*Unofficial translation**

Recommendation No 10/2022. (VIII.2.) of the Magyar Nemzeti Bank

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

1. 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 domiciled in Hungary that are subject to Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises (hereinafter: the Credit Institutions Act) and to Hungarian branches of credit institutions domiciled in another Member State of the European Union or in a country which are not party to the European Economic Area Agreement (third country).

It should be noted that this recommendation is not the only one in 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 first publication of the recommendation, the European Central Bank (hereinafter: "ECB") has issued a guidance on managing climate-related and environmental risks[4], which, although not directly applicable to Hungarian credit institutions, is considered by the MNB as a model.

**In case of divergence between the language versions, the Hungarian language version shall prevail.*

[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[1] 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

In drafting the recommendation, the MNB has taken into account the EBA report on the management and supervision of environmental, social and governance (ESG) risks of credit institutions and investment firms published on 23 June 2021 (hereinafter: the EBA/REP/2021/18 report)[5] and the EBA Guidelines on international governance EBA/GL/2021/05[6] published on 08 July 2021. In addition, the recommendation implements the sustainability-related parts of the Guidelines on loan origination and monitoring, EBA/GL/2020/06[7], 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-related and environmental risks. In this context, the sections on the www.zoldpenzugyek.hu website dedicated to "Financial Institutions" and "Researchers" and the "Green Legal Directory", acting as a knowledge base, also provide practical assistance through a collection of examples, good practices, usable data, resources on methodologies, applicable legislation and expected legislative changes.

The MNB calls for continuous monitoring of the Knowledge Base, as the documents it contains will also help to implement the expectations set out in this recommendation.

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 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.

This recommendation does not provide any guidance on data management and data protection issues, does not contain any expectations regarding 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.

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5 2020-10-15 BoS - ESG report MASTER FILEcl.docx (europa.eu)

6 GL on internal governance under CRD_HU.docx (europa.eu)

7 EBA Guidelines on loan origination and monitoring (EBA/GL/2020/06): Sections 56, 57, 58, 59, 146, 149 and 196 are implemented in Sections 38., 39., 45a)-b), 46-49, 51 and 52d) of this recommendation.

2. INTERPRETATIVE PROVISIONS

1. The Paris Agreement on climate change of 2015[8], the UN Sustainable Development Goals[9] and the Special Report of the Intergovernmental Panel on Climate Change of October 2018[10] call for accelerated and decisive action to reduce greenhouse gas (hereinafter: "GHG") emissions and to create a low-carbon and climate-resilient economy.
2. The European Union (hereinafter: "EU") has set ambitious targets for 2030[11] 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[12] 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 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.

3. 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 National Clean Development Strategy 2020–2050[13], the estimated investment cost of achieving climate neutrality by 2050 for Hungary in the "early action" scenario would be approximately HUF 24,709 billion higher than in the "business-as-usual scenario", which would amount to 4.8% of GDP per year until 2050. Nevertheless, it is projected that the full decarbonisation of the Hungarian economy will generate also significant avoided costs and economic benefits. 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.

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

[9] The 2030 Agenda for Sustainable Development, United Nations Organisation, 2015 https://ensz.kormany.hu/download/7/06/22000/Vil%C3%A1gunk%20%C3%A1talak%C3%ADt%C3%A1sa%20Fenntarthat%C3%B3%20Fejl%C5%91d%C3%A9si%20Keretrendszer%202030.pdf

[10] 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

[11] Decision of the European Council of 11 December 2020 on the European Climate Directive https://www.consilium.europa.eu/hu/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

[12] 2050 long-term strategy, European Commission, 2020. https://ec.europa.eu/clima/policies/strategies/2050_hu

[13] National Clean Development Strategy 2020–2050. https://kormany.hu/dokumentumtar/nemzeti-tiszta-fejlodesi-strategia

4. In March 2018, the Commission published an action plan on financing sustainable growth[14], 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 approach to financial and economic activities. On 6 July 2021, the Commission announced the new phase[15] of the EU Sustainable Finance Strategy, which sets out four main areas: (i) financing the transition of the real economy to sustainability; (ii) developing a more inclusive sustainable finance framework; (iii) improving the resilience and contribution of the financial sector to sustainability; (iv) global ambitions.

5. According to Section 46 of the EBA/DP/2020/03 Discussion Paper on management and supervision of ESG risks for credit institutions and investment firms[16], climate change 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 climate change and other environmental degradation. This definition is also followed in the new package of banking regulation proposals published by the Commission on 27 October 2021 (draft CRR 3 and CRD VI)[17]. According to the draft CRR 3, environmental, social and governance risk is defined as the risk of loss resulting from the adverse financial impact on the institution due to the current or expected effects of environmental, social and governance factors on its counterparties or invested assets.

