

ENVIRONMENTAL SOCIAL AND GOVERNANCE PILLAR 3 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 bank'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 and Banking Book Taxonomy Alignment 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 are the Green Asset Ratio (GAR) and the Banking Book Taxonomy Alignment ratio (BTAR) and why are they important?

The GAR and the BTAR are based on the EU taxonomy and are actually Paris aligned ratios that can be used to identify whether banks are financing sustainable activities, such as those consistent with the Paris agreement goals. They show 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. The GAR mirrors the disclosure that institutions will have to provide under Art 8 of Taxonomy Regulation. The BTAR provides additional information on the taxonomy alignment of exposures towards non-financial corporates not subject to NFRD disclosure obligations.

The GAR and BTAR are particularly important in setting strategies as even a bank with a low value of these KPIs can identify how it wants to change its financing activities over time to meet the Paris agreement objectives and measure 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.
- information on GHG emissions financed by the institution and on alignment of metrics with 2050 Net Zero goals.
- These disclosures are aligned with those recommended by the FSB's TCFD, like e.g. 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 KPIs on taxonomy alignment disclosure requirements so they match 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 guidance that banks should capture ESG information in our Loan Origination and Monitoring Guidelines. Information necessary for the calculation of the BTAR shall be obtained on a best effort basis in the context of the bilateral relationship with counterparties or when needed using estimates, without creating disclosure obligations to them. The EBA expect reliable data for the GAR from December 2023 for counterparties subject to NFRD disclosure obligations and households. And on the BTAR for June 2024.

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.
- relying on data collected on bilateral basis as required in the EBA loan origination and monitoring guidelines.

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