EBA pushes for early action on sustainable finance

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* *The EBA’s workplan on sustainable finance will focus first on key metrics and disclosure to support banks’ green strategies and then look into evidence for any adjustments to risk weights.*
* *The EBA encourages institutions to act proactively in incorporating environmental, social and governance (ESG) considerations into risk management and strategies including setting a green asset ratio.*

**The European Banking Authority (EBA) published today its Action plan on sustainable finance outlining its approach and timeline for delivering mandates related to environmental, social and governance (ESG) factors. The Action plan explains the EBA’s sequenced approach, starting with key metrics, strategies, risk management and moving towards scenario analysis and evidence for any adjustments to risk weights. The Action Plan also aims to communicate key messages on the EBA’s policy direction and the expectations from financial institutions on areas where action is needed now to support the move towards more sustainable finance in the EU.**

Climate change and the response to it by the public sector and society in general have led to an increasing relevance of ESG factors for financial markets. It is, therefore, essential that financial institutions are able to measure and monitor the ESG risks in order to deal with transition and physical risks.

As the exact manifestation of transition and physical risk remains uncertain, the EBA encourages financial institutions to act now to incorporate ESG factors into their business strategies, and to identify measure and monitor ESG risks including simple metrics, such as a green asset ratio.  To this end, they can then use scenario analysis as an explorative tool to understand the relevance of the exposures affected by and the potential magnitude of the ESG risks.

Jose Manuel Campa, the EBA Chairperson,  highlighted the importance of acting now on sustainable finance and said: “The urgent need to act explains why we have also set out early expectations for interim measures, including the identification of simple metrics that can foster market discipline and allow banks to set clear green strategies”

To support this, the EBA’s work will follow the sequencing reflected in its legal mandates and start with a focus on strategy and risk management and associated key metrics and disclosure. In the second stage, the EBA aims to develop a dedicated climate change stress test. The third stage of the work will look into the evidence around the prudential treatment of “green” exposures. The rationale for this sequencing is the need firstly to understand institutions’ current business mix from a sustainability perspective in order to measure and manage it in relation to their chosen strategy, which can then be used for scenario analysis and later for the assessment of an appropriate prudential treatment.

**Legal basis, background and next steps**

The EBA’s remit and mandates on ESG factors and risks are set out in the following legislative acts:

•             amended EBA Regulation

•             revised Capital Requirements Regulation (CRR 2) and Capital Requirements Directive (CRD5)

•             new Investment Firms Regulation (IFR) and Investment Firms Directive (IFD)

•             Commission’s Action Plan: Financing Sustainable Growth and related legislative initiatives.

In the context of the EBA’s mandate to contribute to stability and effectiveness of the financial system, the work on sustainable finance aims to (i) improve the regulatory framework to foster their operation of institutions’ in a sustainable manner and (ii) provide supervisors with adequate tools to understand, monitor and assess ESG risks in their supervisory practices.

 Sustainable finance can be broadly understood as financing as well as related institutional and market arrangements that contribute to the achievement of strong, sustainable, balanced and inclusive growth, through supporting directly and indirectly the framework of the Sustainable Development Goals.

The EBA will develop reports, guidelines, and technical standards, and incorporate ESG consideration in its risk analysis work following the general mandate included in the EBA Regulation and specific mandates provided in the sectoral legislation outlined above.