Recommendation No 47/2021. (IV. 14.) of the Magyar Nemzeti Bank

on climate-related and environmental risks and the integration of environmental sustainability considerations into the activities of credit institutions

I. Purpose and scope of the recommendation

The purpose of the recommendation is to set out the expectations of the Magyar Nemzeti Bank (hereinafter: "MNB") in relation to the identification, measurement, management, control and disclosure of climate-related and environmental risks and the integration of environmental sustainability considerations into the business activities of credit institutions, thereby increasing the predictability of the application of the law and facilitating the uniform application of the relevant legislation.

The recommendation is addressed to credit institutions subject to the Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises (hereinafter: "Credit Institutions Act").

It should be noted that this recommendation is only one of a series of Hungarian supervisory and regulatory actions that address climate-related and environmental risks. In view of the specific characteristics of these risks, not only the MNB is planning to take action, but a number of initiatives are underway to restructure the European regulatory framework, which will also have an impact on Hungarian credit institutions. Among other things, as part of its mandate, the European Banking Authority (hereinafter: "EBA") is reviewing the integration of sustainability considerations into Pillar 1[1], Pillar 2[2] and Pillar 3[3], to which the MNB is actively contributing.

As the MNB considers regulatory changes related to these risks to be essential in the wake of strong international efforts, this recommendation is intended to help Hungarian credit institutions prepare until the final regulatory instruments are finalised. In parallel to the preparation of this recommendation, the European Central Bank (hereinafter: "ECB") has issued a guidance on managing climate change and environmental risks[4], which, although not directly applicable to Hungarian credit institutions, is considered by the MNB as an important model. This recommendation also takes into account the discussion paper on the management and supervision of environmental, social and governance (ESG) risks for credit institutions and investment firms (hereinafter: "Consultation Paper EBA/PD/2020/03")[5], which was submitted for consultation by the EBA in October 2020. In addition, the recommendation implements the sustainability-related parts of the Guidelines on loan origination and monitoring, EBA/GL/2020/06[6], published by EBA.

The MNB aims to facilitate the transition of Hungarian credit institutions to sustainable operations and to prepare for regulatory changes relevant in the context of climate change and environmental risks. In this

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[1] Article 501(c) of the Regulation 575/2013/EU of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation 648/2012/EU (hereinafter: "CRR")

[2] Article 98 of the Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (hereinafter: "CRD").

[3] Article 449a of CRR

[4] Guide on climate-related and environmental risks - Supervisory expectations relating to risk management and disclosure, consultation paper, European Central Bank, 2020. https://www.bankingsupervision.europa.eu/legalframework/publiccons/pdf/climate-related_risks/ssm.202005_draft_guide_on_climate-related_and_environmental_risks.en.pdf

[5] Discussion paper on management and supervision of ESG risks for credit institutions and investment firms: EBA/DP/2020/03. https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Discussions/2021/Discussion%20Paper%20on%20management%20and%20supervision%20of%20ESG%20risks%20for%20credit%20institutions%20and%20investment%20firms/935496/2020-11-02%20%20ESG%20Discussion%20Paper.pdf

[6] EBA Guidelines on loan origination and monitoring (EBA/GL/2020/06): Sections 56, 57, 58, 59, 146, 149 are implemented in Sections 3., 7., 10, 21-24, 27-30 of this recommendation.

respect, the “Knowledge Base” section of the website www.zoldpenzugyek.hu provides practical assistance through a collection of resources on examples, good practices and usable data and methodologies.

The set of rules relevant to the subject matter of this recommendation are included in particular, but not exclusively, in the sectoral legislation.

This recommendation does not fully refer back to the legal provisions when setting out the principles and expectations, but the addressees of this recommendation remain obliged to comply with the relevant legal requirements.

This recommendation does not override or replace any related regulatory supervisory instruments but is intended to further specify the MNB's interpretation of the general expectations in the context of climate change and the prudent management of environmental risks.

A credit institution shall apply the supervisory expectations set out in the recommendation in accordance with the nature of the business model used and the specific characteristics of the provided services of the credit institution or group, including those arising from its organisational structure, its dimension and complexity, its risk profile and the extent of its credit risk exposure.

This recommendation does not provide any guidance on data management and data protection issues, does not contain any expectations with regard to the processing of personal data and the requirements contained in this recommendation should not be in any way interpreted as an authorisation to process personal data. Data processing in the context of the fulfilment of the supervisory requirements set out in the recommendation should only be carried out in compliance with the data protection legislation in force at any time.

II. Interpretative provisions

1. The concept and types of climate-related and environmental risk

   The Paris Agreement on climate change of 2015[7], the UN Sustainable Development Goals[8] and the Special Report of the Intergovernmental Panel on Climate Change of October 2018[9] call for accelerated and decisive action to reduce greenhouse gas (hereinafter: “GHG”) emissions and to create a low-carbon and climate-resilient economy. The European Union (hereinafter: “EU”) has set ambitious targets for 2030[10] regarding the GHG emission reduction, renewable energy and energy efficiency. In 2018, the European Commission (hereinafter: “Commission”) published its long-term strategic vision for a climate-neutral economy[11] to be achieved by 2050. In Act XLIV of 2020 on Climate Protection, Hungary has set the goal to take steps to prevent climate change, reduce its impacts and make effective and feasible interventions to adapt to its consequences, and to align with international and EU commitments as part of its national climate policy. This Act states that Hungary will achieve full climate

[7] Paris Agreement, United Nations Framework Convention on Climate Change, 2015. https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:22016A1019(01)

[8] The 2030 Agenda for Sustainable Development, United Nations Organisation, 2015 https://sustainabledevelopment.un.org/content/documents/21252030%20Agenda%20for%20Sustainable%20Development%20web.pdf

[9] Global Warming of 1.5°C, Intergovernmental Panel on Climate Change, 2018. https://www.ipcc.ch/site/assets/uploads/sites/2/2019/06/SR15_Full_Report_High_Res.pdf

[10] Decision of the European Council of 11 December 2020 on the European Climate Directivehttps://www.consilium.europa.eu/en/press/press-releases/2020/12/17/council-agrees-on-full-general-approach-on-european-climate-law-proposal/, and the European Green Deal, European Commission, 2020. https://ec.europa.eu/clima/policies/strategies/2030_hu

[11] 2050 long-term strategy, European Commission, 2020. https://ec.europa.eu/clima/policies/strategies/2050_en

neutrality by 2050, i.e. Hungary's remaining emissions and removals of GHGs will be in balance by 2050, which will necessarily entail fundamental changes in the socio-economic system.

