MBH BANK

PUTTING SUSTAINABILITY GUIDELINES INTO PRACTICE

Practical Application of Sustainability Guidelines in Credit Risk Management Processes

EXTRACT

The drafting of the internal Policy document 'Practical Application of Sustainability Guidelines in Credit Risk Management Processes ' was made necessary by the credit risk management requirements of the Green Recommendation No. 10/2022 (VIII.2.) of the National Bank of Hungary (MNB) on climate-related and environmental risks and the integration of environmental sustainability considerations into the activities of credit institutions.[1]

The provision covers MBH Bank Prudential Group's employees involved in credit risk underwriting activities (client relationship management, risk management, operational areas, decision-making, etc.).

The purpose of the ESG risk assessment

In 2018, the European Commission proposed an EU-wide climate neutrality target to reduce net EU greenhouse gas emissions to zero by 2050. To support this goal, the European Green Deal, a comprehensive action plan announced in 2019, sets out an intermediate target of a 55% reduction by 2030 compared to 1990 levels. The European Climate Law, adopted in 2021, officially enshrines the climate neutrality target for 2050 and emission reduction targets for 2030 in law.

The EU taxonomy is the first classification system that defines the qualitative and quantitative criteria under which an economic activity related to financing can earn the sustainable or green label. A key objective of the taxonomy is to reduce fragmentation resulting from market-based initiatives and national practices and to mitigate „greenwashing". The taxonomy guidelines have already been incorporated into the sectoral strategies related to some of the Bank's key financed sectors.

The MNB's Green Recommendation clearly states that in the future, it expects stakeholders to conduct environmental assessments of their exposures, which means that banking operations must also be prepared for these challenges. In the initial period, the Bank must begin to prepare its clients for the transition with an educational purpose, which requires the risk-taking process to be supplemented with the inclusion of sustainability considerations.

The Policy covers the ESG risk assessment of several segments, including:

- ESG risk assessment of large corporates, structured, project and syndicated finance clients
- ESG risk assessment of medium-sized companies
- ESG risk assessment of micro and small enterprises
- ESG risk assessment of the local government segment
- ESG risk assessment of the financial institutions segment
- ESG risk assessment of the retail segment

During the ESG risk assessment, four ESG risk categories has been developed:

- low
- medium
- high
- non-preferred

[1] green-recommendation-vol2-no-10-2022-viii2.pdf (mnb.hu)

In the first phase of the process of adding sustainability aspects to the risk-taking process, the primary objective is to assess and continuously monitor the portfolio from an ESG perspective. Depending on its level of detail, the ESG assessment can be automatic and detailed, or, where relevant, include transaction-specific risks in addition to the client risk. It is regularly evaluated throughout the duration of the client relationship.

Based on the data requested by the business area, the analysis is carried out by the risk management area.

The automatic assessment is basically done after an examination of the actual main activity of the client. In all cases of high or non-preferred ESG risk assessment, a brief textual justification of the importance of the transaction and the reason for approval is required.

The contractual and disbursement conditions to be formulated to mitigate ESG risk should be included in the decision documentation.

To summerize, the Bank now has an ESG risk assessment methodology in place for all lending processes and client segments - retail (housing), micro, small, medium and large enterprises. ESG guidelines have been extended, at least indirectly, to the entire retail and corporate lending process.