BANCO DE ESPAÑA
Eurosistema

03.11.2023

ESG risk disclosures and transition plans

Green Fridays/Banco de España

Madrid

Margarita Delgado

Deputy Governor

Good morning and welcome to the latest in the series of Green Fridays organised by the Banco de España. Over the course of the year we have convened a series of workshops addressing environmental topics, seeking to foster financial literacy in aspects closely related to so-called "green finance". Our task is, first, to convey knowledge and, second, to generate informative debate based on the experiences of different stakeholders.

In today's session, the last of 2023, we will be discussing three aspects of great significance. First, the importance of ESG risk disclosures under the current Pillar 3 framework. These have come into prominence this year, with large banks having to report sustainability information under these new criteria for the first time. Second, we will discuss the role played by transition plans within this economic transformation process, and, lastly, the new Corporate Sustainability Reporting Directive (CSRD) from the standpoint of both companies and consultancy firms.

Without wishing to reveal too much of what we will be discussing here today, I would like to touch on each of these aspects now.

First, **ESG risk disclosures under the Pillar 3 framework**. As you know, quality, consistent and comparable data are imperative for supervisors, investors and other users to properly understand and assess these risks. Indeed, financial institutions themselves need such data in order to appropriately manage these risks.

In the first half of 2023, for the first time large European listed banks disclosed quantitative and qualitative information on their exposures to ESG risks, and climate-related risks in particular, pursuant to the new disclosure requirements laid down in prudential regulations. Sustainability information was already available on the market. However, the benefit of these new disclosures lies not only in the fact that institutions are reporting new data, but that they are doing so in a consistent and comparable manner.

We at the Banco de España have been closely monitoring the information stemming from these new disclosures. With this in mind, we conducted a preliminary analysis that was included in our Autumn 2023 Financial Stability Report, published last Monday.

I would like to take this opportunity to briefly mention some of the conclusions that can be drawn from that analysis.

First, for the Spanish banks analysed, a high percentage of exposures to non-financial corporations are in sectors identified by European legislation as highly polluting.

Second, real energy consumption data are not yet available for a large portion of the real estate used as collateral. This is significant given that these buildings account for 40% of all energy consumption in the European Union.

Lastly, nearly 12% of the stock of exposures to non-financial corporations is subject to physical risks, while that figure is nearly 9% for loans secured by real estate.

This information should be interpreted with a great deal of caution at present, for a number of reasons: (i) this is the first time that such information has been reported under this format, raising the possibility of interpretation issues that could be misleading; (ii) the risk categories established, such as the sectors identified as highly polluting, may be too broad; and (iii) the picture remains incomplete since some important data subject to transition periods are yet to be published.

However, this analysis underscores the significance of these exposures and the need to further improve data quality and availability to thus ensure better ESG risk management.

The second session today will focus on **transition plans**. This is a novel topic and one that has received plenty of attention in recent times, particularly in relation to the goals to decarbonise the economy.

I would note here the report published by the Network for Greening the Financial System (NGFS) in May of this year.[1] This report discusses the drawing up of transition plans by companies and financial institutions and their relevance for microprudential supervisory authorities. Specifically, it analyses how these transition plans could be used as supervisory tools.

The report sets out six key findings that should be interpreted from a global perspective given the multitude of NGFS member jurisdictions:

> **1** There are multiple definitions of transition plans, reflecting their use for different purposes.
> **2** There is merit in distinguishing transition planning (understood as the process of designing a transition strategy) from a transition plan (the end-product of the planning process whose purpose is to provide transparency to a specific audience).
> **3** The existing frameworks reflect a mix of objectives and concerns for transition plans but predominantly relate to climate-related corporate disclosures.
> **4** Transition plans could be a useful source of information for microprudential authorities to ascertain whether the risks resulting from an institution's transition strategy are commensurate with its risk management framework.
> **5** Microprudential authorities should not act in isolation.
> **6** There are some common elements to all transition plans which are relevant to assessing the safety and soundness of the institutions, namely governance, strategy, risk management and metrics.

As next steps, the NGFS undertakes to engage with international organisations, such as the FSB and the BCBS, to advance their respective work on transition plans and planning in a coordinated manner.

Although this report is comprehensive and focuses specifically on transition planning in the financial system, it is not the first to be published on the subject.

