



## Joint EBA & EBF Workshop on Sustainable Finance Thursday, 4 April 2019 - Brussels

### Highlights and summary

*On 4 April 2019, the European Banking Authority (EBA) and the European Banking Federation (EBF) held a workshop on sustainable finance. This workshop highlights the willingness of EU supervisors, regulators and banks to move forward on the various challenges related to sustainable finance and engage in a structured dialogue for incorporating sustainability into EU banks' frameworks and risk management.*

*The summary below is intended to provide an overview of the discussions in order to feed the debate around sustainable finance. It does not constitute an official transcription of the workshop and does not cover all the remarks that have been made. The views reflected do not necessarily constitute the official views of speakers or their organizations.*

*The agenda and speakers' presentations can be accessed through the EBA's website.*

Piers Haben (Director of Banking Markets, Innovation and Consumers, EBA) and Sebastien de Brouwer (Chief Policy Officer, EBF) welcomed the participants, noting that this workshop reflects the **urgent need to build sustainable considerations into finance**, taking into account the fact that banks should play a key role towards the mainstreaming of sustainable finance. The attendance reached a good level with 120 representatives coming from credit institutions and financial supervisors. The workshop's purpose was to shed some light on institutions, regulators and supervisor's practices and thinking on how best to incorporate sustainability considerations. In particular, climate-related risks being more and more considered as a financial risk, institutions and supervisors still face and need to overcome some challenges in terms of data and knowledge needed to appropriately measure and manage such risks.

Martin Spolc (Head of Unit Fintech and Sustainable Finance, European Commission) gave an overview of the Commission's Action Plan and of how **all three objectives – scaling-up green finance, mainstreaming climate risk management, ensuring transparency – and the ten actions of this Plan relate to the banking sector**, beyond the (still necessary) debate on the potential need to adjust the prudential framework through specific capital charges, risk management or disclosure requirements. Banks are indeed at the forefront of and will be impacted by the various on-going initiatives on taxonomy, green bonds standard, sustainable benchmarks, incorporation of Environmental, Social and Governance (ESG) aspects in investments and advice activities, ESG ratings, promotion of long-termism and transparency etc. While the need to speed up collectively was highlighted, in order to ensure that the banking sector is already prepared, it also appears necessary to break the silos (e.g. explore synergies between Fintech and sustainable finance) and promote a global and international approach in this field.

The first session of the workshop was dedicated to banks and supervisors' practices related to ESG risks.

- The International Association of Credit Portfolio Managers & Oliver Wyman first gave a presentation of key takeaways and industry perspective from a global survey recently conducted (*see presentation and white paper attached*). It was found that in order to effectively manage climate risks and protect banks from its potential impact, institutions should treat climate risk

as financial risk moving beyond traditional approaches that focus on reputational risk. This shift implies **integrating climate risk into financial risk management frameworks** and expanding the responsibilities and capabilities beyond Corporate Social Responsibility to also include risk management teams.

- The first panel investigated how banks understand ESG risks and incorporate them into business strategy and risk management. While all panellists gave examples of how sustainability considerations are already incorporated in their institution, they highlighted that the topic is gaining more weight and getting more attention throughout banks. **Differences exist in terms of what tools banks are using or are developing with regard to risk management, governance, pricing or measurement of risks.** Examples provided ranged from criteria to be applied by business managers according to sectoral policies to exclusion lists of activities not to finance through reliance on teams of ESG experts as second line of defence, specific due diligence for certain clients or activities, assessment of credit or reputational risks linked to ESG aspects, endorsement of market practices such as the Equator Principles for project finance or the new Principles for Responsible Banking, among others. On the other hand, banks face common challenges such as the need to establish metrics for transition risk or the absence of a common language around ESG, green and sustainability risks.
- Morgan Despres, Head of Secretariat for the Network for Greening the Financial System (NGFS), gave a presentation of the NGFS initiative and the work conducted so far (*see presentation attached*). The stock taking exercise led among NGFS members has shown that supervisors have started working on the topic of climate-related risks and that best practices can already be observed, even if this work is often on its early stages and mostly qualitative. The NGFS highlighted in its first progress report that **climate risk should be considered as financial risk and falls into the mandate of central banks and supervisors.** The first comprehensive report to be released in April will include some recommendations to integrate climate-related risks in supervisory practices; going forward the NGFS will work on a handful of high-level transition scenarios for the purpose of scenario analysis and a practical toolbox for supervisors.