6. As the Commission's "Guidelines on non-financial reporting: Supplement on reporting climate-related information (2019/C 209/01)"[18], stated, the 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 indicated in this recommendation, references to risk should be understood to 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 by credit institutions.

7. 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.

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[14] Communication from the European Commission COM/2018/097 – Action Plan: Financing Sustainable Growth, , 2018. https://eur-lex.europa.eu/legal-content/HU/TXT/?uri=CELEX:52018DC0097

[15] https://eur-lex.europa.eu/legal-content/HU/TXT/HTML/?uri=CELEX:52021DC0390&from=EN

[16] https://www.eba.europa.eu/calendar/discussion-paper-management-and-supervision-esg-risks-credit-institutions-and-investment

[17] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52021PC0664

[18] Guidelines on non-financial reporting: Supplement on reporting climate-related information (2019/C 209/01), Official Journal of the European Union, 2019. https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52019XC0620(01)

Examples of risks caused by negative impacts on credit institutions:

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

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.

8. Not all environmental risks are related to the impacts of climate change. For example, certain agricultural activities can trigger the destruction of natural habitats, which also causes economic and financial losses through biodiversity loss. These, just like the climate-related risks, can be physical and adaptive.[19] For example, a reduction in the number of pollinator species may result in lower yields or higher costs through hand pollination. Likewise, the loss of biodiversity leads to a reduction in natural resilience, which can lead to a faster spread of diseases. Policies to reduce biodiversity loss and protect ecosystems, or consumer preferences, can cause serious transition risks.

9. 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[20], or the development of dedicated green banking products, such as energy efficiency loans and loans linked to ESG considerations ("ESG" or "sustainability linked loan").

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[19] NGFS Occasional Paper on Biodiversity and Financial Stability

[20] 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.

10. 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")[21]. 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").[22]

    The legislation listed in point 11(a) contains concepts and definitions that are not detailed in this recommendation but are potentially relevant.

11. For the purposes of this recommendation:
    a) sectoral legislation:
        - aa) Credit Institutions Act,
        - ab) CRR,
        - ac) Commission implementing regulations issued under the powers conferred by the CRR.
        - ad) Taxonomy Regulation[23],
        - ae) 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 (hereinafter: "SFDR")[24],
        - af) Commission Delegated Regulation (EU) 2021/2139 of 4 June 2021 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by establishing the technical screening criteria for determining the conditions under which an economic activity qualifies as contributing substantially to climate change mitigation or climate change adaptation and for determining whether that economic activity causes no significant harm to any of the other environmental objectives (hereinafter: Taxonomy Delegated Act)

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

[22] 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).

[23] 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 form the basis for further legislative changes (e.g. in 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 T axonomy regulation in their business activities. In addition, the Taxonomy regulation can assist in product design, exposure grouping, client relationship management and strategic goal setting.
[24] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32019R2088

ag) Commission Delegated Regulation (EU) 2021/2178 of 6 July 2021 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by specifying the content and presentation of information to be disclosed by undertakings subject to Articles 19a or 29a of Directive 2013/34/EU concerning environmentally sustainable economic activities, and specifying the methodology to comply with that disclosure obligation (hereinafter: "Disclosures Delegated Act"),

ah) Commission Delegated Regulation (EU) 2021/1253 of 21 April 2021 amending Delegated Regulation (EU) 2017/565 as regards the integration of sustainability factors, risks and preferences into certain organisational requirements and operating conditions for investment firms[25],

ai) Hungarian legislation implementing Commission Delegated Directive (EU) 2021/1269[26] of 21 April 2021 amending Delegated Directive (EU) 2017/593 as regards the integration of sustainability factors into the product governance obligations

aj) MNB Decree No 40/2016 (X. 11.) on the Prudential Requirements for the Rating of Customers and Counterparties, and for Collateral Valuation.

b) related supervisory regulatory instruments:

ba) At the time of issuance of this recommendation, Recommendation No 12/2015 (VIII. 24.) of the Magyar Nemzeti Bank on the Measurement, management and control of liquidity risks[27] [hereinafter: "MNB Recommendation No 12/2015 (VIII. 24.)"],

bb) At the time of issuance of this recommendation, Recommendation No 4/2022 (IV. 8.) of the Magyar Nemzeti Bank on the Application of remuneration policy[28] [hereinafter: "MNB Recommendation No 4/2022 (IV. 8.)"],

bc) At the time of issuance of this recommendation, Recommendation No 7/2022 (IV. 22.) of the Magyar Nemzeti Bank on the General requirements pertaining to the disclosure practices of credit institutions and investment firms[29] [hereinafter: "MNB Recommendation No 7/2022 (IV. 22.)"],

bd) At the time of issuance of this recommendation, 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[30] [hereinafter: "MNB Recommendation No 27/2018 (XII. 10.)"],

be) At the time of issuance of this recommendation, Recommendation No 1/2022 (I. 17.) of the Magyar Nemzeti Bank on the assessment of the eligibility of the members of executive bodies and persons in key position[31] [hereinafter: "MNB Recommendation No 1/2022 (I. 17.)"],

