Pillar 3 framework: ESG-related disclosures

5th JRC Summer School on Sustainable Finance

Raquel Ferreira - Reporting and Transparency Unit

13 July 2023

Background: Introduction

EBA EUROPEAN BANKING AUTHORITY

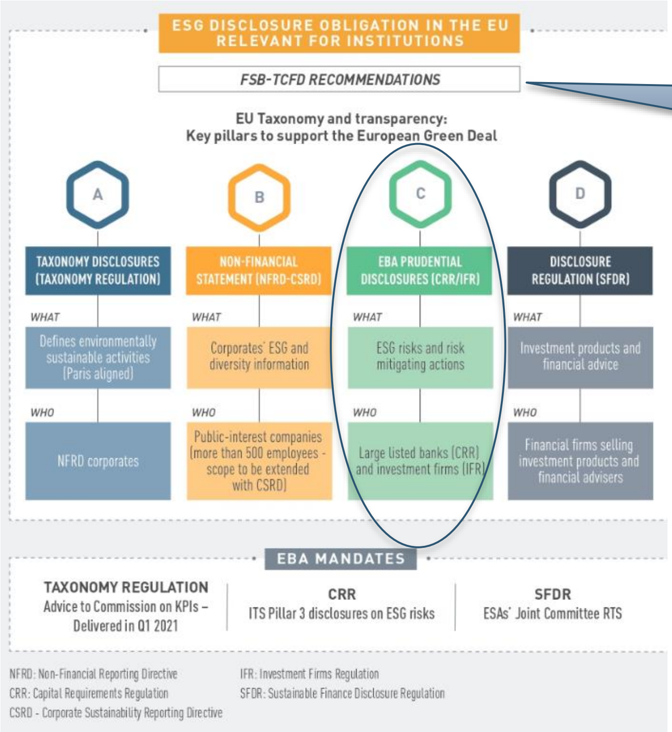
Market discipline as a tool to drive changes towards a more sustainable economy…

Transparency is a key driver of market discipline in the financial sector, reducing asymmetry of information between institutions and stakeholders.

Comparable disclosures allow all stakeholders to understand how institutions are contributing to the objectives of climate change and how risks are being managed.

- Commission's 2018 Action Plan on Sustainable Finance triggered several legislative initiatives on ESG disclosures with impact on institutions;
- One of the objectives is to foster transparency in the financial system;
- Direct mandates to the EBA.

Background: EU and international ESG disclosures



Initiatives at international level – ISSB and BCBS

➔ International Sustainability Standards Board (ISSB):

- Developing sustainability reporting standards at international level;
- Followed different timeline from the EFRAG one;
- Final standards (IFRS S1 and IFRS S2 published on 26 June).

➔ Basel Committee on Banking Supervision (BCBS):

- Currently developing a consultative paper on Pillar 3 Framework;
- Active role of the EBA;
- ISSB standards and Pillar 3 Framework taken as "inspiration" for this work.

Background: EU ESG disclosures

Pillar 3 Framework

- Article 449a CRR: requirement for large institutions with instruments traded in an EU official market to disclose prudential information on ESG risks, including transition and physical risk;
- Article 434a CRR: EBA to develop implementing technical standards (ITS) with uniform formats and associated instructions for these disclosures;
- ITS adopted by the Commission ((EU) 2022/2453 of November 2022).

EU Taxonomy Regulation

- Establishes a common classification system of environmentally sustainable economic activities at EU level;
- Article 8 requires the disclosure of information on how and to what extent undertakings'[1] activities are associated with economic activities that qualify as environmentally sustainable;
- In July 2021, the Commission published the Delegated Act specifying content and presentation, following EBA advice.
- Extended disclosures to other environmental objectives.

[1] Subject to Non-Financial Reporting Directive (NFRD)

Background: EU ESG disclosures

EBA EUROPEAN BANKING AUTHORITY

Corporate Sustainability Reporting Directive (CSRD)

- ➔ Proposes to extend the scope of application of the NFRD to all large corporates (above 250 employees), to all listed corporates and, on a voluntary basis, to SMEs;
- ➔ EFRAG is mandated to develop technical advice on sustainability reporting standards to support the Commission on the adoption of sustainability reporting standards (via delegated acts);
- ➔ Technical advice to the European Commission in the form of draft European Sustainability Reporting Standards(ESRS) accompanied by basis for conclusions and cost benefit analysis;
- ➔ CSRD also establishes the European Commission shall request the opinion of EBA, ESMA and EIOPA on the technical advice provided by EFRAG (Article 49 (3b)).
- ➔ EBA focus on interoperability with Pillar 3 standards (EFRAG standards offer the possibility to cross refer to Pilar 3 reports); and data needs for banks from their counterparties (data needs specifically included in the standards and with mandatory nature).

- ➔ Reporting requirements to be phased in over time
- ➔ First companies applying standards in 2024, for publication in 2025
- ➔ Listed SMEs to report from 2026, with possibility to opt-out until 2028
- ➔ Proportionate standards for listed SMEs under development by the EFRAG

Pillar 3 Framework – Role, ESG disclosures and addressees

Role of Pillar 3 framework:

- To promote market discipline by ensuring that banks convey sufficient information on / to:
  - their solvency and liquidity position,
  - their compliance with minimum prudential requirements,
  - their risks and vulnerabilities,
  - bridge the gap of information between them and their stakeholders, allowing the latter to understand the risk profile of the institution and make informed decisions.

