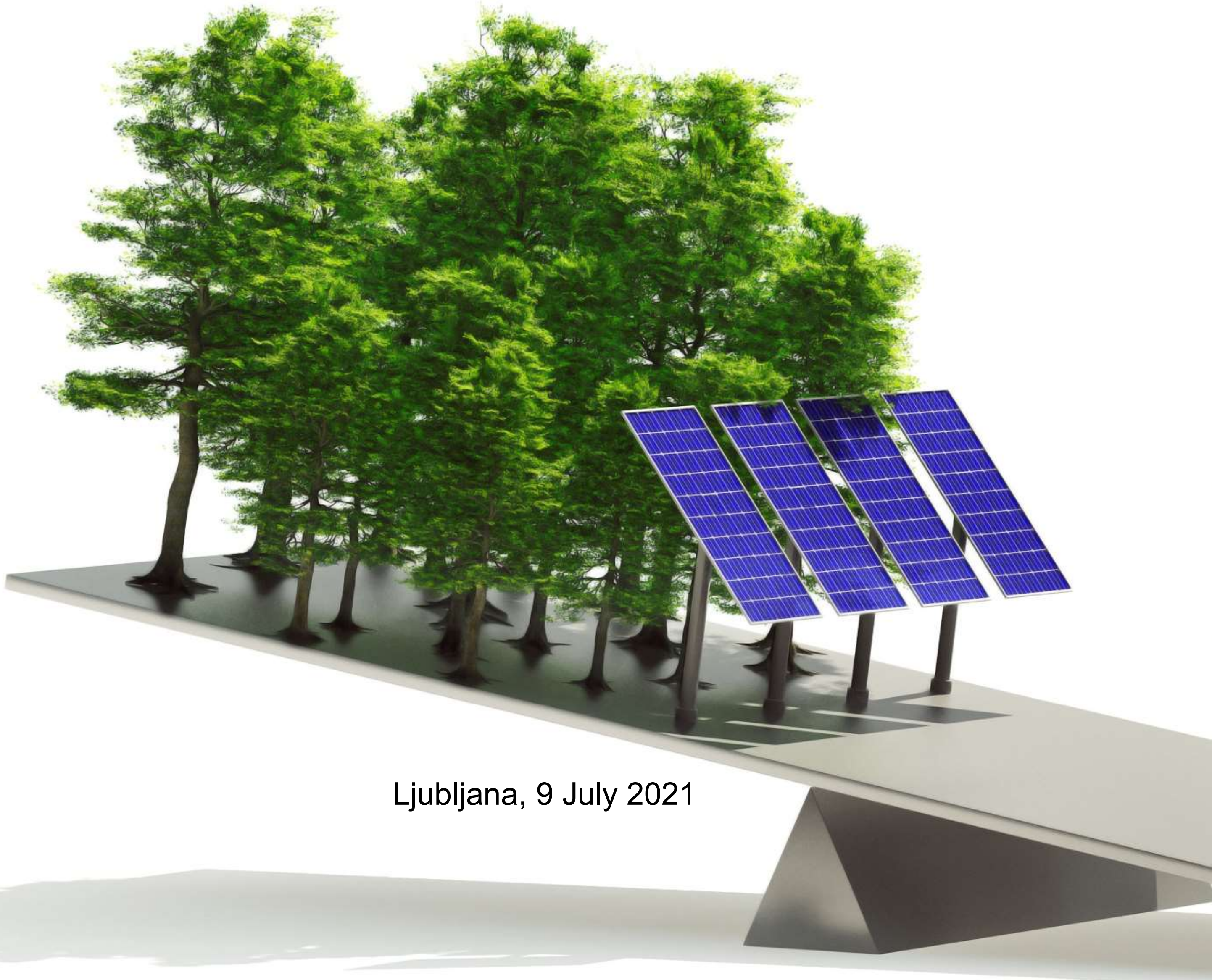
ZBS | Združenje bank Slovenije

ZBS GUIDELINES ON SUSTAINABLE FINANCING

version 1.0



Ljubljana, 9 July 2021

Contents

1. Introduction ... 3
2. Guidelines ... 4
01 Strategy – making commitments and setting goals ... 4
02 Business model – definition of environmentally sustainable activities ... 5
03 Incorporating ESG- and climate-related risks into the risk management process . 6
04 Incorporating ESG factors and risks in a financing process – assessing clients and investments ... 7
05 Relationships with clients and other stakeholders ... 7
06 Transparency – Public reporting and disclosures ... 8
07 Governance and culture ... 9
3. Glossary ... 10
4. List of the key regulatory acts referring to sustainable finance and links ... 11