25 https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32021R1253

26 https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:32021L1269

27 https://www.mnb.hu/letoltes/likviditasi-ajanlas-megjelentetesre-datummal.pdf

28 https://www.mnb.hu/letoltes/8-2021-javadalmazasi-politika.pdf

29 https://www.mnb.hu/letoltes/9-2021-nyilvanossagra-hozatali-gyak.pdf

30 https://www.mnb.hu/letoltes/27-2018-belso-vedelmi-vonalak.pdf

31 https://www.mnb.hu/letoltes/1-2022-alkalmassagi-ajanlas.pdf

bf) At the time of issuance of this recommendation, Recommendation No 14/2021 (IX. 16.) of the Magyar Nemzeti Bank on the measurement, management and control of credit risks[32] [hereinafter: "MNB Recommendation No 14/2021 (IX. 16.)"],

bg) Internal Capital Adequacy Assessment Process (ICAAP), Internal Liquidity Adequacy Assessment Process (ILAAP) and their Supervisory Review Process and Business Model Assessment (BMA), Methodology Manual[33] [hereinafter: ICAAP-ILAAP-BMA Methodology Manual of the MNB].

3. GENERAL EXPECTATIONS

12. Credit institutions shall apply the supervisory requirements set out in the recommendation, in line with Section 10 of MNB Recommendation No 27/2018 (XII. 10.) taking into account the principle of proportionality.

13. Credit institutions subject to consolidated supervision are expected to apply the requirements of the recommendation also at group level. In this context, the MNB expects, in particular, that within the general risk management requirements laid down in the sectoral legislation, the requirements for group-level risk management should also be taken into account in relation to climate-related and environmental risk management activities.

14. The MNB also expects that if the foreign parent company of the credit institution is already a signatory to the UN Principles for Responsible Banking and therefore the credit institution does not consider it necessary to sign the UN Principles for Responsible Banking separately, the credit institution should implement the principles, methods and objectives adopted by the parent company in its own operations within the timeframes set by the parent company.

15. The MNB considers it to be good practice for credit institutions operating as a Hungarian subsidiary of a credit institution domiciled in an EU Member State and whose parent company is subject to the legislation set out in Chapter 7 ("*Expectations regarding disclosure*") at the consolidated level to disclose information under Chapter 7 concerning themselves or their Hungarian group members even if it is not not required by law (if such information can be ascertained from information available at the parent company).

16. 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. If credit institutions manage their climate-related and environmental risks, or some elements of it under another risk type, the MNB expects this to be set out in writing and to be traceable in other relevant internal policies.

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32 https://www.mnb.hu/letoltes/14-2021-hitelkocka-ajanlas.pdf

33 https://www.mnb.hu/felugyelet/szabalyozas/felugyeleti-szabalyozo-eszkozok/modszertani-kezikonyvek/icaap-ilaap-bma-felugyeleti-felulvizsgalatok

17. Credit institutions are expected to apply the expectations set out in the related supervisory regulatory instruments under Section 11(b), by considering the expectations set out in this recommendation.

18. The MNB expects that to the extent credit institutions implement any element of climate-related and environmental risk measurement, management and control using an external service provider, they should consider the requirements set out in Sections 158–164 of MNB Recommendation No 27/2018 (XII. 10.) and in more detail in MNB Recommendation No 7/2020 (VI. 3.).

19. Moreover, the MNB expects the relevant universal credit institutions[34] to ensure internal coordination of compliance with legislation relevant in terms of climate-related and environmental risks.

20. The MNB draws attention to the fact that the MNB's position and expectations on sustainability in relation to certain legislation are set out in a separate Management Circular (Management Circular on Regulation 2019/2088 on sustainability disclosures in the financial services sector)[35].

4. SUPERVISORY EXPECTATIONS FOR INTEGRATING ENVIRONMENTAL SUSTAINABILITY CONSIDERATIONS INTO BUSINESS PLAN, BUSINESS MODEL AND STRATEGY

21. Regarding climate-related and environmental risks, the MNB expects credit institutions in relation to their strategy, business plan and business model to take into account the credit institution's climate-related and environmental risks and opportunities. Climate-related and environmental risks can have a direct impact on the effectiveness of the credit institutions' existing and future strategies and the resilience of their business model. In accordance with Section 108 of the Credit Institutions Act, the MNB expects credit institutions to
    a) identify short-, medium- and long-term (for at least a 10-year time horizon) risks and opportunities arising from climate change and environmental degradation and being part of the business environment. The identification may cover key sectors, geographical areas and the products and services in which they operate or plan to operate, taking into account that some of these risks may materialise over a rather long period of time;

[34] Universal credit institution shall mean a credit institution providing financial services and auxiliary financial services under the Credit Institutions Act and investment services and auxiliary services under Act CXXXVIII of 2007 on Investment Firms and Commodity Dealers, and on the Regulations Governing their Activities.
[35] https://www.mnb.hu/letoltes/129526-3-2021-sfdr-vezetoi-korlevel.pdf

b) identify which climate-related and environmental risks are material to their business strategy in the short, medium and long term (for a minimum time period of 10 years), and the resilience of their business strategy to these risks.

