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ESG risks in banks – UAE

Effective strategies to use opportunities and mitigate risks

KPMG Lower Gulf

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Foreword

Environmental, social, and governance (ESG) issues as well as their associated opportunities and risks are becoming more and more relevant for financial institutions. Banks must approach ESG risks in a holistic fashion when embedding them into their risk management frameworks. This process includes adjusting business and risk strategies and corresponding risk appetite statements, making sure roles and responsibilities are fully transparent throughout all three lines of defense.

While ESG risk is not a fully stand-alone risk type, it exerts influence on financial and non-financial risks present in a bank to varying degrees. Hence, risk management methods and processes must be amended, considering the complex cause-effect relationships across risk types. This involves risk measurement/assessment techniques in run-the-bank and in change-the-bank processes as well as in stress testing applications.

Besides embedding ESG into risk frameworks, banks need to consider related issues in product design, pricing and sales decisions. Also, an appropriate consideration of ESG risks in a wide range of change processes is of vital importance for fostering profitability. Several tools developed by KPMG can help banks to master those challenges.

Last but not least, regulators, rating agencies and other parties around the world are taking a keen interest in the topic, leading to increased requirements and reporting needs. This constant flow of new regulations is bringing extensive compliance challenges for banks.

The United Arab Emirates (UAE) is at the forefront in addressing ESG issues and driving sustainability under the framework of the UAE Vision 2021, in alignment with the UAE Green Agenda 2015-2030, the Dubai Plan 2021, the Paris Agreement (COP21), and the 17 UN Sustainable Development Goals (SDGs). For instance, the UAE government formed a National Committee on SDGs aiming for national implementation of the SDGs. Meanwhile, the UAE's UN Global Compact network aims to root the ten principles of the Global Compact, as well as the SDGs, into the national context.

The Dubai Declaration on Sustainable Finance launched in 2016; eleven UAE-based financial institutions have committed to the Declaration confirming their support for the UAE Vision 2021. Abu Dhabi Vision 2030 aims to build a sustainable and diversified economy and improve accessibility, while Abu Dhabi Global Market (ADGM) manages the Zayed Sustainability Prize Initiative, aligned with the global Sustainable Development Agenda for 2030.

This white paper reviews various ESG factors and sustainability issues in the banking sector, highlighting possibilities to embed these aspects into risk frameworks along with the risk management process and shows parallels that can be used to learn from the current Covid-19 crisis. This paper proposes a holistic approach to ESG risks within risk management.

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Climate risk

— banks need to act

Sustainability has been an overarching goal of many global and local organizations together with governing bodies from the mid-2010s. The Paris Climate Protection Agreement, which obliges 195 countries and territories to change the global economy in a climate-friendly manner, marks an important milestone for international climate policy. In December 2015, it was decided to limit global warming to 1.5 or a maximum of 2 degrees celsius compared to pre-industrial times. To the same extent, the United Nations' 2030 Agenda for Sustainable Development, launched in 2015, with the 17 Sustainable Development Goals (SDGs) has a catalytic effect for a global economy geared towards ecological and social goals.

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Banks have long been concerned with sustainability in a mostly fragmented fashion. However, due to the confounding flood of information and speculations about future regulatory changes, it is **difficult for most institutions to develop a comprehensive strategy for ESG factors.**

While the Paris Climate Protection Agreement and the United Nations' 2030 Agenda for Sustainable Development are not industry-specific, initiatives have been started to involve the financial services industry specifically, confronting them with the challenge to reconcile sustainability and economy.

Increasing awareness about issues such as climate change, social inequality or corporate misconduct is changing the market environment rapidly. Investors across the globe are showing a greatly increased demand for sustainable financial products. Sustainability and corporate conduct are influencing the reputation and business success of financial institutions.

The trend toward sustainability has the potential to drastically transform the global banking sector.

Banks that do not act now will hardly have the chance to integrate regulatory requirements concerning sustainability into their frameworks in good time, let alone adapt to the changed market requirements. Furthermore, simple solutions are rare. For example, banks may be targeted for lending to coal companies. This can upset stakeholders (such as NGOS) who may accuse the bank of unwillingness to support the transformation process to a sustainable economy.

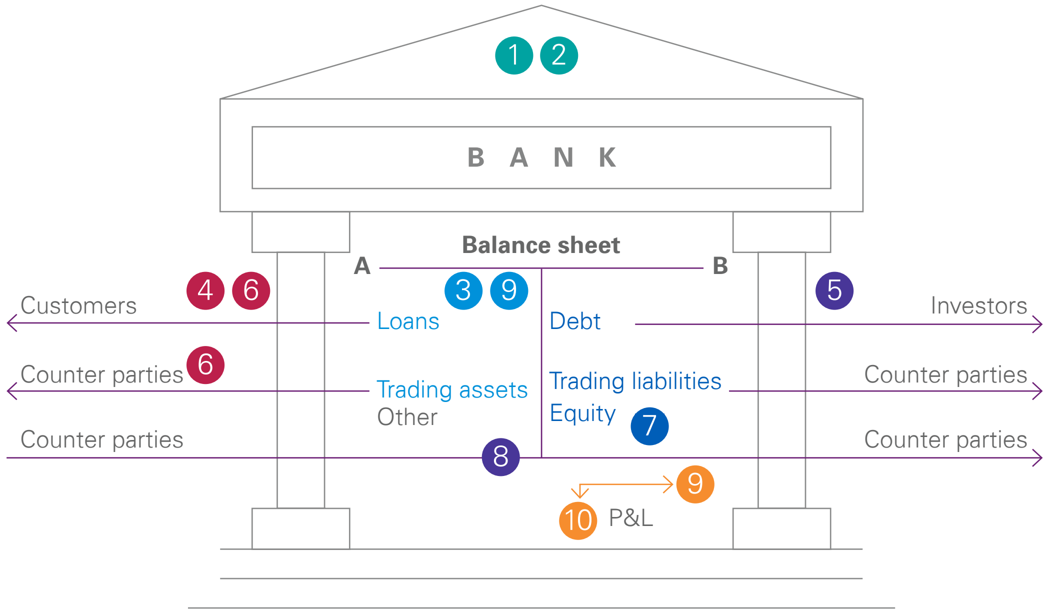
Banks need to respond to this with the following actions:

01
Revision of their business strategies in relation to their target customers, new products, etc.

02
Sharpening of brands and creation of sustainability strategies.

03
Implementation of updated regulatory frameworks along their entire value chains.

Key areas prone to ESG risk



01
Consideration of sustainability in the **business strategy** and the organizational setup/**governance**

02
Adjustment of **product and customer portfolio**

03
Identification/classification of sustainable **assets**

04
Offering of sustainable **financing to customers**

05
Refinancing with sustainable instruments

06
Consideration of ESG risk in **pricing and risk management**

07
Consideration of ESG risks within the **capital charge**

08
Inclusion of ESG criteria in the **distribution process** (including MiFID)

09
Reporting of own ESG risks and their impact to supervising authorities and stakeholders

10
ESG **data management**

Figure 1: ESG risk is expected to affect banks along their entire value chains both from strategic and operational perspectives — and create new opportunities.

Source: ESG risks in banks, KPMG International, 2021

Focusing on ESG risks

ESG risks include environmental risk, social risk and governance risk and the resulting impact on banks' P&L and liquidity. ESG risks can affect the bank directly (e.g. storm damage to bank buildings), but also affect customers (change in sales opportunities, production disruptions, etc.) leading to, for example, higher loan defaults.

Due to the current political debates globally, the focus is currently on the environmental risks and the sub-topic of climate change. For their part, environmental risks are divided into physical risks and transition risks:

— Physical risks arise if economic activities or their value are threatened directly by failure to achieve climate-related objectives (e.g. the direct effects of climate change on the water supply of industrial companies). They can materialize as acute risks (i.e. individual, non-regular physical risk events) or as chronic risks (i.e. permanent deterioration in ESG target achievement with lasting adverse effects on own economic activities).

