

Legal Update

European Banking Authority Proposes Green Asset Ratio as Key Performance Indicator for Banks under EU's Sustainable Disclosure Requirements

On March 1, 2021, the European Banking Authority (**EBA**) published advice to the European Commission (EC) on the disclosure requirement on environmentally sustainable activities in accordance with Article 8 of the Taxonomy Regulation.¹ The EC had called for such advice on September 15, 2020.

In response, the EBA recommends key performance indicators (**KPIs**) and related methodology for the disclosure by credit institutions and investment firms of information on how and to what extent their economic activities are environmentally sustainable in accordance with the Taxonomy Regulation. The EBA also advises on the qualitative information that institutions should disclose under Article 8 of the Taxonomy Regulation and makes policy recommendations to the EC, with a view to facilitating transparency and disclosure by institutions.

The EBA recommends a "green asset ratio" (**GAR**) as a KPI and that credit institutions disclose their GAR to show the extent to which the financing activities in their banking book (including loans and advances, debt securities and equity instruments) are associated with economic activities aligned with the Taxonomy Regulation and are Paris Agreement- and SDG-aligned.

The EBA says that the GAR should cover all exposures in the banking book to financial and non-financial corporates (**NFC**), including small and medium-sized enterprises (**SMEs**), households (residential real estate, house renovation loans and motor vehicle loans only) and local governments/municipalities (house financing), including loans and advances, debt securities, equity instruments and repossessed real estate collateral.

Noting the trading book's volatile and variable nature and that its purpose is different than the banking book's, the EBA recommends that trading book exposures should be excluded from their GAR and that instead credit institutions should disclose the following information, taking into account a proportionate approach.

- Institutions should separately disclose information on the overall sustainability, composition, trends and limits, and investment policy of their trading book.

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, (OJ L 198, 22.6.2020, p.13).

² In particular those institutions that do not meet the conditions set out in Article 94(1) CRR or the conditions set out in Article 325a(1) CRR.

- In addition, those credit institutions with a significant trading book, above a minimum threshold,² should provide more detailed and granular disclosures on the proportion of absolute transactions (purchases plus sales carried out during the disclosure period) on debt and equity securities relating to corporates subject to Non-Financial Reporting Directive (NFRD) disclosure obligations that are taxonomy-aligned compared to total transactions on debt and equity securities relating to corporates subject to NFRD disclosure obligations.

For credit institutions with subsidiaries outside the EU, the EBA acknowledges the additional challenges of collecting relevant information for exposures to non-EU counterparties, as the Taxonomy Regulation and the NFRD apply only at EU level, and recommends a proportionate approach. The EBA recommends that these institutions disclose their GAR at an EU level for exposures to EU counterparties. In addition, given the relevance of their non-EU exposures, they should identify lending and equity exposures in the banking book to non-EU counterparties that pertain to sectors (NACE sectors 4 levels of detail) covered by the Taxonomy Regulation. Then, proxies should be used to determine, on a best effort basis, estimates and ranges on the part of those exposures aligned with the Taxonomy Regulation, and this information should be disclosed separately from the EU GAR with appropriate caveats.

Further, the EBA notes that exposures to general governments other than municipalities and to central banks should not be considered at this stage in either the numerator or the denominator due to the lack of an applicable taxonomy or of standard disclosure obligations for these counterparties but also recommends that the EC consider the eligibility of sovereign bonds and/or central bank exposures for the KPI when reliable disclosures or a methodology for deriving the extent of their taxonomy alignment are or become available.

Finally, for off-balance sheet exposures, the EBA recommends that institutions disclose a KPI on the proportion of taxonomy-aligned financial guarantees backing lending exposures and a KPI on the proportion of taxonomy-aligned assets under management for guarantee and investee companies subject to NFRD disclosure obligations.

In an accompanying 108-page report, the EBA provides further details regarding the definition of KPIs and related methodology for the disclosure by credit institutions and by investment firms of information on how and to what extent their economic activities are environmentally sustainable in accordance with the Taxonomy Regulation.

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