22. The MNB expects
    a) the upcoming review of the strategy, business model and business plan to also take into account the results of the activities under Section 21 and the lessons learned in relation to the achievement of climate change and environment related risk objectives;
    b) the strategy and business plan to include the assumptions related to key climate-related and environmental risks and opportunities used in the projections, and the data, assumptions and methodologies used should be well elaborated and documented;
    c) credit institutions to identify in their strategy and business plan the main competitive advantages, vulnerabilities related to climate change and environmental risks and opportunities, and the key risks associated with the implementation, and these processes should be properly documented;
    d) the main strategic directions and objectives set out in the strategy and business plan regarding the risks and opportunities arising from climate change and environmental degradation should be aligned with the business environment of the credit institution;
    e) the strategy, business plan and business model should be in line with the institution's risk appetite, taking into account also the risks arising from climate change and environmental degradation.

23. In order to take a comprehensive approach to climate-related and environmental risks, taking into account the long-term financial interests of credit institutions, the credit institution is expected to develop its response to achieve climate-related and environmental sustainability objectives. To this end, they should develop a specific plan for monitoring and managing the short-, medium- and long-term (at least 10 years) risks that may arise from the institutions' business model and strategy not being sufficiently aligned with these objectives and the broader trends of the transition to a sustainable economy.

24. In the context of the implementation of the credit institutions’ strategy integrating also climate-related and environmental aspects, the MNB expects the credit institution to apply both key performance indicators (KPIs) and key risk indicators (KRIs) covering relevant climate-related and environmental aspects. The MNB considers it to be good practice if the climate related and environmental KPIs and KRIs used by credit institutions are 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.

25. The recommendations set out in the UN Principles for Responsible Banking (hereinafter: “Principles”) lay the foundations for credit institutions to make a conscious contribution to

sustainability efforts. As an official supporter of the UN Principles for Responsible Banking, 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-related and environmental sustainability objectives ("Alignment") (see more in Chapter 4 - Supervisory expectations for the strategy);
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") (see more in Chapters 4 and 6 - Supervisory expectations for the strategy and risk management);
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") (see more in Chapter 6 - Supervisory expectations for risk management);
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 ("Corporate governance and culture"); (see more in Chapter 5 - Supervisory expectations for corporate governance);
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"). (see more in Chapter 7 - Supervisory expectations for disclosures);

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.

26. Considering that the implementation of the business strategy has an impact on the environment, which may result in increased climate-related and environmental risks and, over time, may affect the resilience of business models, the MNB considers the following to be good practice:
    a) Credit institutions take steps to reduce their overall carbon and ecological footprint and its climate-related and environmental risks, for example by reducing, phasing out or even rapidly eliminating financing for environmentally unsustainable activities, most notably those that "always cause significant environmental harm"[36];

[36] Unsustainable activity that causes significant damage and requires urgent but controlled phase-out. Further information is available: https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/220329-sustainable-finance-platform-finance-report-environmental-transition-taxonomy_en.pdf

b) Credit institutions develop a carbon neutrality plan[37] in line with climate-related and environmental sustainability objectives and this recommendation. These efforts are also in line with the objective of Article 2(1)(c) of the Paris Agreement: “Making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development”[38].
c) Credit institutions shall inform their clients about the environmental sustainability aspects of their products and services and their contribution to climate-related and environmental sustainability objectives, taking into account the relevant legal requirements. Conscious awareness-raising among consumers and financial education focusing on climate-related and environmental risks play a key role in achieving sustainability objectives. The information may, taking into account the characteristics of the products or services, cover climate-related and environmental risks, for example, in the case of real estate collateral, in particular the energy characteristics of commercial or residential property, their potential impact on loan, and the externalities (environmental and societal) over the entire life cycle of the products and services financed by the loan, where this can be reasonably estimated.

[37] Carbon neutrality plan means the reduction of the bank's direct and indirect (scope 1, 2, 3 - including financed emissions) GHG emissions to zero.
[38] https://eur-lex.europa.eu/legal-content/HU/TXT/PDF/?uri=CELEX:22016A1019(01)&from=HU

5. SUPERVISORY EXPECTATIONS FOR CORPORATE GOVERNANCE

27. 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 MNB expects the management body in its supervisory function to 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.

