Institutions

by José Manuel Mansilla-Fernández

Recent international commitments to climate change

The United Nations (UN hereafter) **Climate Change Conference (COP26)**, which was held in Glasgow (UK), brought together many of the world's leaders to address concerning issues related to climate change. The headline decision of COP 26 was the **Glasgow Climate Pact**, an initiative of the UK COP Presidency to capture progress beyond the formal agenda. The **Intergovernmental Panel on Climate Change** (IPCC) released a report in 2018 that identified that global emissions would need to reduce to zero level by at least 2050 to retain a 'high-confidence' level to limit the rise of temperatures to sustainable levels (Masson-Delmotte et al., 2018). The US Treasury Secretary Janet Yellen stated that "rising to this challenge will require the wholesale transformation of our carbon-intensive economies" and that "addressing climate change is the greatest economic opportunity of our time." (COP26, 2021; Depledge et al., 2022).[7]

On the heels of the COP26 Finance Day, the banking industry leaders also met in Glasgow to discuss the leadership role of the banking sector toward net-zero emissions.UN-convened **Net-Zero Banking Alliance** also committed to coordinating climate actions for financial institutions and aligning their

7. The World Economic Forum and PwC released jointly the *Harnessing Technology for the Global Goals* report that identified the significant role that digital technology can play in improving resilience to global warming related, natural hazards, reducing emissions, and improving the ability for humans to take the necessary steps to achieve the zero net target (World Economic Forum & PwC, 2021).

lending and investments portfolios with zero-net emissions by 2050. At the time of writing this note, the Alliance brings together around 100 banks worldwide, representing over 40% of global banking assets. The Alliance acknowledges the crucial role of banks in supporting the transition of the real sector to a greener economy (see Beyene et al., *this issue*).

The European Commission's sustainable finance strategy

The High-Level Expert Group on sustainable finance was created in 2016 and included members from the civil society, the financial sector, and the Academia from international institutions.[8] Notably, the 2018 group's final report established the pillars for the **Action Plan on Financing Sustainable Growth**, which is intended to develop the European Union's sustainable finance strategy and to incorporate environmental, social, and governance (ESG) considerations into the European financial system (European Commission, 2019, González-Martínez, 2021). The **Taxonomy Regulation** (Regulation (EU) 2020/852 of June 2020) is the cornerstone of the whole Action Plan since it establishes the classification system for the 'sustainable' economic activities.[9][10] Interestingly, the **EU Ecolabel** for retail financial products is dedicated to expressing investors' preferences regarding sustainability and the more straightforward access to sustainable products.

8. The European Commission defines **sustainable finance** as the process of dully taking environmental and social contemplations into account when making long-term decisions in sustainable activities (European Commission, 2018). Accordingly, the so-called **Capital Markets Union** is a priority, and a key step for implementing the **Paris Agreement** and the **European Union's sustainable agenda**.
9. See also Regulation (EU) 2019/2088 and Regulation (EU) 2019/2089.
10. In this regard, the European Commission introduced two supplements. First, the **Commission Delegated Regulation (EU) 2021/2139** supplements Regulation 2020/852 by establishing the technical screening criteria for determining the conditions under which an economic activity qualifies as contributing substantially to climate change mitigation or climate change adaptation and for determining whether that economic activity causes no significant harm to any of the other environmental objectives. Second, **Commission Delegated Regulation (EU) 2021/2178** supplements regulation 2020/852 by specifying the content and presentation of information to be disclosed by undertakings subject to Articles 19a or 29a of Directive 2013/34/EU, the methodology to comply with that disclosure obligation.

Disclosures

The Financial Stability Board created the **Task Force on Climate-related Financial Disclosures (TCFD)**, which provides recommendations for assessing and reporting their climate-related strategy.[11] In particular, the final report makes sector-specific recommendations on how companies should disclose climate-related financial risks to inform better their investors, lenders, and insurers (Campiglio, 2016; Campiglio et al., 2018). Notably, the **PCAF Global Greenhouse Gas Accounting and reporting Standard for the Financial industry** offers detailed statistics on measures and disclose emissions for specific assets. The **Science Based Target initiative (SBTi)** published the **Financial Sector Science-Based Targets Guidance** which enables companies to set emissions reductions targets according to the foremost climate science (SBTi, 2021).

The European Commission adopted in April 2021 a proposal for **Corporate Sustainability Reporting Directive (CSRD)** that introduces stricter reporting requirements and widens the scope of applicability with respect to the existing non-financial reporting directive (NFRD). Furthermore, Regulation (EU) 2019/2088 will apply from March 2021. Regarding the development of a **European Union Green Bond Standard**, in early July 2021 the European Commission presented its proposal based on a voluntary framework that remarks transparency, the need for external review, and the European Securities and Markets Authority should supervise it.

