EBA EUROPEAN BANKING AUTHORITY

EBA's roadmap on ESG

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Part 1. Introduction to EBA work

- EBA mission
- EBA in the context of the EU Banking Union
- EBA priorities in 2022 . v

About the EBA (1/3)

- Independent EU agency established in 2011, taking over all tasks and responsibilities from the Committee of European Banking Supervisors (CEBS).
- Mission: to build a single regulatory and supervisory framework for the entire banking sector in the 27 EU Member States, so as to ensure an efficient, transparent and stable Single Market that is beneficial to consumers, businesses and the broader economy in the EU.

Develop an European Single Rulebook

Promote supervisory convergence and cross-border supervisory cooperation

Assess risks and vulnerabilities across the EU banking system

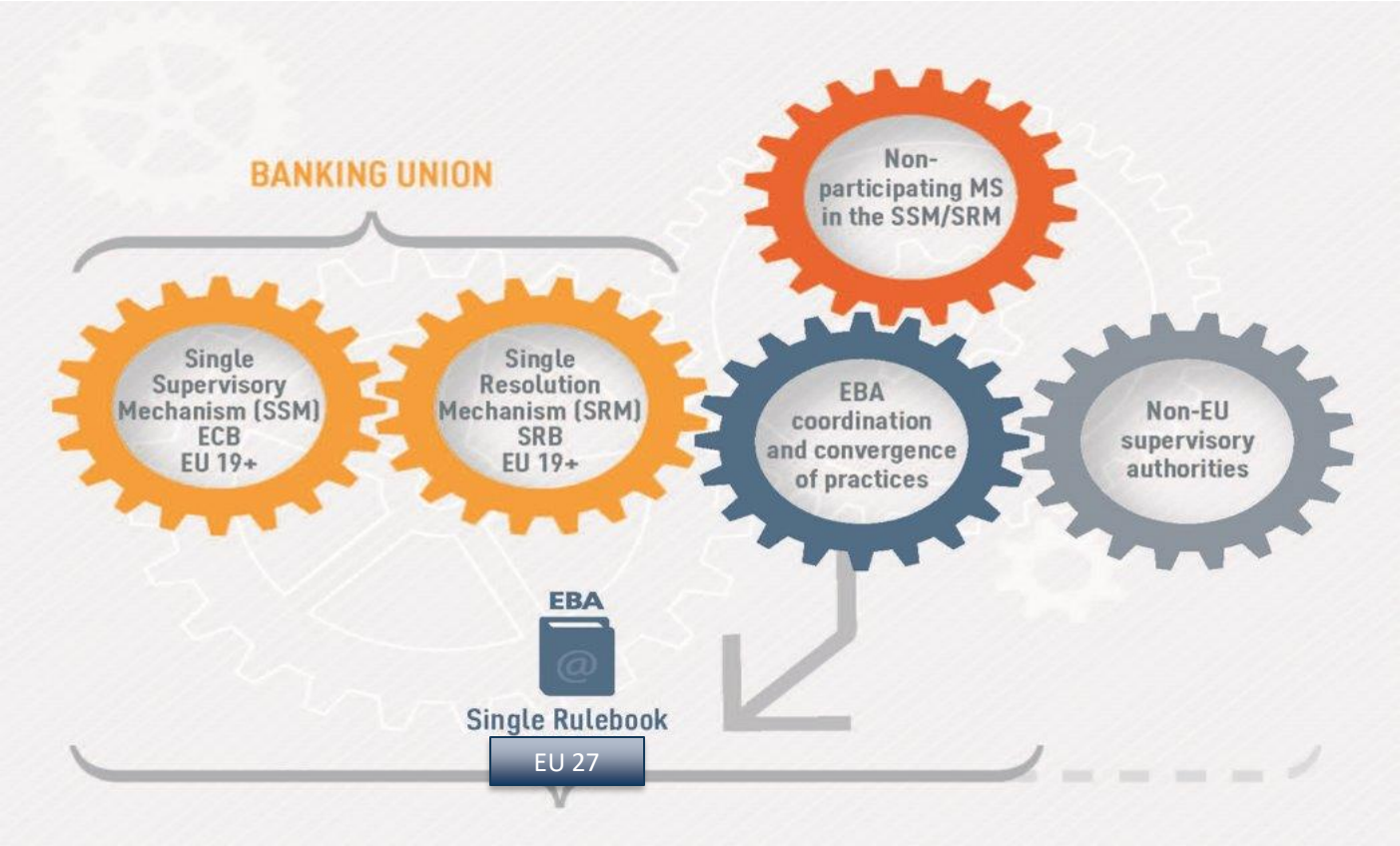
Enhance consumer protection

Other tasks (AML, breach of Union law, cross border mediation, advisory to EP, EC, EC)

- To perform these tasks, the EBA can produce regulatory and non-regulatory documents including binding Technical Standards, Guidelines, Recommendations, Opinions and ad-hoc or regular reports.