— Transition risks arise if the business model that economic activities are based on is permanently endangered by systemic changes and its own negative ESG impact (e.g. the effects of political measures to combat climate change and their impact on manufacturers of combustion engines).

Environmental risks

Physical risks

— Supply chain collapse

— Sea level rise

— Pollution

Transition risk

— Reactions of legislators/ regulators to promote sustainability or bans on unsustainable activities (e.g. CO2 tax)

— Structural changes in demand and supply for products, services and commodities

Social risks

— Non-compliance with labor standards

— Inadequate payment of labor

— Lack of assurance of industrial safety standards and health protection for employees

— Lack of assurance of product safety

Governance risks

— Compliance with tax law

— Compliance with regulations

— Corruption or attempted bribery

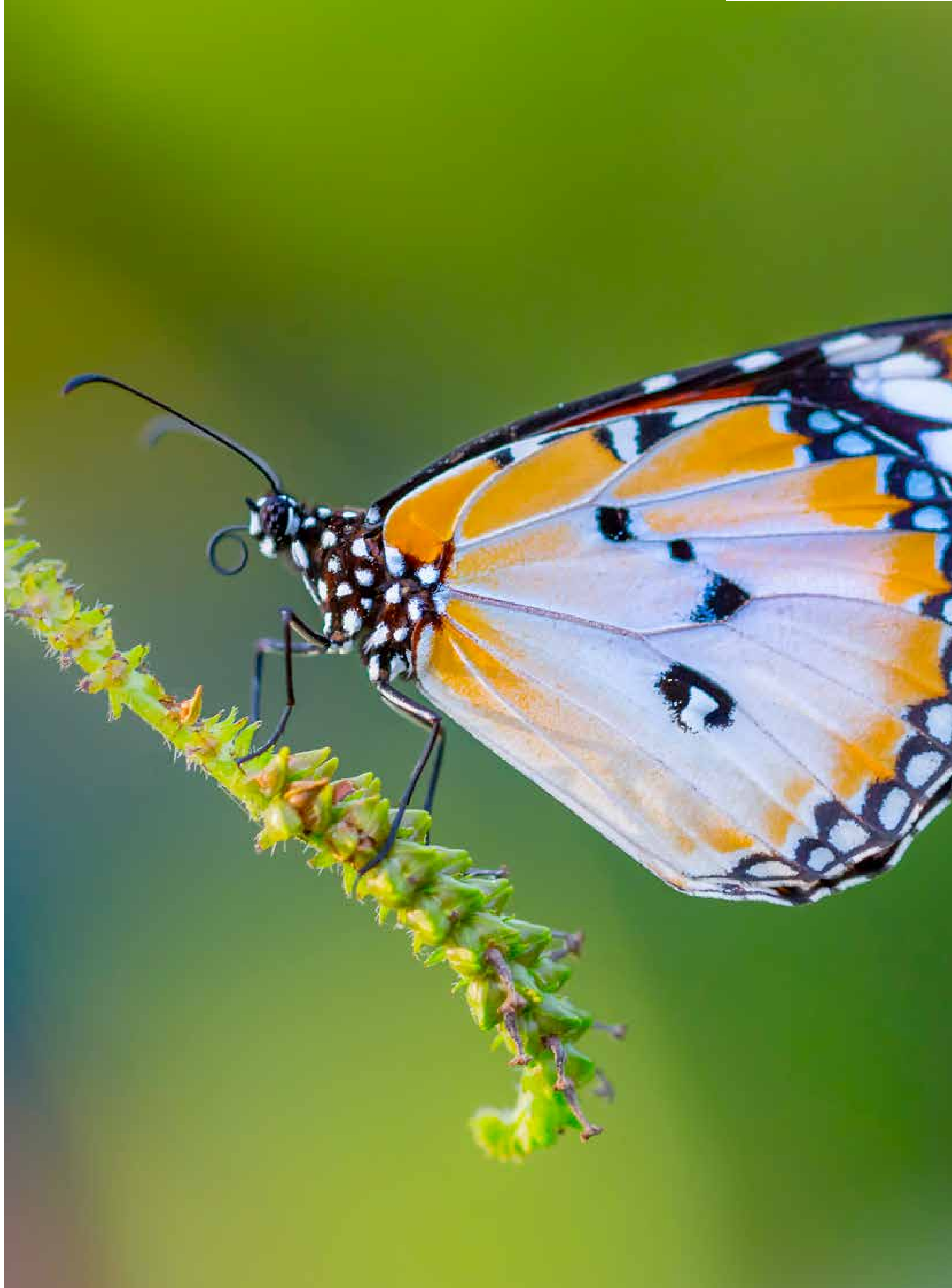
— Inappropriate senior management compensation

— Lack of proper assurance of data protection

— Greenwashing risks

Figure 2: Examples of ESG risks

Source: ESG risks in banks, KPMG International, 2021



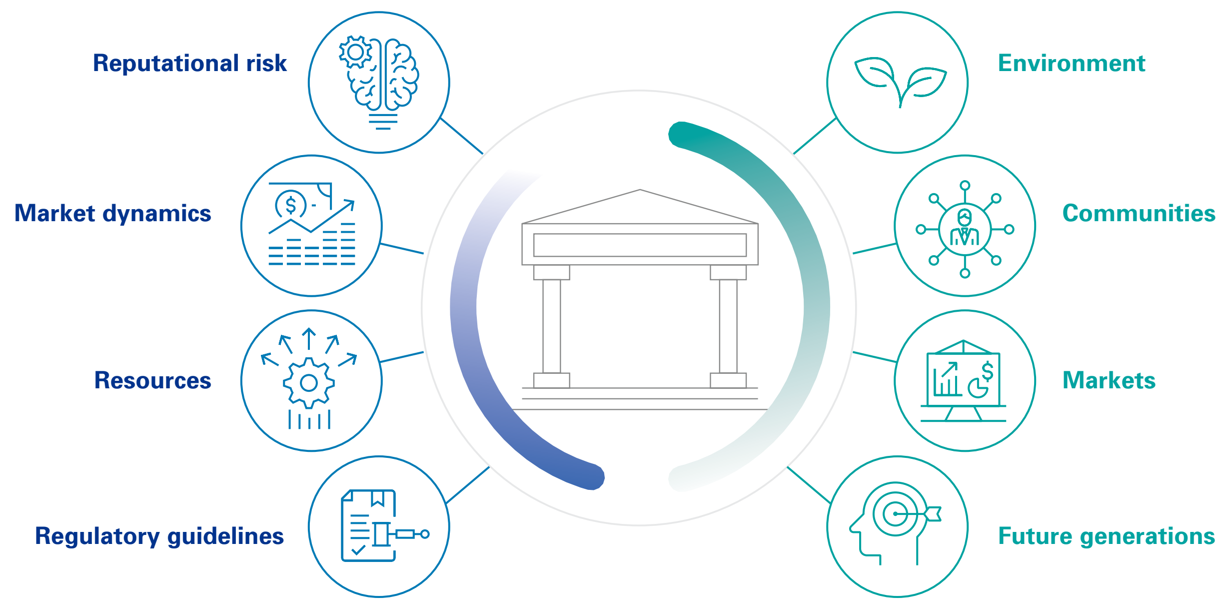


Figure 2b: Dependencies and influences of ESG developments
Source: ESG risks in banks, KPMG International, 2021

Reputational risk

Outside-in effects (dependencies)

Consequences from external actual and expected ESG developments on business

Influencers:

— Regulatory guidelines

— Technology

— Customers

— Quality and availability of resources

— Market dynamics, etc.

