

Focus on: Credits 30 November 2023





Dr. Susanne Knips Senior Credit Analyst T 069/91 32-32 11

European banks The sharpening contours of ESG disclosure

Major banks with an active presence on capital markets are making encouraging progress in integrating climate-related targets into their strategies, governance structures and disclosure policies. At the same time, the regulatory framework is increasingly gaining in profile. A number of significant milestones towards further enhancing transparency, such as the publication of the green asset ratio (GAR), will take effect from the beginning of next year. The aim of this study is to shed more light on the lat-

est regulatory developments and to explore how banks are implementing new requirements. Overall, our findings show that banks are meanwhile reporting extensively on their planned volumes of new sustainable business activities as well as on carbon emissions within their lending and investment portfolios. More detailed information about the impact on their earnings and costs may form the next stage in the process.

Latest developments in regulation

The EBA decides against imposing any additional capital requirements

The potential inclusion of ESG aspects into banks' minimum capital requirements, known as the green supporting factor, which has been under discussion over the last few years, has been dropped. In October 2023, the European Banking Authority (EBA) published its final "Report on the Role of Environmental and Social Risks in the Prudential Framework", in which it concluded that there is no clear correlation between environmental and social (E&S) factors and traditional financial risk categories. Consequently, it decided against imposing any mandatory supporting or penalising factors on banks' regulatory capital ratios. However, it also stated that this does not change the fact that E&S factors could give rise to financial risks and should be considered when conducting credit risk assessments. Similarly, it recommended that rating agencies integrate relevant E&S factors into their risk assessment processes and disclose their impact on ratings.

In publishing its final report, the EBA has provided long-awaited clarity in respect of regulatory capital requirements. In our view, this means that the transparency and disclosure of ESG-related activities and risks have now returned, with even greater urgency, to the spotlight. From the beginning of 2024, various key milestones on the way towards greater transparency and disclosure of ESG-related aspects will be on the agenda for financial institutions. These include the initial disclosure of a **green asset ratio (GAR)** for the 2023 financial year, the transition from the Task Force on Climate-Related Financial Disclosures (TCFD) to the **International Sustainability Standards Board** (ISSB) as well as the ongoing implementation of the **Corporate and Sustainability Reporting Directive (CSRD)**. We will be taking a closer look at these developments on the following pages and, in particular, showing what steps banks are taking to implement ever more demanding transparency requirements from regulators and market participants.

The observations we share below are related to large publicly listed financial institutions that are members of the Net-Zero Banking Alliance (NZBA). The NZBA was convened by the United Nations in 2021 as a group of leading global banks committed to financing ambitious climate mitigation projects in order to transition the real economy towards net-zero greenhouse gas emissions by 2050.

Various disclosure frameworks relevant for banks' ESG-related activities

Major banks active on the capital markets regularly make information available about their ESG-related activities and initiatives, among other things during investor presentations on their quarterly reports. Although governance issues have always featured high on the list of priorities for banks, meanwhile social and environmental aspects are increasingly gaining prominence. In particular, a growing number of slides are being devoted to the latter in presentations. On the one hand, we have found that this information sheds light on their green credentials, in other words the extent to which they finance climate-friendly projects that support the transition of the economy towards greater sustainability. On the other hand, banks are also providing details about the progress they have made in reducing the greenhouse gas (GHG) emissions within their lending portfolios in GHG-intensive sectors, such as energy and real estate. In this way, they are complying with the voluntary commitments required by the NZBA.

The principal ESG disclosure obligations for banks stem from specific financial sector frameworks, particularly regulations governing capital adequacy and liquidity requirements (CRR/CRD). However, they are also subject to rules (CSRD) that apply to all companies, not just financial institutions.

A brief retrospective: Global climate targets the basis for ESG initiatives

The December 2015 UN Climate Change Conference in Paris (COP21) was the initial catalyst for the many and varied global initiatives and measures that have since been launched with the aim of reducing GHG emissions. It culminated in the so-called **Paris Agreement**, in which 195 countries worldwide committed themselves to the goal of limiting the rise in global temperatures to significantly below 2 °C (preferably 1.5 °C) compared to pre-industrial levels. This was followed in Europe by the **European Green Deal** in 2019 which, after further amendments, aims among other things to achieve a reduction in carbon emissions of at least 55 % by 2030 relative to 1990 levels.