28. In line with the general requirements of Section 108 of the Credit Institutions Act, the management body in its supervisory function is expected to exercise effective oversight over the credit institution's climate change and environmental risks, and the impact of the business strategy on climate change and environmental sustainability objectives (see point 23).

29. Credit institutions are expected to clearly define the responsibilities of each individual person performing internal management and internal control functions regarding climate-related and environmental risks, in line with the general principles on internal lines of defence in relation to the general responsibilities under Section 107 of the Credit Institutions Act and the MNB Recommendation No 27/2018 (XII. 10.). In this context, credit institutions are expected to develop an organisational and operational structure that will help and support the board performing the governance function to better understand and effectively manage the climate-related and environmental risks affecting the credit institution or group. It is the responsibility of the management body in its supervisory function to ensure that the relevant lines of responsibility are transparent, clear, well defined, consistent, adequately documented and that compliance with the lines of responsibility can be enforced.

30. In the application of Section 113(3) of the Credit Institutions Act and in the context of the MNB Recommendation No 1/2022 (I. 17.), 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. In line with points 40 and 80 of MNB Recommendation No 1/2022 (I. 17.), the MNB expects credit institutions:
    a) to provide adequate human and financial resources for the training of members of the management body and key personnel concerned[39] on climate-related and environmental risks;
    b) ensure that members of the management body and key personnel concerned are familiarised with the climate-related and environmental risks of the credit institution from the start of their employment, as part of their preparation and training for their duties,

[39] Including the head of the dedicated department responsible for the management and control of climate-related and environmental risks as referred to in Section 32, or the manager in charge of the management and control of climate-related and environmental risks

c) change the composition of the management body or, in the case specified in Section 20 (c) or (d) of the MNB Recommendation No 1/2022 (I. 17.), assess whether the members of the management body with governance and supervisory powers are collectively able to perform the tasks under Section 67 of the MNB Recommendation No 1/2022 (I. 17.) and Section 41 of the MNB Recommendation No 27/2018 (XII. 10.), also covering climate-related and environmental risks.

The MNB also considers it to be a good practice for credit institutions to assess the suitability of the relevant key staff based on their knowledge of climate-related and environmental risks and to provide such staff with tailored training on these risks.

31. In accordance with Article 109 of the Credit Institutions Act, the MNB expects the management body with governance powers to ensure adequate human and financial resources and to provide authority for the departments and areas (with particular attention to areas with control functions) involved in the management of climate-related and environmental risks.

32. In line with points 76 and 78 of MNB Recommendation No 27/2018 (XII. 10.), the MNB expects that
    a) credit institutions to provide regular training to its employees on climate-related and environmental risks affecting the activities, strategy and risk profile of the credit institution, taking into account the responsibilities of the relevant employee in managing those risks;
    b) all employees within the credit institutions should be aware of their responsibilities in relation to the management of climate-related and environmental risks.

MNB also considers it to be good practice for credit institutions to mesure the possibility of a general environmental and climate awareness training.

33. The responsibilities of those performing internal control functions are expected to be defined along the following lines in the context of climate-related and environmental risks:
    a) the MNB considers the inappropriate integration of climate-related and environmental risks into existing processes to be included in the compliance risks under Section 109 of MNB Recommendation No 27/2018 (XII. 10.);
    b) the risk control function is expected to devote sufficient time to identifying risks arising from climate change and environmental degradation in line with Section 106 of MNB Recommendation No 27/2018 (XII. 10.);
    c) the credit institutions' head of risk control is expected to provide the management body with governance powers with comprehensive and understandable information on the credit institutions' climate-related and environmental risks;
    d) It is recommended that the compliance officer, the compliance manager, the head of risk control and the internal controller provide a summarising assessment of climate-related

and environmental risks to the management body with supervisory powers at least annually.

34. The MNB also expects the credit institutions' internal control system and audit trail to cover climate-related and environmental risks arising in the short, medium and long term. Internal audit is expected to verify on a regular basis, using individually or in combination the types of controls set out in Section 134 of MNB Recommendation No 27/2018 (XII. 10.), whether the internal control systems established and operated by the credit institution effectively ensure that the credit institution is prepared to manage its short-, medium- and long-term climate-related and environmental risks and the achievement of its risk management objectives for these risks.

35. The MNB expects credit institutions to establish a dedicated department or function responsible for the management and control of climate-related and environmental risks ("ESG centre" or dedicated "chief sustainability officer") or to appoint a manager in charge of climate-related and environmental risk management and control who will report regularly on this activity to the management body with governance powers – the MNB considers reporting on a quarterly or semi-annual basis, taking into account the principle of proportionality, as a good practice. Considering the principle of proportionality set out in Section 10 of MNB Recommendation No 27/2018 (XII. 10.), in the case of financial institutions with smaller and less complex activities, a member of the management body with governance powers may be appointed to perform the above tasks, 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.).