Affected market participants:

— The bank itself

— Important investors and customers

Effects on:

— Current status

— Performance

— Economic prospects of success

— Reputation

— Long term viability

Inside-out effects (influence)

Possibilities for influencing the environment and society

Influence:

— Environment

— Communities

— Markets

— Future generations, etc.

In addition to their different characteristics described above, two dimensions can be distinguished regarding ESG risks, a **financial** as well as an **extra-financial** dimension:

— With regard to the financial dimension, the key questions banks must ask themselves are: "What ESG risks and opportunities does the business model of our customers and investments hold and what does this mean for our business model?"

This dimension is closely linked with the outside-in effects of ESG, i.e. the consequences from external, current and expected ESG developments on businesses.

— In contrast, the extra-financial dimension considers the impact a bank has on the environment and society. The key question is: "What opportunities will arise from sustainable products and sustainable trading, and how can reputational risks be avoided?"

This addresses the inside-out effect, i.e. the results of a bank's actions on environmental or societal issues.

However, once outside-in and inside-out effects have arisen and triggered further reactions, they are no longer easily distinguishable, at the latest after the occurrence of second-round effects.

Reputational risks in particular act as transmitters between customers and the bank. Inside-out effects harbor reputational risks, which in turn are expected to affect the bank. After a series of rounds of cause-and-effect relationships, it is no longer possible to distinguish when and where original effects were caused.

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ESG risks include environmental risk, social risk and governance risk and the resulting impact on banks' P&L and liquidity. The specialty of the topic concerning banks/the banking sector is that **ESG risks can not only affect the bank directly** (e.g. storm damage to bank buildings), but also affect customers (change in sales opportunities, production disruptions, etc.) **leading to, for example, higher loan defaults.**

Similarities between Covid-19 and ESG risks

The current Covid-19 crisis and its impact on banks has a lot in common with ESG risks.Thus, an unexpected opportunity opens up in observing the current crisis: banks can leverage the experience with Covid-19 to better cope with future ESG risk challenges.

Banks are directly affected (akin to physical ESG risks) by Covid-19 via the following factors (among others):

— Higher sickness rates leading to a reduction in workforce

— Shutdowns in various countries, territories and states, which largely requires homeworking leading to frictions

— Travel bans hindering international business issues with network capacity, cyber risk, and IT security

These developments are particularly effective in the operational risk areas much like ESG risks. They can also exert additional impact on reputation, in case stakeholders' expectations are not fully met even after discounting crisis-induced goodwill for some. Subsequently, business and liquidity risks are likely to surface, while demand for some banking services can decrease and customers can withdraw their deposits.

Just as with ESG risks, the strength of the impact of the changes depends heavily on the industry in which companies operate. That means banks' clients are often hit even harder by the crisis, depending on the industry segment they operate in. In addition to the points above, issues clients are facing include:

— Government orders to shut down various businesses for an undefined period (e.g. restaurants)

— Breakdown of supply chains (hitting global suppliers particularly hard)

— Massive decrease in demand (domestic and abroad)

Outside-in effects, which in turn affect banks due to the issues mentioned, can be noticeable through an increase in defaults. These are expected to occur both in commercial as well as in retail banking, e.g. due to clients becoming unemployed. Also, an impairment of assets (including collaterals) must be expected because, for example, commercial real estate is difficult to rent in times of crisis.

Not only clients are negatively affected by the pandemic, the same can happen to outsourcing partners and suppliers of banks. In this case, services are expected to be of reduced quality or fail completely.

Finally, similar to the transition risks that are described in connection with ESG risks, governments are exerting extensive influence on people and business. Both are expected to affect banks directly (e.g. if employees are put in quarantine) as well as their clients and suppliers (e.g. if additional business segments are forced to close).

The main difference between the Covid-19 crisis and ESG risks is in the relevant time frames. While ESG risks are subject to a multi-year, largely transparent planned transitions, interventions in the Covid-19 crisis are changing almost daily, with little predictability, forcing banks to adapt quickly to changing, unpredictable environments.

In the current pandemic, banks only have the option to react quickly, mostly in an ad-hoc manner. However, if they also use the crisis to investigate direct and indirect effects of external triggers, they can plan for similar transmission channels for future ESG risks.

Banks' ability to cope with the pandemic as well as with ESG risks largely depends on their level of maturity in terms of operational resilience. Frameworks for operational resilience are designed not only to preserve business continuity, but also to enable organizations to permanently adjust to changing conditions. Investing in those frameworks can pay off in multiple ways.

Banks can leverage the experience with the **pandemic** to better cope with future ESG risk challenges.

Risk management framework for dealing with ESG risks

Naturally, dealing with risks is an inevitable and essential element in most financial institutions and banks cannot avoid the risks inherent in their businesses.

The common thread running through all the risk caregories that banks are used to dealing with (i.e. credit and counterparty risks, market risks, liquidity risks, operational risks, etc.) is that they all concern the impact of the risk on the institution itself. However, risk management must consider not only the impact ESG risks have on the organization, but also the potential impact of stakeholders on the bank, and vice vice versa - the risk to which the bank is exposing its stakeholders and the environment due to its business activities.

Governance

A sound governance structure is a key element of effective risk management processes. ESG risks can affect all divisions and departments of a bank and the various parts of the three lines of defense model, including profit and cost centers. While the establishment of a central coordination unit for ESG risks can be beneficial, enhancing the roles and responsibilities of existing units is key.

Profit centers in the first line of defense affected by ESG risks include credit and trading business divisions. They have to consider ESG risk factors in their product development as well as their pricing and sales processes. This consideration should especially focus on the impact of ESG risk factors on financial risks and reputational risks. Dealing with ESG risks needs to become an embedded activity in all relevant processes. For instance, clear decision criteria and control mechanisms must be anchored in the lending process: ESG factors have to be assessed in the course of lending, similar to the examination of reputational risks in the know-your-customer (KYC) process. This means that assessments must not only be implemented initially when granting loans, but also reoccur regularly, surveying all corporate customers.

> Dealing with **ESG risks needs to become an embedded activity in all relevant processes.** For instance, clear decision criteria and control mechanisms must be anchored in the lending process. ESG factors have to be assessed in the course of lending, similar to the examination of reputational risks in the KYC process.

