EBA Chairperson keynote speech at the Euro-Mediterranean Economists Association COP27 side event

9 November 2022

Keynote speech by the EBA Chairperson José Manuel Campa - Investing in and Financing the Acceleration of Sustainable Development in a Net Zero Scenario

Tackling climate change starts with the question what we all can do about it. Each one of us needs to provide our own answer. And that includes of course the financial sector. I am therefore pleased to join this COP27 event to discuss what banks, regulators, and in particular the European Banking Authority, can and is doing to contribute to tackle this challenge.

We speak of climate as a global common good. Likewise, international financial stability has the characteristics of such common good. We as financial regulators understand this and all of us have a shared interest in its preservation. But sometimes we only resorted to action when this common good is eroding.

In the case of the financial system, we had to reach a tipping point, the global financial crisis, to make fundamental changes. These changes also included how we collaborate on banking regulation in Europe. In fact, it was in 2008 when we had to realise that our efforts and institutions did not prevent serious risks to financial stability from materialising. In the European Union, the financial turmoil and the economic and social hardship triggered the complete overhaul of the system of financial supervision.

To that end, the European Union set up the European System of Financial Supervision with the European Supervisory Authorities as regulatory bodies. Among those European Supervisory Authorities, the European Banking Authority was established to help building a single regulatory and supervisory framework for the entire banking sector in the 27 EU Member States.

At the EBA I can testify that we have learnt the lesson that institutionalised dialogue and coordination matter. That proper and early regulatory action can help foster change and prevent unintended consequences. But we are also very much aware that any common good needs constant attention and scrutiny.

And these lessons apply to achieving the goals towards a net zero transition. We need to continue to engage and reiterate our commitment to the actions that need to be taken by each of us to contribute to the global response required to meet the objectives of the Paris Agreement.

Let me address first the role of climate considerations in the banking sector.

Climate change and the banking sector

Banks play an important role when it comes to climate change.

On the one hand, banks will be crucial in financing the transition towards a more resource efficient and sustainable economy. They will also have to cater for customer demand for sustainable products. On the other hand, financial institutions will have to adhere to sustainability standards themselves.

The World Economic Forum recently estimated that approximately 50 trillion USD in incremental investment are needed by 2050 to transition the global economy to net-zero emissions and avert a climate catastrophe. In addition, global clean energy investments of approximately 4 trillion USD are required annually by 2030 which is a more than threefold increase from existing investment levels. Energy supply shortages as result of the Russian invasion of Ukraine may event accelerate this transition. Moreover, in line with decisions at prior COP conferences, developed countries committed themselves to a collective goal of mobilising USD 100 billion per year until 2025 for climate action in developing countries and more maybe needed.

Those finance needs coincide with the growing volume of green bond issuance in global financial markets. Green bond issuance broke through the half trillion mark for the **first time in 2021, ending with USD522.7bn, a 75% increase on 2020.**[1] **Zooming into the EU, the European Commission will become the largest green bond issuer worldwide as part of the issuance under the Next**

[1] https://www.climatebonds.net/market/data/

Generation EU programme.[2] **As a result, banks are needed for providing their expertise to structure these investment products, identify investors and act as underwriters to these large issuers. But much more will be required from banks in this transition. Whole sectors will need their support to be able to transition business models and related operations towards green. This means providing expert advice, direct funding through lending, and adequately assessing the related risks.**

Climate change also confronts banks with challenges, which manifest through existing risk channels. More frequent and severe weather events pose risks to firms' own operations and supply chains as well as to those of their counterparties. It may cause physical damage to real estate and infrastructure and impact generally on some businesses' viability. Such events will likely have an impact on the riskiness of the banks existing loan portfolios. As a result, banks face additional operational and credit risk which requires precise measurement, adequate risk management, and may need dedicated provisioning. The same goes for other climate events like rising sea levels, or changes in temperature. In addition, banks will need to adjust to new regulations and invest on early identification of relevant risks to avoid legal and reputational risks.

Last year already, the EBA conducted a pilot mapping exercise on a sample of 29 volunteer banks in 10 jurisdictions, covering 50% of EU Banking system total assets. It was a data classification exercise to map banks' exposure from a climate risk perspective. It was a learning exercise for both, the EBA and participating banks. Our scenario analysis looked at banks' sensitivity to the process of adaptation in light of climate change. According to our analysis, we estimated that the exposures towards high carbon obligors amounts to almost 25% of banks' corporate non-SME holdings in the sample. Climate relevant exposure was concentrated in manufacturing and electricity.

As our analysis continues, it is getting clearer that banks might be underestimating transition risks in the short and medium-term.[3] Banks might engage too much capital in activities that reinforce climate change or in companies and projects with an inadequate management of climate-related risks. Moreover, they might also be securing loans with assets subject to increased transitional and physical risks.