Credit institutions play a crucial role in the transition to a low-carbon and climate resilient economy. On the one hand, an additional €180 billion of annual investment is already needed to meet the EU's 2030 energy and climate targets, and additional resources will need to be used to achieve climate neutrality by 2050. According to the draft National Clean Development Strategy[12], the estimated cost of achieving climate neutrality in 2050 for Hungary is about HUF 50 thousand billion, which assumes the mobilisation of resources equivalent to 2.5% of GDP per year until 2050. Most of these investments carry significant business potential, however, most of the financing will have to be covered from private capital. On the other hand, it is important for businesses and financial institutions to better understand and manage the adverse environmental impacts of their activities and the risks that climate change and other environmental changes pose to their institutions.

In March 2018, the Commission published an action plan on financing sustainable growth[13], with the aim of redirecting capital towards more sustainable investments, addressing financial risks arising from climate change and other environmental and social problems, and promoting transparency and a long-term appraoch to financial and economic activities.

According to section 46 of the Consultation Paper EBA/DP/2020/03, climate and "environmental risks are the risks posed by the exposure of institutions to counterparties that may potentially be negatively affected by environmental factors, including factors resulting from the climate change and factors resulting from other environmental degradation". Regarding environmental factors, a double materiality approach should be applied as stipulated in section 43 of the same document.

The approach of double materiality is reflected also in the Commission's "Guidelines on non-financial reporting: "Supplement on reporting climate-related information (2019/C 209/01)" (hereinafter: "Commission Communication")[14], which stated that climate-related and environmental risks include both the risks arising from climate change to the business of credit institutions, including those related to their clients and their own operations, and the risks arising from the negative impact of the activities of credit institutions on the climate. Consequently, unless otherwise provided for in this recommendation, references to risk include both the risk of negative impacts on credit institutions (transition risks and physical risks - see below) and the risk of negative impacts on the environment and climate.

Examples of risks having negative impacts on the environment and climate:
The economic activities or companies financed by the credit institution emit GHGs into the atmosphere or cause other negative environmental impacts, such as generation of waste or loss of biodiversity.

Examples of risks having negative impacts on the credit institution:
The risks of climate change to the financial performance of a credit institution's clients may be classified as either transition or physical risks.

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12 National Clean Development Strategy – Draft, Ministry of Innovation and Technology, 2020. https://ec.europa.eu/clima/sites/lts/lts_hu_hu.pdf
13 Action Plan: Financing Sustainable Growth, COM/2018/097, Communication from the Commission https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52018DC0097
14 Guidelines on non-financial reporting: Supplement on reporting climate-related information C/2019/4490, Communication from the Commissionhttps://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52019XC0620(01)

a) Transition risks are the risks to credit institutions arising from the transition to a low-carbon and climate resilient economy.

   aa) Policy-regulatory risks, for example those arising from energy efficiency requirements, carbon pricing mechanisms that increase the price of fossil fuels, or policies that promote sustainable land use.

   ab) Technological risks, for example when a technology with a less harmful impact on the climate replaces a technology with a more harmful impact on the climate.

   ac) Market risks, for example if consumer and corporate client preferences and demand shift towards less climate-damaging products and services.

b) Physical risks are risks to credit institutions arising from the physical effects of climate change.

   ba) Acute physical risks arising from specific events, in particular weather-related events such as storms, floods, fires or heat waves, which can damage production facilities and disrupt value chains.

   bb) Chronic physical risks are those resulting from longer-term changes in climate, such as changes in temperature, rising sea levels, declining water resources, loss of biodiversity and changes in soil fertility.

Although this recommendation focuses more on climate-related and environmental risks, MNB considers it important to stress that these developments also offer potential business opportunities for credit institutions, which may include the development of new, even innovative financing solutions, such as financing local energy communities[15], or the development of dedicated green banking products, such as energy efficiency loans and loans linked to ESG considerations ("ESG linked loan" or "sustainability linked loan").

For the purposes of this recommendation, a specific economic activity is considered to be environmentally sustainable in accordance with Article 3 of 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 (hereinafter: "Taxonomy Regulation")[16]. In this context, it is important to underline that not only the economic activities that are already (almost) carbon neutral can be included in this category, but also those that contribute to the carbon neutral transition but do not yet operate in a way that can be considered carbon neutral ("transitional activity") or those that facilitate the transition of other economic activities ("enabling activity").[17]

The Taxonomy Regulation[18] and sectoral legislation contain concepts and definitions that are not detailed in this recommendation but are potentially relevant.

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[15] The concept of local energy communities is defined in Article 2 of Directive 2019/944/EC of the European Parliament and of the Council of 5 June 2019 on common rules for the internal market for electricity and amending Directive 2012/27/EU.

[16] https://eur-lex.europa.eu/legal-content/en/TXT/?uri=celex:32020R0852

[17] For example, reforestation is a carbon neutral activity; currently the production of a passenger car with emissions of less than 50g CO2/km is considered a "transitional" activity; and the production of wind turbines is classified as an "enabling" activity. Further details include the expert report on green taxonomy (https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/190618-sustainable-finance-teg-report-taxonomy_en.pdf), and the Transition Finance Report by the Platform on Sustainable Finance (https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Guidelines/2020/Guidelines%20on%20loan%20origination%20and%20monitoring/Translations/886684/Final%20Report%20on%20GL%20on%20loan%20origination%20and%20monitoring_COR_HU.pdf).

[18] Although the EU taxonomy does not directly apply to the core business of credit institutions [see Article 1(2)(b) of the Taxonomy Regulation], i.e. their lending activities, it is indirectly relevant to credit institutions in a number of respects. This regulation provides a starting point for a common identification and classification of economic activities that promote a low-carbon, resilient and resource-efficient economy. The explicit objective behind the establishment of the EU taxonomy is to support the redirection of capital flows towards sustainable investment. This objective is in line with the European Commission's Financial Action Plan and Article 2(1)(c) of the Paris Agreement. This regulation is intended to

2. For the purposes of this recommendation:
   1.1 sectoral legislation:
   a) Credit Institutions Act
   b) CRR,
   c) Commission implementing regulations issued under the powers conferred by the CRR.

