

EBA - Pillar 3 ESG

Highlights and challenges

April, 2022

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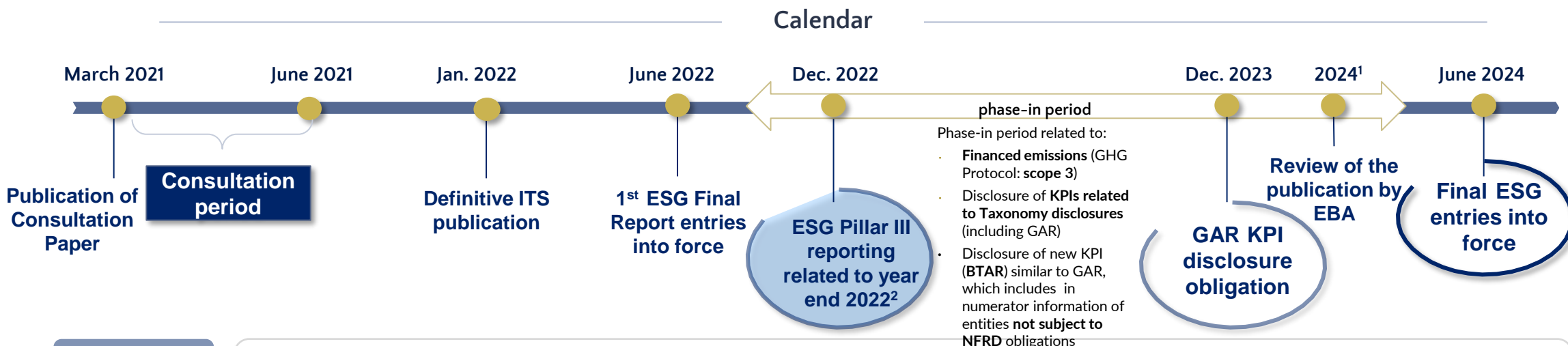
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1 | Pillar 3 ESG

Milestones

On 24 January 2022 EBA published its Final Report on the ITS on Pillar 3 ESG risks. With these templates, EBA aims to develop a single and complete framework of Pillar 3 under CRR, which integrates all the requirements of relevant information for prudential purposes



Scope of Pillar 3 ESG

- **Reporting** of information on those **assets which are more exposed to the risks that institutions may face from the transition to a low-carbon and climate resilient economy or subject to climate change physical risk**, including those exposures towards non-financial corporates of banking of the institution by sector of economic activity.
- **Sequential approach**, in line with the approach that has been followed in the development of the Taxonomy Regulation and other relevant ESG initiatives in the EU (planned developments of other environmental objectives and social objectives).
- **Timing of disclosures**, with transitional and phase-in periods until June 2024, for certain issues (Scope 3 Emissions, ESG for corporations not subject to NFRD,...).
- **Proportionality**, taking into account the challenges to be faced when preparing the required ESG disclosures (use of proxies, Taxonomy compliance with EU criteria for objectives 1 and 2 for non-EU exposures, certificates and level of energy efficiency for non-EU exposures,...).

