Sustainability – The View from a Brexit Bank Perspective

Comparative Analysis of BaFin, ECB, TCFD and PRA Expectations

August 2020

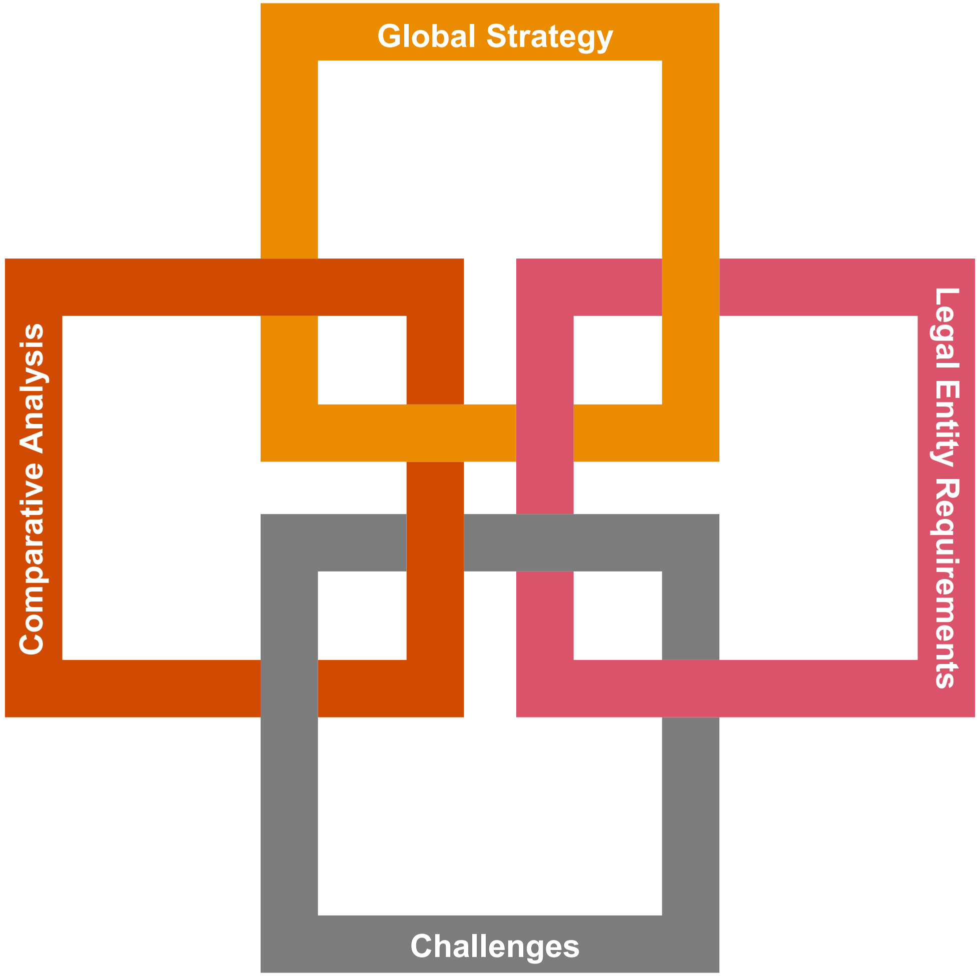
pwc

The greatest threat to our planet is the belief that someone else will save it.

Robert Swan
Author

Executive Summary

Sustainability – The View from a Brexit Bank Perspective



Global Strategy
Requirements stemming from global regulatory or economic developments are usually addressed by global Capital Markets institutions based on a top down approach, i.e. starting with the definition of frameworks and processes at head quarter, subsequently rolled out to subsidiaries and branches across the globe.

Legal Entity Requirements
Specific challenges arise in case of deviating country or region specific requirements and respective supervisory expectations, which need to be addressed from a local legal entity perspective. This is the case for expectations and regulatory requirements in relation to Sustainability.

Comparative Analysis
Acknowledging the challenge to identify deviations with regard to existing requirements, this presentation provides an overview over the comparative analysis of BaFin, ECB, TCFD and PRA expectations in relation to Sustainability and highlights the respective challenges in addressing local requirements as part of a global framework.

Challenges
PwC can support you in addressing these challenges and implement local legal entity specific requirements, e.g. identify remedial actions to address expectations in relation to social and governance related requirements, management of sustainability in relation to outsourcing, analyse additional legal entity specific reporting requirements, etc.

