GBB-Rating

Sustainability: green-washing or emerging issues for deposit insurers?

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GBB-Rating – the Rating Agency for the Deposit Protection Structure of the Private Banks

08 October 2021 IADI/BIS/EFDI - virtual Conference

Thesis

ESG* is a relevant issue for Deposit Guarantee Schemes.

Both for general considerations

and

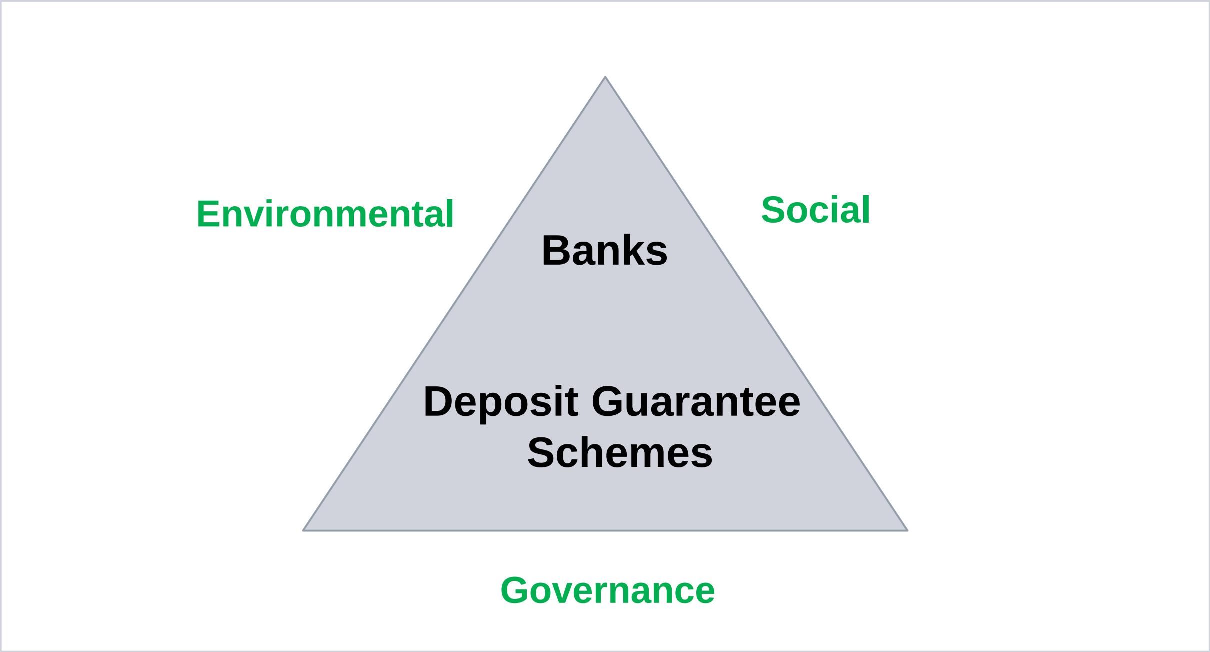
for the risk assessment of banks.

*ESG = Environmental, Social and Governance

DGSes Environment | main Stakeholder

Government

Customer



Investor

Regulator / Supervisor

EU Commission /HLEG | Financing a sustainable European economy

Intention

- To **introduce a common sustainable finance taxonomy** to ensure market consistency and clarity, starting with climate change.
- To clarify investor duties to **extend time horizons and bring greater focus on ESG factors**.
- To upgrade Europe's disclosure rules to **make climate change risks and opportunities fully transparent**.
- To **empower and connect Europe's citizens with sustainable finance issues**.
- To develop official European **sustainable finance standards**, starting with one on green bonds.
- To establish a '**Sustainable Infrastructure Europe**' facility to expand the size and quality of the EU pipeline of sustainable assets.
- To **reform governance and leadership** of companies to build sustainable finance competencies.
- To enlarge the role and capabilities of the ESAs to promote sustainable finance as part of their mandates

EBA | Action Plan on sustainable Finance

‘Sustainable finance’ can be broadly understood as financing and related institutional and market arrangements that contribute to the achievement of strong, sustainable, balanced and inclusive growth, through supporting directly and indirectly the framework of the Sustainable Development Goals.
As included in the European Commission’s Action Plan, 'sustainable finance' also refers to the process of taking due account of environmental and social considerations in investment decision-making, leading to increased investments in longer-term and sustainable activities.