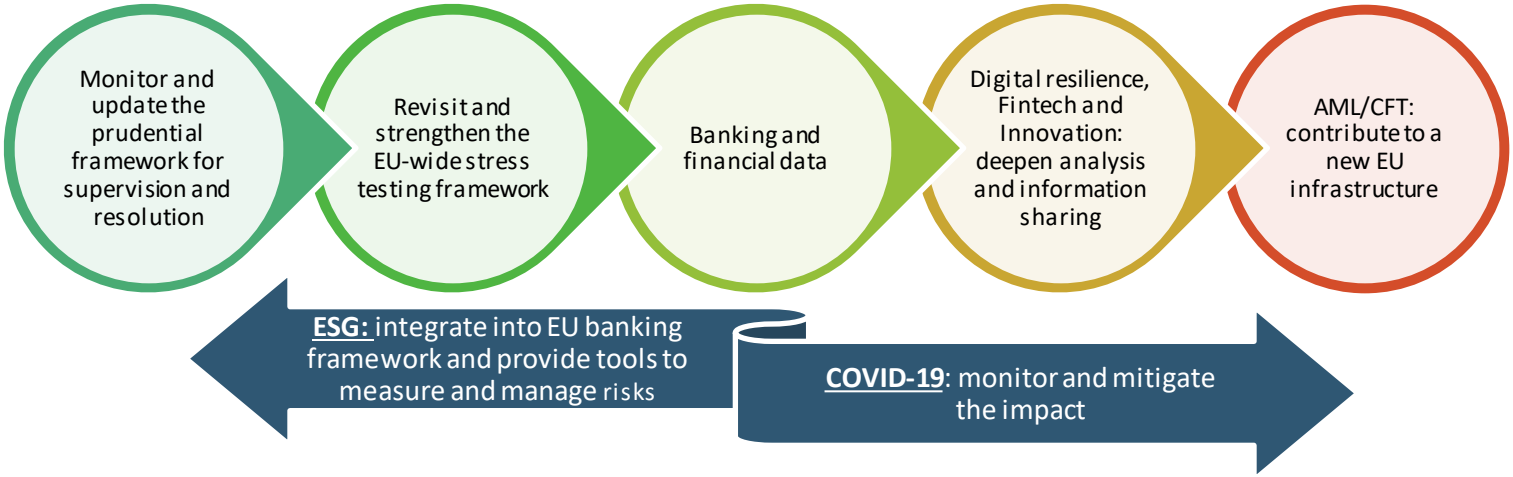
About the EBA (2/3)

- **EBA in the context of the EU Banking Union**



About the EBA (3/3)

- **EBA priority works in 2022**



- Environmental Social and Governance (ESG) risks are a horizontal priority for the EBA.
- Ongoing and future ESG work covers issues that cut across the entire regulatory spectrum – the focus is on anchoring ESG definition and risk aspects within the regulation, supervisory practices and credit institutions' risk management.
- Commissions renewed sustainable finance strategy published in July 2021 resulted in new ESG related mandates for the EBA.
- Close coordination with EC, BCBS, NGFS, ECB/SSM, ESAs and NCAs is needed to ensure that public sector initiatives continue to reinforce one another.