1. Introduction

In the context of the transition to a low-carbon society, the European banking sector is cast to play one of the leading roles. Building on the Goals and targets set out in the Resolution adopted by the UN General Assembly – Transforming our world: the 2030 Agenda for Sustainable Development, and the first-ever universal, legally binding global climate change agreement adopted at the Paris climate conference – the Paris Agreement, EU Member States have made pledges to achieve ambitious climate and energy targets by 2030. The EU's long-term strategy is to arrive at zero net greenhouse gas emissions by 2050.

As early as in 2018, the European Commission launched a package of proposals containing legislative tools for the financial services sector – Action Plan: Financing Sustainable Growth – which provides the basis for the reorientation of private capital towards financing sustainable economic activities and paves the way for the EU to achieve the goals set out in the Paris Agreement. The Action Plan on financing sustainable growth identifies three objectives:

1. Reorienting private capital flows towards sustainable investments;
2. Managing financial risks arising from climate change, depletion of natural resources, degradation of the environment and social issues;
3. Fostering transparency in relation to sustainability performance of companies and enhancing a long-term orientation of business models.

In order to achieve the set objectives, the following actions have been agreed:

- Developing harmonious taxonomy for sustainable activities;
- Creating standards and labels for green financial products;
- Expanding sustainable finance actions;
- Incorporating sustainable development (sustainability) in the investment process;
- putting in place benchmarks for sustainable development (sustainability benchmarks).

The investment plan on financing sustainable growth (InvestEU) is part of the Commission's plan also known as the European Green Deal Investment Plan, which aims to mitigate climate change, reduce pollution and protect biodiversity. The Investment Plan adopted by the European Commission pencils in that one quarter of the long-term EU budget spanning the period from 2021 to 2027 will be mobilised for financing climate-related and other environment-related objectives.

In the wake of the social change and the adoption of new legislative building blocks, banks and savings banks (hereinafter: **banks**) are strongly encouraged to finance a fair and just transition towards a low-carbon society. With a view to facilitate the process of putting in place appropriate and as uniform as possible banking practices, meeting stakeholders' expectations and, by doing so, provide for the banking sector's contribution to ensuring sustainable transformation of the economy, the Bank Association of Slovenia (hereinafter: the Bank Association) has drafted this document in which the basic orientations for sustainable finance are laid down (hereinafter: the **Guidelines**) by banks – members of the Bank Association. Notwithstanding the fact that the Guidelines are primarily focused on the financing process in the form of lending to legal entities (investment loans, credit facilities for working capital financing, merchant banking…), banks may also use them *mutatis mutandis* for other products such as, for example, wealth management.

The concept of the guidance document is not aimed at the prescription of any requirements banks will have to comply with but rather at guiding and helping them to develop sustainable finance roadmaps tailored by each bank in line with:

- its strategy and policy,
- the requirements governing sustainable financing set out in EU regulation, and
- the developing best practice in the area of sustainable financing.

In line with the principle of proportionality, banks shall pursue sustainable finance in a manner appropriate to their size, level of sophistication, nature and complexity of their activities, organisational structure, scope of operations and the level of exposure to different types of risks associated with the environmental, social and governance factors.

At its 15 regular meeting held on 16 June 2021, the Supervisory Board of the Bank Association of Slovenia passed a resolution endorsing the Guidelines and recommending that the Association's member institutions should follow the guidance set out in the document, which will be adequately amended and adjusted as the legal bases relating to sustainable development, as well as the society's attitude towards the environment continue to evolve.

2. Guidelines

01 Strategy – making commitments and setting goals

(1) Banks shall make the commitment to sustainable finance in their strategies. By accepting these commitments, a bank shall internally and externally reveal its engagement in addressing the issues related to sustainable development within the framework of its operations and financing. For the purpose of making commitments, a bank shall take into account a set of Sustainable Development Goals articulated by the United Nations (UN SDGs).[1] A bank shall make broad-based commitments within individual areas, which are key to the bank (they may also be materially significant or the bank wants to exercise an influence on them), or they may also be concrete (e.g. climate change mitigation and adaptation, improved resource efficiency and circular economy, financial inclusion, gender equality…).