The second session of the workshop dealt with disclosures through a panel discussion. Representatives from financial institutions, banks and supervisors involved in designing, applying and supervising climate-related disclosures provided their views on how banks currently integrate ESG information in public disclosures, what will change with the recent international (Task force for Climate related Financial Disclosure's recommendations) and European (non-binding Guidelines under the Non-Financial Reporting Directive) initiatives. Even though banks are at different stages in their publications and applications of the TCFD recommendations, **common issues were highlighted such as difficulties around scope 3 emissions measurement, switching from qualitative to quantitative disclosure or the importance of integrated reporting and availability of counterparties' data**, e.g. on ESG performance or strategy. The approach promoted by the EU non-binding Guidelines under review was deemed appropriate, i.e. disclosures should cover the climate risks' impact on the financial resilience of the bank but also the bank's impact on climate and the environment. In the absence of common and well-developed methodologies to measure climate-related risks, specific sectoral metrics would represent a first step towards improved risk assessments and disclosures. Supervisors warned that further work needs to be done before fully integrating ESG disclosures into the prudential supervision. The regulatory framework should be carefully calibrated to serve the purpose of raising awareness and transparency while ensuring fairness and comparability.

The third session of the workshop looked into ways to assess and monitor banks' exposures to climate-related risks, especially considering the role of scenario analysis and stress-testing.

- Dr David-Jan Jansen (De Nederlandsche Bank) gave a presentation of DNB's study on an energy transition risk stress test for the financial system of the Netherlands that investigates the **potential financial stability impact of a disruptive energy transition** (*see presentation*

*attached*). The stress test method, which accounts for uncertainties and is a familiar instrument to identify vulnerabilities, allows analysing the impact of severe scenarios on financial institutions, keeping in mind that this does not constitute a forecast but a (necessarily hypothetical) scenario analysis. Financial stress under disruptive energy transition appears as potentially sizeable.

- The panel discussion that followed highlighted that banks, supervisors and regulators are starting to analyse and improve their knowledge about the physical and transitional risks linked to climate change, their channels of transmission and implications for the financial resilience of institutions, and about potential methods to assess vulnerabilities. However, the official sector can help by creating common understanding and definitions for example in relation to data as a foundation for any work as well as some basic parameters for analysis and providing the framework for scenarios. In this regard **whilst scenario and sensitivity analysis is a key tool to understand better the risks both physical and transitional for banks, the question is rather when and how to perform such exercises**. Banks have started to test some of their portfolios against some scenarios, e.g. relying on the methodological framework provided by market pilot initiatives. While the challenges linked to a fully-fledged or traditional regulatory stress-test still appear as significant (need to gather relevant data, clarify channels of transmission, need to account for a longer time horizon and the dynamism of balance sheets...), an ad-hoc sensitivity analysis approach that would look at business model implications and inform on the need for management actions was deemed an interesting area to explore.

During the next session, market opportunities, initiatives, impediments and potential incentives to support green finance were discussed. A panel of banks provided examples of **various green financial instruments, products and services (green loans, green bonds, green covered bonds, green securitization, green mortgages etc.) offered as a response to green funding needs**. Even if the market has been quite active, the industry highlighted the impediments and challenges faced today, e.g. regarding the lack of competitiveness of products or the difficulty in identifying eligible projects or assets to refinance. The important role the public sector should play in terms of providing incentives was mentioned by the industry, e.g. in terms of prudential supporting factors where there is indication of reduced risk, green securitization, taxation and subsidies or guarantee funds mechanisms. Innovation and digitalization also appear as potential key dimensions for mainstreaming sustainable finance, e.g. through blockchain, collaboration with Fintech or the use of new technologies in the development of sustainable retail products.

Slavka Eley (Head of Banking Markets, Innovation and Products, EBA) and Antoni Ballabriga (Global Head of Responsible Business, BBVA & Chair of the EBF sustainable finance working group) summarized the discussions held during the workshop and provided their views on the way forward (*see presentations attached*). The EBA informed about its **work plan on sustainable finance, translating the European Commission's Action Plan and legislative mandates into specific steps and publications**. Engagement with stakeholders will play an important role in this work and the industry will be invited to provide input into the work related to collecting evidence on short-termism and mapping market practices on incorporation of ESG considerations. Some areas for the public sector to move forward were mentioned such as considering what simple metrics can be identified for risk management and disclosure whilst more formalized reporting and disclosure are explored, and considering setting some expectations on the incorporation of ESG factors into banks' internal capital allocation processes whilst treatment of ESG risks under pillar 2 is explored. Facilitating banks' scenario analysis and enhancement of their own stress testing frameworks through the development of common scenarios and assumptions also appeared as a short-term priority for the public sector. The EBF highlighted that sustainable finance is a key priority and provided details on its future implication which will include active engagement with EBA, EU legislators and Technical Expert Group, as well as some publications (report on incentives to promote sustainable finance through banking, guidelines to apply EU taxonomy to lending portfolios) and the signature of the Principles for Responsible Banking.