1. The ITS explicit that the results of the publication will be reviewed tentatively in 2024

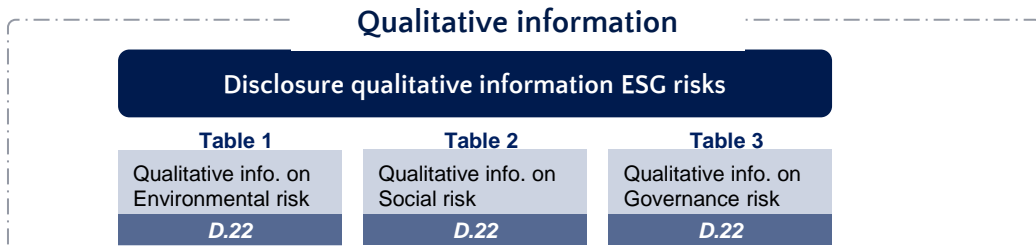
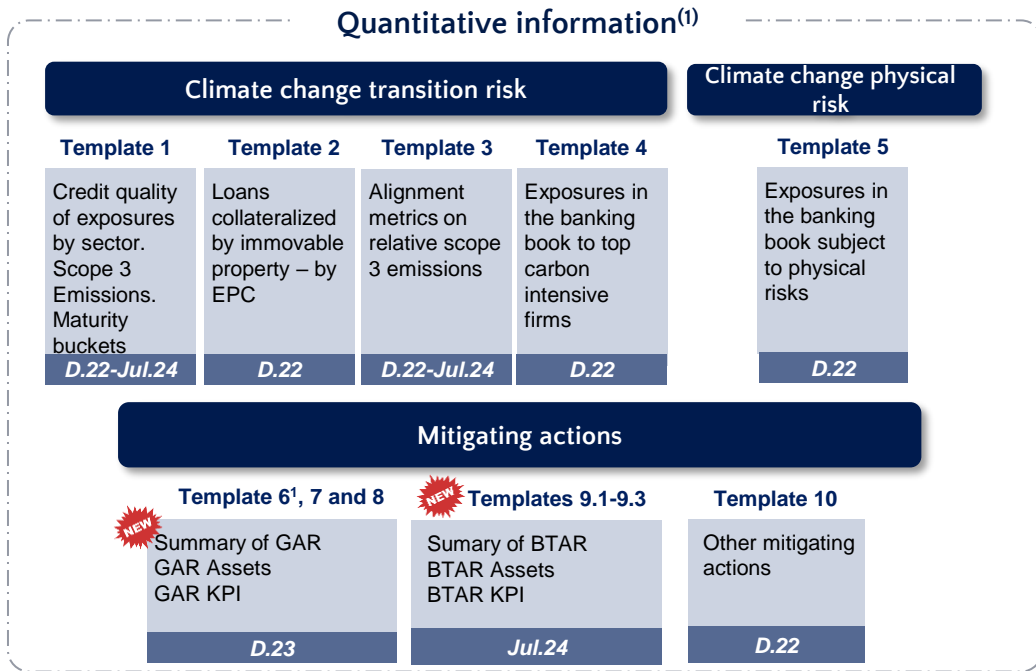
2. This information shall be disclosed on an annual basis for the first year and semi-annually thereafter. This means that the disclosure for the first year would be annual, and related to the disclosure reference date 31 December 2022

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Overview of structure and main contents

**12 quantitative templates transition risks (4), physical risk (1) and mitigation actions (7) related.
5 to be disclosed on March 2023 with reference date 31 December 2022
3 to be disclosed by 2024**

Structure of Pillar 3 ESG Disclosure



Main contents

- **Credit quality** of exposures by carbon-intensive and sustainable sectors and GHG emissions. Scope 3 emissions for oil, gas, and mining sectors shall start to be disclosed when available, from 2021 onward and additional sectors will be added subsequently until June 2024 (full requirement).
- **Energy efficiency** of the collateral and immovable property obtained by taking possession, for EU and non-UE countries.
- **Alignment metrics** on relative scope 3 emissions. Disclosure in accordance with institutions Paris Agreement sectoral alignment.
- Exposures to **top 20 carbon intensive firms in the World**
- Exposures subject to **physical risks**
- **Green Asset Ratio (GAR)**: assets, KPI on stock and flows
- **Banking Book Taxonomy Alignment Ratio (BTAR)** assets, KPI on stock and flows
- **Other climate change mitigation actions**: bonds and loans by type of counterparty.
- **ESG qualitative information**: governance, business model and strategy, risk management.

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Main changes - Final vs previous draft

NACE allocation might be different from FINREP, clarifications on finance emissions disclosure roadmap, EPC expanded to non EU countries, alignment metrics disclosure aligned with Paris agreement sectoral alignment, top polluting firms disclosure limited to top 20 in the world, simplified physical risk disclosure, trading book out of scope, GAR delayed, new BTAR

