

# Financial Risk & Regulation

## New green discounts and ESG disclosure rules for credit institutions

Newsletter – March 2022

The National Bank of Hungary (NBH) recently amended and supplemented the rules of the capital requirement discount for Green municipal and corporate loan exposures, which changes will be briefly described in this newsletter.

In addition, the European Banking Authority (EBA) has just published its final draft regulation (ITS) on ESG risks for Basel Pillar 3 disclosures, which is expected to enter into force on 28 June this year. The draft provides for comparable disclosures to show how climate change affects to the institutions balance sheets' other risks and also it intends to mitigate these risks. The publication of the new, detailed ESG data should already be implemented in the disclosure document to be prepared for 2022.

### **NBH Green capital requirement program**

In connection with the changes in the rules of the capital requirement discount for NBH Green municipal and corporate loan exposures, we would like to highlight the following:

- NBH clarified the basis of the available discount: multiplying its total applicable gross exposure and the Green Ratio. The gross exposures include the gross carrying amount of a loan and the amount of uncalled credit limit, in case of a bond, the real market price.
- NBH regulated in more detail the steps and rules of the calculation of the Green Ratio.
- In the context of sustainable agriculture, the discounts have been clarified and in some points the rules for use have been simplified.
- As expected by the market, NBH has published in detail which exposures can be granted capital requirement discounts in connection with the construction, sale, and modernization of sustainable real estate. The regulation

distinguishes 3 categories and determines a very detailed set of criteria for each. The first group is exposures that meet Taxonomy and meet the DNSH criteria, the second and the third are such non-compliant projects which have an international building certification certificate (BREEM, LEED, DGNB) or other projects that meet sustainability.

### **New mandatory ESG disclosures for banks**

#### **Legal background and purpose of the regulation**

Article 434a of the CRR authorizes the EBA to develop its unified disclosure formats and related guidelines.

The essence of ESG publication in a single format is to provide sufficiently comprehensive and comparable information to assess the relevant risk profile of the institutions. In developing the rules, EBA built on the recommendations of the Financial Stability Board's Working Group on Climate Financial Disclosure (FSB-TCFD), the Commission's non-

binding guidelines on climate change reports, and the EU Taxonomy Regulation. The purpose of the amendment is to provide stakeholders with adequate information about ESG exposures, risks and strategies of credit institutions, and to make informed decisions accordingly, whether it is an investment, financing or regulatory decision.

ITS provides, among others, uniform disclosures and KPIs, such as the Green Asset Indicator (GAR) known from the Taxonomy Regulation and the Banking Book Taxonomy Alignment Ratio (BTAR), which shows to what extent does a bank finances economic activity that the EU considers relevant to the green economic transition. The aim of developing this framework is to ensure the consistency, comparability, and relevance of the institutions' disclosures.

### **Main elements of publication**

The specification of the ITS draft set out comparable quantitative disclosures on temporary (transit) and physical risks related to climate change, including information relating to carbon emissions or the ratio of exposure to assets dependent on climate change events. In addition to the specific climate change risks caused by extreme weather events, information on other risks caused by the green economic transition will also need to be provided, including exposures to the most polluting industries, where regulatory risk is greatest, so the possibility of legal restrictions on certain economic activities in the future. The information made public also covers the institutions' mitigation measures to support their customers' transition to carbon neutral operations in line with the Paris climate goals and their adaptation to climate change. In addition, the draft contains KPIs for financing activities for environmentally sustainable instruments.

Beside the quantitative indicators, the draft regulation also requires the publication of qualitative information. These text publications contain information about the operation of a bank, such as how institutions embed ESG considerations in their corporate governance methods, business model, strategy, and risk management framework.

### **Requirements and challenges of publication**

EBA has also published report templates in Excel format. The 10 quantitative reporting tables require much more serious data content than before, many of which could pose a serious challenge to banks and indirectly to companies applying for financing. In general, there are several new expectations and complex calculations on Pillar 3 disclosure, which for the time being raise questions of interpretation for banks in many cases, including the case of accepted Scope 3 calculation methodologies and acceptable rating frameworks other than EU Taxonomy. The sectors for which it might be of essential to collect proper quality and quantity of data, such as car production, can already be

identified. Accordingly, credit institutions with a particular interest in the relevant sectors, based on the provided templates, should assess what types of data are needed and what kind of data is not available yet for the bank in any system. It also can be seen, that in case of real estate collateral, data that has not previously been stored in a searchable form may be required, such as the energy classification of real estate, and institutions should compile new breakdown reports such as presentation of collateral by NUTS geographical region.

