Hellenic Republic Capital Market Commission
Sustainable Finance Conference – The Future of Sustainable Finance
Wednesday, 29 June 2022 **Keynote Speech**
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Introduction

Ladies & gentlemen –

It is with great pleasure that I take the floor to address today's conference on the Future of Sustainable Finance, a topic of great importance

- for businesses and households,
- for the financial sector
- for the economy,
- and for our society at large.

I would like to thank the organizers, the Hellenic Capital Markets Commission, and Ms. Lazarakou in particular, for inviting me to participate in today's gathering.

During the morning, in the previous panels and speeches, we all had the opportunity to listen and understand better the policymakers' vision as well as the regulators' expectations on sustainability.

I will try to pick up the thread to outline **the banking sector's view on sustainable finance,** on the opportunities and challenges that lie ahead for banks, **both from a strategic perspective as well as an operational or implementation perspective**.

The strategic perspective – bringing the policymakers' vision to life

Let me start by outlining the **strategic perspective,** which involves bringing the policymakers' vision to life and addressing investor expectations.

It is interesting to note that banks, through their financial intermediation role, have already demonstrated their will to play an active role in the promotion of the global sustainability policy Agenda.

Globally, 290 banks representing over 45% of banking assets worldwide, among which 92 are EU banks, including all 4 Greek systemic banks, are signatories of the **UN Principles for Responsible Banking**. Namely, they are in the process of aligning their strategy and practices to the vision society has set out for its future in the United Nations Sustainable Development Goals and the Paris Climate Agreement.

In the more extended financial sector, there are also over 4,900 global signatories to the **UN Principles for Responsible Investment**, while over 200 insurers representing over 25% of world premium volume have adopted the **UN Principles for Sustainable Insurance**.

Furthermore, 113 banks representing 38% of global banking assets, among which 35 are EU banks, have already joined the industry-led, UN-convened **Net-Zero Banking Alliance**, committing **much more strictly** to support the transition of the real economy to net-zero emissions by 2050.

The objectives of these global alliances are challenging for banks. If one looks at bank balance sheets, a significant share of exposures is accounted by **high climate impact sectors** (HCIS), such as energy, manufacturing, mining & quarrying, construction, transportation, and agriculture.

Traditional bankers tend to protect their share of wallet in such exposures, but these portfolios are inevitably exposed to climate-related and environmental risks, both transition and physical risks. For example, coal- and lignite-power plants may see closures before the end of their useful economic life, which is a transition risk. Agriculture and farming are directly exposed to droughts and floods, a physical risk.

Banks themselves view Climate & Environmental risks as likely to bear material impact on credit risk, operational risk and business model risk. Last year, roughly 30% of the EU institutions assessed such impact as material in the short-to-medium term. This percentage goes up to 50% in longer term horizons for credit risk.

Business model risk is also in focus, as the future impacts of climate change and environmental degradation are strategic in nature, entailing both risks and opportunities. Strategically, banks need to understand these risks and reduce their exposures in an orderly manner.

The shift away from high climate-impact-exposures will be an ongoing process. And will be coupled with bank strategies to capture emerging opportunities as the sustainability agenda is gradually rolled out.

Increasingly, banks recognize and support the green transition initiatives of borrowers, thus engaging into positive portfolio diversification efforts, in favour of a sustainable economy.

We see two big banking sector opportunities in Greece, as our country has set out to achieve a reduction of 55% in emissions by 2030, 80% by 2040, and net zero emissions by 2050.

First, in the energy sector we expect the ongoing big shift towards sustainable energy sources to scale up wind as well as solar projects.

- For example, McKinsey estimates that for Greece to leap ahead as a clean energy hub, it will need more than €15 billion of investments by 2030 and more than €50 billion by 2050.

Banks are already financing part of this capital expenditure.

Second, Greek businesses in sectors other than energy, and Greek households, will also invest to successfully transition to a more sustainable model.

- Transportation (including electric vehicles, private & commercial),
- real estate (including upgrades of the existing stock of buildings),
- industry and agriculture

will carry the bulk of the investments here. In total, more than €65 billion by 2030 and approximately €380 billion by 2050 is estimated by McKinsey.

For these projects to materialize, Greek banks will need to complement private equity and public funds (including the Recovery & Resilience Facility). The targets are ambitious, but achievable and we have the duty as banks to enable their fulfilment.