(2) Banks shall determine their measurable key performance indicators (KPIs) by considering the characteristics of their portfolios and their general investment strategy by means of which they will monitor their commitments and targets in the area of

[1] Published on the website https://sdgs.un.org/goals.

sustainable finance. A bank may set out key indicators for the area for which the targets have been set such as the target number of transactions, the target of the scope of financing in the chosen area of sustainable development as part of sustainable finance (*Green Assets Ratio* - *GAR*), the share of the portfolio in a certain activity... Clearly set targets and measurable KPIs enable banks to show the realisation of its commitments in the sustainable finance area.

(3) Banks shall incorporate sustainable aspects stemming from the assessment of the ESG[2] factors into their risk appetite framework (RAF), in their statements on risks, and on their limit systems, which contribute to a more effective achievement of strategic objectives in that area.

02 Business model – definition of environmentally sustainable activities

(4) Banks shall define in their strategy an orientation towards sustainable finance and a purpose (e.g. they determine the types, purposes and the quotas of financing they will have on their priority lists for future financing, caps on exposure to the portfolios not oriented towards the environment, etc.). For the purposes of financing set out in their strategy, banks shall specify individual financing policies, (e.g. financing hydro-electric projects, the stance vis-à-vis financing in the agricultural sector, policy for financing transport activities, etc.).

(5) Banks shall draw up and publicly announce for the purpose of informing other stakeholders their key strategic orientations for sustainable actins/activities/projects financed by them, as well as the activities/projects they do not intend to finance (e.g. coal, tobacco).

(6) As regards environmentally sustainable finance, a bank shall set out the requirements or the criteria on the basis of which eligibility for environmentally sustainable lending shall be evaluated. A bank shall set the criteria in accordance with the existing standards for environmentally sustainable lending, i.e. it shall shape such criteria that will comply with the implementing acts stemming from the Regulation on the establishment of a framework to facilitate sustainable investment (Regulation (EU) 2020/852) (taxonomy).

(7) As regards environmentally sustainable finance, a bank shall define the process in place for assessing compliance of financing with the sustainable finance criteria. The assessment process shall comprise (a) information gathering from the borrower, its projects and activities, (b) evaluating compliance of financing with the criteria for environmentally sustainable finance, and (c) monitoring the alignment of investments with the screening criteria.

[2] ESG – Environmental, Social and Governance factors.

(8) Banks shall evaluate the impact of the current and future environmental, social and governance (ESG) risks (with a focus on climate- and environment-related risks) on the business environment in which they operate and take these risks into account when drafting business strategies and any adjustments to the business model that may be required.

03 Incorporating ESG- and climate-related risks into the risk management process[3]

(9) Banks shall enhance understanding of ESG factors by sector, by maturity, by geography and in particular of the risks associated with climate factors (physical risks, transition risks)[4] and at the same time, financing of which activities may decrease or increase those risks. In doing so, banks in the area of physical risks (merely) focus attention on significant and relevant risks, which may be present in the local/regional environment in which they operate.

(10) Banks shall elaborate specific details of ESG risks in their internally adopted internal risk catalogues.

(11) Banks shall undertake to assess impacts of climate change-related risks on all other categories of risks (credit, market, operational, liquidity, interest-rate, reputational and other risks) and, if these risks are significant, incorporate them in the ICAAP and ILAAP processes.

(12) Banks shall put in place systems for gathering data relating to climate-related client risks on the basis of which they can measure, analyse, manage and monitor exposures to those types of risks and potential impact on financial profile of clients and of business segments.

(13) Banks shall explore the possibilities to incorporate quantitative variables of climate change-related risks into prudential requirements and the collateral value as their intermediate targets, i.e. to deploy qualitative and expert evaluations tailored to their characteristics.

[3] NB: The content referring to the management of risks associated with sustainability factors will be elaborated by the end of 2021 in a document titled »*Smernice upravljanja tveganj ZBS*« (Guidelines on Risk Management of the Bank Association of Slovenia).
[4] Climate-related risks are divided into two main groups of risks: physical risks and transition risks. The first group is sub-divided into acute physical risks and chronic physical risks, whereas the second group is sub-divided into legal and regulatory compliance risk, technology-related risks, market risk and reputational risks and strategic positioning.