The EU Commission had previously unveiled its **Action Plan on Financing Sustainable Growth** as early as March 2018, the primary objectives of which were to redirect capital flows towards sustainable investments, manage financial risks stemming from climate change, scarce resources and social issues as well as promote transparency. Among other elements, the package of measures the EU Commission put forward in May 2018 to implement the Action Plan included the development of a uniform classification system for sustainable economic activities (taxonomy). The legal basis for this was established in the Taxonomy Regulation adopted in June 2020 (for more detailed information about the Taxonomy Regulation and subsequent delegated acts resulting from it, see: "European Banks: Activities becoming ever greener" of 27 April 2022).

Disclosure requirements in CRR specific to banks

Large institutions which have issued securities that are admitted to trading on a regulated market have been required to disclose information on ESG risks, including physical and transition risks, since as early as the end of June 2022 (Article 449a CRR¹). Meanwhile, these rules have been tightened and data must be published on a semi-annual basis. For the time being, quantitative disclosures must be made for climate-related and environmental risks, as a taxonomy is already available for these aspects. However, from a qualitative perspective, it also includes details on business strategy, governance and risk management.

Financial institutions are subject to full disclosure requirements regarding their **green asset ratio** (GAR) for the first time as of the 2023 reporting year. This disclosure, the so-called **taxonomy alignment**, shows the proportion of a bank's taxonomy-eligible exposures in relation to its total credit portfolio². The assets in question relate to activities that make a substantial contribution to at least one of the six environmental objectives, do no significant harm to any other environmental objectives and comply with certain minimum social safeguards. Banks were already required to report their **taxonomy eligibility ratio** for the 2021 and 2022 financial years.

¹ Regulation (EU) No. 575/2013 (Capital Requirements Regulation)

² Pursuant to Taxonomy Regulation and related delegated acts

Taxonomy disclosures based on example of Swedish bank SEB

Assets*	Assets bn SEK 2022	Share of covered assets %	Share of total assets %
Exposures to Taxonomy-eligible economic activities**	708.3	33	22
Exposures to Taxonomy non-eligible eco- nomic activities**	133.7	6	4
Exposures to non-NFRD undertakings***	1,266.1	58	40
Derivatives, hedge accounting	0.2	0	0
On demand inter-bank loans	4.6	0	0
Other assets	59.5	3	2
Exposures to central governments, central banks and supranationals	537.3		17
Trading portfolio (including derivatives ex- cluding hedge accounting)	440.4		14
Total assets	3,150.1		100

^{*} The Taxonomy disclosures are based on the scope of prudential consolidation as defined in the Regulation (EU) No 575/2013, Title II, Chapter 2, Section 2; the SEB Group's insurance companies are included according to the equity method instead of full consolidation ** Reported only to the extent data is reported for the underlying economic activity *** Undertakings not obliged to report according to NFRD (non-NFRD) are undertakings other than large (>500 employees) listed or public-interest companies Sources: SEB Annual and Sustainability Report 2022, Helaba Research & Advisory

However, our analysis suggests that, as things currently stand, the **GAR** is of limited informative value. This is because the taxonomy does not reflect the entire breadth of the real economy and collecting data is a major challenge, especially since many corporate customers are not yet required to disclose their climate risks and are therefore not included in the GAR calculation (see next section on the CSRD). In addition to this, there are limitations in terms of the methodology used - for instance, interbank lending is only factored into the denominator of the ratio. At the end of the day, we anticipate that banks will publish GARs in the single-digit range. What may be useful, though, is a comparison of the taxonomy eligibility ratio with that of the previous year as this would at least provide an indication as to the progress individual banks have made in expanding their sustainable activities.

The EBA has additionally proposed introducing a **Banking Book Taxonomy Alignment Ratio (BTAR)** in order to facilitate a more effective overview of taxonomy-eligible exposures. This ratio would explicitly cover exposures to companies that are not required to comply with the CSRD. Were this to be implemented, banks could then publish their BTARs on a voluntary basis after obtaining the necessary data on a bilateral basis from the respective companies - even if they are not (or not yet) subject to reporting requirements themselves - in order to disclose assets within the scope of the Taxonomy Regulation.