Regulatory scrutiny increases on sustainability topics

Joint ESA Priorities – Sustainable Finance and Climate Risk

Considerable expectations from the finance sector to meet targets

In order to meet the EU energy and climate targets for 2030 and to transition to a low carbon- and more environmentally sustainable economic model, the EU faces an investment gap of **€150 - €177 bn** + of additional investment per year to **2030**.

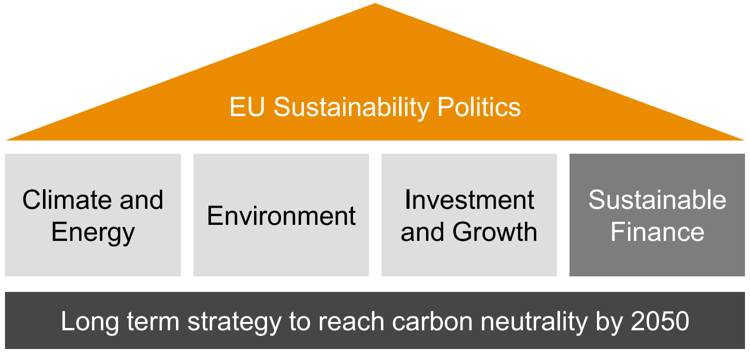
The transition to a net-zero greenhouse gas economy in **2050** will require additional investments, in the range of **€175 to €290 bn** a year (including investments needed to replace vehicles).

EU energy and climate targets for **2030**:

- Reduction of greenhouse gas emissions: -40% as compared to 1990
- Renewable energy: 32% of gross final energy consumption
- Energy efficiency: 32.5% of primary energy saved

Source: European Commission, June 2019

Sustainable Finance is part of a global EU strategy



Source : European Commission, 2018

Sustainable Finance is instrumental to meet COP21 and SDG targets[1]

Reorienting private capital to more sustainable investments requires a comprehensive shift in how the financial system works.

This is necessary if the EU is to develop more sustainable economic growth**, ensure the stability of the financial system, and foster more transparency and long-termism in the economy**.

Such thinking is also at the core of the EU's Capital Markets Union (CMU) project.

[1] COP21 = United Nations Framework Convention on Climate Change, 21st Conference of the Parties; SDG targets = United Nations Sustainable Development Goals

Source: European Commission COM(2018) 97 – Action Plan: Financing Sustainable Growth – 8 March 2018

Expectations and Standards regarding Sustainability

Common themes and taxonomy

Sustainability – Common Themes and Taxonomy

1. **Definition of Sustainability Risks**
General remarks and risks in scope of expectations and standards

2. **Business Strategy**
Incorporating sustainability considerations into the institution’s strategy

3. **Governance and Processes**
Expectations for different departments and processes with regard to sustainability

4. **Risk Management**
Incorporating sustainability risks into the risk management framework and associated processes

5. **Stress Tests**
Expectations regarding the consideration of sustainability risks in stress testing

6. **Outsourcing**
Considering sustainability risks in relation to outsourced services

7. **Ratings**
Adapting existing credit ratings and usage of (external) ESG ratings regarding investments

8. **Disclosure of Sustainability Risks**
Expectations in relation to the disclosure of sustainability related considerations

Expectations and Standards regarding Sustainability

Comparative Analysis and Summary (1/2)