04 Incorporating ESG factors and risks in a financing process – assessing clients and investments

(14) Banks shall incorporate aspects of sustainable finance into the process of assessing customers and investments into their operations. Banks shall upgrade the system of non-financial assessment of clients and investments currently in place by setting out a scoring system from the angle of the environmental, social and governance factors and risks (ESG) with the aim to avoid causing material harm within the meaning of sustainable development.

(15) For the purpose of identifying the ESG-related factors and risks, which a bank will monitor at the company, the bank shall take into consideration its strategy, sustainable commitments and goals. It is important that a bank primarily identifies those ESG factors, which can materialise as risks in the future.

(16) Banks shall adjust their creditworthiness assessment of corporate borrowers by applying ESG factors and risks by taking into account the economic sector in which the borrower operates.

(17) When assessing the ability of micro and small enterprises to meet the obligations under the loan agreement, banks may deploy simplified procedures for the assessment of ESG factors (e.g. the evaluation of ESG factors against the backdrop of the sector or the portfolio).

(18) Banks shall present to corporate borrowers in a timely and straightforward manner their expectations regarding the disclosures required for such an evaluation.

(19) Banks shall develop their in-house approaches and tools for the assessment of ESG factors or use ESG models already developed by various credit rating agencies or other institutions.

(20) Banks shall adjust their lending processes and upgrade support applications by adding appropriate fields that enable assessing compliance of concrete financing with acceptable ESG frameworks determined in the adopted strategy and risk-taking propensity.

05 Relationships with clients and other stakeholders

(21) Banks shall work responsibly with their clients and their customers for the purpose of encouraging sustainable practices and facilitating circular transformation of economic activities that create shared prosperity for current and future generations.

(22) Banks shall inform their clients and customers of the importance of ESG factors in relation to the economy sector in which their companies are classified and encourage them to implement standardised monitoring of ESG aspects within the company.

(23) Banks shall warn their clients and customers against any and all negative consequences insofar that they will not be compliant with the elements of sustainable finance as defined and disclosed by an individual bank (e.g. less favourable terms and conditions or even the inability to provide financing).

(24) Banks shall seek synergies with environment-oriented companies and showcase them as the examples of best practice regarding cooperation in the area of sustainable finance.

(25) Banks shall also cooperate with other relevant stakeholders to achieve the set sustainable finance goals. Banks shall strive to build partnerships to achieve positive impacts on the climate crisis, as well as with other goals associated with sustainable development.

(26) Banks may develop systems for timely (internal and external) communication with stakeholders in relation to sustainability serving to the latter as a channel for exchanging information on banks' sustainable operations.

06 Transparency – Public reporting and disclosures

(27) Banks shall publish on their websites or in annual reports strategic orientations and goals of sustainable finance (including KPIs) to signal to what extent and in what way they are engaged in facilitating and financing environmentally sustainable activities of their clients.

(28) Banks shall publish and disclose on a regular basis on their success in achieving the goals and implementing commitments falling within the scope of sustainable finance and thus enable that also external stakeholders may monitor their performance in achieving these goals.

(29) Banks with over 500 employees required to report non-financial information, shall disclose the KPI ratios associated with sustainable finance prescribed by law (e.g. *Green Assets Ratio* (GAR), KPI ratios in the area of climate-related risks). Banks with less than 500 employees, which in their strategies have made clear commitments and set sustainable finance goals, may decide to voluntarily disclose selected KPIs.

(30) Banks are encouraged to disclose information regarding the following areas:

a. Corporate governance (disclosures in relation to corporate governance with reference to ESG risks and opportunities);

b. Corporate strategies and business model (disclosures of actual and potential impacts of ESG risks and opportunities on operations, strategies and financial plans);

c. Managing ESG risks with emphasis on the management of climate-related and environmental risks (disclosing how a bank identifies, assesses, i.e. measures and manages ESG risks) and non-financial sustainability of customers due diligence;

d. KPIs and targets (disclosing the measurement system and target values of individual KPIs when assessing and managing material ESG risks and opportunities).