   2.2 related supervisory regulatory instruments:
   a) Recommendation No 12/2015 (VIII. 24.) of the Magyar Nemzeti Bank on the Measurement, management and control of liquidity risks[19] [hereinafter: "MNB Recommendation No 12/2015 (VIII. 24.)"],
   b) Recommendation No 3/2017 (II. 9.) of the Magyar Nemzeti Bank on the Application of remuneration policy[20] [hereinafter: "MNB Recommendation No 3/2017 (II. 9.)"],
   c) Recommendation No 8/2017 (VIII. 8.) of the Magyar Nemzeti Bank on the General requirements pertaining to the disclosure practices of credit institutions and investment firms[21] [hereinafter: "MNB Recommendation No 8/2017 (VIII. 8.)"],
   d) Recommendation No 27/2018 (XII. 10.) of the Magyar Nemzeti Bank on setting up and using internal safeguards and on the management and control functions of financial organisations[22] [hereinafter: "MNB Recommendation No 27/2018 (XII. 10.)"],
   e) Recommendation No 11/2019 (V. 6.) of the Magyar Nemzeti Bank on the assessment of the eligibility of the members of executive bodies and persons in key position[23] [hereinafter: "MNB Recommendation No 11/2019 (V. 6.)"],
   f) Recommendation No 15/2019 (VII. 9.) of the Magyar Nemzeti Bank on the measurement, management and control of credit risk[24] [hereinafter: "MNB Recommendation No 15/2019 (VII. 9.)"],
   g) Internal Capital Adequacy Assessment Process (ICAAP), Internal Liquidity Adequacy Assessment Process (ILAAP) and their Supervisory Review Process and Business Model Assessment (BMA), Methodology Manual[25] [hereinafter: ICAAP-ILAAP-BMA Methodology Manual of the MNB].

III. Supervisory expectations for integrating environmental sustainability considerations into business model and strategy

3. Climate-related and environmental risks may affect the business environment of credit institutions. In accordance with Article 108 of the Credit Institutions Act, in the course of assessing the business environment, the MNB expects credit institutions to identify the risks arising from climate change and environmental degradation at the level of key sectors, geographical areas as well as in relation to products and services in which they operate or plan to operate, taking into account that some of these risks may materialise over a fairly long period of time.

form the basis for further legislative changes (e.g. In the case of the Directive on the disclosure of non-financial information). In line with the EBA, the MNB advises credit institutions to consider the implications of the taxonomy regulation in their business activities. In addition, the taxonomy regulation can assist in product design, exposure grouping, client relationship management and strategic goal setting.

19 https://www.mnb.hu/letoltes/likviditasi-ajanlas-megjelentetesre-datummal.pdf
20 https://www.mnb.hu/letoltes/3-2017-jav-politika.pdf
21 https://www.mnb.hu/letoltes/8-2017-altalanos-nyilvanossagra-hozatali-mod.pdf
22 https://www.mnb.hu/letoltes/27-2018-belso-vedelmi-vonalak.pdf
23 https://www.mnb.hu/letoltes/11-2019-alkalmassagi.pdf
24 https://www.mnb.hu/letoltes/15-2019-hitelkockazat.pdf
25 https://www.mnb.hu/letoltes/icaap-ilaap-bma-kezikonyv-2020-julius.docx

Climate-related and environmental risks can affect, for example, economic growth, employment or property prices at national, regional or local level. Weather events can cause droughts or floods that affect a region's agricultural production, housing demand or the value of collateral at national, regional or local level. In parallel, competition is influenced by the development of a green financing market and consumer preferences that are shifting away from high carbon or otherwise polluting goods and services towards low carbon or otherwise "green" products and services. In the domain of technology, credit institutions serving clients energy-intensive industries and power plants that rely heavily on fossil fuels may see their clients face significant investment requirements to de-carbonise their energy mix. Thus, in identifying risks, a credit institution may categorise its clients or portfolios according to climate risk exposures. For example, geographic grouping can help to identify exposures that are exposed to high physical risks, such as high risk of flood or drought. Sectoral categorisation can help to identify transition risks, for example by assessing the share of highly GHG-intensive sectors in the lending portfolio.[26]

4. Climate-related and environmental risks can have a direct impact on the effectiveness of a credit institution's existing and future strategies. In accordance with the ICAAP-ILAAP-BMA Methodology Manual, the MNB expects credit institutions to identify and assess which climate-related and environmental risks are material to their business strategy in the short, medium and long term, and the resilience of their business strategy to these risks.

5. MNB expects credit institutions to adequately document the processes by which they assess the significance of climate-related and environmental risks to their business environment.

6. MNB considers it to be a good practice, if the implementation of a credit institution's business strategy reflects the credit institution's consideration of material climate change and environmental risks, for example by establishing and monitoring key performance indicators (hereinafter: "KPIs"), key risk indicators (hereinafter: "KRIs") or risk limits. MNB expects credit institutions to strive to make these indicators measurable and quantifiable. Depending on the nature of the credit institution's activities, these indicators may be developed, as appropriate, for the relevant business lines and portfolios.

7. In line with item II, MNB draws the attention of credit institutions, in terms of business model and strategy development, to the impact of the implementation of the business strategy on the environment, for example through the GHG emissions or resource efficiency of the economic activities financed. As a consequence, transition risks may increase and, over time, affect the resilience of business models. MNB recommends that credit institutions should take steps to mitigate the transition risks, for example by gradually or even rapidly reducing and phasing out financing of environmentally unsustainable activities. MNB considers it to be a good practice for a credit institution to develop a carbon neutrality plan in line with the overall climate-related and environmentally sustainable objectives[27]. These efforts are also in line with the objective of Article 2(1)(c) of the Paris Agreement:

[26] The text in italics in this recommendation is intended to facilitate practical application through illustrations and examples.

[27] In this section, and hereinafter, "climate change and environmentally sustainable general objectives" refers to the international and national objectives in force, as contained in conventions, legislation or strategies such as the Paris Agreement (or its Hungarian transposition in Act XLIV of 2020 on Climate Protection), the European Green Agreement, the National Climate Change Strategy, Hungary's National Clean Development Strategy or the National Energy and Climate Plan. These objectives have been set on scientific basis, on the basis of results of well-established climate change-related and environmental assessments, such as those carried out by the Intergovernmental Panel on Climate Change (IPCC) and the Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services (IPBES). In the "Knowledge Base", a number of methodologies and resources have been collected to help apply these.

"Making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development"[28].

8. The recommendations set out in the UN Principles for Responsible Banking[29] (hereinafter: "Principles") lay the foundations for credit institutions to make a conscious contribution to sustainability efforts. As an official supporter of the Guidelines, the MNB also recommends that credit institutions:
   a) review and, if necessary, revise their business operations to ensure that they are consistent with and help to meet society's needs and achieve its overall climate change-related and environmentally sustainable goals ("Alignment");
   b) continuously increase the positive socio-environmental impacts of banking activities, products and services, while reducing negative impacts and risks, by setting and publishing targets in areas where the most significant impacts can be achieved ("Impact and Objectives");
   c) cooperate responsibly with counterparties and clients, encouraging sustainable practices and enabling economic activities that serve the common well-being of present and future generations ("Partners and Clients");
   d) proactively and responsibly consult and engage with relevant stakeholders to achieve societal goals ("Stakeholders");
   e) put the commitment to responsible banking into practice through effective corporate governance and a responsible banking culture (see in more detail in section IV) ("Corporate governance and culture");
   f) regularly review and monitor the practical implementation of the Guidelines and ensure transparency and accountability for both positive and negative societal impacts ("Transparency and accountability").