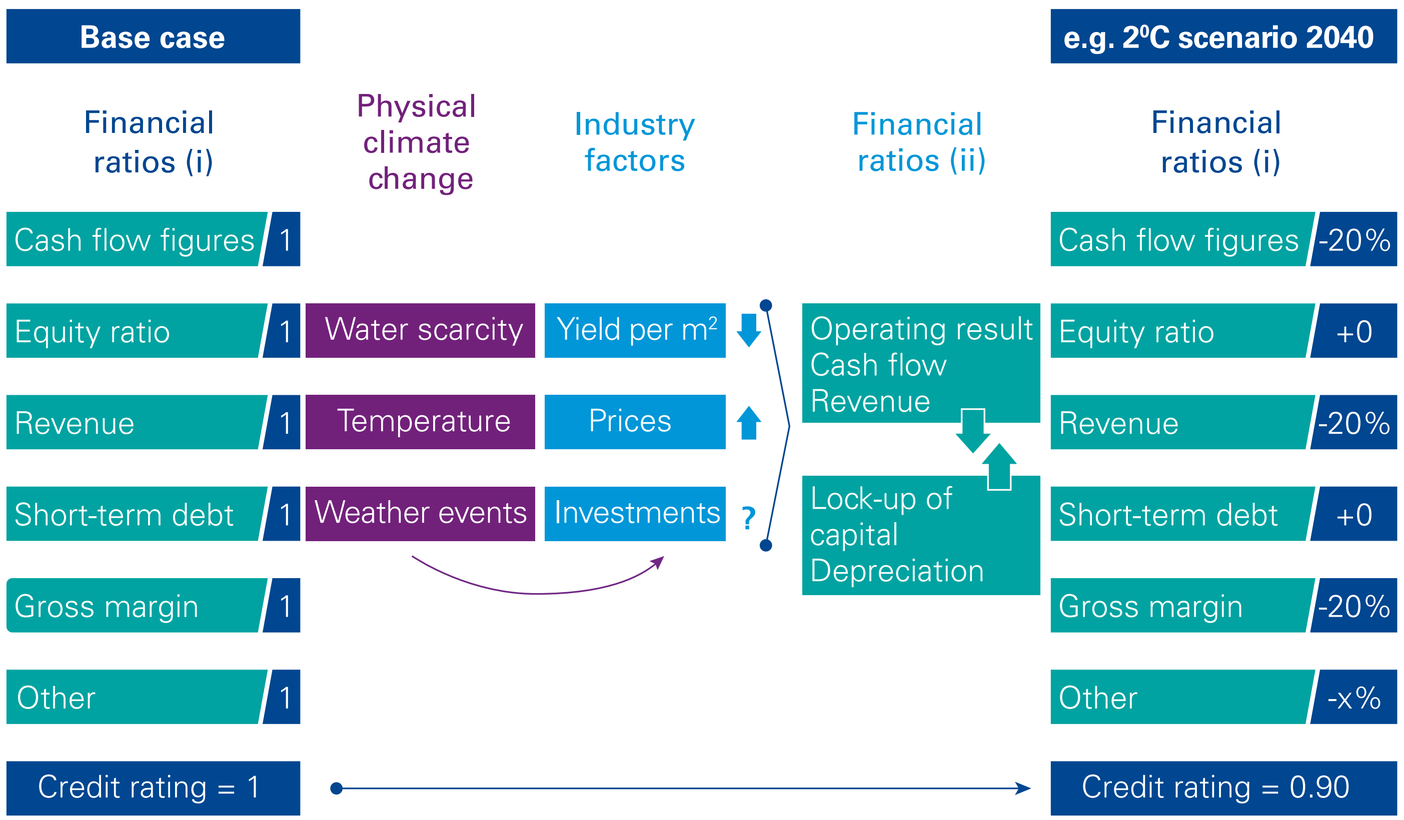


Figure 3: Example: Physical climate change and credit rating in a probability of default model

Source: ESG risks in banks, KPMG International, 2021

Cost centers typically consider a broad range of non-financial risks in a specialized manner. Still, they will have to amend their risk management processes accordingly. This includes the enhancement of (qualitative) risk assessment methods and tools by including ESG risk-related aspects and questions. The connection to non-financial risks (operational risk and reputational risk in particular) has to be made.

The second line of defense includes, but is not limited to, risk controlling, compliance, and business continuity management (BCM) functions. Risk control must develop the methods, processes and tools for dealing with ESG risks (starting with an amended risk inventory) and include the results in risk reporting. Compliance in turn has to examine if the entity meets legal or voluntarily introduced ESG guidelines. BCM must regard ESG risks as a trigger for business disruption and provide for continuity.

Internal audit as the third line of defense has to make sure that all relevant processes include aspects of ESG risks in an adequate manner and that they are being met consistently.

Risk strategy

In order to achieve sustainable development, financial institutions are required to define and implement an effective business strategy. Doing so, the discussion of motivation behind incorporating sustainability can serve as a starting point to the examination of upcoming challenges and necessary courses of action in the development and implementation of a business strategy. The motivation for considering the topic can range from purely economic, regulatory and/or legal reasons to intrinsically driven social and/or ecological motives. As business strategies move along a maturity ladder based on motivation, the degree of integration into the business model varies from little more than some corporate social responsibility (CSR) activities to embracing ESG as a core part of the business model. The closer ESG aspects are to the core part of a bank's business model, the closer the activities have to be aligned and the more senior the managers in charge of ESG topics need to be.

The risk strategy on ESG risks has to be aligned closely with the business strategy and constantly updated. One key issue to be included is concentration risk: concentration risk from ESG factors arises because on the one hand ESG risks are in complex cause-and-effect relationships across risk types within a bank. On the other hand, especially due to transition risk, companies within the same or related industries are simultaneously affected — as well as the banking sector doing business with them.

The risk strategy needs to be operationalized through a corresponding system of risk appetite statements. Starting with an inspection of ESG risk factors across all risk types, quantitative and/or qualitative limits can be assigned on an aggregate level and finally be broken down into individual risk types.

When taking ESG risks into account in their strategies, banks must keep in mind that ESG risks' planning horizons are usually much longer than the 3–5 years traditionally considered in business and risk strategy design. This especially applies to the climate-change aspects of ESG risks.

Risk management cycle

One of the greatest challenges is to break down the topic of sustainability risks to individual or partial aspects, but not to treat them completely distinctly. Sustainability risks have complex cause-effect relationships: on the one hand between customers, service providers and the bank, and on the other hand between the individual types of financial and non-financial risks. These need to be made transparent and appropriately considered in the risk management process.

Identification

The identification of ESG risks can depend on location. The physical dangers that banks and their customers see themselves exposed to (e.g. weather damages to assets, danger to employees due to political unrest, or the effects of persistent droughts) are of course determined by which locations are particularly important for maintaining the respective businesses.

Transition risks, however, are not only dependent on the business model, but also on behavior. A bank's own non-ESG-compliant behavior can cause reputational risks. This in turn, can — together with a stronger ESG awareness of stakeholders — lead to legal disputes, among other complications, i.e. legal risks are increased.

Identification could start by considering ESG risk factors in the risk inventory, thus expanding the risk landscape. Due to the broad range of dependencies across financial and non-financial risks, ESG risks cannot be assessed in a linear fashion. Instead, ESG risks have to be identified by investigating cause-effect relationships and/or common triggers. ESG risks must be considered for every risk type, i.e. within each risk type, an examination must be made of the extent ESG risks are apt to change the assessment of the respective risk type, ideally considering second-round effects. To run those identification steps, highly qualified personnel are required. Special training will be inevitable.

Results from this amended risk inventory process can be used as a basis for the construction of a consistent taxonomy. The design and derivation of possible scenarios as part of capital planning and stress testing are based on these results.

Measurement and evaluation

ESG risks materialize in known risk types. For example, extreme weather conditions can manifest through credit defaults and changes in market sentiment in impairments.

ESG risks therefore can affect counterparty, market price, liquidity and operational risks. A crucial process step in measuring and evaluating ESG risks is the assessment of the current ESG exposure. This includes the consideration of ESG risks while evaluating capital adequacy as well as calculating regulatory and economic capital.