The implementation perspective – adhering to the regulators' expectations

Let me continue by outlining the **implementation perspective,** which involves adhering to regulators' expectations and changing banks' operating models to support the sustainability agenda.

Tangible progress has been achieved by many banks, but there is a long way ahead of us and a need to expedite actions. The **2021 Thematic Review on Climate-related & Environmental Risks**, in which 112 ECB-supervised banks with combined assets of €24 trillion participated, indicated that

- more than 80% were not aligned to regulatory expectations,
- and less than 20% were only partially aligned.

In Europe, enhanced regulatory expectations and initiatives going forward aim to do two things: Assess progress plus incentivize faster integration. These EU initiatives are the EU-wide Stress Tests and the Thematic Review on Climate-related & Environmental Risks that are ongoing in 2022.

The ECB will integrate climate and environmental risks into its SREP (Supervisory Review and Evaluation Process) qualitative guidance. It seems that climate and environmental risk considerations will eventually influence capital requirements.

Today we are going through a demanding but still a learning stage for banks and supervisors together, as is evident in the 2022 EU-wide Climate Risk Stress Test: The stress test is not a pass or fail exercise, nor does it entail direct implications for banks' minimum capital levels.

The focus is initially on assets that are most vulnerable to climate-related risks, both Transition and Physical risks. The spectrum of scenarios covers three different transition risk pathways

1) An orderly scenario,
2) A disorderly scenario,
3) An extreme hot-house world scenario,

plus, it includes major Physical risks (Flood and Drought scenarios).

To give you a better flavour on the perimeter of risks, please observe that the ECB analysis extends over different horizons, starting from one year for acute shocks, to three years, 10 years, 20 years, and 30 years, hence reaching the net-zero date of 2050. The information in these exercises captures, for example,

- the relative bank exposure to climate-sensitive industries,
- the bank income reliance on such sectors,
- the level of CO_2 emissions being financed,
- the loan collaterals' energy profile and regional distribution.

The above regulatory demands imply that banks are called to upgrade their internal risk management framework, enhance their analytical and reporting capabilities, and embark on a full review of their governance, processes, data, and systems. It is not easy. I will give you two examples.

<u>One example</u> is the need to adapt lending processes for corporate clients. Specifically, new ESG assessments of both obligors and specific transactions are being incorporated into our lending processes.

And in those cases, assessed to have high climate impact, banks have an obligation to require and monitor client action plans that ensure obligors are moving in the right direction.

In the future, we are likely to see implications for the pricing of loans – especially as capital requirements may well increase for high climate impact cases.

Another example, related to the first, is the need to materially enhance the quality of data on sustainability. Here, there is still work to be done. Most importantly:

- there is scarcity of data,
- ensuring the reliability of data is still under formulation,
- risk impacts are correlated across sectors and across time, representing enormous conceptual and content-like challenges to both regulators and banks

Currently, the main sources of data for climate-related and environment risk assessment and monitoring, are

- public disclosures
- as well as bilateral bank engagements with clients and external data providers.

Substantial investments are required to collect such data in banks' systems, and to upskill their human resources, so that sustainability is truly embedded in banks' day-to-day commercial activities and operations.

Clearly, banks need to invest a lot now to effectively contribute to the global goals of sustainability and capture the benefits from this shift in the decades to come.

Closing

Closing, I'd like to share a few thoughts from our own experience at NBG over the past couple of years.

We have built a solid footprint of financing the renewable energy sector. We also keep a strong bank tradition with respect to the "S" and "G" pillars of ESG, having received

- the **Diamond** ESG & Social Responsibility **award 4 times** since it started 14 years ago in Greece by the Corporate Responsibility Institute's (CRI)**.**

Our experience to-date is that the sustainability transformation of banks requires

- active top-down guidance from the Board of Directors and the CEO,

- and continuous bottom-up collaboration from cross-functional teams, covering all three lines of defense.

We are still at the early stages of this process. Yet implementation is picking up speed. Importantly, **we chose to revamp our Purpose Statement** to reflect the new reality that is emerging.

Environmental issues are at the core of our strategy. They are widely shared across the bank. And I feel certain that we all share its importance.

Thank you very much for your attention.