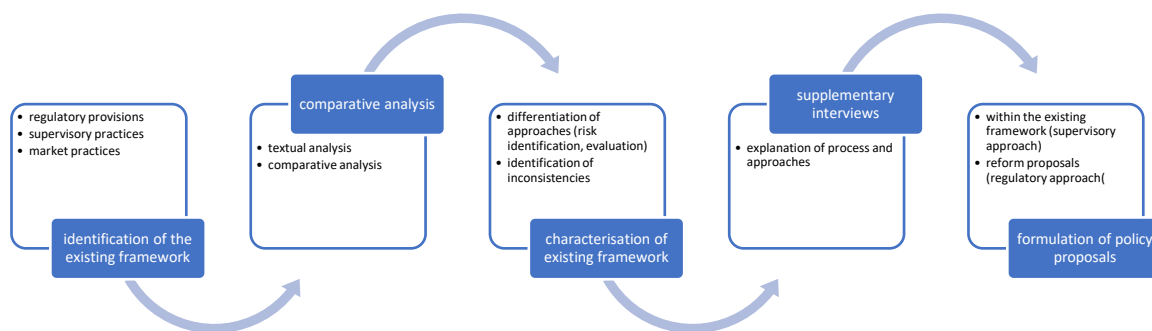


A Risky Bet: Climate Change and the EU's Microprudential Framework for Banks

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Supplementary material

I. Research approach



II. Legal acts and provisions

DIRECTIVE 2013/36/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC. (OJ L 176 27.6.2013, p. 338) (consolidated version 2021)

Article 98

Technical criteria for the supervisory review and evaluation

1. In addition to credit, market and operational risks, the review and evaluation performed by competent authorities pursuant to Article 97 shall include at least:

(a) the results of the stress test carried out in accordance with Article 177 of Regulation (EU) No 575/2013 by institutions applying an internal ratings based approach;

(b) the exposure to and management of concentration risk by institutions, including their compliance with the requirements set out in Part Four of Regulation (EU) No 575/2013 and Article 81 of this Directive;

(c) the robustness, suitability and manner of application of the policies and procedures implemented by institutions for the management of the residual risk associated with the use of recognised credit risk mitigation techniques;

(d) the extent to which the own funds held by an institution in respect of assets which it has securitised are adequate having regard to the economic substance of the transaction, including the degree of risk transfer achieved;

(e) the exposure to, measurement and management of liquidity risk by institutions, including the development of alternative scenario analyses, the management of risk mitigants (in particular the level, composition and quality of liquidity buffers) and effective contingency plans;

(f) the impact of diversification effects and how such effects are factored into the risk measurement system;

(g) the results of stress tests carried out by institutions using an internal model to calculate market risk own funds requirements under Part Three, Title IV, Chapter 5 of Regulation (EU) No 575/2013;

(h) the geographical location of institutions' exposures;

(i) the business model of the institution.

2. For the purposes of point (e) of paragraph 1, the competent authorities shall regularly carry out a comprehensive assessment of the overall liquidity risk management by institutions and promote the development of sound internal methodologies. While conducting those reviews, the competent authorities shall have regard to the role played by institutions in the financial markets. The competent authorities in one Member State shall duly consider the potential impact of their decisions on the stability of the financial system in all other Member States concerned.

3. Competent authorities shall monitor whether an institution has provided implicit support to a securitisation. If an institution is found to have provided implicit support on more than one occasion the competent authority shall take appropriate measures reflective of the increased expectation that it will provide future support to its securitisation thus failing to achieve a significant transfer of risk.

4. For the purposes of the determination to be made under Article 97(3) of this Directive, competent authorities shall consider whether the valuation adjustments taken for positions or portfolios in the trading book, as set out in Article 105 of Regulation (EU) No 575/2013, enable the institution to sell or hedge out its positions within a short period without incurring material losses under normal market conditions.

5. The review and evaluation performed by competent authorities shall include the exposure of institutions to the interest rate risk arising from non-trading book activities. The supervisory powers shall be exercised at least in the following cases:

(a) where an institution's economic value of equity as referred to in Article 84(1) declines by more than 15 % of its Tier 1 capital as a result of a sudden and unexpected change in

interest rates as set out in any of the six supervisory shock scenarios applied to interest rates;

(b) where an institution's net interest income as referred to in Article 84(1) experiences a large decline as a result of a sudden and unexpected change in interest rates as set out in any of the two supervisory shock scenarios applied to interest rates.