9. MNB considers it to be a good practice if credit institutions formally become a signatory to the Guidelines, thereby explicitly committing to the application of the related framework. If the foreign parent company of the credit institution is already a signatory to the Guidelines and therefore the credit institution does not consider it necessary to sign the Guidelines separately, MNB expects the credit institution to apply in its own operations the principles, methods and objectives adopted by the parent company.

10. MNB considers it to be a good practice for a credit institution to set targets to support the development and integrity of the environmental sustainability of its business activity and operations, and to make efforts to assess the extent to which such development is consistent with and contributes to the overall climate change-related and environmental sustainability objectives. Conscious awareness-raising among consumers and financial education focusing on climate-related and environmental risks play a key role in achieving sustainability objectives. With this in mind, MNB considers it to be a good practice for credit institutions to inform their clients about the environmental sustainability aspects of their products and services, their contribution to climate change-related objectives and to the overall environmental sustainability goals. *Taking into account the characteristics of the products or services, the information may cover climate-related and environmental risks, for example, in the case of real estate collateral, in particular the energy usage characteristics of commercial or residential property, their potential impact on the terms of the loan, and the externalities (environmental and societal) over*

[28] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:22016A1019(01)
[29] https://www.unepfi.org/banking/bankingprinciples/

the entire life cycle of the products and services financed by the loan, where this can be reasonably estimated.

IV. Supervisory expectations for internal governance

11. MNB considers climate-related and environmental risks to be included in the internal governance requirements set out in Section 109 of the Credit Institutions Act. Accordingly, the management body in its supervisory function must have sufficient knowledge and understanding of climate-related and environmental risks to ensure that the level of risk assumed is consistent with the credit institution's risk appetite and strategy, internal rules and policies, and that the credit institution complies with applicable legal requirements and other obligations. *For example, the MNB considers it to be a good practice if the management body in its supervisory function receives regular reports on climate-related and environmental risks or is regularly informed about them under a dedicated agenda item at its meetings.*

12. In the application of Article 113(3) of the Credit Institutions Act and in the context of the MNB Recommendation No 11/2019 (V. 6.), the MNB expects the management body of the credit institution to have adequate collective knowledge, skills and experience also with regard to climate-related and environmental risks. MNB considers it to be good practice for credit institutions to require also key personnel to have expertise in climate-related and environmental risks relevant to the performance of their duties and for members of the management body and key personnel to be familiar with the climate-related and environmental risks of the credit institution as soon as at the start of their employment, as part of their on-boarding and training for their duties.

13. Credit institutions are expected to clearly define the responsibilities of each individual person performing internal management and internal control functions with regard to climate-related and environmental risks, in line with the general principles on internal lines of defence in relation to the general responsibilities under Article 107 of the Credit Institutions Act and the MNB Recommendation No 27/2018 (XII. 10.), and to clearly describe the mandate, work processes and objectives for these functions. It is the responsibility of the management body in its supervisory function to ensure that the relevant responsibilities are clear, well defined, consistent, enforceable and adequately documented.

14. MNB also expects that a separate organisational unit or function ("ESG centre" or dedicated "chief sustainability officer") responsible for the management and control of climate change and environmental risks is established within the credit institution or a senior manager is designated under the management body in its supervisory function, responsible for the management and control of climate-related and environmental risks (for example, a chief executive officer or a key person in charge of an area with a control function other than the internal auditor). Taking into account the proportional application, in a credit institution with smaller and less complex activities a member of the management body may be also designated to carry out the above functions, subject to an appropriate separation of duties and responsibilities. Where the credit institution establishes a separate department or function for climate-related and environmental risks, it is expected that the integration of the separate department or function into existing processes and its relationship with other functions is clearly defined (division of responsibilities and duties, cooperation and reporting obligations, etc.).

15. MNB expects credit institutions to ensure that the functions involved in managing climate-related and environmental risks have adequate resources, both human and financial, and have the authority necessary to fulfil their role effectively. MNB also considers it to be good practice for credit institutions to provide relevant training opportunities for their staff focused on climate-related and environmental risks and to consider the possibility of a general environmental and climate awareness training.

16. In line with the general requirements of Article 108 of the Credit Institutions Act, the management body in its supervisory function is expected to exercise effective oversight over the credit institution's exposure to climate-related and environmental risks and regarding the impact of the business strategy on climate and environmental sustainability objectives (see point 7).

17. In order to take a comprehensive approach to risk, taking into account the long-term financial interests of the credit institution, it is recommended for the management body to develop the credit institution's response to the general climate-, and sustainability objectives.

18. In line with Articles 117-121 of the Credit Institutions Act and the MNB Recommendation No 3/2017 (II. 9.), remuneration policies and practices are expected to contribute to a long-term approach to addressing climate-related and environmental risks. MNB considers it to be a good practice for credit institutions to set KPIs related to sustainable finance in their remuneration policies.

19. In line with the MNB Recommendation No 27/2018 (XII. 10.), credit institutions are expected to integrate both climate-related and environmental risks into their internal reporting systems to inform decision-making at management level. MNB is aware that the relevant metrics and tools are evolving and that the available data at credit institutions may be incomplete at present. Nevertheless, it expects that reporting on climate-related and environmental risks will improve over time. In the short term, MNB expects credit institutions to assess their data requirements from their strategy development and risk management units, identify data gaps, and outline plans to address them and overcome any inadequacies.

20. In accordance with Article 108 of the Credit Institutions Act, the management body in its supervisory function is expected to ensure that the credit institution has effective and reliable internal and external data reporting, disclosure and communication systems that are capable of aggregating climate- and environmental risk-related data. Given the specific characteristics of these risks, MNB recommends that credit institutions should assess the need to adapt their information systems to be able to collect and aggregate the necessary data to assess their exposure to these risks. MNB expects credit institutions to build a data taxonomy of these risks. Where this is not feasible due to lack of common definitions, incomplete taxonomies and data gaps, the MNB considers it to be a good practice for credit institutions to consider developing processes and procedures based on internal or even external rating risk metrics. In this case, it is expected that the management body is aware of the limitations of the data and information produced by the information systems.