‘Environmental considerations’ refer to climate change mitigation and adaptation, as well as the environment more broadly and related risks (e.g. natural disasters).
‘Social considerations’ may refer to issues of inequality, inclusiveness, labor relations, investment in human capital and communities. Environmental and social considerations are often intertwined, as especially climate change can exacerbate existing systems of inequality.
The **governance** of public and private institutions, including management structures, employee relations and executive remuneration, plays a fundamental role in ensuring the inclusion of social and environmental considerations in the decision-making process.

ECB | Guide on clima-related and environmental Risks

Overview of ECB supervisory expectations

1. Institutions are expected **to understand the impact of climate-related and environmental risks** on the business environment in which they operate, in the short, medium and long term, in order to be able to make informed strategic and business decisions.
2. When determining and implementing their **business strategy**, institutions are expected to integrate climate-related and environmental risks that impact their business environment in the short, medium or long term.
3. The **management body** is expected to consider climate-related and environmental risks when developing the institution's overall business strategy, business objectives and risk management framework, and to exercise effective oversight of climate-related and environmental risks.
4. Institutions are expected to **explicitly include climate-related and environmental risks in their risk appetite framework.**
5. Institutions are expected to assign responsibility for the management of climate-related and environmental risks within the organisational structure in accordance with **the three lines of defence model**.
6. For the purposes of **internal reporting**, institutions are expected to report aggregated risk data that reflect their exposures to climate-related and environmental risks with a view to enabling the management body and relevant sub-committees to make informed decisions.

ECB | Guide on clima-related and environmental Risks

7. Institutions are expected to incorporate climate-related and environmental risks as drivers of existing risk categories into their existing **risk management framework**, with a view to **managing**, **monitoring** and **mitigating** these over a sufficiently long-term horizon, and to review their arrangements on a regular basis. **Institutions are expected to identify and quantify these risks within their overall process of ensuring capital adequacy.**
8. In their **credit risk management**, institutions are expected to consider climate-related and environmental risks at all relevant stages of the credit-granting process and to monitor the risks in their portfolios.
9. Institutions are expected to consider how climate-related and environmental events could have an adverse **impact on business continuity** and the extent to which the nature of their activities could increase **reputational and/or liability risks**.
10. Institutions are expected to monitor, on an ongoing basis, the effect of climate-related and environmental factors on their current market risk positions and future investments, and to develop **stress tests** that incorporate climate-related and environmental risks.
11. Institutions with material climate-related and environmental risks are expected to evaluate the appropriateness of their stress testing with a view to incorporating them into their **baseline and adverse scenarios**.

ECB | Guide on clima-related and environmental Risks

12. Institutions are expected to assess whether material climate-related and environmental risks could cause **net cash outflows or depletion of liquidity buffers** and, if so, incorporate these factors into their liquidity risk management and liquidity buffer calibration.
13. For the purposes of their **regulatory disclosures**, institutions are expected, to **publish meaningful information** and key metrics on climate-related and environmental risks that they deem to be material, with due regard to the European Commission's Guidelines on non-financial reporting: Supplement on reporting climate-related information

Investor perspective | ISS and BlackRock

Institutional Investor Service (ISS, Proxy Avisor) – Global Voting Principles 2021
Stewardship
A company's governance, social, and environmental practices should meet or exceed the standards of its market regulations and general practices and should take into account relevant factors that may impact significantly the company's long-term value creation. Issuers and investors should recognize constructive engagement as both a right and responsibility.