Reporting requirements applicable to all companies pursuant to CSRD/ESRS

Large banks active on the capital markets and companies with more than 500 employees have already been legally required to disclose the extent to which their business operations are in line with the climate targets of the Taxonomy Regulation for some time. The CSRD³ was adopted in December 2022 and came into force on 5 January 2023, replacing the Non-Financial Reporting Directive⁴ (NFRD). From 2024, companies that were required to disclose information in accordance with the NFRD are also required to do so under the CSRD. Additional categories of large companies will fall under the scope of the new directive from 2025, with publicly listed small and medium-sized enterprises following suit from 2026. The disclosure requirements as defined by the CSRD will apply to non-EU companies from 2028. Taken together, this means the number of companies subject to reporting requirements will increase from a current figure of 11,000 to 49,000. As a result, banks will gradually have easier access to ESG data and facts on their credit exposures.

The information that companies have to disclose covers the entire spectrum of ESG-related aspects. Based on a **double materiality assessment**, they have to report the impact of ESG factors on the company (outside-in) as well as the company's own impact on the environment and society (inside-out). The data they provide must be verified by auditors and, as of 2027/28, will be freely available on the **European Single Access Point** in digital form. This will further improve the availability of data.

³ Directive (EU) 2022/2462

⁴ Directive 2014/95/EU

Some encouraging strides have also been made in harmonising **reporting standards**. For instance, a number of guidelines for sustainability reporting have been in place for many years, with one of the most widely accepted global frameworks being the Global Reporting Initiative (GRI) standards. In order to enhance transparency, the Task Force on Climate-related Financial Disclosures (**TCFD**) was established in 2015 by the Basle-based Financial Stability Board (FSB). The latter also serves as a basis for many large banks with capital market activities in their sustainability reporting activities.

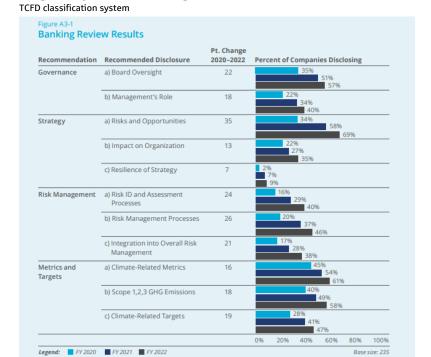
At the 2021 UN Climate Change Conference in Glasgow, the Trustees of the IFRS Foundation announced the establishment of the International Sustainability Standards Board (ISSB), which will replace the TCFD in 2024. Companies subject to the CSRD must report data in line with the applicable European Sustainability Reporting Standards (ESRS)⁵. It is likely that the ESRS will therefore also replace the GRI as the gold standard for sustainability reporting in Europe. Meanwhile, the Taskforce on Nature-related Financial Disclosures (TNFD) also provides disclosure recommendations that align with the TCFD and the ISSB. These recommendations and guidelines relate to risk management and disclosures in respect of biodiversity aspects.

Some insights into banks' disclosures

Reporting on green activities and TCFD recommendations

In the latest Status Report published by the TCFD in October 2023, the proportion of publicly listed companies disclosing TCFD-aligned information has been steadily rising; however, further progress is required. According to the report, 58 % of companies made at least five of the eleven recommended disclosures, compared to 18 % in 2020. However, only 4 % made information available on all 11 disclosures. Based on our understanding, these figures are consistent with the overall picture in the banking industry. The percentage of the 235 large banks examined in the report that make TCFD-aligned disclosures is slightly higher than that of all sectors, chiefly in respect of strategy and risk management.