Part 2. EBA's work on ESG

- Overview
- Pillar 3
- Pillar 2
- Pillar 1
- Standards and labels
- Other

Overview

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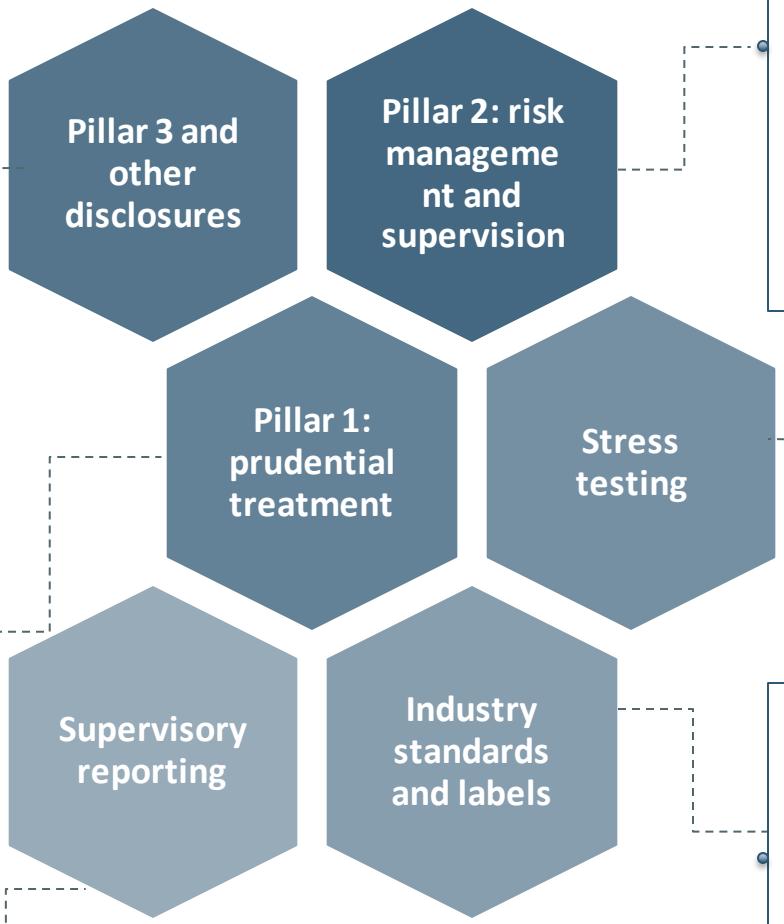
Pillar 3 disclosures on ESG risks under Art. 449a CRR

EBA's advice to EC on Art. 8 of the Taxonomy Regulation

Joint ESAs RTS under Sustainable Finance Disclosure Regulation and Taxonomy Regulation

Joint ESAs RTS on sustainability disclosures for STS securitisation

Report on ESG risk management and supervision under Art. 98(8) CRD and Art. 35 IFD - integration of ESG considerations in banks' business strategy, governance arrangements and risk management, further work planned on ESG risk management and supervision



EBA EU-wide pilot exercise on climate risk (2020-2021) and current preparations to meet future mandates: develop methods, scenarios, and run stress test

EBA discussion paper leading to a report under Art. 501c CRR and Art. 34 IFR - prudential treatment of exposures

Renewed Sustainable Finance Strategy

Report on sustainable securitisations

Advice on green retail loans and mortgages *(planned)*

Proposed point (h) of Art. 430(1) CRR – inclusion of banks' exposures to ESG risks in supervisory reporting *(planned)*

Pillar 3 – ESG disclosures

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ITS on disclosures on ESG risks under Article 449a CRR published in January 2022

First disclosures by banks expected in **early 2023** (based on 2022 data). Phased-in approach for selected elements.

Qualitative information on all three aspects of ESG (strategy, governance, risk management framework), quantitative information on E

Templates propose that banks disclose information on inter alia:

Climate transition risk: Banks' exposures to high carbon sectors and their counterparties' scope 1, 2 and 3 emissions

Climate transition risk: Loans collateralised by immovable property (RRE and CRE) and their energy efficiency

Climate physical risk: banks' exposures (and their maturity) that are subject to physical risk