### **Specific requirements for publication**

Table 1 entitled "Transition risks in the banking book" will require publication, especially in polluting sectors, the carrying number of exposures to non-financial corporations, cumulative impairments, and Scope 1, 2, and 3 GHG emissions, based on NACE code.

Currently it is not required to publish data for Scope 3, but the table can also be filled with the amount of CO<sub>2</sub> equivalent (CO<sub>2</sub>e) emissions reported by the customer or estimated by the bank. The Scope 3 emission estimate raises many questions due to the lack of data and the uniformly agreed methodology. The current template has been also criticized for not showing that, although the given exposure is at a company in a polluting sector, but the given exposure contributes to sustainability goals (e.g. an investor developing energy-efficient project).

In the second table the institution shall report the energy classification of commercial and residential properties forming collateral and the book exposure value realized to them, which can also serve as good basis for estimating Scope 3 emissions. The PCAF methodology, used by many credit institutions, considers it acceptable for mortgages to forecast CO<sub>2</sub>e emissions based on the energy rating and floor area of the given property.

The third table requires an adjustment metric for several predefined sectors (e.g. the automotive industry), which allows the comparison of customer emissions with the Paris climate targets (e.g. CO<sub>2</sub>/passenger-kilometer in the case of transport).

The fourth table expects detailed data to be published on exposures of companies operating in the 20 most carbon-intensive groups, such as the duration. Regarding this table it is not clarified how to establish the scope of the companies concerned and the table is not informative enough for banks that primarily finance SMEs.

The fifth table is about exposures to physical risks, including real estate coverage, which must be given in several breakdowns. Such a breakdown is the geographical region, the two main types of physical risks (acute or chronic), or even the Stage 2 classification of the exposure. Accordingly, data will

be required on the gross book value of exposures that are particularly sensitive to chronic effects such as gradual changes in the weather, and on acute effects such as sudden physical damage or even its secondary effect, for example, in a supply chain disturbance. It is also necessary to identify exposures that are sensitive to both types of physical risk.

The sixth, seventh, eighth, and ninth tables expect reports according to the criteria set out in the Taxonomy Regulation. About these tables, it is not clear whether, as in Article 8 of the Taxonomy Regulation, only exposures to companies covered by the NFRD should be reported, or whether data collection will also be required for SMEs. It is also not clear whether the two reports would be consistent in logic, or whether there may be differences between Taxonomy Article 8 and Pillar 3 publications. In case of similar content, the two reports may be redundant.

The last, tenth table expects data on exposures not affected by the Taxonomy Regulation but are sustainable and mitigate the effects of climate change, broken down by loans, bonds, non-financial, financial companies, or households.

## Effects, tasks

In general, therefore, several new expectations and complex calculations are emerging in relation to Pillar 3 disclosure, which raise many questions of interpretation, including in the case of accepted Scope 3 calculation methodologies and in relation to acceptable rating frameworks other than EU Taxonomy.

The sectors, in which highly important to collect proper quality and quantity of data (e.g. car production) can be identified, so credit institutions with a special interest in the sectors should assess what types of data will be needed, and which of these will not yet be available to the bank in any system.

It also can be seen, that in case of real estate collateral, data that has not previously been stored in a searchable form may be required, such as the energy classification of real estate, and institutions should compile new breakdown reports such as presentation of collateral by NUTS geographical region. It is a clear that the range of non-financial data to be reported is constantly increasing and finding the synergy between different reports has an utmost importance to the market players.

---

The newsletter was prepared by: Evelin Barna, Péter Vajda and Gergő Wieder.

## Contacts:



**Ágnes Rakó**  
**Partner**  
**M:** +36 70 370 1792  
**E:** agnes.rako@kpmg.hu



**Péter Szalai**  
**Associate Partner**  
**M:** +36 70 370 1739  
**E:** peter.szalai@kpmg.hu



**Gergő Wieder**  
**Senior Manager**  
**M:** +36 70 333 1471  
**E:** gergo.wieder@kpmg.hu



**József Soltész**  
**Manager**  
**M:** +36 70 370 1766  
**E:** jozsef.soltesz@kpmg.hu

[KPMG.hu](https://www.kpmg.hu)



The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation. The KPMG name and logo are registered trademarks or trademarks of KPMG International.

© 2022 KPMG Advisory Ltd. a Hungarian limited liability company and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.