EU TAXONOMY AND ITS IMPACT ON BANKING STRATEGY: a retail banking perspective

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Energy Efficient Mortgages Initiative | ENERGY EFFICIENT MORTGAGE LABEL

CAJA RURAL DE NAVARRA

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EU Taxonomy main impacts

The EU taxonomy will be relevant for important new requirements for EU banks:

- Banks' disclosure requirements under Non Financial Reporting Directive (NFRD).
- Banks' products (& services) disclosure requirements under the Sustainable Finance Disclosure Regulation (SFDR)
- Banks' supervisory reporting under Basel Framework (Pilar III): EBA's public consultation on draft technical standards on Pillar 3 disclosures of ESG risks
- Banks' wholesale funding: EU Green Bond Standard

But nothing explains and determines more a bank's strategy than its assets composition and evolution. This is where the EU Taxonomy is a critical game changer for banks and their customers (i.e.: European SMEs and citizens). Green Asset Ratio (GAR) will be key.

Banks' asset side – where the strategy lies

The asset composition and evolution determines each bank's:

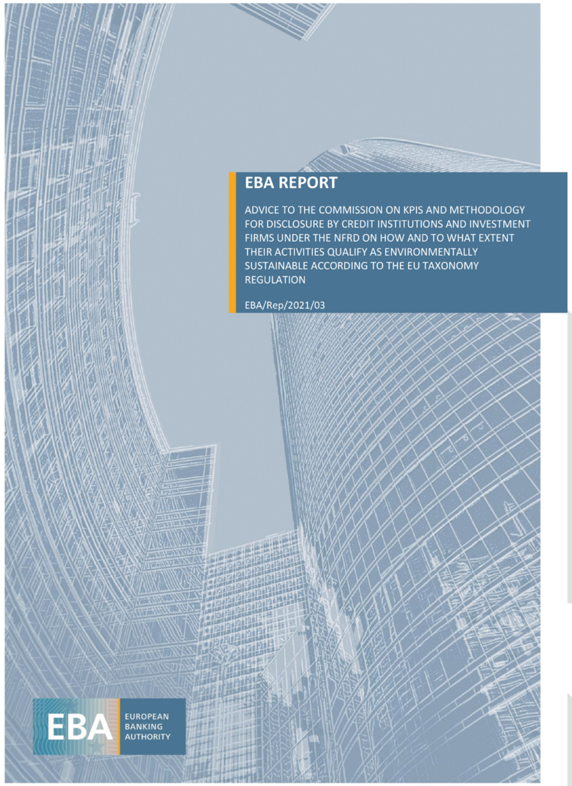
- Risk profile,
- Profitability,
- And also its sustainability (environmental and social) impacts.

It has also a strong link to governance and overall ESG credentials:

- What do we finance and what do we intend to finance tomorrow?
- Do we engage with clients in improving social/environmental impacts? (Do we focus on "green only" or also on transition?)

Banks' asset side – where the strategy lies

EBA's Opinion and **EBA's Report** on the disclosure requirement on environmentally sustainable activities in accordance with Article 8 of the Taxonomy Regulation – The Green Asset Ratio (GAR).



Banks' asset side – The bond portfolio

Debt (and equity securities) should be included in GAR reflecting the extent to which the issuers' activities are associated with those aligned with the EU Taxonomy and are therefore Paris Agreement and SDG-aligned.

- Exposures to central banks and to general governments other than municipalities should not be considered at this stage in either the numerator nor the denominator, due to the lack of an applicable taxonomy.

- The trading book should also be excluded, due to its "volatile and variable nature".