Progress by banks in making climate-related financial disclosures

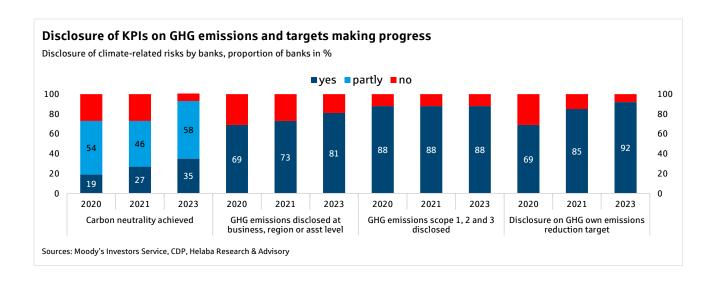


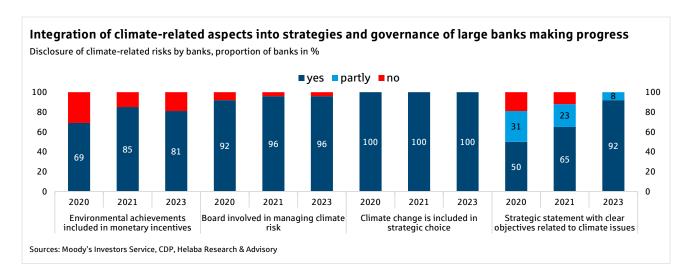
Sources: TCFD 2023 Status Report, Helaba Research & Advisory

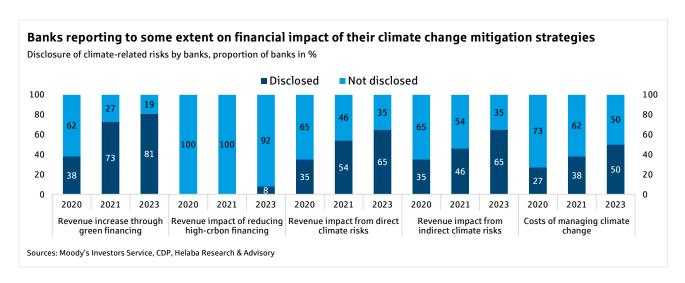
⁵ On 31 July 2023, the EU Commission resolved to make the ESRS mandatory for all companies subject to the CSRD.

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Moody's Investors Services arrived at similar results in its own research, with the 26 large global banks analysed making encouragingly good progress in integrating climate-related issues into their strategies and governance. What is more, they appear to be forging ahead in their efforts to disclose the carbon emissions within their credit portfolios.







Transition towards sustainable activities offers new business potential

The TCFD reviews the data provided by companies on substantial climate-related risks and estimates of the potential financial impact by sector. Of the 235 banks disclosing information, 81 % identified substantial climate-related risks, while 55 % provided an estimate of the potential financial impact. **Political risks were by far the most frequently cited**, with 73 % of respondents mentioning them.

Banks identify climate-related risks ...

Share of companies that have identified substantial climate-related risks, in %

	Banks (136)	All companies (2,755)
Transitory risks		
Policy & Legal	73 %	76 %
Market	24 %	33 %
Reputational	21 %	18 %
Technological	12 %	14 %
Physical risks		
Acute	65 %	56 %
Chronic	22 %	30 %

Sources: TCFD 2023 Status Report, Helaba Research & Advisory

On a positive note, banks are **also clearly aware of the opportunities** that sustainable activities present. 80 % of the 145 banks that provided information on this identified substantial opportunities in relation to certain products and services.

... but also opportunities

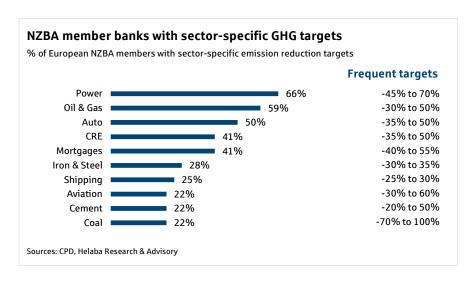
Share of companies that have identified substantial climate-related opportunities, in %

	Banks (145)	All companies (2,675)
Resource Efficiency	32 %	38 %
Energy Sources	16 %	35 %
Products & Services	80 %	70 %
Markets	39 %	24 %
Resilience	5 %	11 %

Sources: TCFD 2023 Status Report, Helaba Research & Advisory

Ambitious voluntary commitment by the Net-Zero Banking Alliance

The Net-Zero Banking Alliance (NZBA) was set up by the United Nations Environment Programme Finance Initiative (UNEPFI) as part of the Glasgow Financial Alliance for Net Zero (GFANZ). As signatories to this voluntary commitment, banks commit themselves to transitioning the operational and attributable greenhouse gas (GHG) emissions from their lending and investment portfolios to align with pathways to net zero by 2050 or sooner. Within 18 months of joining, they commit to setting targets for 2030 or sooner and a 2050 target, with intermediary targets to be set every 5 years from 2030 onwards. The first 2030 targets focus on priority sectors where banks can have the most significant impact, i.e. the most GHG-intensive sectors within their portfolios. NZBA members are committed to disclosing the status of emissions and the measures and progress they have made in reducing them.