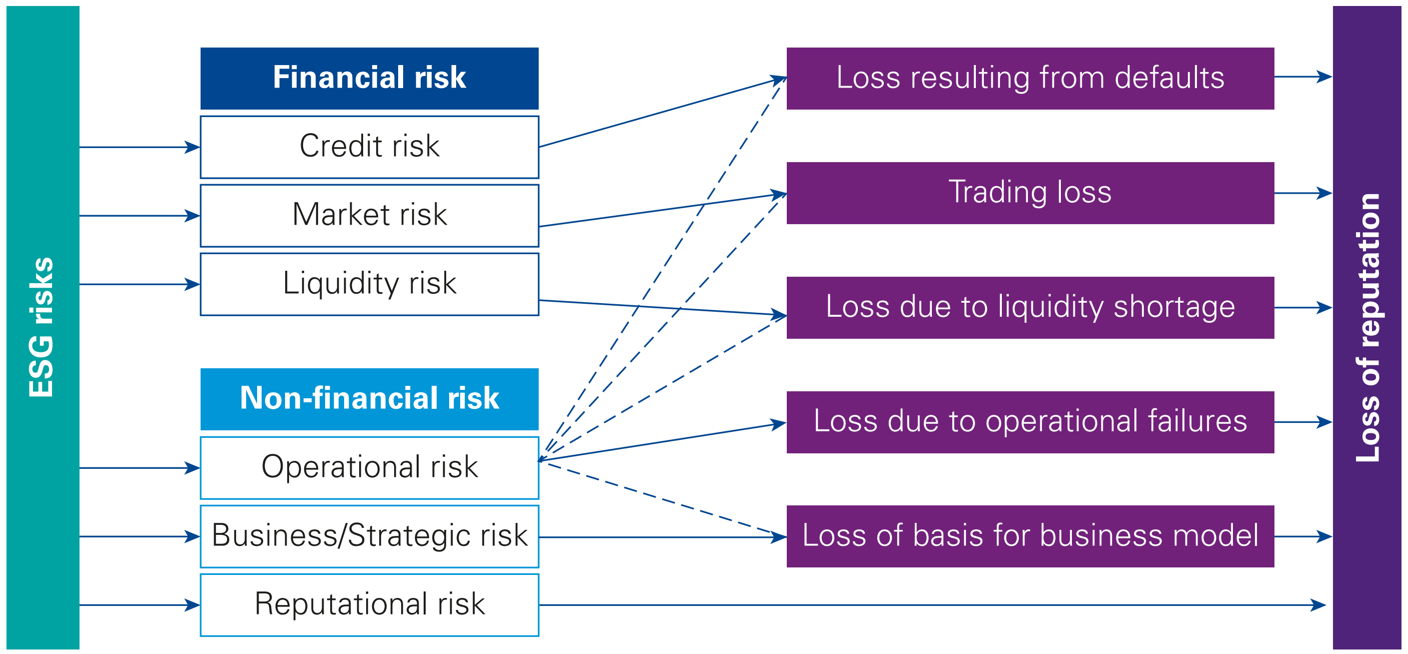
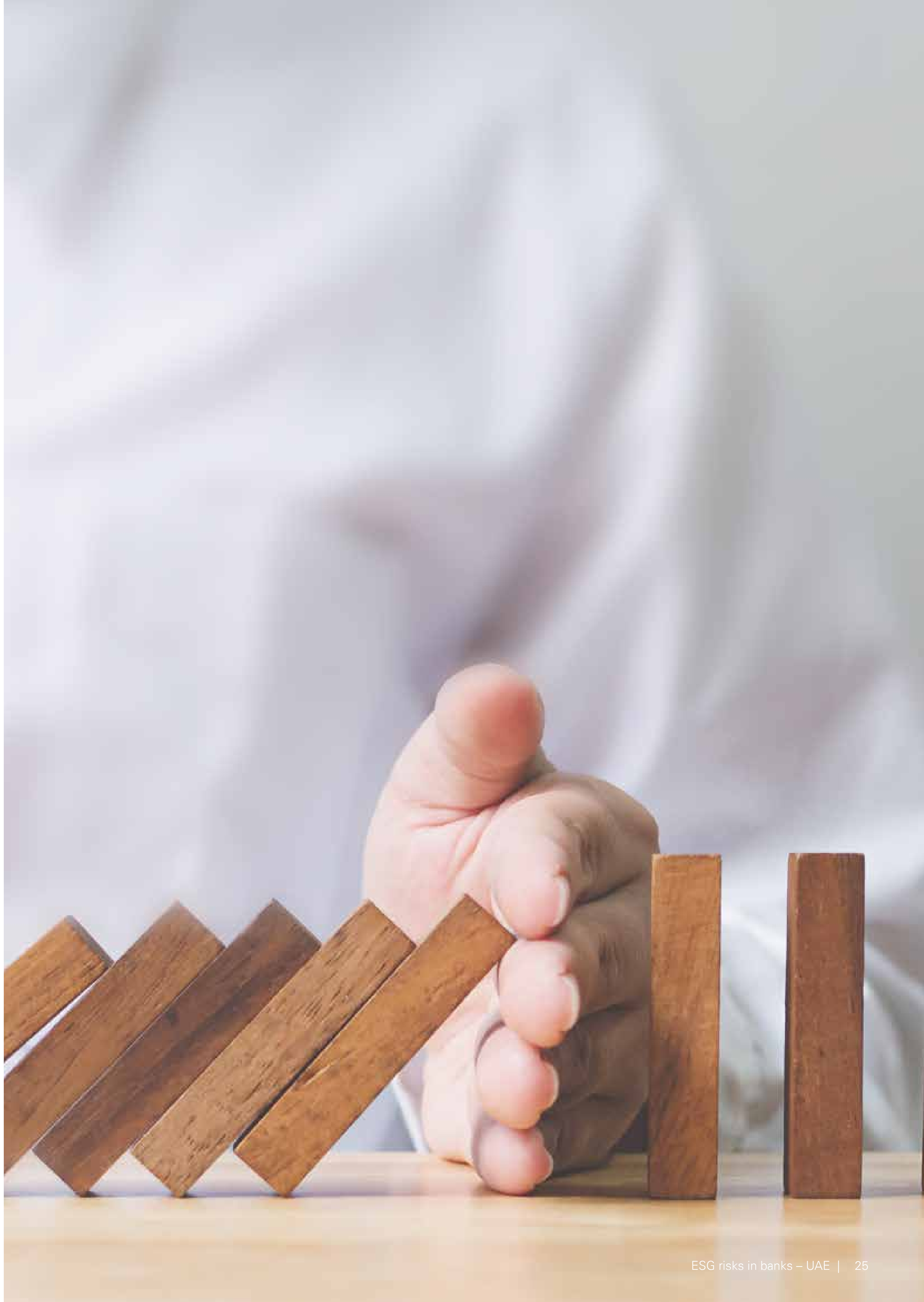


Figure 4: : Identification and materialization of ESG risks

Source: ESG risks in banks, KPMG International, 2021



Steering

As with all risk types, development of preventive and reactive control measures is at the heart of steering.

The options available to a bank for steering ESG risks are varied and must be selected individually. They range from setting limits or defining exclusion and/or inclusion criteria, e.g. for portfolios with ESG relevance up to divestments in companies that do not meet the desired ESG goals.

Preventative measures include:

Mandatory consideration of **ESG risks** in all change-the-business processes, e.g. when designing products or processes

Implementation of preventive **steering measures** for all risk types via detailed specifications, e.g. rejection of a loan if the ESG exposure of the loan applicant > x.

Reactive measures include:

Treatment of materialized **ESG risks of the bank** (operational risk, compliance, reputational risk, etc.)

Revaluation of portfolios, new ratings, rejection of prolongations, etc. in response to transition risks (e.g. due to a new legal situation).

Monitoring

In order to continually monitor the ESG risk profile, the identification and monitoring of indicators related to ESG risk is key. The usage of existing tools for the creation of an ESG risk dashboard is possible. Information should be provided to all relevant actors and considered throughout the decision-making process.

Furthermore, the effectiveness of control measures has to be critically assessed. As the effectiveness of ESG risk can not be taken for granted, it is important to regularly check whether actions could be deemed successful or whether additional measures are needed.

Reporting

Transparency on ESG risk exposure and control measures throughout the bank is needed, therefore comprehensive, action-oriented internal reporting is vital.

Information on ESG risks can be included in existing risk-reporting frameworks and risk types. However, it can be useful to create a specific system for ESG risk reporting with a medium- to long-term outlook since the effects of ESG issues can materialize much later than those of other risk types.

