Looking at the journey ahead, in order to accelerate market development, policies and regulations will likely have a critical role to play in encouraging sustainable investing, with possible tools ranging from mandating specified levels of green holdings (such as proposing a minimum Green Asset Ratio[32]), or limiting the amount of non-green holdings, to a widespread use of the EU's Sustainable Taxonomy, or maybe even preferential capital treatment or haircuts for green assets in the future for further promotion. But there is also an important role for industry standards and best practices to develop a clear understanding of the position of sustainability in repo markets and the concept of green and sustainable repo.

ICMA is now actively looking at ways to drive initiatives from a repo and collateral perspective. It aims to promote the importance of repo in sustainable finance and to establish a multi-dimensional standard approach to enable short-term financing and investment opportunities for green, social and sustainability bonds, and to ensure the fluidity of 'responsible collateral' through the financial system. This consultation paper, by opening up the debate for industry stakeholders, is the first step towards defining a standard approach for green repo and collateral.

32 https://www.eba.europa.eu/eba-advises-commission-kpis-transparency-institutions%E2%80%99-environmentally-sustainable-activities

Annex

Responding to the consultation paper:

ICMA invites comments from ERCC members and all interested stakeholders on the matters covered in this paper. In particular, we would welcome your feedback on the specific questions set out below. ICMA will consider all comments received which will help us to steer our work and define concrete follow-up actions. Please submit your contributions online. Contact ercc@icmagroup.org for more information. The consultation will close on 28 May 2021.

Q1. Which of the intersections between repo and sustainability described in Section 3 are most relevant to your firm? Please detail the reasons for your response.

Q2. Are there any other possible intersections between the repo market and sustainable finance which your firm is considering but are not covered in the paper? Please explain.

Q3. Do you agree with the opportunities listed in Section 4? Do you foresee any other opportunities in developing a green and sustainable repo market? Please detail the reasons for your response.

Q4. Do you agree with the risks listed in Section 5? Which of them do you consider the most relevant to your firm? Do you foresee any other issues relating to the development of a green and sustainable repo market? Please detail the reasons for your response.

Q5. In your opinion, what could and should ICMA do to contribute to the development of a green and sustainable repo market? Please detail the reasons for your response.

Q6. In your opinion, do you think the developing regulatory framework supports the role of repo and collateral in the broader context of sustainable finance? Do you think monetary policy can be further adapted to support the role of repo and collateral in sustainable finance?

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