36. In line with Sections 117–121 of the Credit Institutions Act and the MNB Recommendation No 4/2022 (IV. 8.), remuneration policies and practices are expected to contribute to a long-term approach to addressing climate-related and environmental risks. In this context, the MNB considers it to be a good practice for credit institutions to set KPIs related to sustainable finance in their remuneration policies.

37. 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. The MNB is aware that the relevant metrics and tools are evolving and that, for the time being, the data available at credit institutions may be incomplete. Nevertheless, in line with the provisions of Section 109 (3) of the Credit Institutions Act, Section 295 of MNB Recommendation No 14/2021 (IX. 16.) and Section 129 of MNB Recommendation No 27/2018 (XII. 10.), the MNB expects:

a) the management body of the credit institutions to receive regular reports on the implementation of the Green Recommendation action plan sent to the MNB by 30 September 2021, and it is good practice to receive them quarterly or semi-annually;
b) the management body of the credit institutions to have adequate information on the credit institution's climate-related and environmental risks and their potential changes through the management information system;
c) the area(s) of the credit institutions as defined in Section 29 to comply with their reporting obligations on climate-related and environmental risks at the frequency specified in the legislation or in MNB recommendations;
d) reports on climate-related and environmental risks to be regularly reviewed and improved (in terms of data content and quality) as the range of available data on climate-related and environmental risks continues to expand.

38. In accordance with Section 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 data reporting, disclosure and communication systems that are capable of aggregating climate- and environmental risk-related data. In this context, the MNB expects credit institutions
    a) 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.
    b) to assess the need for possible adaptation their information and IT systems in order to be able to collect and aggregate necessary data to assess their exposure to these risks, in particular the data to be published under Article 8 of the Taxonomy Regulation and, where relevant, the SFDR Regulation, as well as the aggregated energy characteristics of real estate collateral;
    c) to build a data taxonomy of these risks.

    Where the requirements in (b) and (c) – due to lack of common definitions, incomplete taxonomies and data gaps – are not feasible, the MNB considers it to be a good practice for credit institutions to consider establishing reporting processes and procedures based on internal qualitative data or even external risk measures. This will ensure that management body in its supervisory function receives appropriate reports on climate-related and environmental risks. In this case, it is expected that the management body in its supervisory function is aware of the limitations of the reports they receive.

6. SUPERVISORY EXPECTATIONS FOR RISK MANAGEMENT

6.1. Risk management framework

39. The MNB expects credit institutions to define their risk appetite framework, risk strategy and risk management policies in line with MNB Recommendation No 27/2018 (XII. 10.), also regarding climate-related and environmental risks. The MNB expects climate-related and environmental risks to be gradually integrated into the documents mentioned above, with the climate-related and environmental risk data getting more and more granular with each revision of these risk-related policies.

40. Credit institutions are expected to strive to create a risk management culture that:
    a) takes into account credit institutions' climate-related and environmental risks;
    b) ensure that emerging climate-related and environmental risks are identified, measured and managed on an ongoing and timely basis.

41. The MNB expects credit institutions
    a) to take measures to quantify climate-related and environmental risks,
    b) to develop procedures, tools and methodologies to measure and mitigate these risks, and
    c) to implement procedures and metrics to monitor these risks at the exposure, client and portfolio levels.

    The MNB emphasises that climate-related and environmental risks should not be excluded from the assessment of risks because they are difficult to quantify or because the relevant data is not available.

42. In order to identify and manage climate and environmental risks, credit institutions are expected
    a) to develop appropriate risk indicators,
    b) to set appropriate limits,
    c) to develop procedures to be followed in case the established limits are exceeded.

    It is recommended to monitor current data on climate-related and environmental risk exposures, preferably in the form of quantitative measures[40], based on a combination of historical facts and forward-looking estimates. 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 uniform measures.

[40] The non-exhaustive "Knowledge Base" contains the metrics that credit institutions may take into account.

43. Credit institutions are expected to assess the impact of climate-related and environmental risks when calculating their internal capital requirements. 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 operate its business model in a sustainable manner, while ensuring economic and regulatory capital adequacy. Where credit institutions consider climate-related and environmental risks to have an economic impact, it is required to consider the potential impact on their projected capital adequacy as reflected in its baseline and adverse scenario assessments. Credit institutions are also expected to consider the implications of this when determining their risk appetite and business strategy.