V. Supervisory expectations for risk management

V.1 Risk management framework

21. MNB expects credit institutions to have a comprehensive and well-documented picture of the impact of climate-related and environmental risks on existing risk categories. Climate-related and environmental risks may be considered as factors affecting existing risk categories, but credit institutions may treat these risks as a separate risk category for organisational or analytical purposes. *For example, extreme weather events (e.g. drought) may be considered as a factor affecting credit risk (as an existing category) in agricultural lending, but the credit institution may treat them as part of a separate stand-alone risk category called "ESG", "climate" or other.*

22. It is recommended for credit institutions to take steps to quantify climate-related and environmental risks. In line with the general expectations of the MNB ICAAP-ILAAP-BMA Methodology Manual, climate-related and environmental risks should not be excluded from the assessment because they are difficult to quantify or because the relevant data are not available. MNB recommends that credit institutions should make active effort to develop and implement appropriate tools and methodologies. *Methodologies developed in-house or by the parent company but adapted to the Hungarian business environment and tailored to the credit institution's needs, can greatly contribute to a more accurate understanding of risks.* Different approaches are available to measure environmental and climate risks (for more details see EBA/DP/2020/03 Discussion Paper and the "Knowledge Base"):
    a) *Portfolio Alignment Method (How aligned is an institution's portfolio relative to global sustainability targets?),*
    b) *Risk Framework Method, including climate stress testing, scenario analysis and sensitivity analysis (How will sustainability related issues affect the risk profile of a bank's portfolio and its standard risk indicators?),*
    c) *Exposure Method (How do individual exposures and clients perform in terms of ESG risk?)*

    The different approaches should not necessarily be seen as substitutes (mutually exclusive options) but can be used together to complement each other.

23. MNB expects that, in line with the MNB Recommendation No 27/2018 (XII.10.), credit institutions consider the need to review their risk management policies in light of climate-related and environmental risks, *for example by setting limits on the financing of certain sensitive economic (sub)sectors, geographical exposures, businesses or real estate exposures, or by excluding certain (sub)sectors or borrowers from lending; by modifying its conditions for borrowers on the list of eligible clients; and by engaging in a constructive dialogue with contracting partners; by agreeing on measures to mitigate climate-related or environmental risks with the intention of improving a contracting partner's sustainability rating or credit rating; by setting a conscious exposure reduction strategy for sectors or assets with high climate risk or causing environmental damage, and a limit increase strategy*

for activities or sectors with positive environmental yield; by undertaking ESG diversification in the case of climate risk concentration in its trading portfolio[30].

24. The integration of climate-related and environmental risks into the risk appetite framework increases the credit institution's resilience to such risks and improves its ability to manage these risks, therefore, MNB expects this from credit institutions. *For example, a credit institution may develop a well-defined description of climate-related and environmental risks in its internal risk appetite policy.*

25. Credit institutions are expected to develop appropriate risk indicators and set appropriate limits for climate-related and environmental risks. Credit institutions are also expected to monitor and disclose, where available, its policies for economic (sub)sectors, geographical exposures, current data on climate-related and environmental risk exposures, preferably in the form of quantitative measures[31], based on a combination of historical data and forward-looking estimates, in accordance with the requirements in section VI. MNB acknowledges that common definitions and taxonomies are being developed in these risk areas. As an interim step, until credit institutions develop appropriate numerical measures or until common measures are available, non-numerical findings may be also used, taking into account that the long-term goal is to develop common measures.

26. Credit institutions are expected to assess the impact of climate-related and environmental risks when calculating their internal capital requirements, in line with the MNB's ICAAP-ILAAP-BMA Methodology Manual. In calculating capital requirements, it is recommended for credit institutions to consider the impact of climate-related and environmental risks in a way that allows the credit institution to pursue its business model in a sustainable manner, while ensuring economic and regulatory capital adequacy. In line with the MNB's ICAAP-ILAAP-BMA Methodology Manual, where credit institutions consider that climate-related and environmental risks have an economic impact, it is recommended for credit institutions to consider the potential impact on their projected capital adequacy as reflected in its baseline and adverse scenario assessments. It is also expected that credit institutions consider the implications of this when determining risk appetite and in their business strategy.

V.2 Credit risk management[32]

27. In line with the general expectations set out in the MNB Recommendation No 15/2019 (VII. 9.), MNB expects credit institutions to develop specific details of their environmentally sustainable credit risk policy and related internal processes and procedures. MNB expects that credit institutions set out their environmentally sustainable lending policy and internal processes and procedures in line with their overall objectives, strategy and policy on sustainable finance. *Defining environmental sustainability requires the development of new internal set of criteria or the incorporation of existing standards (e.g. the taxonomy regulation) into the credit risk policy and credit risk assumption procedures.*

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[30] As explained in section V.4, climate-related and environmental risks can also emerge as market risks. For example, if a credit institution has a high proportion of exposures with high climate risks in its trading portfolio, this concentration risk should be managed in line with the credit institution's risk appetite. One way to do this is through diversification, which takes also these risks into account.

[31] The non-exhaustive “Knowledge Base” contains the metrics that credit institutions may take into account.

[32] The expectations and good practices contained in Section V.2 apply to both new loans (flow) and existing loans (stock).

28. MNB expects credit institutions to consider climate-related and environmental risks at all relevant stages of credit risk assumption and credit risk management. In addition to credit risk assumption, the process of credit risk management also requires procedures and methodologies through which credit institutions can verify that the loan has in fact been used to finance sustainable activities. In the case of loans to businesses, the credit risk assumption and credit risk management process is expected to include the following:
    a) collecting information about the climate-related and environmental or otherwise sustainable business objectives of the borrowers;
    b) assessing the conformity of the borrowers’ funding projects with the qualifying environmentally sustainable projects or activities and related criteria;
    c) ensuring that the borrowers have the willingness and capacity to appropriately monitor and report the allocation of the proceeds towards the environmentally sustainable projects or activities;

    monitoring, on a regular basis, that the proceeds are allocated properly (which may consist of requesting that borrowers provide updated information on the use of the proceeds until the relevant credit facility is repaid).
29. Credit institutions are expected to assess the impact of climate change and environmental risks on the borrower's risk of default (probability of default, PD), the value of the exposure at default (EAD) in the event of default and the average loss given default (LGD). As part of this assessment, it is recommended that credit institutions consider the quality of climate-related and environmental risk management of their own clients, as well as changes in the risk profile of sectors and geographies driven by climate-related and environmental risks.

30. Credit institutions are expected to conduct climate-related and environmental risk due diligence on their clients both before and after taking on risk. MNB considers it to be a good practice if this includes the collection and verification of information and data necessary to assess the vulnerability of borrowers to climate-related and environmental risks, in particular before entering into a credit agreement or a significant modification thereof, in line with the credit institution's onboarding policies and procedures. Credit institutions are expected to have an understanding of the impact their clients have on climate change and the environment, as well as their vulnerability from them. Furthermore, credit institutions should be aware of their clients' attitudes to managing these impacts and risks. *For example, credit institutions may consider using analytical tools that highlight the climate-related and environmental risks of each economic (sub)sectors on a graph or scale. For loans or borrowers with higher environmental, social and governance risks, a more intensive analysis of the borrower's business model is required, including a review of current and projected GHG emissions, the market environment, regulatory environmental, social and governance requirements and an analysis of the likely impact of regulation concerning the environmental, social and governance aspects on the borrower's financial position.* In addition, environmental due diligence can also reduce reputational and liability risks if the results are taken into account by the credit institution in the risk origination.