Remarkably, integrating ESG risks into the **Supervisory Review and Evaluation Process (SREP)** performed under the Pillar 2 as not exempt from difficulties. However, the EC has considered these recommendations in developing the **EU Banking Package** that finalises the implementation of **Basel III** in Europe. Formally, Pillar 3 disclosure requirements are expanded from applying to large, listed institutions to all in the scope of the CRR (EBA, 2021; Marullo Reedtz, *this issue*). Importantly, as a part of the Pillar 3 disclosure and the NFRD, the **Green Asset Ratio** measures the "greenness" of the bank's balance sheet, and it will allow investors and regulators to evaluate and foster

11. Disclosures of the financial impacts of climate-related and environmental risks are crucial for achieving the transparency necessary to preserve market discipline. In other words, promoting peer pressure incentivizes companies to manage and diminish their individual risk (ECB, 2020).

new legislation toward green finance. Recently, in January 2022 the European Banking Authority (EBA) released the final draft of the *Implementing Technical Standards* (ITS) on Pillar 3 disclosures on ESG risks (Mikkelsen et al., *this issue*).

The role of central banks

Globally, the **Network of Central Banks and Supervisors for Greening the Financial System** (NGFS) in December 2017 was aimed at defining and promoting good practices, conducting analysis, fomenting climate risk management in the financial sector, and mobilising funds needed for a transition towards a sustainable economy (NGFS, 2021). In Europe, the national central banks incorporate climate-related questions intro their actions. Furthermore, central banks not belonging to the Eurosystem are even introducing environmental questions into their design of the monetary policy. Central banks have begun integrating sustainable and responsible investment (SRI) principles into their portfolio management (NGFS, 2019, 2020). Outstandingly, the European Central Bank is progressing in evaluating and limiting the potential aftermaths of climate change (ECB, 2021a,b; Reghezza et al., 2021).The European Central Banks is advancing on preparing and executing the ECB Thematic Review on Climate-Related and Environmental (C&E) Risks and the ECB Climate Stress tests that include transition and physical risks in a horizon of 30 years. Accordingly, the SSM included climate-related risks in its 2019 and 2020 roadmaps that draw up supervisory expectations for relevant banks (Alonso and Marqués, 2019; Gonzalez and Núñez, 2020, 2021).

References

Alonso, A., and Marques, J.M. (2019). Financial innovation for a sustainable economy. Occasional paper No. 1916. Bank of Spain. Available at: https://www.bde.es/f/webbde/SES/ Secciones/Publicaciones/PublicacionesSeriadas/DocumentosOcasionales/19/Files/do1916e.pdf (Accessed on April 18, 2022).

Beyene, W., Delis, M., and Ongena, S. (2021). Disclosure of banks fossil exposures. European Economy – Banks, Regulation and the real Sector, *this issue*.

Campiglio, E. (2016). Beyond carbon pricing: The role of banking and monetary policies in financing the transition to a low-carbon economy, Ecological Economics 121, 220-230. DOI: https://doi.org/10.1016/j.ecolecon.2015.03.020

Campiglio, E., Dafermos, Y., Monnin, P., Ryan-Collins, J., Schotten, G., and Tanaka, M. (2018). Climate change challenges for central banks and financial regulators. Nature Climate Change 8, 462-468. DOI: https://doi.org/10.1038/s41558-018-0175-0

COP26. (2021). COP26 Goals. Available at: https://ukcop26.org/cop26-goals. (Accessed on April 18, 2022).

Depledge, J., Saldivia, M., and Peñasco, C. (2022). Glass half full or glass half empty?: The 2021 Glasgow Climate Conference, Climate Policy, 22, 147-157, DOI: 10.1080/14693062.2022.2038482

European Central Bank (2020). ECB report on institutions' climate-related and environmental risk disclosures. Available at: https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.ecbreportinstitutionsclimaterelatedenvironmentalriskdisclosures202011~e8e2ad20f6.en.pdf (Accessed on April 18, 2022).

European Central Bank (2021a). Climate-related risk and financial stability. ECB/ESRB Project Team on climate risk monitoring. Available at: https://www.ecb.europa.eu/pub/pdf/other/ecb.climateriskfinancialstability202107~87822fae81.en.pdf (Accessed on April 18, 2022).

European Central Bank (2021b). Detailed roadmap of climate change-related actions. Available at: https://www.ecb.europa.eu/press/pr/date/2021/html/ecb.pr210708_1_annex~f84ab35968.en.pdf (Accessed on April 18, 2022).

European Commission (2019). Guidelines on reporting climate-related information. Available at: https://ec.europa.eu/finance/docs/policy/190618-climate-related-information-reporting-guidelines_en.pdf (Accessed on April 18, 2022).

González-Martínez, C.I. (2021). Overview of global and European institutional sustainable finance initiatives. Bank of Spain. Available at: https://www.bde.es/f/webbde/SES/Secciones/Publicaciones/InformesBoletinesRevistas/ArticulosAnaliticos/21/T3/Files/be2103-art30e.pdf (Accessed on April 18, 2022).