In the case of climate and ESG-related risks:

- To provide enough information to allow users to have a comprehensive view of the risk profile of the institution and understand how climate and other ESG-related risks may exacerbate other traditional prudential risks in their balance sheet, notably credit risk, but also market, liquidity risk or operational/legal/reputational risk.

Addressees:

- Pillar 3 information provides a good way of accessing risk-relevant information to all type of stakeholders, who should be able to compare across institutions and exercise market discipline.

Pillar 3 Framework – Overview of ESG disclosures

	WHAT TO DISCLOSE?	EXAMPLES OF DISCLOSURES
RISK DISCLOSURES	CLIMATE CHANGE TRANSITION RISK Information on exposures to sectors or assets that may highly contribute to climate change	▶ Exposures to fossil fuel companies excluded from sustainable climate benchmarks, and to other carbon-related sectors ▶ For real estate exposures, distribution of the exposures by energy performance of the collateral
	CLIMATE CHANGE PHYSICAL RISK Risk exposures subject to extreme weather events (sector/geography)	▶ Assets subject to impact from chronic climate change events by sector and geography ▶ Assets subject to impact from acute climate change events by sector and geography
MITIGATING ACTIONS	Actions that support counterparties in the transition to a carbon neutral economy but that do not meet taxonomy criteria	▶ Building renovation loans that improve the energy efficiency of the building but do not meet the taxonomy screening criteria
	Actions that support counterparties in the adaptation to climate change but that do not meet taxonomy criteria	▶ Loans to build barriers against flooding, or water management mechanisms against draughts but to not meet the taxonomy screening criteria
GREEN ASSET RATIO	Information on exposures towards NFRD Corporates and Retail financing taxonomy-aligned activities consistent with Paris Agreement goals that contribute substantially to climate change mitigation (CCM) and adaptation (CCA), including information on transitional and enabling activities.	▶ Contributing to CCM: Generation of renewable energy ▶ Enabling CCM: Manufacture of renewable energy technologies ▶ Contributing to CCA: Afforestation ▶ Enabling CCA: Engineering activities for adaptation to climate change
BANKING BOOK TAXONOMY ALIGNMENT RATIO	Information on exposures towards non-NFRD corporates not assessed in the GAR financing taxonomy-aligned activities consistent with Paris Agreement goals, contributing substantially to CCM and CCA. Simplified assessment, based on bilateral information and estimates.	
QUALITATIVE DISCLOSURES	Qualitative information on environmental, social and governance risks	▶ Governance arrangements ▶ Business model and strategy ▶ Risk management

Pillar 3 Framework – Quantitative disclosures

EUROPEAN BANKING AUTHORITY

Technical standards on Pillar 3 ESG ITS – Disclosure quantitative templates on climate change (banking book)

Climate change Transition risk

- Template 1: Banking book – Credit quality of exposures by sector, scope 3 emissions, maturity buckets
- Template 2: Loans collateralised by immovable property – by Energy Efficiency of collateral
- Template 3: Alignment metrics on relative scope 3 emissions
- Template 4 - Exposures in the banking book to top carbon-intensive firms

Climate change Physical risk

- Template 5 - Banking book, credit quality of exposures subject to physical risk by sector, geography, maturity buckets

Mitigating actions

- Templates 6 to 9 – investment supporting customers transition/ adaptation (taxonomy aligned)
- Template 10 on other climate change mitigation actions (non-taxonomy aligned)

Pillar 3 Framework – Qualitative disclosures

EUROPEAN BANKING AUTHORITY

Technical standards on Pillar 3 ESG – Disclosure qualitative information ESG risks

Table 1 - Qualitative information on Environmental risk	Table 2 - Qualitative information on Social risk	Table 3 - Qualitative information on Governance risk

Business strategy and processes

- Integration of ESG consideration in business model and strategy, including objectives, targets and limits to address (ESG) risks in different time horizons and including in terms of EU Taxonomy alignment; policies and procedures relating to engagement with customers

Governance

- Role of the management body in relation to (ESG) risk management; integration of (ESG) factors and risks in organisational structure; measures, role of committees, allocation of tasks/responsibilities; lines of reporting and remuneration

Risk management

- Integration of (ESG) factors and risks in risk management framework; processes to identify/monitor (ESG) risk sensitive sectors and exposures; tools to identify (ESG) risks on capital and liquidity; data availability and accuracy; limits and controls; stress test and scenario analysis

Pillar 3 Framework – GAR and BTAR

Green asset ratio – GAR

$$\frac{\text{Eligible assets funding taxonomy aligned sectors (Only NFC subject to NFDR)}}{\text{Total banking book (with a few exclusions)}} = \textit{GAR}$$

Banking Book Taxonomy Alignment Ratio - BTAR

$$\frac{\text{Eligible assets funding taxonomy aligned sectors (all NFC)}}{\text{Total banking book (with a few exclusions)}} = \textit{BTAR}$$

