

EBA sets out intent on ESG risks in its Sustainable Finance Action Plan

AT A GLANCE

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Contacts

Jon Williams
Partner

T: +44 (0) 7595 609666
E: jon.d.williams@pwc.com

Luke Nelson
Senior Manager

T: +44 (0) 7808 107043
E: luke.a.nelson@pwc.com

What's new?

- The European Banking Authority (EBA) published its [Action Plan on Sustainable Finance](#) on 6 December 2019.
- The EBA is required to provide guidance on Environmental, Social and Governance (ESG) factors and risks under a range of new legislative acts including the revised Capital Requirements Regulation (CRR II) and Directive (CRD V), the Investment Firms Regulation (IFR) and Directive (IFD), and the amended EBA Regulation as well as various initiatives under the European Commission's Sustainable Finance Action Plan.
- Climate change is the priority ESG area for the EBA because it believes this is the most material risk area. It encourages banks to act now on climate-related risks.

What does this mean?

- The EBA must deliver a raft of standards and guidance relating to ESG between now and 2025.
- Among other things, the EBA is required to consider the inclusion of ESG risks in the supervisory review and evaluation process (SREP), how ESG disclosures should be dealt with in CRR 2 Pillar 3 disclosures and whether a dedicated prudential treatment of ESG exposures would be justified.
- In prioritising its work, the EBA initially plans to focus on strategy and risk management and associated key metrics and disclosure. It then plans to focus on developing a dedicated climate change stress test and to look into the evidence around the prudential treatment of "green" exposures.

What do banks need to do?

- Firms should act now to identify and manage their climate-related risks rather than waiting for rules to be finalised. Firms operating in the UK should consider both the EBA's guidelines and the PRA's [Supervisory Statement SS3/19](#) of April 2019.
- Specifically, firms should begin to adopt climate considerations into their governance structures, business strategies and risk management frameworks.
- Firms should aim to make progress on identifying at least some simple metrics that provide transparency on how climate-related risks impact their business or use those recommended by the Financial Stability Board's Task Force on Climate-related Financial Disclosures.
- Firms should adopt climate scenarios and use scenario analysis to understand their exposure to climate-related risks including physical and transition risks, as well as a range of timescales.

Next steps

The EBA plans to publish a number of discussion papers, technical standards and further guidance across its ESG mandates. These include the following:

- Q2-Q3 2020: Discussion paper on developing a uniform definition of ESG risks and the potential inclusion of ESG risks in the SREP.
- June 2020: Technical standards on ESG-related Pillar 3 disclosures.
- H2 2020: Sensitivity analysis for climate risks for sample of volunteering banks.
- By 2025: Deadline for reports on a dedicated prudential regime for ESG.

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