Notwithstanding the second subparagraph, competent authorities shall not be obliged to exercise supervisory powers where they consider, based on the review and evaluation referred to in this paragraph, that the institution's management of interest rate risk arising from non-trading book activities is adequate and that the institution is not excessively exposed to interest rate risk arising from non-trading book activities.

For the purposes of this paragraph, the term 'supervisory powers' means the powers referred to in Article 104(1) or the power to specify modelling and parametric assumptions, other than those identified by EBA pursuant to point (b) of paragraph 5a of this Article, to be reflected by institutions in their calculation of the economic value of equity under Article 84(1).

5a. EBA shall develop draft regulatory technical standards to specify for the purposes of paragraph 5:

(a) the six supervisory shock scenarios as referred to in point (a) of the second subparagraph of paragraph 5 and the two supervisory shock scenarios as referred to in point (b) of the second subparagraph of paragraph 5 to be applied to interest rates for every currency;

(b) in light of internationally agreed prudential standards, the common modelling and parametric assumptions, excluding behavioural assumptions, that institutions shall reflect in their calculations of the economic value of equity as referred to in point (a) of the second subparagraph of paragraph 5, which shall be limited to:

(i) the treatment of the institution's own equity;

(ii) the inclusion, composition and discounting of cash flows sensitive to interest rates arising from the institution's assets, liabilities and off-balance-sheet items, including the treatment of commercial margins and other spread components;

(iii) the use of dynamic or static balance sheet models and the resulting treatment of amortised and maturing positions.

(c) in light of internationally agreed standards, the common modelling and parametric assumptions, excluding behavioural assumptions, that institutions shall reflect in their calculations of the net interest income as referred to in point (b) of the second subparagraph of paragraph 5 which shall be limited to:

(i) the inclusion and composition of cash flows sensitive to interest rates arising from the institution's assets, liabilities and off-balance-sheet items, including the treatment of commercial margins and other spread components;

(ii) the use of dynamic or static balance sheet models and the resulting treatment of amortised and maturing positions;

(iii) the period over which future net interest income shall be measured;

(d) what constitutes a large decline as referred to in point (b) of the second subparagraph of paragraph 5.

EBA shall submit those draft regulatory technical standards to the Commission by 28 June 2020.

Power is delegated to the Commission to supplement this Directive by adopting the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010.

6. The review and evaluation performed by competent authorities shall include the exposure of institutions to the risk of excessive leverage as reflected by indicators of excessive leverage, including the leverage ratio determined in accordance with Article 429 of Regulation (EU) No 575/2013. In determining the adequacy of the leverage ratio of institutions and of the arrangements, strategies, processes and mechanisms implemented by institutions to manage the risk of excessive leverage, competent authorities shall take into account the business model of those institutions.

7. The review and evaluation conducted by competent authorities shall include governance arrangements of institutions, their corporate culture and values, and the ability of members of the management body to perform their duties. In conducting that review and evaluation, competent authorities shall, at least, have access to agendas and supporting documents for meetings of the management body and its committees, and the results of the internal or external evaluation of performance of the management body.

8. EBA shall assess the potential inclusion in the review and evaluation performed by competent authorities of environmental, social and governance risks (ESG risks). For the purposes of the first subparagraph, EBA's assessment shall comprise at least the following:

(a) the development of a uniform definition of ESG risks, including physical risks and transition risks; the latter shall comprise the risks related to the depreciation of assets due to regulatory changes;

(b) the development of appropriate qualitative and quantitative criteria for the assessment of the impact of ESG risks on the financial stability of institutions in the short, medium and long term; such criteria shall include stress testing processes and scenario analyses to assess the impact of ESG risks under scenarios with different severities;

(c) the arrangements, processes, mechanisms and strategies to be implemented by the institutions to identify, assess and manage ESG risks;

(d) the analysis methods and tools to assess the impact of ESG risks on lending and financial intermediation activities of institutions.

EBA shall submit a report on its findings to the Commission, the European Parliament and to the Council by 28 June 2021.

On the basis of the outcome of its report, EBA may, if appropriate, issue guidelines, in accordance with Article 16 of Regulation (EU) No 1093/2010, regarding the uniform inclusion of ESG risks in the supervisory review and evaluation process performed by competent authorities.