Banks' asset side – Loan portfolio

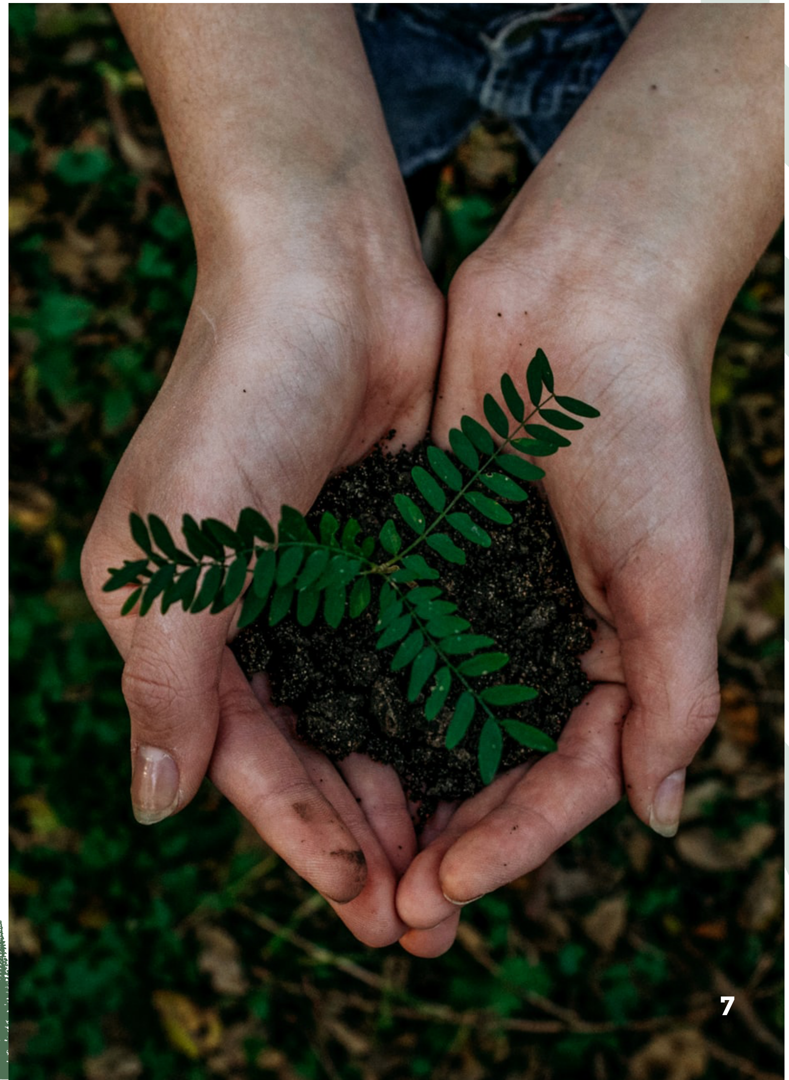
Exposures to corporates

For those corporates subject to NFRD disclosure obligations, taxonomy alignment should be determined based on the proportion of the turnover compliant with EU Taxonomy, with the information that these will have to start disclosing form January 2022.

For those not subject to NFRD (SMEs), based on information collected on a bilateral basis as "part of their credit review and monitoring process"

- Loans to SMEs collateralised by commercial immovable property: same criteria than for residential real estate lending (see next section).

- Other loans to SMEs: on a best effort basis, using a classification by sector (NACE code 4 levels). If SMEs are not able to provide the relevant data, credit institutions should make use of coefficients and proxies that "independent EU bodies may provide" **(JRC-UZH taxonomy).**



Banks' asset side – Loan portfolio

Exposures to real estate

Only for the objective of "climate change mitigation" (there is no relevant criteria or supportive information similar to EPCs that could be used to propose a similar KPI for the objective of climate change adaptation).

Acquisition & Ownership of buildings: **"20% better than NZEB"** for those built after 31 December 2020 and **"15% best of the building stock"** approach for those built before 31 December 2020 (as proposed by TEG):

- Leaves 85% out.
- It is a "moving target".
- It should incentivise renovations so that the renovated building reaches the "15% best".

Renovation of buildings: a 30% reduction in Primary Energy Demand.

Environmental impact:
Why Buildings Energy Efficiency

- In the EU, buildings are responsible for 40% of the energy consumption & 36% of the CO_2 emissions.

- 75-90% of the building stock in the EU is predicted to still be standing in 2050 making Energy Efficiency (EE) refurbishment and energy efficient mortgage financing a top priority for Europe.

- Probably the greatest positive environmental impact that we can favour as banks is represented by the improvement of the physical collateral which underlies our mortgage origination business, including the commitment to identify, tag and promote greener residential mortgages, which is key in order to reduce CO_2 emissions in Europe.

Environmental impact:

Why Buildings Energy Efficiency

It is considered necessary beyond that to invest €100 billion per year until 2050 in the EU building stock in order to deliver on Europe's commitments on climate change.

While the EU has increased the amount of public funds available for EE, the European Commission suggests there is a need to boost private EE investment to deliver on the 2020 and 2030 energy targets and policy objectives.

The new **EU Next Generation Fund** shall underpin the focus on EE investments.

The Taxonomy is not the end of the story, it is just the beginning. Once GAR is in place, who knows?

- Different Capital requirements for compliant/non compliant loan exposures?
- Carbon tax / renting or selling restrictions for non compliant assets?
- Impact on asset quality?

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