> "The definition of objectives and clear initiatives for ESG, that are laid out in the business strategy, their inclusion in the risk strategy, **together with their operationalization through the risk appetite framework are the basis for managing ESG risks.**

Actions for banks

The implementation of ESG risks into the risk management framework scales up the function, with the addition of a new perspective: an understanding of their stakeholders and in turn, their effect on the institution's overall performance. This perspective may also shed new light on other risk types and influence their ratings.

Despite the ever-growing stock of new publications and the expected regulatory changes, banks can approach ESG risks in a structured manner. Topics that have to be dealt with include, but are not limited to:

- Degree of integration of sustainability into business
- Impact of ESG factors on pricing and evaluation
- Selection of sustainability risks to be communicated (e.g. in EU Disclosure Regulation)
- Consistent processes for ESG data use to create transparency regarding the impact of different investment strategies (impact and risk)
- Identification of ESG risks in business strategy, risk strategy and other relevant strategies
- Consideration of ESG risks in risk management: risk inventory, identification, management, limitation, control, capital requirements, and reporting
- Provision of ESG risk data for customers and investors
- Examination of usefulness of ESG data to adequately prepare a portfolio for ESG trends (e.g. climate change)
- Integration of ESG data into existing data
- Ascertainment of required costs, technical skills and capacities

KPMG supports banks facing ESG-related challenges as well as their establishment of a holistic ESG risk management framework.

We will analyze the regulatory and economic risk management process (strategy, inventory, risk measurement, control and reporting) and incorporate ESG risk factors:

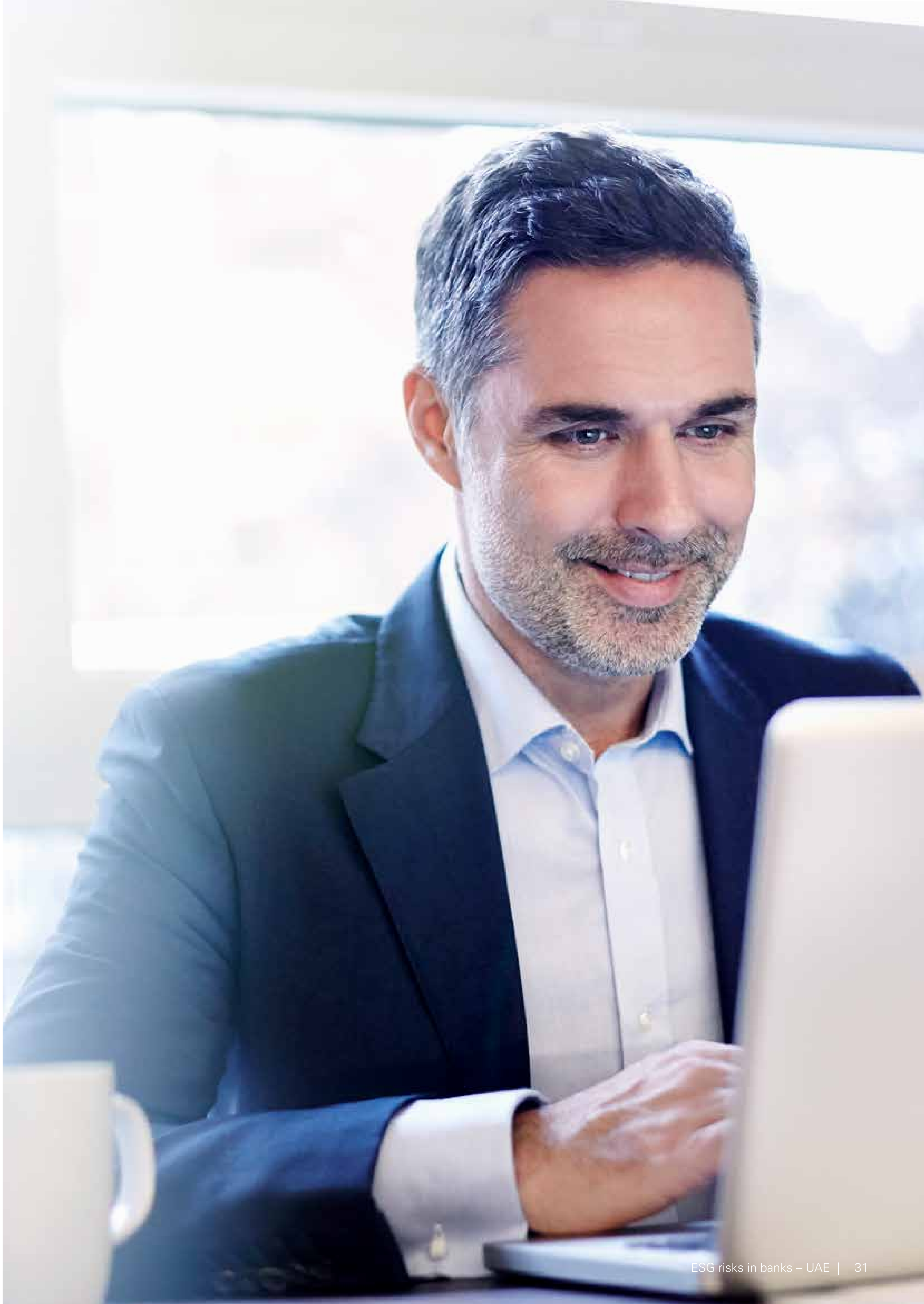
— Integration of ESG risks, i.e. full consideration of the ESG risk drivers and impact relationships with known risk types (taxonomy/risk inventory/risk strategy)

— Integration into the existing risk and model landscape

— Selection of risk assessment tools

— Involvement in reporting and forecasting processes

— Consideration of ESG factors in business and capital planning (via scenario or sensitivity analysis).



Hallmarks of a good ESG report

Tell your unique ESG Story - ESG reporting can be an opportunity to not only discuss compliance with ESG regulations, but also engage with investors, stakeholders and customers of ESG initiatives and programmes. ESG activities and reporting is a topical subject and many stakeholders are increasingly differentiating which banks to work with based on their ESG activities.

Task Force on Climate-Related Finance Disclosures - The TCFD standards provide comparable indexes for comparing data around climate change risks and opportunities. As banks develop strategies for reporting climate activity, reporting against the TCFD gives a standardized standard against which to report and is widely being adopted by banks for reporting disclosures.

ESG reporting standards - Report against an internationally recognized ESG framework, or ideally a number of internationally recognized frameworks. Many banks aim to align their reporting to the Dow Jones Sustainability Indices, Global Reporting Initiative, or the Sustainability Accounting Standards. The World Economic Forum Stakeholder Capital metrics were prepared to foster some sense of comparability.

United Nations Sustainable Development Goals – The 2030 agenda for sustainability development, which was adopted by all UN member states in 2015, embraced 17 comprehensive goals for use by UN member states in developing agendas and programs through to 2030. The agenda recommends that companies report in line with the 17 goals when reporting on sustainability and disclose progress over time on alignment to the goals. This will also give a comprehensive view of ESG activity, and allow investors to make an informed decision based not just on past data, but also on future plans/projections.

Financial reporting - Align ESG reporting with the bank's financial reporting; as investors and customers increasingly review the bank's financials and ESG disclosures in tandem (integrated reporting), this can also save money. Whilst this may not be easy to achieve in the first round of reporting, it can have a positive effect on dividends in particular as ESG audits and financial audits can occur concurrently.

Risk management – ESG initiatives present a new lens through which risks and opportunities should be considered as part of the bank's enterprise risk management framework. The COSO framework provides guidance on how ESG reporting can be integrated into the bank's risk management strategy.

ESG data access - Provide ESG data that underpins the reporting. Engagement with investors as well as rating agencies is improved when access to the data is given, i.e. when the data is presented in a tabular format, so that the data can be placed into the pertinent ESG model (SASB or GRI).