The energy and industrial sectors are key priorities in terms of decarbonisation targets. A joint study by the Carbon Disclosure Project (CDP) and the management consulting firm Oliver Wyman published in February 2023 found that around half of European NZBA members had already set themselves initial targets for reducing emissions that they had been involved in financing. At the time of the study, it covered the 50 large European NZBA member banks with total assets of EUR 32.4 bil-

lion. For exposures in the energy sector, for instance, the planned reduction targets by 2030 range from 45 % to 70 %.

Key takeaway: Growing transparency

In conclusion, our findings show that the disclosure of ESG-related information in the banking sector is making steady progress. There is a clear trend towards more reporting and transparency, particularly with respect to climate-related disclosures. At the beginning of 2024, additional milestones in the implementation of disclosure standards will raise the level of transparency even further. In our view, continuing efforts to consolidate frameworks and standards are especially welcome and will lead to the emergence of industry-leading standards from the current plethora of initiatives and measures, providing greater clarity for generalist institutions that do not specialise in ESG-related activities.

In the meantime, for instance, large banks that are focused on the capital markets provide extensive information on the objectives of new "green" lending as well as on the physical and transition risks, and opportunities, arising from financing the transition towards a sustainable economy. More detailed information about the impact on their earnings and costs may form the next stage in the process. One example here is Standard Chartered plc in the UK, whose disclosures facilitate an external analysis.

Standard Chartered reports extensively on income from sustainable finance

Sustainable Finance income by product*

	2022 USD (millions)	2021 USD (millions)	2022 vs. 2021 %
Transaction Banking	80	32	150
Trade & Working capital	60	25	140
Cash Management	20	7	186
Financial Markets	326	241	35
Macro Trading	54	21	157
Credit Markets	268	217	24
Financing & Securities Ser- vices	4	3	33
Lending & Portfolio Manage- ment	102	88	16
Total sustainable finance income by product	508	361	41

^{*}SF income is defined as portion of the Group's income generated by products and services as approved by the Sustainable Finance Governance Committee. This includes interest and margins earned on assets as disclosures in the Green and Sustainable assets, and fees from advisory and hedging activities for clients' ESG products.

Sources: Standard Chartered, Helaba Research & Advisory

For third-parties assessing balance sheets, additional information to quantify the impact of the net-zero transition is extremely desirable. In this respect, there remain a number of hurdles to overcome in terms of data collection;

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these will be reduced further over the next few years as the CSRD is gradually implemented. Greater transparency in relation to banks' exposures will also be provided by the GAR, the full disclosure of which will be made for the first time in the 2023 financial statements - albeit only for a relatively small part of institutions' total assets. The green transformation not only entails additional risks and costs for banks; it also presents them with attractive new business opportunities.

Annex

Standards and requirements for climate-related reporting

Standard setter	Task Force on Climate-related Financial Disclosures (TCFD)	International Sustainability Standards Board (ISSB)	EU, through the Corporate Sustainability Reporting Directive (CSRD)	EU, through the Capital Requirements Regulation (CRR)
Geographical scope	Global recommenda- tions for reporting on climate risks	Global standards for sustainability reporting	European standards for sustainability reporting	European requirements for reporting on climate risks (Pillar 3 report)
Mandatory reporting	No (voluntary)	Yes (for those countries that adopt the standard)	Yes	Yes
Implementation	2017. A deadline of five years applies to the commitment of an individual company.	Completed in 2023 and will enter into force on 1 January 2024. Implementation takes place thereafter.	Phased implementation based on the size of the companies. First reporting in 2025 (for the 2024 financial year). Phased implementation of the various reporting requirements.	Phased implementa- tion of the various re- porting requirements. First reporting in 2023.

Sources: Swedish FSA, Helaba Research & Advisory



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Publisher and editor

Helaba Research & Advisory

Editor: Sabrina Miehs Corporate Research

Publisher:
Dr. Gertrud R. Traud
Chief Economist/
Head of Research & Advisory

Neue Mainzer Str. 52-58 60311 Frankfurt am Main Germany Tel. +49 69/91 32-20 24 Internet: www.helaba.com/int/ **Disclaimer**

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