REGULATION (EU) No 575/2013 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 26 June 2013 on prudential requirements for credit institutions and amending Regulation (EU) No 648/2012 (OJ L 176 27.6.2013, p. 1) (consolidated version 2021)

Article 449a

Disclosure of environmental, social and governance risks (ESG risks)

From 28 June 2022, large institutions which have issued securities that are admitted to trading on a regulated market of any Member State, as defined in point (21) of Article 4(1) of Directive 2014/65/EU, shall disclose information on ESG risks, including physical risks and transition risks, as defined in the report referred to in Article 98(8) of Directive 2013/36/EU.

The information referred to in the first paragraph shall be disclosed on an annual basis for the first year and biannually thereafter.

Article 501c

Prudential treatment of exposures related to environmental and/or social objectives

EBA, after consulting the ESRB, shall, on the basis of available data and the findings of the Commission High-Level Expert Group on Sustainable Finance, assess whether a dedicated prudential treatment of exposures related to assets, including securitisations, or activities associated substantially with environmental and/or social objectives would be justified. In particular, EBA shall assess:

(a) methodologies for the assessment of the effective riskiness of exposures related to assets and activities associated substantially with environmental and/or social objectives compared to the riskiness of other exposure;

(b) the development of appropriate criteria for the assessment of physical risks and transition risks, including the risks related to the depreciation of assets due to regulatory changes;

(c) the potential effects of a dedicated prudential treatment of exposures related to assets and activities which are associated substantially with environmental and/or social objectives on financial stability and bank lending in the Union.

EBA shall submit a report on its findings to the European Parliament, to the Council and to the Commission by 28 June 2025.

On the basis of that report, the Commission shall, if appropriate, submit to the European Parliament and to the Council a legislative proposal.

Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 (Text with EEA relevance) OJ L 198, 22.6.2020, p. 13–43

Article 3

Criteria for environmentally sustainable economic activities

For the purposes of establishing the degree to which an investment is environmentally sustainable, an economic activity shall qualify as environmentally sustainable where that economic activity:

(a) contributes substantially to one or more of the environmental objectives set out in Article 9 in accordance with Articles 10 to 16;

(b) does not significantly harm any of the environmental objectives set out in Article 9 in accordance with Article 17;

(c) is carried out in compliance with the minimum safeguards laid down in Article 18; and

(d) complies with technical screening criteria that have been established by the Commission in accordance with Article 10(3), 11(3), 12(2), 13(2), 14(2) or 15(2).

Article 8

Transparency of undertakings in non-financial statements

1. Any undertaking which is subject to an obligation to publish non-financial information pursuant to Article 19a or Article 29a of Directive 2013/34/EU shall include in its non-financial statement or consolidated non-financial statement information on how and to what extent the undertaking's activities are associated with economic activities that qualify as environmentally sustainable under Articles 3 and 9 of this Regulation.

2. In particular, non-financial undertakings shall disclose the following:

(a) the proportion of their turnover derived from products or services associated with economic activities that qualify as environmentally sustainable under Articles 3 and 9; and

(b) the proportion of their capital expenditure and the proportion of their operating expenditure related to assets or processes associated with economic activities that qualify as environmentally sustainable under Articles 3 and 9.

3. If an undertaking publishes non-financial information pursuant to Article 19a or Article 29a of Directive 2013/34/EU in a separate report in accordance with Article 19a(4) or Article 29a(4) of that Directive, the information referred to in paragraphs 1 and 2 of this Article shall be published in that separate report.

4. The Commission shall adopt a delegated act in accordance with Article 23 to supplement paragraphs 1 and 2 of this Article to specify the content and presentation of the information to be disclosed pursuant to those paragraphs, including the methodology to be used in order to comply with them, taking into account the specificities of both financial and non-financial undertakings and the technical screening criteria established pursuant to this Regulation. The Commission shall adopt that delegated act by 1 June 2021.

III. Semi-structured interviews questionnaire

1. What existing practices are in place to ensure that climate change-related risks are incorporated in banking/supervisory practice?
2. How did you participate in the EU legislative process that led to the incorporation of climate change considerations within the microprudential framework?
3. What are the principal drivers of this change? Who were the main actors and what were their demands?
4. What difficulties persist in the incorporation of environmental/climate change related factors in microprudential regulation?
5. How could the incorporation of climate change/environmental risks be improved within the existing microprudential framework? And beyond it?