6.2. Credit risk management[41]

44. MNB expects
    a) the credit risk policies and procedures, credit risk culture, credit risk appetite and credit risk strategy of the credit institution to also take climate-related and environmental risks into account;
    b) credit institutions to apply procedures and risk mitigation techniques for reducing and mitigating climate-related and environmental risks, and in light of this to design a credit risk limit system that facilitates the achievement of climate-related and environmental risk mitigation objectives.

45. The MNB expects credit institutions that carry out or plan to carry out environmentally sustainable lending activities to develop an environmentally sustainable lending policy and internal regulations as part of their credit risk policy, in line with their overall objectives, strategy, policies concerning sustainable finance and the objectives set out in Section 14. The MNB expects credit institutions to set – quantifiable targets where possible – to improve its environmentally sustainable lending activities, to ensure their integrity and to regularly assess their achievement and contribution to the objectives set out in Section 17.

46. The environmentally sustainable lending policy is expected to include:
    a) a list of projects and activities, and criteria, which the credit institution considers to be an environmentally sustainable financing objective, or
    b) refer to the standards on environmentally sustainable lending that define which loans are considered environmentally sustainable.

47. In addition, the process of credit risk taking and credit risk management also requires procedures and methodologies through which credit institutions can verify that the loan has

[41] The expectations and good practices contained in the credit risk management chapter apply to both new loans (flow) and existing loans (stock).

in fact been used to finance sustainable activities. In the case of loans to corporates, the credit risk taking 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 compliance 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;
d) monitoring, on a regular basis, that the proceeds are allocated properly (which may include requesting updated information from borrowers on the use of the proceeds until the relevant loan instrument is repaid).

48. The MNB expects the documentation of credit risk taking decisions to include the results of the client's climate-related and environmental risk screening and the contractual and disbursement conditions for mitigating such risks.

49. The decision-making process under MNB Recommendation No 14/2021 (IX. 16.) Subsection 84 (aa) should include the results of the climate-related and environmental risk screening of the client as part of the preliminary data collection.

50. MNB expects credit institutions to consider climate-related and environmental risks at all relevant stages of credit risk taking and credit risk management processes, in line with the MNB Recommendation No 14/2021 (IX. 16.).

51. Credit institutions are expected to exercise due diligence of climate-related and environmental risks on their clients and counterparties both before and after taking on risk, and the results from this due diligence process are included in the credit report. 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. The MNB expects credit institutions to have an understanding of the impact their clients have on climate change and the environment[42], as well as their vulnerability from them. Furthermore, credit institutions should be aware of their clients' attitudes to managing these impacts and risks.

52. The MNB expects credit institutions to pay particular attention to exposures from increased climate-related and environmental risks.

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[42] The GHG emissions generated by the clients of credit institutions are to be classified under scope 3. Measuring these financed emissions can provide important support in analysing the transition risks.

53. The MNB expects credit institutions,
    a) to develop their client and counterparty rating processes in a way, that it can identify and assess climate change related and environmental risks by setting appropriate risk indicators or ratings,
    b) to develop their data provision requirements for client and counterparty rating by taking climate-related and environmental risks also into account,
    c) to take all reasonable steps to identify the client's exposure to, and any changes in their exposure to climate-related and environmental risks in the course of the client and counterparty rating process, in the context of which they shall regularly conduct climate-related and environmental risk audits on their clients and counterparties even after the risk has been taken, and to include the results of this due diligence in the credit report.

54. Credit institutions are expected to take climate-related and environmental risks into account when assessing collateral (including ex post assessment of collateral), as they may affect the value of the collateral. The MNB considers it to be good practice for credit institutions to take into account the location, technical and energy characteristics of commercial or residential property when assessing the real estate collateral and to record these in their own records.

55. It is expected that the credit institution's credit pricing framework reflects climate-related and environmental risks and those are reflected in the credit institution's 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 the climate, while increasing their exposures to sectors that have a positive impact on the environment or the 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 against 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-related and environmentally sustainable goals.*

56. Climate-related and environmental risks may arise through various cost factors, such as the cost of capital, the cost of funds or credit risk premiums. *Environmentally sustainable instruments might 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 the details of the preferential capital treatment introduced by the MNB[43] *into account. 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.

With regard to points 55 and 56, 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 environmentally sustainable according to the Taxonomy Regulation, the draft of Taxonomy Delegated Act and Complementary Climate Delegated Act[44], 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, if it results in at least a 30% reduction in primary energy demand, the renovation of an outdated residential building, 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.* 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 aimed at a substantial improvement of that. *For example, an investment by an unsustainable agricultural company will reduce its climate exposure if, for example, it shifts to organic farming.*

57. The 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 14/2021 (IX. 16.) in mind. To this end, it is essential that credit institutions differentiate their green, i.e. environmentally sustainable, exposures, subject to the provisions of Section 46.
The MNB draws attention to the planned extension of the EU Taxonomy[45], which may in the future require the designation of "red", i.e. environmentally harmful, and "yellow", i.e. neutral exposures. Differentiating exposures in this way can help at several stages of credit risk management.