Fighting climate change as EBA priority

The environmental, social and governance risks are a multi-year horizontal priority of the EBA. Our climate related agenda, is part of our overall sustainability agenda, but a fundamental part of that agenda. At the same time, we are constantly balancing the urgency for action with the build-up of sufficient data to inform our regulatory work.

As EBA, we follow a sequential approach focusing at this juncture on better embedding climate related risks in institutions' practices and fostering transparency on ESG risks in banks' balance

[2] **Objective: raise up to 30% of the 250 billion Euro Next Generation European Programme through the issuance of green bonds and use the proceeds to finance green policies**

[3] EBA Q2 2022 Risk Dashboard

sheets, enhancing the measurement, modelling and management of these risks by banks and supervisory authorities.

Until now, we have provided recommendations on ESG risk management and supervision. Those recommendations specify definitions and methodologies and give guidance of how to incorporate ESG considerations in strategies and objectives as well as governance arrangements. We also updated relevant EBA products to reflect the growing materiality of ESG risks in the overall activities of financial institutions. For example, our EBA guidelines on loan origination and on remuneration by financial institutions have been amended to include ESG considerations when banks make such decisions. Also for supervisory activity, our guidelines on the supervisory review and evaluation process, the so-called SREP, now feature the assessment of ESG impact.

The EBA is also helping to put the EU taxonomy for sustainable activities into practice. Under EBA standards for disclosures on key ESG risks[4], banks are required to report on comparable data on environmental risks as well as key performance indicators. The data provide more transparency on the impact of physical and transition risks on banks' balance sheets. They also show how institutions are embedding sustainability considerations in their risk management, business models, and strategy. At the same time, it will enable supervisors to assess the banks' performance on their pathway towards the Paris Agreement goals.

Together with the other European Supervisory Authorities, we are working to improve sustainability-related disclosures for the whole financial sector. Consumers must get the right amount of information which is useful to them. They should be able to judge on the greenness and to compare among product offerings. To that objective, we developed standards on the content and presentation of disclosure and proposed additional disclosures for products which contribute to environmental objectives. In addition, we have put forward proposals of how to increase transparency on investments in fossil gas and nuclear energy economic activities

Looking again at the banking sector only, there is a discussion on how to ensure that ESG risks are properly reflected in the banks' capital requirements. The EBA is an active contributor to this debate. Over the summer, we published in a discussion paper our preliminary views and sought to open a discussion and receive feedback on the best way to approach this issue. We have received ample feedback from stakeholders and this feedback[5] will be included in our report to be delivered in 2023 to further enhance our regulatory framework. Not preempting the final statement in the report, we would however like to stress that it is important that our prudential response on ESG matters remains risk based.

Going forward, the EBA will continue to deliver more work on ESG risk management. We will advise the European Commission on what should be our common understanding on what greenwashing means in the financial sector and best ways to monitor and tackling it if necessary.

[4] EBA ITS: Final draft implementing technical standards (ITS) on prudential disclosures on ESG risks in accordance with article 449a CRR (EBA/ITS/2022/01), 24 January 2022. Available here.

[5] EBA Discussion Paper on the role of environmental risks in the prudential framework (EBA/DP/2022/02), 2 May 2022. Available here.

Without financial stability the already challenging transition will be much more difficult to achieve. Proper and quick preparation by financial institutions and preserving financial stability are fundamental while we go through this transition to a sustainable economy. Thorough monitoring of ESG risks will also continue to be at the forefront of our agenda. We will work with financial institutions, bank supervisors and other authorities across the financial sector to stress test and assess the robustness of the financial sector to the challenges and the risks that may arise in this transition. The results of this exercise to be published in 2024 will certainly provide further evidence on how to best adjust the framework for sustainable finance and guide our decisive action on climate change.

Let me conclude with some final reflections.

Going forward, a well-funded and stable banking system will be the backbone of the transition to provide adequate financing to our investment needs. Well capitalized and resilient banks are good news in the fight against climate change. Only a sound and resilient financial system will help to facilitate the financing towards a low-carbon economy and to mitigate the disruptive impacts of environmental risks.

Second, the banks have made progress but they still need to accelerate and truly manage climate-related and environmental risks like we expect them to manage any other material risk. This includes managing expected losses and their institutions overall soundness to potential unexpected scenarios as we progress through this transition.

Third is collaboration. The EBA is proudly joining the European Commission's leadership ambition on ESG matters. At the same time, we must make sure that ESG standards across the globe remain comparable. I touched upon the importance of institutionalised dialogue and coordination. We need to have common reference points around ESG to advance in our work. It is important to open dialogue to stakeholders from different sectors and regions around the world. Only such dialogue will consolidate our joint understanding of net zero and how to achieve it.

In that regard, I am looking forward to both panels and how to foster climate considerations in financial regulation internationally.