Financial performance – ESG programs have a direct impact on the bank's bottom line, for example sustainable finance and green bonds are among the fastest growing sectors. ESG reporting should not solely focus on the initiatives and reporting activities that the bank is required to perform, but can also support new sources of revenue and new customer entry points. This also extends to loan assessment, and ESG data should be considered as well as traditional risk modelling.

ESG data validation – Increasing investor reliance on ESG reporting has led to an increased interest in ESG data and reporting validation. KPMG has deep experience in supporting and assurance of ESG reporting for banks. CFOs of banks that are publicly traded should be able to support their disclosures, with attestation from a recognized ESG adviser.

The journey of global regulators over recent years

Outlined below are the significant instances of implementation of and changes to regulations or guidelines around ESG risk management, disclosures, and to a lesser extent, assurance. Banks in the UAE are starting to voluntarily make disclosures in line with the Task Force on Climate-Related Financial Disclosures (TCFD), and are including some key performance indicators of the Non-Financial Reporting Directive (NFRD) and the Corporate Sustainability Reporting Directive (CSRD) in their sustainability reporting. The timeline below, based on developments in European legislature, is a good indicator of the direction of travel in the sector.

TCFD framework is created to develop consistent climate-related financial risk disclosures.

Introduction of MiFID II/ MiFIR, a new legislative framework to strengthen investor protection.

EU strategy set out on sustainable finance and future roadmap for work across the financial system.

Establishment of EU Green Bond Standard (EUGBS).

EU Taxonomy Regulation published and came into force.

CFRF publishes a guide to help the financial sector approach and address climate-related financial risks.

EFRAG to draft a standard, incorporating CSRD and EU sustainability reporting standards.

EU Taxonomy to publish a second delegated act for the remaining objectives.

Expected increases in mandatory reporting requirements, regulations and strategies. Reasonable assurance to be considered for existing scope plus limited assurance for new entities in scope.

2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025

NFRD disclosure requirements introduced to help companies disclose environmental and social information.

Climate-related financial disclosure recommendations are released.

Additional guidelines to the NFRD released.

The Climate Financial Risk Forum (CFRF) is established.

Adoption of CSRD by amending existing NFRD requirements.

TCFD recommendations are mandated for all listed UK banks.

NFRD disclosures become mandatory across various sectors, including banking.

Amendment to MiFID II/MiFIR with regard to the integration of sustainability risks and factors.

Mandatory disclosure requirements under CSRD introduced for more entities, including banking. Limited Assurance requirement introduced.

Acronyms

CFRF	Climate Financial Risk Forum
CSRD	Corporate Sustainability Reporting Directive
EBA	European Banking Authority
EFRAG	European Financial Reporting Advisory Group
ESMA	European Securities and Markets Authority
EUGBS	Establishment of EU Green Bond Standard
FSB	Financial Stability Board
TCFD	Task Force on Climate-related Financial Disclosures
MiFID	Markets in Financial Instruments Directive
MiFIR	Markets in Financial Instruments Regulation
NFRD	Non-Financial Reporting Directive
PRA	Prudential Regulation Authority

The reporting environment

European Commission (EC)

Reporting

- The EC introduced NFRD to help companies disclose environmental and social information. These guidelines were introduced in 2017 and were not mandatory. Companies could use either international, European or national guidelines as per their requirements.
- Climate-related information was added to the existing NFRD in 2019.
- In 2021, the EC adopted the CSRD, amending the existing NFRD to extend the scope of organizations, audit (assurance) requirements, and mandating EU sustainability reporting standards, allowing companies to digitally tag reported information to ensure consistency.
- The EC have assigned EFRAG to draft standards that contain CSRD along with EU sustainability reporting standards by 2022.

EU Taxonomy

- The Taxonomy regulation came into effect in 2020 as a classification system, establishing a list of environmentally sustainable economic activities. The EU taxonomy would provide companies, investors and policymakers with appropriate definitions for which economic activities can be considered environmentally sustainable.
- An amended and comprehensive act will be published in 2022.

EU Green Bond Standard

- The EC announced in 2020 that the European green deal investment plan would establish an EU Green Bond Standard (EUGBS) due to the lack of direct financial and capital flow to green investments.

Financial Stability Board

- In 2015, the FSB created the TCFD, to develop consistent climate-related financial risk disclosures for use by companies, banks, and investors in providing information to stakeholders.
- The TCFD released climate-related financial disclosure recommendations in 2017, designed to help companies provide better information to support informed capital allocation.
- In 2021, UK banks mandated TCFD recommendations for listed UK banks to accelerate compliance with the overall reporting standards of TCFD.

Financial Conduct Authority (FCA)

- The FCA and the Prudential Regulation Authority (PRA) established the Climate Financial Risk Forum (CFRF) in 2019, to build capacity and share best practice across financial regulators and the industry, to advance the financial sector's responses to the financial risks of climate change.
- In 2020, the CFRF published a guide to address climate-related financial risks. The guide provides practical tools, experience, knowledge and case studies, which firms can use as they develop their strategies, processes and approaches. The key areas are risk management, scenario analysis, disclosures, and innovation.

European Securities and Markets Authority (ESMA)

- ESMA introduced a new legislative framework, named MiFID II/MiFIR in 2018. This framework aimed to strengthen investor protection and improve the functioning of financial markets, making them more efficient, resilient and transparent.
- In 2021, ESMA made amendments to MiFID II with regard to the integration of sustainability risks and factors. The new rules integrate sustainability considerations into the investment, advisory and disclosure processes in a consistent manner across sectors.

European Banking Authority (EBA)

In 2018, the EBA introduced three mandates in the area of sustainable finance:

- EBA will assess the potential inclusion of ESG risks in the supervisory review and evaluation process performed by competent authorities.
- Large institutions with publicly listed issuances will disclose information on ESG risks, physical risks and transition risks as defined in the report referred to in Article 98 of the CRD.
- EBA will assess whether a dedicated prudential treatment of exposures related to assets or activities associated substantially with environmental and/or social objectives would be justified.

Country focus: United Arab Emirates

Over the last few years, the UAE has made a concerted effort to drive sustainability under the framework of the **UAE Vision 2021**, in alignment with the UAE Green Agenda 2015-2030, the Dubai Plan 2021, Paris Agreement (COP21) and the 17 UN Sustainable Development Goals (SDGs), which were adopted by 193 members states at the United Nations in 2015.

Target 6 under SDG 12, "Ensure sustainable consumption and production patterns", requires member states to encourage companies, especially large and transnational companies, to adopt sustainable practices and to integrate sustainability information into their reporting cycle. Based on this target, the Global Reporting Initiative (GRI) engages with national and regional governments to enable, monitor and accelerate company progress on SDG reporting and fulfillment.

In line with SDG 12, the UAE government has drawn up several short and long-term sustainability-related goals and developed national frameworks and guidelines for public and private institutions.

In January 2017, the UAE government formed a **National Committee on SDGs** aiming for national implementation of the SDGs. The UAE government has also developed a local platform for businesses, academic institutions and the public sector to work towards the SDGs.

The **UAE's UN Global Compact network** aims to root the ten principles of the Global Compact, as well as the SDGs, into the national context.

Abu Dhabi Vision 2030 aims to build a sustainable and diversified economy, improving accessibility and providing higher-value opportunities for its residents.

The **Dubai Declaration on Sustainable Finance** launched in 2016. Eleven UAE-based financial institutions have committed to the Declaration confirming their support for the UAE Vision 2021, with the aim of transforming to a green economy through recognizing the important role that the finance sector can play in enabling a climate-resilient, inclusive green economy and sustainable development and committing to accelerate sustainable finance practices in partnership with the UAE government.

Abu Dhabi Global Market (ADGM) manages the Zayed Sustainability Prize Initiative, aligned with the global Sustainable Development Agenda for 2030 and Sheikh Zayed's vision of "uplifting vulnerable communities across the world through technology and sustainable solutions."

