

PRINCIPAL PRUDENTIAL INITIATIVES IN THE AREA OF ENVIRONMENTAL, SOCIAL AND GOVERNANCE RISK

Set forth below is a description of the principal prudential initiatives developed over the course of 2022 by the Basel Committee on Banking Supervision (BCBS), the European Banking Authority (EBA) and the European Commission, which follow a holistic approach to address the treatment of environmental, social and governance (ESG) risk in the prudential framework, within the scope of their respective mandates. However, it is important to note that many studies and reports have been prepared on this subject, both in global fora, such as the Network for Greening the Financial System or the Financial Stability Board (FSB) and in European institutions, such as the European Central Bank or the European Systemic Risk Board¹.

After publishing two major analytical reports on the financial risks stemming from climate change² in 2021, the BCBS concentrated its efforts in 2022 on assessing whether measures need to be taken in the area of banking supervision, regulation and disclosure.

In the area of supervision, in June 2022 the BCBS published high-level principles for the effective management and supervision of climate-related risks³. These principles, addressed to institutions and supervisors, were designed taking into account the principle of proportionality and they cover aspects such as corporate governance, internal controls and the assessment and management of climate-related financial risks. The BCBS expects the principles to be implemented by jurisdictions as soon as possible and it will establish a mechanism to assess the progress made. On the regulatory side, in December 2022 the BCBS published a question and response paper⁴ clarifying how climate change may be captured in the various standards of the existing Pillar 1 framework. These clarifications are intended to promote consistent interpretation of how to address climate risks, and should in no way be interpreted as changes to the aforementioned standards. Lastly, in

the area of disclosure, the BCBS is working in coordination with the International Sustainability Standards Board and other international bodies to improve the quality and granularity of climate risk information provided to the market.

At the European level, in 2022 the EBA continued to develop the mandates received in CRD-V/CRR-II on how to incorporate ESG risks into prudential banking legislation.

In February 2022, the EBA published the final report⁵ of implementing technical standards on disclosures on ESG risks, addressed to large banks which have issued securities for trading. Implementing Regulation 2022/2453⁶ of December 2022 is based on the EBA's ITSs and contains a set of templates with qualitative and quantitative information on the ESG risks (essentially climate change risk) to which institutions are exposed. In the first half of 2023, credit institutions subject to these standards will start disclosing the first data sets on this matter.

In relation to Pillar 1, in May 2022 the EBA published the discussion paper⁷ analysing whether a dedicated Pillar 1 treatment for exposures related to assets or activities substantially associated with environmental objectives would be justified. The paper analyses various elements of Pillar 1 in detail, explaining the advantages and disadvantages of possible changes. Also, the report emphasises that it takes a risk-based approach, i.e. that prudential requirements should reflect the risk profiles of exposures. It is expected to be finalised by the EBA in the second quarter of 2023.

Lastly, in the banking package published in October 2022, the European Commission explicitly incorporates sustainability in the Pillar 2 framework, in line with the recommendations received from the EBA a year earlier.

1 <https://www.bde.es/bde/es/secciones/sobreelbanco/sostenibilidad-medioambiental/foros-internacionales/foros-internacionales-de-los-que-es-miembro-el-banco-de-espana.html>

2 Climate-related risk drivers and their transmission channels y Climate-related financial risks – measurement methodologies

3 <https://www.bis.org/bcbs/publ/d532.htm>

4 <https://www.bis.org/bcbs/publ/d543.pdf>

5 <https://www.eba.europa.eu/eba-publishes-binding-standards-pillar-3-disclosures-esg-risks>

6 <https://www.boe.es/doue/2022/324/L00001-00054.pdf>

7 https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Discussions/2022/Discussion%20paper%20on%20the%20role%20of%20environmental%20risk%20in%20the%20prudential%20framework/1031947/Discussion%20paper%20on%20role%20of%20ESG%20risks%20in%20prudential%20framework.pdf

Box 7.4

PRINCIPAL PRUDENTIAL INITIATIVES IN THE AREA OF ENVIRONMENTAL, SOCIAL AND GOVERNANCE RISK (cont.)

Other relevant amendments regarding ESG risks refer to the extension of disclosure requirements to all credit institutions, taking into account the proportionality

principle, or the clarification —through a recital— of the possibility of using the systemic risk buffer to address these risks.