| | | | |
|---------------------------------------|--|---------------------------------|---|
| NACE | Additional details clarifying the relevant NACE to disclose. Implications in additional criteria to consider in the reconciliation with Taxonomy and FINREP relevant NACEs. | Credit Risk | Average PD not required anymore. |
| Financed emissions | Scope 3 finance emissions should be specifically disclosed. Clarifications on disclosure roadmap: oil, gas, and mining sectors shall start to be disclosed, when available, from 2021 onward and additional sectors will be added subsequently until June 2024 (full requirement). | Market risk | Trading book excluded from the perimeter. |
| Immovable properties | Certificates of EPC labels equivalences required for non-EU countries Buckets by Level of energy consumption should be estimated | Physical risk | Breakdown by acute and chronic subtype of events deleted. |
| Alignment metrics | Disclosure roadmap in accordance with institutions Paris Agreement sectoral alignment. Deeper IEA sectorization and corresponding NACE relation detailed. New alignment metrics are defined Also, target metric (3 years horizon) and the year of reference of the alignment metrics is requested | GAR | GAR disclosure delayed one year: December 2023 as new reference date New template for summary of the GAR is included (Template 6) |
| World's Top 20 Carbon Emitters | Aggregated exposure towards Top 20 carbon intensive firms in the world over total exposure. Top 20 EU and Top 20 Member Estate not needed anymore. | New KPI BTAR | New KPI Banking Book Taxonomy Aligned Ratio (BTAR) included with corresponding new templates 9.1, 9.2, and 9.3 Similar KPI to GAR, but including in the numerator of the ratio taxonomy compliant operations from counterparties not subject to NFRD (EU and non-EU) |
| | | Other mitigation actions | Further concretion about the kind of instruments to be reported: loans and debt securities not aligned with EU taxonomy. |

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Pillar 3 ESG

Main challenges - Overview

Entities face the following challenges in order to obtain the necessary information for the Pillar 3 report

Interconnections

- **Different reports** in parallel with different **synergies** between them (e.g. climate stress test and Art. 8 of Taxonomy Regulation)
- **Reconciliation**: need to ensure **consistency with other reports** (FINREP / COREP / Pillar 3) and consistency with other **supervisory exercises** (e.g. ICAAP, Climate Report, ESG ratings)
- **Governance**: several teams involvement per template / data requirement

Data & information gaps

High volume of **unavailable information**, which implies:

- **Gaps** between the **information requested by regulation** in Pillar 3 ESG and the **information available**: **client classification** (i.e. NACE codes), **collaterals** (i.e. EPC label), **exposures** (i.e. sustainable exposures)
- Integrity: same (climate and non climate data for different uses.
- Need to launch lines **to capture information** both internally and externally
- Need to define **tactical solutions** / proxies for the **first disclosures**.
- **Different treatments for stock and new production**.
- **Data quality remediation plans will be required**.

Countries dependencies

- The **involvement of countries** is necessary for providing information
- In the case of **subsidiaries outside the European Union**, there are **different regulations** by jurisdiction



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Main challenges - Details of data & information gaps

Key aspects on most relevant climate related data: NACE, EPC, financed emissions and sustainable exposures


NACE

- Higher granularity than traditionally considered for reporting purposes.
- Equivalences must be developed for Non-EU countries where local sector activities does not fit with NACE classification.
- Different from FINREP criteria.


EPC

- Use of **external suppliers** to obtain EPC for the stock.
-  **Lack of equivalent labelling** regulation outside EU.
- Implementation of energy efficiency estimation **methodology**.

Financed emissions and alignment metrics

- Implementation of financed emissions estimation **methodology** (such as PCAF).
-  Difficulty on estimating alignment metrics **distance to IEA NZE2050** scenario (such as tons of CO2/GJ), including a larger scope of sectors and three year target projection.
- Criteria for **management (e.g. target setting) vs reporting**.

Sustainable exposures

- Implementation of **screening criteria** on products to identify green exposures under taxonomy and under management criteria.
-  Obtaining taxonomy compliant information disclosed by clients: **limited information** available with focus on EU and non EU corporations, specially for those not subject to NFRD.



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2 | Why MS?