BlackRock - ESG Integration Statement 2021
As long-term investors on behalf of our clients, accounting for environmental, social, and governance (ESG) risks and opportunities helps us provide sustainable value to our clients.
ESG integration is the practice of incorporating material ESG information into investment decisions with the objective of improving the long-term financial outcomes of our clients' portfolios, consistent with our clients' objectives. We are doing this across all our active portfolios in both public and private markets seeking to enhance risk-adjusted returns. In index portfolios, we engage with companies on ESG issues to enhance long-term value for our clients.

EFDI | Principles for Sustainable Deposit Guarantee and Investor Compensation Schemes i

Pursuing our missions

Our primary objective is to contribute to **financial stability** and inter alia **protect the covered clients** of our member financial institutions.

Dealing with financial institutions' clients

We will abide by a **strict principle of equality and impartiality vis-à-vis financial institutions' clients**, whatever their nationality and residence, and of course, sex, gender, colour, age or religion. We will take special care to adequately protect personal data of financial institutions' clients, in line with the applicable regulations. Where we see examples of **poor corporate practice or behaviour we will identify and report** those to the appropriate regulatory, civil or criminal authorities.

Applying sound governance rules

Whatever our status, public or private, independent, autonomous or not, we will strive to ensure **sound, transparent and unbiased decision-making processes** and that our decisions reflect and are only driven by our mission and applicable legislation. We will be mindful that actual or perceived conflicts of interest are correctly anticipated and handled under strict **ethical requirements**. We are of course committed to comply with all applicable laws and

Implementing ethical and responsible corporate principles

We adhere to the principles of **equal pay and equal rights for our teams**, without regards for sex, gender, colour, age, religion or nationality. We are conscious of the **carbon footprint** and general impact of travel in our work participation at events, and will seek to exploit environmentally friendly alternatives where possible.

EFDI | Principles for Sustainable Deposit Guarantee and Investor Compensation Schemes ii

Risk management

In order to adequately achieve our role and mission in all circumstances, we have [or will shortly] put in place risk **management tools, internal control policies and contingency plans** aimed at better identifying, anticipating and remedying the internal and external risks associated with our activities, both in crisis as well as ordinary times. In addition to operational risks e.g. as to payout or reputation, those risks include, without being limited to, where applicable, the risk of fraud, cyber risks, climate risks, pandemic risks, business discontinuity. We will regularly assess and upgrade those tools and policies as far as needed.

Raising contributions

We are committed to raise contributions in a way that could **mitigate moral hazard** in the financial system, making riskier business models more costly on one hand, and encouraging stable business models on the other..

Setting the level of our resources

Our resources found the promise we bring towards financial institutions' clients and their **confidence towards us**. They should be proportionate to our liabilities.

Investing our funds

The two main objectives of our investment strategy are **liquidity and security**. As part of our investment strategy, where possible, we will consider taking into account, if not already the case, a **Corporate Social Responsibility** approach in order to favour the financing of responsible and ethical entities. We will strive at excluding controversial weapons and red flags issuers from our investments.

UNEP FI | Principles of Responsible Banking

PRINCIPLE 1:
ALIGNMENT

We will align our business strategy to be consistent with and contribute to individuals' needs and society's goals, as expressed in the Sustainable Development Goals, the Paris Climate Agreement and relevant national and regional frameworks.

PRINCIPLE 2:
IMPACT & TARGET SETTING

We will continuously increase our positive impacts while reducing the negative impacts on, and managing the risks to, people and environment resulting from our activities, products and services. To this end, we will set and publish targets where we can have the most significant impacts.

PRINCIPLE 3:
CLIENTS & CUSTOMERS

We will work responsibly with our clients and our customers to encourage sustainable practices and enable economic activities that create shared prosperity for current and future generations.

PRINCIPLE 4:
STAKEHOLDERS

We will proactively and responsibly consult, engage and partner with relevant stakeholders to achieve society's goals.

PRINCIPLE 5:
GOVERNANCE & CULTURE

We will implement our commitment to these Principles through effective governance and a culture of responsible banking.