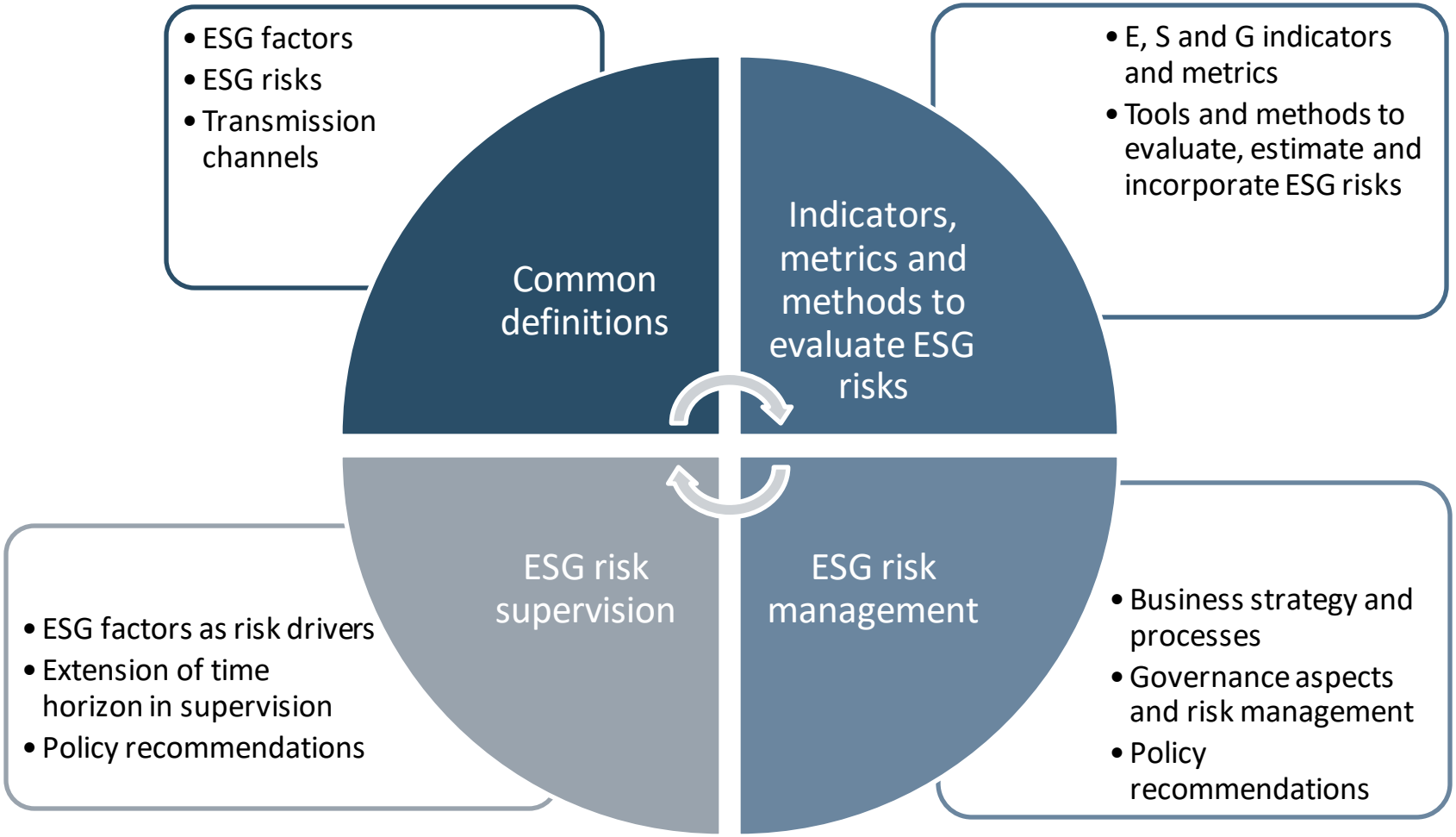
Mitigating actions: Green Asset Ratio (GAR) and Banking Book Taxonomy Alignment Ratio (BTAR) - climate risk adaptation and mitigation

Metrics on banks' alignment towards international sustainability goals, e.g. IEA NZE2050 scenario

Other mitigating actions (beyond taxonomy-aligned), e.g. instruments with proceeds dedicated towards sustainable activities

Pillar 2 – ESG risks management and supervision

EBA report on management and supervision of ESG risks published in June 2021



Pillar 2 – ESG risks management

- Current practices illustrate a growing recognition of the potential materiality of ESG risks but much progress remains to be done.
- Three main areas where ESG should be incorporated:
  - **Business strategies and business processes** (EBA Guidelines on loan origination and monitoring)
  - **Governance arrangements** (EBA Guidelines on internal governance and on remuneration)
  - **Risk management process**, including stress testing (planned EBA Guidelines on ESG risk management)

Need for a proactive risk management approach

- Monitoring business environment – ESG trends
- Setting strategic ESG risk objectives and limits
- Engaging with counterparties
- Considering sustainable products

Pillar 2 – ESG risks supervision

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Integration into SREP

Inclusion of ESG factors and risks into existing SREP elements:

- Business model analysis (proposal of a qualitative longer-term analysis of minimum 10 years)
- Internal governance
- Risks to capital and capital adequacy
- Liquidity and funding risks and liquidity adequacy