Key aspects and differential value

At MS we know the sector and we are specialists in both Sustainability and Regulatory Reporting, with knowledge of best practices in different industries and geographies, mobilising a team with extensive experience in the field

ESG

- ✓ **50+ projects** developed in the field of Sustainability, focusing on diagnosis and development of information models supporting management and regulatory reporting, development of models, strategic plans, adaptation to regulatory requirements, etc
- ✓ **Exhaustive knowledge of ESG regulation**, with a **Regulatory Observatory** specialising in sustainability requirements, including regulatory exercises (e.g. Pillar 3 ESG, stress tests).
- ✓ **R&D team specialised** in the definition and implementation of **climate risk measurement solutions** in different fields (physical risk, transition risk, portfolio alignment) used as accelerators in different projects.
- ✓ **Reference consultant for the World Bank**, maintaining a partnership through the IFC-Green Banking Academy in internal training and training for financial institutions in Climate Change Risk Management.
- ✓ Member of the **Social Impact Chair of internationally renowned universities** to promote training and development of social impact measurement methodologies.



Data Governance & Regulatory Reporting

- ✓ **100+ Data Transformation and Data Governance projects** in different industries (banking, insurance, energy, Telco, Retail, ...), considering the architecture, quality, data governance, etc. fronts.
- ✓ **Multidisciplinary team** with relevant experience in Regulatory Reporting and **Governance and Quality** projects.
- ✓ Capacity for **technical and functional challenge** through in-depth knowledge of **data management**.
- ✓ Our value proposition relies on a **specialist, cutting-edge R&D** team with centres of excellence in the field of modelling.
- ✓ **Independent view of any supplier**, collaborating with leading suppliers in these areas.

General capabilities of Management Solutions

- ✓ **Leadership in business consultancy** with a presence in **+40 countries**, through **+31 offices**, which gives us a global vision at world level, fundamental in this field.
- ✓ Proven **commitment and delivery capacity** (agile but high-value deliverables) and compliance with committed deadlines.
- ✓ **Unique partnership** model which facilitates our **benchmarking capability**.

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Detail by template (1/3)

In the Final Report launched by EBA, the following templates are detailed, which gather qualitative and quantitative information regarding the new reporting requirements on the climate transition:

| | Draft Template | Final Template | Description | Changes in templates | Entity Impact | Reference date* |
|--------------------------------|----------------|--|---|---|---------------|----------------------|
| Qualitative information | Table 1 | Table 1 - Qualitative information on environmental risk. | Integration of environmental risks into business strategy and processes, governance and risk management | | ● | 2022 |
| | Table 2 | Table 2 - Qualitative information on social risk. | The integration of social risks into its 5 business strategies and processes, governance and risk management is described | - The three aspects under which the disclosure requirements are focused on each risk category are new: business processes and strategy, governance and risk management. | ● | 2022 |
| | Table 3 | Table 3 - Qualitative information on governance risk. | The integration of governance risks into its business strategy and processes and risk management is described | | ● | 2022 |
| Climate change transition risk | T1 | Template 1 - Banking book- Climate Change transition risk: Credit quality of exposures by sector, emissions and residual maturity. | Risks that institutions face from the transition to a low-carbon economy. Credit quality of exposures by carbon-intensive , sustainable sectors and GHG emissions and breakdown by maturity bucket. | - The variables for other carbon-intensive sectors and probability of default (PD) were removed | ● | 2022 2023 2024 |
| | T2 | | | - Information on scope 1, 2 and 3 included on a 'best effort basis'. | | |
| | T3 | Template 2 - Banking book - Climate change transition risk: Loans collateralized by immovable property - Energy efficiency of the collateral | Includes information on the distribution of real estate loans and advances and collateral recovered energy efficiency (EPC label) by EU area and non-EU area. | - Information on immovable properties on non-EU countries are included - Exposition by energy efficiency buckets - CO2 Emissions are not to be reported | ● | 2024 |
| | T4 | Template 3 - Climate change transition risk – alignment metrics for the banking book. | GHG emissions intensity by sector and distance to benchmark scenario based on alignment metrics | - New sectors included - New alignment metrics to report on - Includes three-year target - Aligns with Net Zero Emissions 2050 | ● | 2022 |

*To be disclosed with reference date 31 December 2022, 31 December 2023 and 31 July 2024 respectively



Significant change



Change




No change

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Detail by template (2/3)