[1] "Stocktake on Financial Institutions' Transition Plans and their Relevance to Micro-prudential Authorities". May 2023.

In October 2021, the Task Force on Climate-related Financial Disclosures published guidance which made very significant contributions, such as:

1 Identifying the key characteristics of effective transition plans,[2]

2 A description of general elements that organisations should consider as part of their transition planning,[3] and

3 Flagging the aspects of transition plans that companies that have made GHG emissions reduction commitments, voluntarily or otherwise, should disclose.[4]

In addition, in November 2022 the Glasgow Financial Alliance for Net Zero published recommendations and guidance[5] for transition planning by financial institutions, setting out the key components of a credible net-zero transition plan.

Other legislative initiatives also address topics relating to the economic transition, business models and transition plans, such as, for example, the Directive on Corporate Sustainability Due Diligence.[6]

Similarly, once approved, the Capital Requirements Directive (CRD) will oblige institutions to prepare prudential transition plans. The Directive would give a mandate to the EBA to issue guidelines on managing these risks, including the key components of transition plans. Likewise, it will stipulate that the plans drawn up by the supervised institutions must be reviewed by the competent authorities.

Lastly, regarding the supervision of credit institutions, I should mention that the ECB's supervisory priorities for the period 2023-2025 again include stepping up efforts to address climate-related risks. The ECB's key activities for the coming years include preparatory work on the supervisory approach to assessing credit institutions' transition planning capabilities, with a view to meeting the requirements of the future CRD.

The last session today will focus on the **Corporate Sustainability Reporting Directive** (CSRD).

As you know, this Directive aims to enhance the transparency and accountability of listed companies and large non-financial corporations. The CSRD represents a major step

---

[2] Plans should be (i) aligned with the company's overall strategy; (ii) anchored in quantitative elements, including climate-related metrics and targets; (iii) subject to effective internal governance processes; (iv) actionable (articulating specific initiatives for effective execution of the plan); (v) credible (containing sufficiently detailed information); (vi) periodically reviewed and updated; and (vii) reported annually to stakeholders.

[3] These include strategy, governance, risk management, and metrics and targets.

[4] Including (i) current GHG emissions performance; (ii) the impact of the transition on their businesses, strategy and financial planning; (iii) actions and activities to support transition (GHG emissions reduction targets and planned changes to businesses and strategy).

[5] "Financial Institution Net-zero Transition Plans – Fundamentals, Recommendations, and Guidance".

[6] Companies subject to the Directive, which is yet to be approved, would have to draw up plans to ensure that their business model and strategy are compatible with the transition to a sustainable economy.

towards corporate sustainability and responsibility in the European Union and has significant implications for non-financial corporations.

The Directive seeks to address a series of challenges currently facing non-financial corporations, in particular relating to environmental, social and corporate governance disclosures.

It poses a challenge for companies, which will have to report on a range of topics including their environmental impact, labour practices, human rights and anti-corruption efforts. Furthermore, they must do so in a standardised, consistent and comparable manner. It also obliges companies to assess and disclose their environmental and social risks and opportunities, and how these affect their business models.

The CSRD has significant implications for non-financial corporations, requiring them to be more transparent on their non-financial practices and performance, in turn making them more accountable to investors, consumers and other stakeholders. Ultimately, this regulation aims to use disclosures as a means of identifying, and effectively improving, the management of sustainability-related risks, which could lead to better decision-making and help protect companies' reputations in the long term.

In short, the CSRD represents a major shift in how non-financial corporations disclose information and manage their operations. It contributes positively towards sustainability, corporate responsibility and transparency, and is expected to foster a more balanced and sustainable approach to corporate decision-making in the European Union.

The views of the companies with us here today will provide valuable insight into how they are adapting to this new environment, in which sustainability considerations have taken centre stage.

As we have seen, it promises to be a stimulating workshop, both in terms of the topics that will be discussed and the speakers who will be joining us, offering viewpoints from different realms of the financial and corporate sectors. This will no doubt help us to build a fuller picture of environmental matters, the management of these specific risks and the challenges that lie ahead.

I would like to reiterate my thanks to the organisers, speakers and all those in attendance for their invaluable contributions. I hope you enjoy the day.

Thank you.