González, C. I., and S. Núñez (2020). Cambio climático y sistema financiero: una necesaria mirada al futuro. Papeles de Economía Española No 163, pp. 130-145. Available at: https://www.funcas.es/articulos/cambio-climatico-y-sistema-financiero-una-necesaria-mirada-al-futuro-transicion-hacia-una-economia-baja-en-carbono-en-espana-2019-n-163/ (Accessed on April 18, 2022).

González, C. I., and S. Núñez (2021). Markets, financial institutions and central banks in the face of climate change: challenges and opportunities. Occasional Paper No. 2126. Bank of Spain. Available at: https://www.bde.es/f/webbde/SES/Secciones/Publicaciones/PublicacionesSeriadas/DocumentosOcasionales/21/Files/do2126e.pdf (Accessed on April 18, 2022).

Marullo Reedtz, P. (2021). Financing the environmental transition in Europe. European Economy – Banks, Regulation and the real Sector, *this issue*.

Masson-Delmotte, V., Zhai, P., Pörtner, H. O., Roberts, D., Skea, J., Shukla, P. R.,. and Waterfield, T. (2018). Global warming of 1.5C. An IPCC Special Report on the impacts of global warming of, 1(5).

Mikkelsen, D., Viscardi, S., Montes, M., and De Amicis, F.P. (2021). Climate change regulation and supervision in Europe and implications for commercial banks. European Economy – Banks, Regulation and the real Sector, *this issue*.

NGFS (2019). First comprehensive report. A call for action, April.

NGFS (2021). Annual Report 2020, April.

Reghezza, A., Altunbas, Y., Marques-Ibañez, D., Rodriguez d'Acri, C., and Spaggiari, M. (2021). Do banks fuel climate change? ECB Working Paper Series No. 2550. Available at: https://www.ecb.europa.eu/pub/pdf/scpwps/ecb.wp2550~24c25d5791.en.pdf (Accessed on April 18, 2022).

Science-Based Targets initiative (SBTi). 2021. Financial Sector Science-Based Targets Guidance Pilot Version 1.1, Science-Based Targets initiative (SBTi), Report. Available at: https://sciencebasedtargets.org/resources/files/Financial-Sector-Science-Based-Targets-Guidance-Pilot-Version.pdf (Accessed on April 18, 2022).

World Economic Forum & PwC (2021), Harnessing Technology for the Global Goals: A framework for government action, Accessed on 31st October 2021. Accessed at: https://assets.2030vision.com/files/resources/wef-harnessing-technology-for-the-global-goals-2021.pdf?470b76352b (Accessed on April 18, 2022).

Legislation cited

Commission Delegated Regulation (EU) 2021/2139 of 4 June 2021 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by establishing the technical screening criteria for determining the conditions under which an economic activity qualifies as contributing substantially to climate change mitigation or climate change adaptation and for determining whether that economic activity causes no significant harm to any of the other environmental objectives. Available at: http://data.europa.eu/eli/reg_del/2021/2139/oj (Accessed on April 18, 2022).

Commission Delegated Regulation (EU) 2021/2178 of 6 July 2021 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by specifying the content and presentation of information to be disclosed by undertakings subject to Articles 19a or 29a of Directive 2013/34/EU concerning environmentally sustainable economic activities, and specifying the methodology to comply with that disclosure obligation. Available at: http://data.europa.eu/eli/reg_del/2021/2178/oj (Accessed on April 18, 2022).

Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups Text. Available at: https://eur-lex.europa.eu/eli/dir/2014/95/oj (Accessed on April 18, 2022).

European Commission (2019). Communication from the Commission — Guidelines on non-financial reporting: Supplement on reporting climate-related information (2019/C 209/01). Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52019XC0620%2801%29 (Accessed on April 18, 2022).

European Commission (2018). Communication from the European Parliament, the European Council, the Council, the European Central Bank, The European Economic and Social Committee of the Regions. Action Plan: Financing Sustainable Growth (COM/2018/097 final). Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52018DC0097 (Accessed on April 18, 2022).

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) Available at: https://eur-lex.europa.eu/eli/reg/2020/852/oj (Accessed on April 18, 2022).

Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector (PE/87/2019/REV/1). Available at: https://eur-lex.europa.eu/eli/reg/2019/2088/oj (Accessed on April 18, 2022).

Regulation (EU) 2019/2089 of the European Parliament and of the Council of 27 November 2019 amending Regulation (EU) 2016/1011 as regards EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks (PE/90/2019/REV/1). Available at: https://eur-lex.europa.eu/eli/reg/2019/2089/oj (Accessed on April 18, 2022).

Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 Text with EEA relevance. Available at: http://data.europa.eu/eli/reg/2013/575/oj (Accessed on April 18, 2022).