	BaFin	ECB	TCFD	PRA	Summary	Severity of Differences
	Guidance Notice on Dealing with Sustainability Risks, *published on 20 Dec 2019*	Guide on climate-related and environmental risks, *published on 20 May 2020*	Recommendations of the Task Force on Climate-related Financial Disclosures, *published on 15 Jun 2017*	SS3/19: Enhancing banks' and insurers' approaches to managing the financial risks from climate change, *published on 15 Apr 2019*		
1 Definition	Sustainability risks are defined as **environmental, social and governance risks (ESG risks**)	Clear focus on **climate-related and environmental risks;** Reference is made to ESG risks in a few instances	Clear focus on **climate risks**	Clear focus on **climate risks**	**Scope of expectations differs with regard to the definition of sustainability risks**; No difference wrt definition of physical and transition risks	
2 Business Strategy and Governance	Expectation to fully review the business strategy against ESG risks and either develop new strategies or adapt existing strategies accordingly	Institutions are expected to under-stand the impact of climate-related and environmental risks on the business environment in which they operate in the short, medium or long term and reflect these in their strategy	Expectation that board and/or board committees consider climate-related issues when reviewing and guiding strategy	Board is expected to understand and assess the financial risks from climate change that affect the firm and to address and oversee these risks within the firm's overall business strategy	**Difference in level of detail**: Relevance of reflecting the impact of sustainability risks in firm's business strategies is **highlighted across all papers**; BaFin and ECB are more descriptive with regard to strategy processes	
3 Organization and Processes	Potential involvement/ relevance of certain divisions and processes with regard to ESG risks are explicitly called out; **Potential impact and/or required actions** to reflect ESG risks included	Expectation to assign responsibilities to manage and reflect climate-related and environmental risks in existing processes in line with the **three lines of defense model**	Climate risks to be included in existing organizational structures and processes; **Focus on financial impact and performance** in relation to climate risks	Expectation to reflect **climate risks in governance arrangements** and risk management processes; No further description of departments or processes affected	**Difference in level of detail**: BaFin and ECB describe most important departments and processes potentially affected, while other papers refer to existing governance and processes	
4 Risk Management	Expectation that ESG risks are included in existing risk mgmt. framework; **detail included** wrt risk strategy, risk inventory, limit framework, policies, processes, reporting, etc.; reference to contingency plans	Expectation is that climate-related and environmental risks are included in existing risk mgmt. framework and processes; **detail** included wrt how **different risk types** could be particularly affected	**High level expectation** included wrt disclosure of how the organization identifies, assesses, and manages climate-related risks and uses targets and metrics as part of their risk mgmt. framework	PRA expects firms to understand the financial risks from climate change and how they will affect their business model; No detailed wording included with regard to risk mgmt. framework	**Difference in level of detail**: Relevance of inclusion of sustainability risks in existing risk management frameworks **highlighted across all papers**. While BaFin and ECB are quiet descriptive, others refer to existing frameworks; BaFin and ECB make a reference to expectations in **contingency planning**	

Expectations and Standards regarding Sustainability

Comparative Analysis and Summary (2/2)

	BaFin	ECB	TCFD	PRA	Summary	Severity of Differences
5 **Stress Tests**	Considers how ESG risks could be captured as part of **stress tests and scenario analyses** with the aim to identify the entity's ability to withstand adverse events or scenarios caused by physical and transition risks	Detailed guidance with regard to risk quantification by means of scenario analysis and stress testing; A **rigorous programme of stress testing** incl as part of the ICAAP (economic and normative perspective) is expected	Detailed expectations described with regard to the adaption of existing scenarios or creation of new **climate-scenarios**; **no reference** included however with regard to **stress testing** in particular	Firms should use **scenario analysis and stress testing** to inform the risk identification process; detailed expectation to not only use historical data but consider **future trends in catastrophe modelling** as well	While **TCFD** only refers to climate-scenarios, **BaFin, ECB and PRA are referring to stress testing as well as scenario analyses** and provide guidance on how this could be done at different levels of detail	
6 **Outsourcing**	Outsourcing processes to be **reviewed against the impact of ESG risks** (including outsourcing guidelines, agreements, risk analysis and outsourcing management)	No specific requirements with regard to outsourcing but **reference to EBA Guidelines on Outsourcing** included	Outsourcing is not a part of the TCFD guidelines	PRA expects firms to identify potential impact of **physical risk factors on outsourcing arrangements** and supply chains	**BaFin** guidance includes most detailed outsourcing requirements, while **ECB** refers to EBA GL on outsourcing and **PRA** expects impact assessment in relation to existing outsourcing arrangements	
7 **Ratings**	**Credit Ratings**: Should only include ESG factors if they have an influence on creditworthiness **ESG Ratings**: Can be used to determine sustainability of financial investments	**Specific expectations** included, e.g. 1LoD to identify, assess and monitor c-/e-risks relevant for creditworthiness; scoring/rating of a client; conduct proper due diligence on c-/e-risks incl. definition of ratings for counterparties	No explicit expectations included with regard to rating concepts and related processes	No explicit expectations included with regard to rating concepts and related processes	While the **BaFin** Guidance suggests the usage of ESG ratings, the **ECB** is more prescriptive with regard to their expectations on including climate-related and environmental risks in ratings and related processes; **TCFD and PRA** have not included a reference to ratings	
8 **Disclosure**	Reference is made to TCFD standards with regard to disclosure requirements but **no further detail included in BaFin guideline**	Expectation of publishing **information and metrics** on environmental risks that they deem to be material in line with the EU COM Guidelines on non-financial reporting (based on TCFD expectations)	The TCFD standards provide an **international framework** for financial and non-financial companies; cover governance, business strategy, risk management, metrics and targets	Reference to existing requirements (CRR, Solvency II and UK Companies Act); **Specific expectations** included wrt e.g. integration of climate risks into Gov. and RM processes, identification of risks, etc.	While the **TCFD** sets the standard for consistent climate disclosures, the **ECB** leverages on these expectations as well as the EU COM (but specified); while the **BaFin** refers to TCFD standards, the **PRA** is more detailed about what should be included in firm's disclosures	