In the Final Report launched by EBA, the following templates are detailed, which gather qualitative and quantitative information regarding the new reporting requirements on the climate transition:

| | Draft Template | Final Template | Description | Changes in templates | Entity Impact | Reference date* |
|--------------------------------|--|--|--|--|---------------|-----------------|
| Climate change transition risk | T5 | Template 4 - Banking book - Climate change transition risk: Exposures to top 20 carbon-intensive firms. | (Environmentally sustainable) exposures towards top 20 polluting firms in the world, EU and/or member state. | <ul style="list-style-type: none"> - Only Top 20 World is considered - CCM Alignment delayed to 2023 - Average Maturity is now requested | ● | 2023* |
| | T6 | This template has been removed | | | | |
| Physical risk | T7 | Template 5 - Banking book - Climate change physical risk: Exposures subject to physical risk. | Credit quality of exposures prone to impact from climate change events by geography and sector | <ul style="list-style-type: none"> - The simplified version of this template is maintained, the extended version is eliminated (Old Template 7.2) - Maturity buckets are included - More detail on sources and estimates on a best effort basis | ● | 2022 |
| Mitigating actions |  T8 | Template 6 - Summary of GAR KPIs. | Summary of the GAR values | <ul style="list-style-type: none"> - Template included as a summary of the Gar Turnover of the Stock and Flow - The disclosure of the templates related to the calculation of the GAR is delayed to December 2023 data | ● | 2023* |
| | T8 | Template 7 - Assets for the calculation of GAR. | Detailed information on the GAR showing the Taxonomy-aligned activities. Green Asset Ratio (GAR): assets, KPI on stock and flows | <ul style="list-style-type: none"> - Adapts to GAR Asset template on taxonomy (T1)** - The disclosure of the templates related to the calculation of the GAR is delayed to December 2023 data | ● | 2023* |
| | T9 | Template 8 - Green Asset Ratio (GAR) KPIs. | Information on GAR, by environmental objective and counterpart, for specialized loans, transitory and enabling activities, and the total GAR | <ul style="list-style-type: none"> - Adapts to the taxonomy GAR KPI templates (T3 and T4)** - The disclosure of the templates related to the calculation of the GAR is delayed to December 2023 data | ● | 2023* |

*To be disclosed with reference date 31 December 2022, 31 December 2023 and 31 July 2024 respectively

**Refers to Article 8 of EU Taxonomy delegated act templates published by the European Commission

● Significant change








● Change

● No change

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Detail by template (3/3)

In the Final Report launched by EBA, the following templates are detailed, which gather qualitative and quantitative information regarding the new reporting requirements on the climate transition:

| Draft Template | Final Template | Description | Changes in templates | Entity Impact | Reference date* |
|---|--|---|---|--|-----------------|
|  | Template 9.1 - Assets for the calculation of BTAR. | Information on the gross book value of the relevant assets for the calculation of the BTAR | <ul style="list-style-type: none"> - New template included for the calculation of the new Banking Book Taxonomy Alignment Ratio (BTAR) - The part of companies not subject to NFRD that is taxonomy compliant for the calculation of the KPI is included in the numerator - Similar to GAR template 7. |  | 2024 |
|  | Template 9.2 - BTAR %. | % of BTAR assets disclosed in template 1 compared to total assets in BTAR denominator | <ul style="list-style-type: none"> - New template for BTAR calculation - Similar to GAR template 8 - New KPI calculated based on the GAR and including the new assets from template 9.1. |  | 2024 |
|  | Template 9.3 - Summary table - BTAR %. | Summary of the BTAR KPI, broken down environmental objective, and total, and with the breakdown by stock and flow | <ul style="list-style-type: none"> - New template for BTAR summary - Turnover of the Stock and Flow. - Similar to GAR template 6 |  | 2024 |
| T10 | Template 10 - Other climate change mitigating actions | It provides information on other actions implemented by the institution to mitigate climate change related risks. It covers other institutions that are not included in template 7 and 8. | <ul style="list-style-type: none"> - New fixed structure - No taxonomy-aligned detail - Able to include info on actions that comply with non-EU standards |  | 2022 |

Mitigating actions





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