31. MNB expects credit institutions to design their client and counterparty rating processes in a way that allows them to identify and assess climate-related and environmental risks by setting appropriate risk indicators or ratings.

32. Credit institutions are expected to take climate-related and environmental risks into account when assessing collateral, as they may affect the value of the collateral. *For example, in this respect, it is recommended for credit institutions to take into account the location of the commercial or residential property, its technical and energy characteristics, the efficiency of the mechanical engineering systems.*

33. It is expected that the credit institution's credit pricing framework reflects climate-related and environmental risks and those are reflected in its credit risk appetite and business strategy too. *For example, as part of defining its business strategy and risk appetite, credit institutions may choose to reduce or limit their exposures to sectors that are harmful to the environment or climate, while increasing their exposures to sectors that have a positive impact on the environment or climate. Thus, the pricing framework is expected to support the chosen risk perspective and strategy, for example by differentiating the price of loans according to the energy efficiency of the exposures or by applying sector- or client-specific fees. In line with their business strategy and risk appetite, credit institutions may also consider encouraging their clients to take due account of climate-related and environmental risks in order to improve creditworthiness and resilience to such risks. This may involve, for example, that credit institutions offer a reduced interest rate on an environmentally sustainable loan or linking the interest rate of the loan to a sustainability target to be achieved by the client that contributes to or is consistent with the overall climate change-related and environmentally sustainable goals.*

34. Climate-related and environmental risks can arise through various cost factors, such as the cost of capital, the cost of funds or credit risk premiums. *Environmentally sustainable instruments can be financed through target-oriented instruments such as green bonds (secured or unsecured) and thus entail different financing costs. And certain economic activities may have lower transition or physical risks, such as energy-efficient real estate or other activities defined by the taxonomy as environmentally sustainable, and these may have a lower cost of capital. For this purpose, it is recommended to take into account the details of the preferential capital treatment introduced by the MNB*[33]*. Credit losses may increase in areas exposed to increased physical risks from climate change, such as floods and droughts.* MNB therefore expects credit institutions to take these developments into account and reflect them in the pricing of their loans, for example by differentiating the cost of funding for assets particularly affected by physical and transition risks, by making lending to less sustainable businesses relatively more expensive.

35. With regard to Sections 33 and 34, the MNB considers it important to draw the attention of credit institutions to the fact that, as mentioned in Section I, certain economic activities may be considered as environmentally sustainable according to the taxonomy, even if they belong to a sector with high GHG emissions intensity, if they contribute to achieving carbon neutrality ("transitional activity") or facilitate the transition of other economic activities ("enabling activity"). *For example, the renovation of an outdated residential building, if it results in at least a 30% reduction in primary energy demand, can meet the taxonomy and be considered green. Cement production can also be considered environmentally sustainable if its CO2-emissions are below the limit currently set in the taxonomy.* Certain investments reduce the climate-related and environmental risk exposure of credit institutions, even if the asset or activity financed has an initially high environmental impact but the investment is

[33] www.zoldpenzugyek.hu

aimed at a substantial improvement of this. *For example, an investment by an unsustainable agricultural company will reduce its climate exposure if, for example, it shifts to organic farming.*

36. MNB expects credit institutions to monitor and manage climate related and environmental risks in their credit portfolios with the general requirements of MNB Recommendation No 15/2019 (VII. 9.) in mind, for example through sectoral/geographical concentration analysis and scenario analysis and stress testing. It is recommended to give priority to addressing increased exposure to climate-related and environmental risks. Where appropriate, the use of different scenarios is recommended to enable the credit institution to implement risk mitigation measures (including pricing, adjustment of exposure limits, implementation of deleveraging strategies) in a timely manner.

V.3 Operational risk management

37. In line with the general provisions of Section 108 of the Credit Institutions Act, the MNB expects credit institutions to assess the impact of physical risks arising from climate change on their own operations, including their ability to quickly restore their capacity to continue providing services. The geographical location in which a credit institution operates may make it more susceptible to physical risks. This is particularly relevant for outsourced services and IT activities, especially if service providers are located in locations with a higher risk of extreme weather events or other environmental vulnerabilities.

38. In particular, when assessing critical functions, it is recommended for credit institutions to consider the impact of climate change on the provision of such services. Where the outcome of that assessment is material to any business line or the overall operations of the credit institution, it is recommended to be reflected in the credit institution's business continuity plan.

39. The MNB expects credit institutions to consider the extent to which the nature of the activities it carries out increases the future risk of reputational damage or liability. In line with the MNB Recommendation No 27/2018 (XII. 10.), in order to avoid reputational risks related to environmental and climate risks, credit institutions are expected to assess whether their investment products comply with international or EU best practices, such as the EU's prospective Green Bond Standard[34] or the regulation on sustainability disclosures in the financial services sector [35].

40. The MNB considers it important that credit institutions strive to reduce their own ecological and carbon footprints, as insufficient knowledge of these or failure to reduce them effectively, in addition to preventing constructive contributions to the efforts required by international agreements, also entail reputational risks. The MNB therefore considers it to be a good practice for credit institutions to operate an environmental management system that complies with internationally accepted standards[36], and to measure and seek to continuously improve their environmental performance.
As regards the GHG emissions, the MNB proposes the following:

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[34] https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/eu-green-bond-standard_en

[35] Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector. https://eur-lex.europa.eu/legal-content/HU/TXT/?uri=CELEX:32019R2088

[36] The application of the ISO 14001 Environmental Management System and the EMAS Eco-Management and Audit Scheme, which sets higher standards than the requirements of the ISO 14001, is considered a good practice by the MNB.

a) measuring direct emissions from own activities (Scope 1)[37],
b) measuring indirect emissions related to purchased energy (Scope 2),
c) measuring other indirect emissions (Scope 3)[38], with the financed emissions primarily related to credit and market risk management rather than to operational risk management.

As regards other environmental impacts of operations and measures to reduce them, the MNB recommends the following:

d) introduction and promotion the use of cashless payment methods,
e) realisation of paperless or paper-saving payment methods,
f) other initiatives related to own operations, along the validated environmental performance indicators.

As regards the ecological footprint, the MNB proposes the following:

g) developing plans to further reduce the ecological footprint,
h) neutralisation and offsetting emissions remaining after emission reductions, which cannot be further reduced technically or economically, by implementing, if possible, credible and verified, primarily domestic habitat rehabilitation projects[39], which, in addition to GHG neutralisation, also serve biodiversity improvement, secondly by purchasing so called carbon credits.

