Climate Change and ESG Risks in Debt and Equity Corporate Finance

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Climate Change and ESG Risks bring radical changes in Bank's Business Model and Risk Management, leading to new challenges and opportunities.

Assessment of these risks is important both for Banks as well as corporates, impacting their business strategy as well as the debt and equity financing transactions.

Key challenges

1	Regulatory Compliance	**Increasingly stringent regulations** related to ESG and Climate Change require significant effort to ensure compliance
2	ESG Risk Assessment	**ESG-related risks** may **impact corporates' resilience** to climate risk events affecting portfolio quality
3	ESG criteria in underwriting	**ESG criteria are incorporated in debt and equity corporate financing**, tailored per industry, region and **with specific targets** (e.g. sustainability performance targets)
4	Financed impact strategy	**Banks shall adjust their financed impact strategy** in order to respond to **corporates needs for sustainable financing solutions** to enable their **transition to a circular economy**

The Climate Change Challenge

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Impact of Climate Change	
1	Physical Risks

Business may face increased operational and financial challenges due to climate-related events, such as recent floods and wildfires, that can directly damage assets, disrupt supply chains and increase costs.

2	Transition Risks

Business-related risks from the transition towards a carbon-neutral economy driven by the abrupt adoption of climate and environmental policies, technological progress or changes in market sentiment and preferences.

Financial Implications & Opportunities

Climate-related risks may have direct financial implications for companies and affect banks' portfolios:

- Introduction of a carbon tax rate could impact on corporates' profitability
- Shift of business model to greener activities (e.g. shift to RES power production) that could impact profitability as well as CAPEX needs of corporates
- Greener technology requirements to respond to climate transition (e.g. ships with lower carbon emissions / eco-friendly engines)
- Physical events, such as wildfires and floods due to prolonged drought could result in loss of operational capacity and financial losses for corporates

Addressing climate change can create opportunities

- Financing of investments in RES infrastructure, energy efficiency / improvement of commercial and residential properties
- Investment in green bonds / sustainability bonds issued by corporates
- Financing with inclusion of sustainability targets, e.g. % reduction of emissions, % reduction in energy /water consumption

Banks' efforts will be disclosed i.e. through Green Asset Ratio[1], and will be benchmarked across industry

[1] *Green Asset Ratio "GAR": the proportion of Taxonomy-aligned on-balance-sheet exposures in relation to the total assets*

Understanding the ESG factors

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Understanding ESG is crucial in the context of Corporate Lending and credit decisioning, as it plays a pivotal role in assessing the sustainability and the ethical practices of borrowing companies:

ESG factors

Environmental

Issues related to company's impact on environment such as:

- Carbon emissions
- Energy usage
- Water usage and marine resources
- Biodiversity and ecosystems management
- Air, water and soil pollution
- Waste management and circular economy

Social

Company's relationship with its stakeholders and its impact on society including:

- Labour practices, including workplace diversity and fair wages
- Community engagement and philanthropic efforts
- Product quality and safety
- Health and safety
- Data Privacy & information security

Governance

Structure, policies and practices that guide how the company is managed, such as:

- Board composition and independence
- Ethics and compliance
- Shareholder rights and corporate transparency
- Accountability and reporting
- Remuneration
- Procurement policies

Significance in underwriting

- ESG factors have become **integral part of corporates' risk assessment** because they offer a comprehensive view on company's risk profile and long-term sustainability.
- ESG factors provide **insights** into a company's ability **to manage risks associated** with environmental and social issues, and may signal company's **capacity to adapt** to changing market conditions and regulatory requirements.
- Addressing ESG issues can **enhance company's reputation**, **attract investors** and potentially **lower cost of borrowing**

1. Regulatory Compliance
ESG regulatory developments for Banks apply in tandem with respective regulations for Corporates

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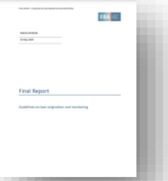
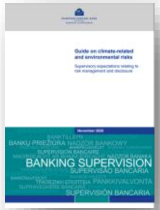
Banks



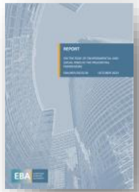
EBA: Guidelines on Loan Origination and Monitoring

- ✓ **ESG factors** and associated risks in **credit risk appetite** and **risk management policies**, **credit risk policies** and **procedures.**
- ✓ Take into account the risks associated with **ESG factors on the financial conditions of borrowers**, and in particular the **potential impact of environmental factors and climate change.**