Dubai Financial Market (DFM) updated its Shari'a standards to cater to the growing interest in sustainability. The standards cover the issuance of green instruments such as green sukuk, shares and green investment funds.

Meanwhile, local banks are embracing sustainability. For example, a major local bank issued an ESG-linked syndicated loan, with the cost of the USD 1.75 billion facility facility, based on the percentage of women in senior management and water efficiency. Forty-three branches were equipped with disability-friendly servicing facilities, and in 2020, 62% of branches were made more accessible.

Mandates of the UAE Securities and Commodities Authority

The UAE's Securities and Commodities Authority (SCA) requires public joint stock companies listed in the UAE to comply with specific ESG disclosure requirements.

In accordance with Article (76) of the Chairman of SCA Board Decision No. (03 R.M.) of 2020 concerning adoption of the Corporate Governance Guide for Public Joint Stock Companies (Governance Code), public joint stock companies listed on the Abu Dhabi Securities Exchange (ADX) or the Dubai Financial Market (DFM) in the UAE (Listed PJSCs) must publish a sustainability report.

On 10 January 2021, the SCA issued a general clarification to Article (76) of the Governance Code which sets out in detail the required contents of sustainability reports and a confirmation that such report must be published annually.

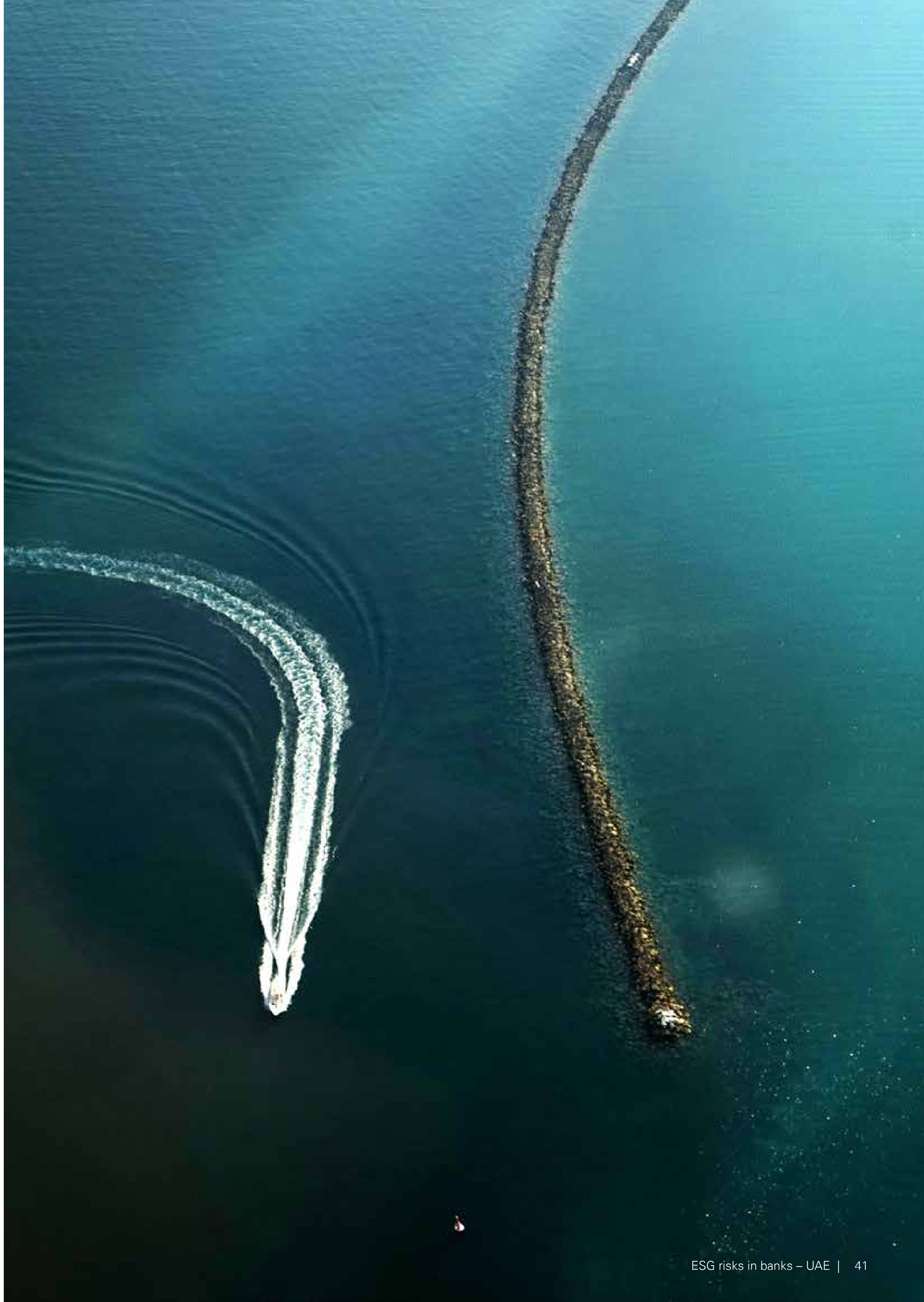
Listed PJSCs are required to prepare a sustainability report reflecting the company's long-term strategy and its impact on the following fields:

The environment – the impact of the company's operations and decisions on the environment and the communities in which the company operates

Society – how the company's policies and operations contribute or could contribute to social justice, the well-being of workers and employees and the surrounding community

The economy and governance – how the company is contributing to the economic benefit of society and the impact of the company's operations on the local economy

- Listed PJSCs must also comply with the Global Reporting Initiative (GRI) standards and any sustainability standards and requirements issued by the DFM or ADX, depending on which market it is listed on.
- Listed companies are required to submit their annual sustainability report for the financial year 2020 within six months following the end of the financial year. For subsequent financial years, listed PJSCs must submit the sustainability report to the SCA within 90 days from each financial year end or before the date of the annual general assembly meeting, whichever is earlier.



UAE legislature aimed at bolstering ESG activities

Regulation	Impact
– Cabinet Decision No. 26/2014 on the national system for ozone depleting substances	– Restriction in the export and import of materials and equipment containing ozone depleting substances
– Cabinet Decree No (12) of the year 2006 concerning the protection of air from pollution	– Regulations implemented to reduce air pollution – Established environmental impact evaluation for projects and permissible threshold for air pollutants
– Federal Law No. 238/2016 – The ratification of the Paris Agreement on climate change	– Amendment to coordinate strategies in alignment with climate change plans implemented and enforced by the government
– Federal Law No. 12/2018 on integrated waste management	– Strict regulation of waste management process
– Ministerial Decision No. 21/2018 on the Implementing Regulation of Federal Law No. 23/1999 on the exploitation, protection and development of living aquatic resources in the UAE and its amendment	– Restriction in obtaining fishing and boat licenses – Restriction in circulation, sale and marketing of aquatic creatures
– Ministerial Resolution No. (228) of 2020 on the adoption of the infectious biological waste management handbook – 3rd. edition [Arabic]	– Regulations implemented concerning waste management site in relation to handling, storage and disposal of biological waste
– Regulation No. 238/2010 prohibiting printing on non-recycling plastic bags	– Prohibition of printing on plastic and biodegradable bags in line with the ban on the use of non-biodegradable plastic products
– Abu Dhabi Administrative Decision No. 45/2019 on the issuance of the regulation outlining the scope of the application of district cooling	– Reduction in carbon emissions and consumption of energy – Cost saving and investment opportunities
– Ministerial Decision No. 21/2019 on the use of materials recycled from construction and demolition waste from road and infrastructure projects	– Cost saving by using recycled aggregates from construction and demolition waste from public infrastructure projects

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