In addition, in line with the requirements of Section VI, the MNB considers it to be good practice to publish the progress on the steps taken related to the above-mentioned proposals in the context of sustainability or integrated reports prepared according to an internationally accepted standard.

V.4 Market risk management

41. Regarding the management of market risk, the MNB expects credit institutions to take into account that environmental and climate risks may lead to shifts in the supply and demand of financial instruments (e.g. securities, derivatives), products and services, which may affect their value. *A credit institution that invests in companies with business models that are assessed as environmentally unsustainable or in geographical areas exposed to physical risks may suffer a decline in the value of its investments as a result of policy measures, changes in market sentiment or technology, or as a result of gradual adverse changes in severe weather events or climatic conditions.*

42. In particular, with regard to the credit spread risk component of bank book positions, the MNB expects credit institutions to assess the importance of climate risk- and environmental risk-related credit spreads across all determinants of overall market risk. *This is relevant when financial instruments issued by companies in sectors that are assessed as environmentally unsustainable or that do not apply a comprehensive sustainable governance approach suffer a sudden drop in value.*

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[37] Detailed information on the scopes is available in the GHG Protocol standards: https://ghgprotocol.org/

[38] For credit institutions, the volume of GHG emissions falling within Scope 3 is likely to be orders of magnitude higher than Scope 1 or 2 emissions. Expectations and good practices regarding the measurement and disclosure of financed emissions are reflected in a number of sections of this recommendation.

[39] For example, the MNB, in cooperation with WWF Hungary, is offsetting CO2 emissions from its operational activities through a complex long-term habitat restoration ecological project: https://www.mnb.hu/en/pressroom/press-releases/press-releases-2021/the-mnb-becomes-carbon-neutral-with-wwf-hungary

V.5 Liquidity risk management

43. In connection with the general requirements of Section 108 of the Credit Institutions Act, MNB expects credit institutions to consider whether climate-related and environmental risks are significant from a liquidity risk perspective. Where these risks are considered material, it is recommended that the credit institution take steps to identify, measure, manage and monitor liquidity risk over appropriate time horizons and to maintain adequate liquidity buffers, within the framework of the legislation on liquidity risk measurement and management and MNB Recommendation No 12/2015 (VIII. 24). *For example, liquidity risk may materialise as a result of a severe environmental crisis, or ESG factors may even affect the availability or stability of funding, for example through reduced or more expensive access to market funding.*

V.6 Sensitivity-, scenario analysis and stress testing

44. In line with Section 86 of the MNB Recommendation No 27/2018 (XII. 10.) and the MNB's ICAAP-ILAAP-BMA Methodology Manual, credit institutions are expected to assess climate-related and environmental risks through the use of sensitivity-, scenario analysis or stress testing.

45. As regards climate-related and environmental risks, it is recommended for credit institutions to consider the use of scenarios that are consistent with scientific climate change trajectories, such as the IPCC and IEA scenarios[40]. The MNB expects credit institutions to take into account at least the following aspects when conducting sensitivity-, scenario analysis and stress testing as regards climate-related and environmental risks:
    a) how physical and transition risk may affect the credit institution;
    b) how climate-related and environmental risks might evolve under different scenarios, taking into account the features of this type of risk (uncertainty and non-linearity, probability that cannot be based on historical data, potentially extreme and widespread impacts[41]);
    c) how climate-related and environmental risks may occur in the short, medium and long term, depending on the scenarios considered.

46. MNB expects credit institutions to define their own risk profile and assumptions regarding its specific features, and it is also recommended considering several scenarios based on different combinations of assumptions. It is expected that as part of their capital planning, credit institutions assess their capital adequacy against a credible baseline and institution-specific adverse scenarios. As regards adverse scenarios, MNB recommends credit institutions to assume extraordinary but plausible developments of sufficient severity in terms of their impact on capital adequacy.

47. Taking into account the ICAAP-ILAAP-BMA Methodology Manual, the MNB expects credit institutions to consider using a longer time horizon for climate-related and environmental risks, given the likelihood that they will mostly occur in the medium to long term. In particular, longer time horizons may be reflected in stress testing with an economic perspective.

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[40] The "Knowledge Base" contains scenarios adopted by the MNB and considered international best practice.
[41] The Green Swan, Bank for International Settlements, 2020. https://www.bis.org/publ/othp31.pdf

48. MNB considers it necessary for the credit institutions to interpret the results of stress tests and, if necessary, to take clear risk mitigation measures based on them. MNB expects that stress testing programmes are communicated effectively across all relevant business lines and at senior management level in order to raise risk awareness, improve risk culture and facilitate dialogue within the organisation on possible risk management measures.

VI. Supervisory expectations for disclosures

49. Disclosures regarding climate-related and environmental risks allow market players to make a more informed assessment of physical and transition risks. This in turn allows institutions and investors to better understand the financial implications of climate change. Under Article 8 of the Taxonomy Regulation, companies and financial institutions subject to the non-financial reporting directive[42] (hereinafter: "NFRD") will be required from 1 January 2022 to provide additional transparency on the extent to which their activities are considered environmentally sustainable. By 1 June 2021, the Commission will issue a Commission Delegated Regulation setting out the detailed rules of this obligation, for which EBA has published its proposal.[43]
In addition, Article 449a of the CRR requires large institutions with securities traded on a regulated market to disclose information on certain ESG risks after 28 June 2022. The EBA has also developed detailed disclosure requirements in this respect in the context of the Commission's draft implementing regulation for the third pillar, which has been published [44]. In line with this, the MNB expects credit institutions to start preparing for these new disclosure requirements, if they are subject to them.

50. MNB expects from the credit institution which operates as a Hungarian subsidiary of a credit institution established in an EU Member State and whose parent is subject to the obligation under Article 8 of the Taxonomy Regulation or Article 449a of the CRR at the consolidated level, to disclose information on the Hungarian subsidiary.

51. The MNB considers it to be good practice for a credit institution that is not subject to the obligation under Article 8 of the Taxonomy Regulation or Article 449a of the CRR to voluntarily comply with all or part of the disclosure rules referred to in Section 49.

52. In relation to the disclosure obligations regarding climate-related and environmental risks, the MNB expects that the disclosure policy of a credit institution specifies how the credit institution assesses the materiality of climate change and environmental risks, taking into account the expectations set out in the MNB Recommendation No 8/2017 (VIII. 8.). The MNB also draws attention to Section 2.2 of the Commission Communication, which states that a credit institution should not prematurely consider climate-related and environmental risks as immaterial due to their long-term nature.