ECB: Guide on CR&E risks

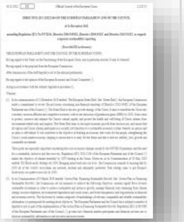
- ✓ Conduct a **proper climate-related and environmental due diligence**, both at the inception of a client relationship and on an ongoing basis.
- ✓ **Climate-related and environmental risks** are expected **to be included** in all relevant **stages of the credit-granting process and credit processing.**
- ✓ **Adjust risk classification procedures** in order to **identify and evaluate**, at least qualitatively, **climate-related and environmental risks.**



EBA: Report on the role of Environmental and Social risks in prudential framework

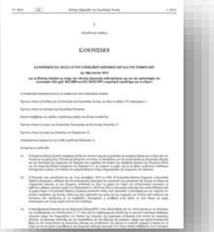
- ✓ Inclusion of environmental and social factors as part of due diligence requirements **and valuation of immovable property collateral**.
- ✓ The introduction of environment-related concentration risk metrics under the **Pillar 1 framework**.

Corporates



EU: Corporate Sustainability Reporting Directive (CSRD)

- ✓ A broader set of large companies, as well as listed SMEs, will now be required to **report on sustainability**.
- ✓ Modernizes and strengthens the rules concerning the **social and environmental information** that companies have to report, including inter alia:
  - Governance
  - ESG Strategy
  - Metrics & Targets on the following topics:
    - Environment: Climate, pollution, water, biodiversity, resource use
    - Social: own workforce, workers in the value chain, affected communities, consumers and end users
    - Governance: Business conduct



GR: National Climate Law

- ✓ **Submission of a Report about Companies' Carbon Footprint** (Scope 1 and 2 Emissions) including voluntary targets and initiatives about reducing or offsetting emissions.

ESRSs: European Sustainability Reporting Standards

Scope 1 emissions are direct emissions that are owned or controlled by a company, Scope 2 are indirect emissions owned by the company such as consumption of purchased electricity, and Scope 3 are indirect emissions not owned by the company, but occur in the value chain of the company

1. Regulatory Compliance
The developments in the Greek Market in response to the ESG and Climate Change ecosystem

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Companies climate transition

- An increasing number of corporates have embarked on the climate transition journey, disclosing net zero targets **(c. 30 companies, big majority by 2050 with interim targets by 2030)** or are disclosing a sustainability report **(140 companies)**
- The vast **majority of Greek micro, small and medium-sized** corporates **are now starting to consider their ESG profile** and the required steps they need to take going forward

Physical Risk Events

- Recent wildfires and floods pinpoint the need for corporates to assess their resilience in climate-related events
- The **need for insurance coverage against physical events** is emerging for Banks and their clients

Greek Banks sustainable financing

- Greek Banks are starting to enhance their sustainable financing solutions and products to capture climate transition and physical risks mitigation
- **ca. €10 bn of sustainable financing** has been granted by Greek Banks so far
- **RRF funds/financing** also are contributing in the transition of the economy

Regulation

- As part of the **climate law**, companies in the Greek market are required to **disclose their emissions on an annual basis**, starting as of November 2023
- **Upcoming CSRD disclosures** will enhance the visibility of corporate practices on addressing ESG risks and ESG strategy

ESG Data availability

- **Upcoming regulations and the evolving strategy of corporates will enhance the publicly available data** for use by the Banks (emissions profile, net zero targets, ESG profile and practices, taxonomy alignment of turnover)
- **Greek state or interbank initiatives in progress will contribute to the provision of additional key data**, such as interbank ESG questionnaire and Energy Performance Certificate (EPC) database

An Interbank initiative for ESG data collection and assessment

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Benefits of the interbank ESG

- In line with regulatory requirements and international market practices on ESG factors assessed and data collected
- Ensures uniformity of ESG data requested from corporates and is tailored to specific sustainability issues of each relevant industry
- Minimize disruption to the banks' clients – uniformity of the requests from corporates across the Greek banks

Key features of the ESG questionnaire

1. 2 main types of ESG questionnaires – full blown for large corporates and simplified for SMEs/SBs
2. Common set ESG questions to be addressed to all corporates in each type of questionnaire
3. Additional set of questions to be addressed for large corporates in specific sectors (e.g. Energy, Oil & gas, Transportation, Manufacturing)
4. Corporates will respond to ESG questionnaire through interbank systemic platform

2. ESG Risk Assessment
Indicative dimensions and type of ESG data and information to be requested by Corporates

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ESG Data and information requested by Corporates span across the three ESG components and the dimensions assessed comprise:

- Existence of ESG policies and processes within the corporation
- Historical performance on key ESG metrics (last 2 years)
- Targets set and commitments undertaken

ESG components

Assessment dimensions

- **Policies and processes**
- **Metrics and performance**
- **Strategy and targets**