Pillar 3 Framework – Reference dates

Timeline (phased-in approach)

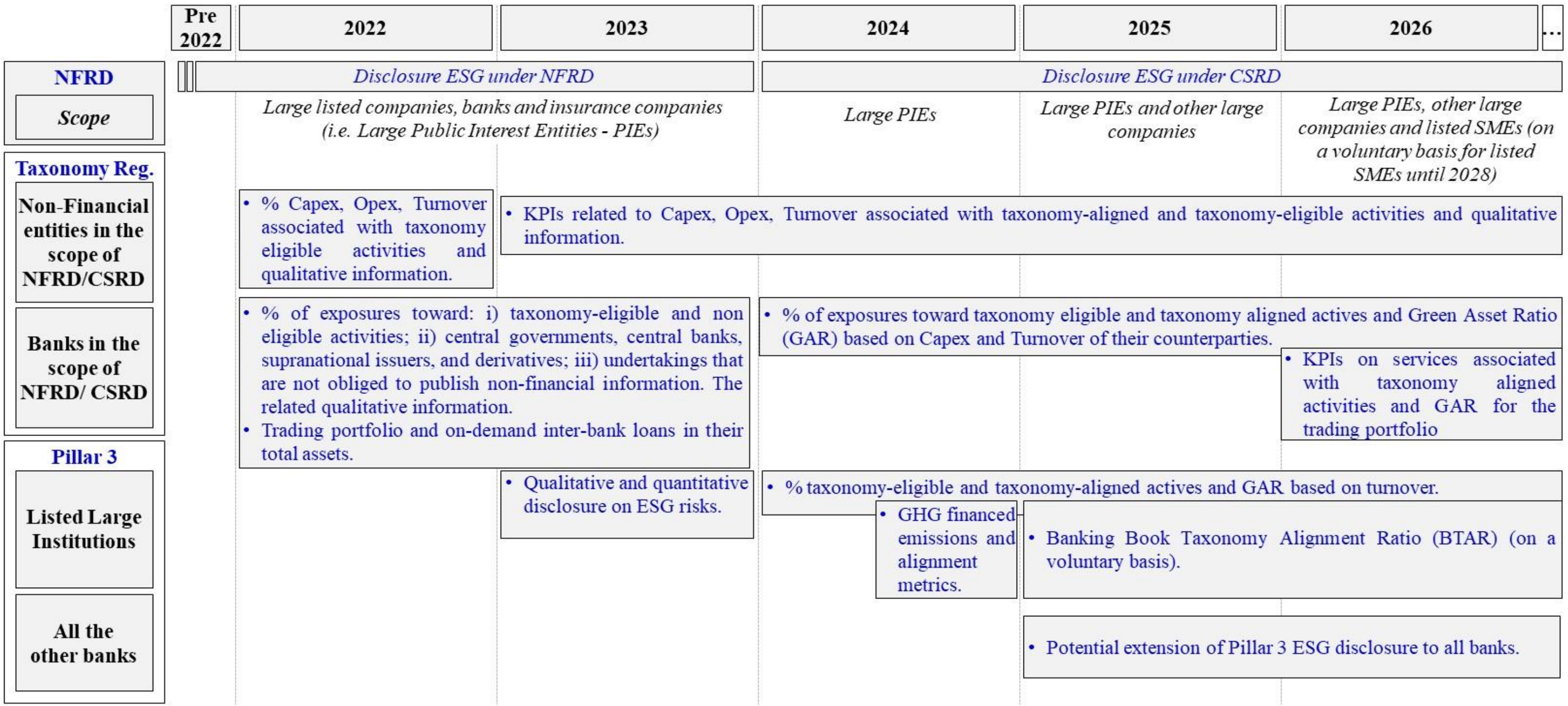
Reference date: 31 Dec 2022
First reporting date, with a few exceptions (phasing-in provisions)

Reference date: 31 Dec 2023
Disclosure of information on GAR, in line with the Commission's Delegated Act

Reference date: 30 June 2024
Phased-in period for disclosures on institutions' scope 3 emissions and alignment metrics

Reference date: 31 Dec 2024
Additional and separate information on BTAR

Pillar 3 Framework – Comparative reference dates (with Article 8 and CSRD)



Pillar 3 Framework – Status update and next steps

- First disclosures took place in Q1 and Q2 2023 for December 2022 reference date.
- Large institutions are disclosing comparable information on ESG risks for the first time. Some of them are anticipating disclosures that are phased in.
- Important milestone, in challenging obligation, with big room for improvement but important step forward.
- EBA supporting institutions in disclosure obligations – close to 30 Q&As published.
- Review of the ITS during 2024:
  - Extension to rest of the institutions based on CRR 3 requirements. Proportionality is an important driver.
  - Possible adjustments to existing templates, also based on Q&As and experience gained.

EUROPEAN BANKING AUTHORITY

Floor 24-27, Tour Europlaza
20 Avenue André Prothin
92400 Courbevoie, France

Tel: +33 1 86 52 70 00
E-mail: info@eba.europa.eu

https://eba.europa.eu/