ENVIRONMENTAL SOCIAL AND GOVERNANCE DISCLOSURES

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Why is the EBA's ESG disclosure work important?

Environmental Social and Governance (ESG) factors help measure the sustainability and societal impact of business activities that are financed by banks. The EBA has a role to play in identifying key metrics and methodologies for: risk management and supervisory assessment; disclosure and market discipline; and the prudential treatment of banks' assets.

Disclosure of ESG factors is a vital tool for market discipline allowing stakeholders to assess banks' environmental risks and their sustainable finance strategy. Many stakeholders have a legitimate interest in the physical and transition risks that banks are exposed to from climate change. They also want to understand a banks's strategy in financing the transition to a zero carbon economy.

The EBA is asking banks to disclose information on:

- **Climate risks:** how climate change may exacerbate other risks within banks balance sheets whether it be the risk of stranded carbon intensive assets or loans to property within a flood plain.

- **Mitigating actions:** what mitigating actions banks have in place to address those risks including financing activities that reduce carbon emissions.

- **Green Asset ratio:** to understand how institutions are financing activities that will meet the publicly agreed Paris agreement objectives of climate change mitigation and adaptation based on the EU taxonomy of green activities.

The EBA is also asking banks to describe their ESG strategies, governance and risk management arrangements with regard to ESG risks.

WHAT IS THE GREEN ASSET RATIO AND WHY IS IT IMPORTANT?

The Green Asset Ratio (GAR) is based on the EU taxonomy and is actually a Paris aligned ratio that can be used to identify whether banks are financing sustainable activities, such as those consistent with the Paris agreement goals. The GAR shows the proportion of assets that are environmentally sustainable and contribute substantially to the objectives of climate change mitigation or climate change adaptation or that enable other activities to contribute substantially to those objectives.

The GAR is particularly important in setting strategies as even a bank with a low GAR can identify how it wants to change its financing activities over time to meet the Paris agreement objectives and measures and monitor that strategy.

How does the EBA expect banks to capture environmental risks and activities that reduce those risks?

The EBA will ask banks to disclose exposures to carbon intensive activities and assets that may experience physical risk as a result of climate change. In particular, it will ask banks to provide information with the following breakdown:

- Information towards fossil fuel companies excluded from sustainable climate benchmarks,

- information towards other carbon-related sectors, as identified in the same sustainable climate benchmark Regulation, or identified by the institution based on sector aggregate GHG emissions (as e.g. published by EUROSTAT).

This disclosure is aligned with that recommended by the FSB's TCFD, on exposures towards carbon-related sectors, although with a broader definition of which sectors are carbon-related. Banks are also encouraged to explain what measures they have in place to mitigate those risks such as reducing financing activities that reduce the carbon footprint of currently carbon intensive activities.

Where will banks get the data from?

The EBA has deliberately designed the GAR disclosure requirements so it matches the data, and timelines, that large corporates under the Non Financial reporting Directive are required to produce following Article 8 of the Taxonomy Regulation. The EBA also set out, last year, expectations that banks would capture ESG information in our Loan Origination Guidelines. Still, we know it will be difficult to obtain accurate data which is why banks can use proxies, estimates and ranges where reliable data is not yet available. For example, the EU's Joint Research Centre identifies coefficients of Taxonomy-alignment of economic sectors to be used in SMEs counterparties, or aggregate information on energy performance certificates can help with disclosing information on mortgage portfolios. The EBA expect reliable data for the GAR from December 2022 from counterparties subject to NFRD disclosure obligations. But much longer, until June 2024, for other data including from SMEs, corporates below 500 staff and retail counterparties. Non EU data is also treated separately and proxies estimates and ranges may be needed there.

HOW DOES THE EBA'S DISCLOSURE FIT WITH ALL THE OTHER DISCLOSURE INITIATIVES?

The EBA disclosure proposals leverage existing international and EU work including:

- following the recommendations from the FSBs TCFD reports.

- using the EU Taxonomy of activities as a starting point.

- relying on the data that banks' biggest borrowers subject to the Non Financial Reporting Directive will produce in 2022.

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