Expectations and Standards regarding Sustainability

Challenges from a Local Perspective and How We Can Support

Definition of sustainability risks

Challenge: *Already existing global processes and guidelines might have a narrower scope, i.e. potentially focus on climate risks only, without taking into account social and governance related aspects as required by the BaFin guidance.*

Recommended actions: *Potential gaps between existing global processes and documentation and the BaFin/ECB expectations regarding sustainability risks with regard to social and governance related aspects should be identified. This includes the review and challenge of all business areas, processes and internal policies, impacted by sustainability risks.*

How PwC can support: *We can support you in identifying business areas, processes and documentation impacted by the increasing supervisory expectations on sustainability as well as in conducting a gap analysis and identifying any remedial actions against existing global processes and projects to ensure adherence to BaFin/ECB specific expectations in relation to sustainability.*

Outsourcing

Challenge: *The business might not consider sustainability risks in relation to outsourcing processes, management, existing arrangements and supply chains.*

Recommended actions: *The existing outsourcing agreements and the internal outsourcing management (including policies and risk analysis) should be monitored and adapted with regard to the expectations of the authorities regarding sustainability risks.*

How PwC can support: *We offer our support with regard to conducting a comparative analysis regarding supervisory expectations as well as the management of sustainability risks in relation to outsourcing. This includes the review of processes and existing outsourcing agreements with regard to sustainability risks.*

Ratings

Challenge: *Sustainability projects on a global level might not focus on how to identify, assess and monitor sustainability risks and consider these risks in relation to credit- and ESG-ratings including in relation to the responsibilities within the three lines of defense model.*

Recommended actions: *Considerations regarding sustainability risks should be included into existing ratings and related processes. Relevance and potential usage of ESG-ratings should be analyzed. Related responsibilities should be identified taking into account the three lines of defense model.*

How PwC can support: *Analyzing options on how to best factor in sustainability considerations into existing credit ratings as well as identifying use-cases for (external) ESG-ratings. Furthermore, we can support you in defining roles and responsibilities in relation to sustainability risks along the three lines of defense model.*

Further Topics

Challenge: *Depending on the number and severity of identified gaps (e.g. scope of processes and guidelines might be too narrow with regard social, governance related aspects and contingency plans, disclosure requirements might need to be developed etc.), remedial actions need to be identified and prioritized.*

Recommended actions: *Identify and prioritize remedial actions, including tactical and strategic solutions, depending on availability of resources and communication with supervisory authorities.*

How PwC can support: *PwC offers customized strategic support regarding the identification and prioritization of remedial actions as well as developing tailored project plans. Furthermore, we can support you in project management related tasks as well as by providing operational support, e.g. with the aim of implementing remedial actions.*

Your contacts.

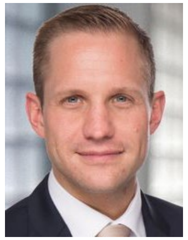
Capital Markets Experts

Partner

Stephan Lutz

+49 69 9585 - 2697
stephan.x.lutz@pwc.com

Director



Benjamin Münch

+49 69 9585 - 3239
benjamin.münch@pwc.com

Senior Managerin

Ina-Alexandra Steiner

+49 711 25034 - 1099
ina-alexandra.steiner@pwc.com

Sustainability Experts

Partner

Daniel Wildhirt

+49 69 9585 - 2950
daniel.wildhirt@pwc.com

Partner

Ullrich Hartmann

+49 69 9585 - 2115
ullrich.hartmann@pwc.com

Partner

Michael Rönnberg

+49 69 9585 -1524
michael.roennberg@pwc.com

Thank you.

pwc.de

© 2020 PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft.
All rights reserved. In this document, "PwC" refers to PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft, which is a member firm of PricewaterhouseCoopers International Limited (PwCIL). Each member firm of PwCIL is a separate and independent legal entity.