53. Where a credit institution does not consider climate-related and environmental risks to be material, MNB expects the credit institution to document this decision with qualitative and quantitative information supporting the assessment. In line with the MNB Recommendation No 8/2017 (VIII. 8.), it

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[42] Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, transposed into national law by Act C of 2000 on accounting.
[43] https://www.eba.europa.eu/eba-advises-commission-kpis-transparency-institutions%E2%80%99-environmentally-sustainable-activities
[44] https://www.eba.europa.eu/eba-launches-public-consultation-draft-technical-standards-pillar-3-disclosures-esg-risks

is also expected that when a credit institution decides not to disclose information on the grounds that it is not material, it should clearly disclose this fact.

54. When a credit institution discloses data, metrics and targets that are considered material to climate-related and environmental risks, the MNB expects it to disclose or refer to the methods, definitions and criteria related to them.

55. MNB recommends credit institutions to take steps to be able to disclose the total GHG emissions it finances in addition to its own GHG emissions. The MNB considers it to be a good practice for credit institutions to adopt a sufficiently detailed approach to measuring and disclosing GHG emissions. *This may, for example, require a project-by-project approach to measuring the carbon intensity of large corporate portfolios, as well as a property-by-property measurement of actual energy consumption or an energy efficiency rating of property portfolios.*

56. The Commission's Communication consolidates the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD)[45] and provides guidance consistent with the NFRD. The MNB draws attention to Annex I, Section 5 of the Commission Communication, which details that credit institutions are encouraged to consider disclosing the following key performance indicators:
    a) Amount or percentage of carbon-related assets in each portfolio in MEUR or as a percentage of the current portfolio value and, to the extent possible, a forward-looking best estimate of that amount or percentage over their planning horizon;
    b) Weighted average carbon intensity of each portfolio, where data are available or can be reasonably estimated, and, to the extent possible, the best forward-looking estimate of that weighted average carbon intensity over their planning horizon;
    c) Volume of exposures by sector of counterparty and, to the extent possible, the best forward-looking estimate of this volume over their planning horizon.

    Pending the publication and entry into force of the Commission implementing regulations and detailed rules detailing the disclosure of climate-related and environmental risks, the MNB recommends credit institutions to take steps to disclose also the key performance indicators mentioned above, for example by assessing the availability of the necessary data and the possibilities to address any data gaps. Also on the basis of the Commission Communication, the MNB considers it to be good practice for credit institutions to consider disclosing the following performance indicators based on their lending and investment activities:
    d) Credit risk exposures and volumes of collateral by geography/country of location of the activity or collateral, with an indication of those countries/geographies highly exposed to physical risk;
    e) Volume of collaterals related to assets or activities in climate change mitigating sectors;
    f) Volume of financial assets funding sustainable economic activities contributing substantially to climate mitigation and/or adaptation (absolute figures and compared to total exposures – green asset ratio) according to the EU taxonomy[46];
    g) Total amount of the fixed income portfolios invested in green bond certified according to a potential EU Green Bond Standard if and when such a standard is approved, or according to any

[45] Final Report - Recommendations of the Task Force on Climate-related Financial Disclosures, Task Force on Climate-related Financial Disclosures, 2017 https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-2017-TCFD-Report-11052018.pdf

[46] EBA ACTION PLAN ON SUSTAINABLE FINANCE (43-44), European Banking Authority, 2019.

other broadly recognised green bond framework (at year-end) divided by (a 5-year rolling average of) total amount of holdings in fixed income portfolios.

Additional metrics and performance are included in the "Knowledge Base" and can be used to complement the metrics mentioned in this section.

57. The MNB recognises that the detailed and complete information listed in Section 56 may not necessarily be available at the credit institutions. Nevertheless, it expects that, in the context of the disclosure requirements referred to in Section 49, which will be mandatory for part of the credit institutions from 2022, the credit institution concerned assesses its data gaps and outline a concrete plan to bridge them, taking into account the ongoing EU regulatory work.

58. The MNB encourages all credit institutions to contribute to the achievement of overall climate change and environmentally sustainable objectives. If a credit institution commits to contribute to climate change related or environmental objectives, it is expected to provide a comprehensive overview of the impact of the credit institution as a whole, providing comprehensive and meaningful information on how it contributes to the former objectives, in order to avoid greenwashing risk[47]. *For example, in the case of a credit institution committed to discontinuing or restricting the financing of certain industries or activities, the precise definition of the activity and the related objectives, time frames and extent of outstanding exposures must be disclosed. It is also important for the credit institution to communicate the progress it made towards achieving these objectives, the internal monitoring processes and relevant methodological considerations, in particular the criteria for identifying the counterparties covered by the funding policy and the size of the business relationships involved. Likewise, when reporting on its contribution to environmental objectives, it is appropriate for the credit institution to take into account all business lines and the entirety of its exposures.*

59. Given the rapidly evolving climate-related and environmental risk disclosure frameworks and the needs of market actors in this area, it is recommended that disclosures are actively developed on an ongoing basis.

VII. Closing provisions

60. The recommendation is a regulatory instrument, issued in accordance with Article 13(2)i) of the Act CXXXIX of 2013 on the Magyar Nemzeti Bank, with no binding force on the supervised financial organisations. The content of the recommendation issued by the MNB expresses the statutory requirements, the principles proposed to be applied based on the MNB's law enforcement practice as well as the methods, market standards and practices.

61. In line with the general European supervisory practice, during its audit and monitoring activity the MNB monitors and assesses compliance with the recommendation by the financial organisations supervised by it.

62. The MNB highlights that credit institutions may make the contents of this recommendation part of

[47] In line with the Taxonomy Regulation, "greenwashing" refers to the practice of gaining an unfair competitive advantage in the market by marketing a financial product as environmentally friendly, when in fact basic environmental standards have not been met.

their policies. In such case, the credit institution is entitled to indicate that the provisions of its relevant policies comply with the relevant recommendation issued by the MNB. If the credit institution wishes to incorporate only certain parts of the recommendation in its policies, it should not make reference to the recommendation as a whole or should only do so in respect of the parts taken from the recommendation.

63. The MNB expects credit institutions to apply this recommendation, except as provided for in Sectons 64 and 65, from 1 June 2021.

64. Sections 3, 7, 10, 21 to 24 and 27 to 30 of this recommendation shall apply from 30 June 2021.

65. MNB expects credit institutions to carry out a self-assessment, including a detailed gap analysis, in relation to the requirements detailed in this recommendation and, on the basis of this survey, to develop an ambitious but feasible plan to address the gaps and to submit it to the MNB by 30 September 2021. The MNB plans to hold prudential discussions based on the self-assessment of credit institutions and the roadmap they have developed.

66. Following the analysis of the submitted gap analyses, action plans and prudential discussions, the MNB will, taking into account also EU legislative developments, set more detailed deadlines for the latest dates of compliance for the different expectations, which will be published in the context of the next revision of this recommendation.

Dr György Matolcsy
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