PRINCIPLE 6:
TRANSPARENCY & ACCOUNTABILITY

We will periodically review our individual and collective implementation of these Principles and be transparent about and accountable for our positive and negative impacts and our contribution to society's goals.

Risk aspects | Relevant for DGSes - threats for banks business models

Environmental

GBB Flash-Survey Banks 2019 on sustainability:
6.4 % using sustainability aspects for credit assessment and
2.1 % for collateral valuation

In the past the focus was on sustainable investment products or gadgets (e.g. credit cards made of bamboo instead of plastic)

Risk = SREP impact!

Banks

Deposit Guarantee Schemes

Social

Increased customer sensitivity and expectations (Fridays for Future)

Risk = customer acceptance

Turning from an employer's market to an employee's market (work-live-balance, purpose, home-office/ digitalization)

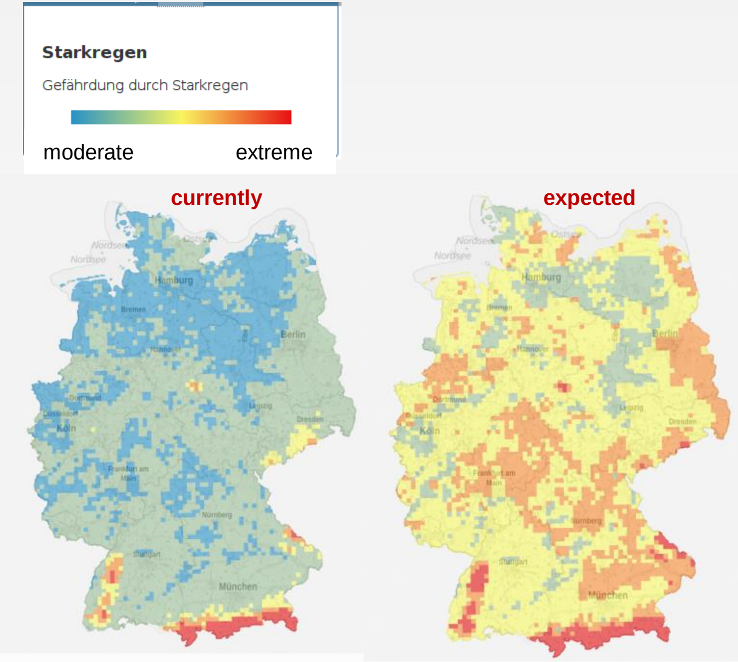
Risk = challenge for talents, employee loyalty

Governance

AML, data protection, data security,
fit & proper (board), remuneration, etc.

Sustainability | Not only an theoretical issue

Heavy Rain Events (Germany)



River Ahr Valley, Germany 2021

Source: https://gisimmorisknaturgefahren.de/immorisk.html
Bundesinstitut für Bau-, Stadt- und Raumforschung (BBSR), im Bundesamt für Bauwesen und Raumordnung (BBR)

Bernd Bretschneider | CV

- Bernd is managing director and working with GBB-Rating since 1996. GBB-Rating is the Rating Agency of the Deposit Guarantee Scheme for the Private Banks in Germany.
- He studied business administration at the Universities of Nuremberg (Germany), Cologne (Germany) and Bradford (UK) and has two master degrees.
- Before Bernd entered GBB-Rating he completed a two year term apprenticeship with a Bank in Frankfurt/M. (Germany) and afterwards worked in the SME business with a Bank in Berlin (Germany) for a couple of years.
- Beside his job as managing director, he is head of EFDI Research Working Group on `Risk-based Contribution´ and co-initiator of the EFDI Sustainability Charter. He was member of IADI´s Differential Premium Systems Technical Committee and worked as a Deposit Insurance Systems consultant for World Bank.

GBB-Rating | at a glance

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1996

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Oliver Mohr

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European Securities and Markets Authority, ESMA, Paris

Independent Non-Executive Directors (INEDs)

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W. Weißenberger, CPA

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