Environment

- **Climate Change**
  - Business Continuity Plan (BCP) for covering Physical Risk events
  - Physical risk events incidents and Insurance
- **Emissions**
  - Scope 1, 2, 3 and GHG emissions intensity
- **Energy**
  - Energy consumption
- **Water and Waste**
  - Water consumption
  - Liquid and solid waste generated/ recycled
- **Pollution and biodiversity**
  - Operations located in high biodiversity areas
- **Incidents**
  - Imposed fines for non-compliance with environmental laws
- **EU Taxonomy alignment**
  - % of Taxonomy-aligned Turnover, CAPEX, OPEX

Social

- **Occupational health & safety**
  - Work-related injuries/ accidents
- **Community relations**
  - Corporate Social Responsibility spending
- **Diversity and inclusion**
  - % of women in total workforce
  - Gender pay gap
- **Employee training & development**
  - Average hours per employee on training and development
  - Total amount of monetary expenditure on employee training
- **Labour management relations**
  - Number of new jobs created
- **Incidents**
  - Incidents on non-compliance with regulations in social and economic area
  - Breaches of customer privacy and losses of customer data

Governance

- **ESG governance**
  - Sustainability/ ESG strategy
  - Governance body responsible for the oversight and management of CR&E risks
- **Accountability, reporting and transparency**
  - Sustainability report
  - ESG-related rating indices
- **Corporate governance**
  - % of female members in the BoD
- **Business ethics & anti-corruption**
  - Training on anti-corruption/ business ethics
  - Internal/ external mechanisms for reporting
- **Remuneration**
  - Incentives to Board/ management for the achievement of ESG targets
- **Sustainable procurement**
  - % of suppliers undergoing due diligence process on ESG matters
- **Incidents**
  - Incidents of corruption/ unethical/ anti-competitive behaviour

ESG Risk Assessment and integration into the underwriting process

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1. ESG Questionnaire

- ✓ Questionnaire will be addressed to specific clients depending on their size, maturity and business model
- ✓ Specific ESG/climate risk data points could be collected at this point (e.g. emissions, Energy Performance Certificate)
- ✓ Identify the clients' ESG/climate transition strategy and pathway

2. ESG Scoring

- ✓ Approach for scoring per E,S,G area
- ✓ Industry view of specific risks (e.g. climate risks, ESG materiality issues per sector)
- ✓ Borrower-level, taking into consideration sustainability performance

3. Integration into underwriting process

- ✓ The credit rating will be supplemented by the ESG Risk Score
- ✓ Banks should define specific mitigation actions required
- ✓ Update Credit Policy Manuals to include a decision-tree approach, taking into account borrower and transaction specificities
- ✓ Streamline ESG scoring for debt and equity underwriting for corporates in Greece

Availability of companies' ESG data from public / internal sources is critical for the proper assessment of Bank's clients

What is the Banks' strategic approach for Debt and Equity Corporate Finance towards addressing ESG Risks

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Level of maturity of corporates in response to their ESG profile and climate transition needs and progress

Mature

Less than 1% of total number of corporates

These are the '**large companies**' that have a **clear ESG strategy**, with disclosed net zero/climate transition targets and goals and, some of them, have already a strong ESG position.

The Banks shall **finance and support these corporates to their climate transition journey** within established sustainable finance frameworks (EU Taxonomy, market practices).

Immature

These are the micro, **small and medium-sized companies** that represent **99% of the total number of corporates**.

These corporates are now starting to consider their ESG profile and the required steps they need to take going forward.

The Banks should **support these corporates to increase their ESG awareness** and provide **sustainable financing solutions targeted to the specific ESG/Climate change risks per industry**.

Highly Impacted Industries

These are mainly the companies in **oil & gas industry.**

The Banks shall consider their financed impact strategy towards these clients in order both to **mitigate ESG and Climate change risks** that are high, but **at the same time preserve their profitability** through the transition period.

The Banks **should define and apply a set of minimum safeguards** through their Risk Appetite Strategy and underwriting standards (credit policy, investment policy, etc.).

Approach

Manage greenwashing and profitability protection

Transition / Physical risk financing using ESG risk assessment and climate change tools

Risk Appetite

Key Takeaways

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1	Climate Change and ESG Risks bring radical changes in Banks’ credit underwriting and risk management, leading to new challenges and opportunities.
2	Assessment of these risks is important both for Banks as well as corporates in order to steer financing opportunities and avoid greenwashing risks.
3	EU and Greek State are also setting the regulatory ground for enhancing the transparency of ESG information from the corporates.
4	Banks as well as large corporates in the Greek market are starting taking more concrete steps for the climate transition of the economy.
5	Green banking cannot exist without green transition of the economy and vice versa, thus a close cooperation of all involved parties is important.