In doing so, banks shall follow the principle that the disclosure of material information shall be fair, balanced and comprehensible, exhaustive but concise, strategic and forward-looking, as well as focused on interested stakeholders.

07 Governance and culture

(31) Banks shall implement their commitment to these Principles through effective governance and a culture of responsible banking.

(32) Strategy shall be initially identified and accepted by a bank's management body in its management function and then at the lower levels of its organisational structure, whereas all the employees are informed about it, implement it and also have the opportunity to shape it.

(33) As regards the management of their own tangible assets, banks shall systematically seek possibilities to mitigate adverse impact on the environment (heating the head office and branches, consumption of paper, plastics, potable water, transportation, working from home…) and include them in their financial plans. In doing so, banks encourage their employees to play a proactive role in making proposals for operations better tuned to sustainable practices.

(34) Banks shall endeavour to develop a system for measuring and monitoring high standards in the human resources area (promotion of descent work, gender equality, inclusion, non-discrimination…) and clients and customers (ensuring financial inclusion, reducing inequalities …).

(35) Banks shall review their individual and collective implementation of these Principles on a regular basis and take a responsible approach to the adoption and implementation of appropriate corrective measures.

3. Glossary

***Sustainable finance* =**
Taking into account environmental + social + governance considerations in financing (ESG = *Environmental* + *Social* + *Governance*)

ESG factors =
Environmental factors, social factors, governance factors, which may have positive or negative impacts on financial performance of an undertaking, of a country or of an individual.

Environmental factors =
Climate factors, i.e. climate change factors + greenhouse gas emissions + consumption of resources (energy and water) + waste and pollution + biodiversity and ecosystems + air quality + environmental hazards

Social factors =
Health and safety at workplace + working conditions + job diversity + concern for local communities and society, disadvantaged groups + humanitarian crises + customer relations + safety and quality of products + human rights + poverty/famine

Governance factors =
Integrity + values and ethics + (non)avoiding tax + bribery and corruption + strategy and risk management system + executive pay/remuneration + board structure and diversity + inclusion/non-discrimination + transparency

ESG risks =
The risks of any negative financial impact on an institution stemming from current or future impacts of ESG factors on its counterparties, i.e. on investment.

Climate-related risks =
Financial risks stemming from the exposure of institutions to counterparties potentially held accountable for the negative impact of their activities on climate-related or affect it. We can distinguish between transition climate-related risks, i.e. transition risks (the sub-categories are: legal and regulatory compliance risk, technology-related risks, market risk, and reputational risks and strategic positioning) and physical climate risks (the latter can be categorised as acute risks or chronic risks).

4. List of the key regulatory acts referring to sustainable finance and links[5]

EU regulations:

1) 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 https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32020R0852&from=sl
2) COMMISSION DELEGATED REGULATION (EU) …/... 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 with annexes I (climate change mitigation) and II (climate change adaptation) https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=PI_COM:C(2021)2800
3) 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 https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32014L0095&from=SL (currently under revision)
4) 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 https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32019R2088&from=sl

EBA:

1) Guidelines on loan origination and monitoring (EBA/GL/2020/06; 29 May 2020) – applicable from 30 June 2021 https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Guidelines/2020/Guidelines%20on%20loan%20origination%20and%20monitoring/884283/EBA%20GL%202020%2006%20Final%20Report%20on%20GL%20on%20loan%20origination%20and%20monitoring.pdf
2) Draft Implementing Standards on prudential disclosures on ESG risks in accordance with Article 449a CRR https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Consultations/2021/Consultation%20on%20draft%20ITS%20on%20Pillar%20disclosures%20on%20ESG%20risk/963621/Consultation%20paper%20on%20draft%20ITS%20on%20Pillar%203%20disclosures%20on%20ESG%20risks.pdf

[5] The list was updated as at 1 July 2021.

3) EBA Report on management and supervision of ESG risks for credit institutions and investment firms (EBA/REP/2021/18; 23 June 2021) https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Reports/2021/1015656/EBA%20Report%20on%20ESG%20risks%20management%20and%20supervision.pdf

ECB:

1) Guide on climate-related and environmental risks - Supervisory expectations relating to risk management and disclosure https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.202011finalguideonclimate-relatedandenvironmentalrisks~58213f6564.en.pdf