Principle of proportionality

Smaller institutions are not immune to ESG risks but intensity of ESG SREP assessment may vary

Phase-in approach

Short-term: inclusion into business model analysis and internal governance assessment

Medium-longer term: inclusion into risks to capital and risk to liquidity, leaving time to build data and tools

More prominence to E in the first steps

Next steps:

- ✓ ESG risks as one of key supervisory priorities for 2022
- ✓ EBA SREP Guidelines to be updated to include ESG risks

Pillar 1 – prudential treatment of exposures

Scope of Discussion Paper

- Pillar 1 framework for credit institutions and investment firms
- Focus on environmental risk
- The most relevant areas of the framework: credit risk, market risk, operational risk, concentration risk, investment firms
- No conclusions or recommendations yet, rather initial ideas and questions

Final report

- To cover environmental and social risks
- Commission's proposal to anticipate the deadline from 2025 to June 2023
- Mandate focused on methodologies and criteria, as well as potential effects of dedicated prudential treatment of exposures subject to impacts from environmental and/or social factors

Pillar 1 – Discussion Paper

- **Holistic approach:** Pillar 1 is only part of the overall prudential framework, other tools must also be taken into consideration, avoiding double counting with:
  - accounting framework
  - supervisory activities and Pillar 2 requirements
  - supervisory stress testing and Pillar 2 guidance
  - macroprudential buffers
- **Risk-based approach:**
  - Objective is to keep resilience of the financial sector
  - Prudential framework should not substitute other policy tools and be used to redirect financial flows
- **Feedback** is requested among other things on:
  - existing mechanisms within the framework which allow capturing new risks (external credit ratings, valuations, internal models)
  - possible targeted adjustments to the framework
  - forward-looking nature of environmental risk and relevant time-horizons
  - potential introduction of risk-weights adjustment factors

Standards and labels

- **EBA report on sustainable securitisation (published in March 2022)**

EBA is proposing **a pragmatic approach** to green securitisation to allow securitisation to play a role in the financing of the transition toward a greener economy:

- ✓ Aligned with the Green Bonds Standard, i.e. relying on use of proceeds and not the underlying assets – to avoid fragmentation in the EU standards
- ✓ Proposals to adjust the EU Green Bonds Standard
- ✓ Interim solution to allow the EU sustainable market to grow
- ✓ Careful disclosure and monitoring will be needed
- ✓ In the medium-term, a specific securitisation solution should be re-assessed
- ✓ Too early to look at a social securitisation (no harmonised definition of social investments)

- **Further work on labelling expected based on the Commission's Renewed Sustainable Finance Strategy**

- ✓ EBA Opinion on the definition and possible supporting tools for green retail loans and green mortgage
- ✓ Advice on greenwashing & supervisory power (in coordination with other ESAs)
- ✓ Commission and ESAs to develop sustainable loans and bonds standards

And also…

ESG risk monitoring & identification

- ***Monitoring system :*** *EBA to put in place a monitoring system to assess material ESG risks including extension of supervisory reporting to capture ESG risks.*

- **Framework for systemic monitoring of climate-related financial stability risks :** *COM envisages systemic, joint monitoring by EC, ECB, ESAs, NCAs of climate-related financial stability risks.*

Stress testing

- **Guideline on internal stress testing for institutions :** *EBA to provide guideline on how institutions should test their resilience to climate change risks and long-term negative impacts.*

- **Regular climate risk stress testing :** *EBA to perform regular climate change stress tests or scenario analyses, using a bottom-up approach.*

- **Conduct coordinated sectoral climate stress tests with other ESAs :** *one-off exercise, ESAs together with the ECB to conduct a coordinated, bottom-up and top-down EU-level climate change stress test to assess the resilience of the financial sector in line with the Fit-for-55 package.*

- **Developing supervisory stress testing methods :** together with other ESAs develop guidelines to ensure that consistency, long-term considerations and common standards for assessment methodologies on ESG risks are integrated in supervisory stress testing

Macroprudential toolkit

- **Advice on the review of the macroprudential framework :** *EBA to assist COM in assessing whether the macroprudential toolkit is suitable to address climate-change related financial systemic risks. COM in turn to consider possible legislative proposal for amending the macroprudential framework.* (Q2 2022)

Thank you!

For more information on the EBA's work on ESG:
https://www.eba.europa.eu/financial-innovation-and-fintech/sustainable-finance

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