43 www.zoldpenzugyek.hu

44 COMMISSION DELEGATED REGULATION (EU) …/... of XXX amending Delegated Regulation (EU) 2021/2139 as regards economic activities in certain energy sectors and Delegated Regulation (EU) 2021/2178 as regards specific public disclosures for those economic activities

45 https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/220329-sustainable-finance-platform-finance-report-environmental-transition-taxonomy_en.pdf

6.3. Operational risk management

58. In line with the general provisions of Section 108 of the Credit Institutions Act, the MNB expects credit institutions to assess the impact of climate change and environment-related transition and physical risks 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 situated in locations with a higher risk of extreme weather events or other negative environmental events. From an operational risk perspective, climate change can also increase the operating costs of credit institutions through the transition risk channel, for example through higher energy prices or increased emissions reporting obligations.*

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

60. The MNB expects credit institutions
    a) to also take climate-related and environmental risks into account in their operational risk management framework;
    b) collection of loss-data activities to cover events due to climate change – at least - whose impact can be detected in the accounting (general ledger or analytic) records;
    c) to conduct scenario analyses to assess the risk of events connected to climate-related and environmental risks that have an impact on operational risks;
    d) to develop risk mitigation procedures for the events connected to climate-related and environmental risks that have an impact on operational risks;

61. The MNB expects credit institutions to take the extent to which the nature of their operational and business activities increases the future reputational damage or legal risks (liability risk or litigation risk) related to losses from physical or transition risks of climate change[46] into account. 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,

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[46] EBA/REP/2021/18 report, point 66: Legal risks – i.e. liability risk or litigation risk – can also be classified as physical or transition risk. These, however, can also be considered as a separate risk category, as they can arise not only from climate-related and environmental risks, but also from social and governance risks. The liability and litigation risk in relation to ESG factors relates to the risk arising from persons or corporations claiming compensation for losses they may have suffered as a result of ESG factors, for example when institutions' counterparties are held liable for the negative effects of their activities on ESG factors. Changing preferences in the context of climate-related and environmental risks may mean that business activities and behaviours that are considered acceptable today may become legally actionable in the future. Possible causes include "principal-client conflict", asymmetry in producer-consumer information on environmental risks, or legal claims that are the consequence of inadequate climate adaptation and mitigation actions.

such as the EU's prospective Green Bond Standard[47] or the regulation on sustainability disclosures in the financial services sector.

62. The MNB considers it important that credit institutions themselves strive to reduce their 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 and the objectives set out in point 14, also entail reputational risks.

    With regard to the credit institutions' own operational risk, the MNB expects the following:

    a) measuring direct emissions from activities (Scope 1)[48],
    b) measuring indirect emissions related to purchased energy (Scope 2),
    c) measuring indirect emissions other than financed emissions (Scope 3)[49],

    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[50], and to measure and seek to continuously improve their environmental performance. As regards other environmental impacts of operations and measures to reduce them, the MNB recommends the following:

    d) the introduction and promotion of 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) neutralising 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[51], which, in addition to GHG neutralisation, also serve biodiversity improvement, secondly by purchasing so called carbon credits.

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

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

49 Credit institutions should focus on GHG emissions falling within Scope 3, as these are likely to be orders of magnitude higher than Scope 1 or 2 emissions. This, however, is relevant from a credit risk measurement, management and mitigation perspective. Expectations and good practices regarding the measurement and disclosure of financed emissions are reflected in a number of sections of this recommendation.

50 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.

51 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/sajtoszoba/sajtokozlemenyek/2021-evi-sajtokozlemenyek/az-mnb-a-wwf-magyarorszaggal-egyuttmukodve-valik-karbonsemlegesse

6.4. Market risk management

63. Regarding the management of market risk, the MNB expects credit institutions to take into account that climate-related and environmental 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. Larger credit institutions with significant trading portfolios and more complex positions are expected to integrate the impact of environmental and climate-related factors of market risk into their processes for identifying, measuring, managing, monitoring and reporting market risks in a documented manner.

64. With regard, in particular, to the credit spread risk component of the banking book, 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.

6.5. Liquidity risk management

65. 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 expected that the credit institution takes measures to integrate climate-related and environmental risks as material factors affecting liquidity risk into its processes, within the framework of the legislation on liquidity risk measurement and management and MNB Recommendation No 12/2015 (VIII. 24).
    a) identification, measurement, management and monitoring of liquidity risk over an appropriate set of time horizons, tailored to business lines, currencies and legal entities of the group, and the maintenance of adequate liquidity buffers,
    b) measurement and management of all key sources and impacts of market liquidity risk and for managing liquidity shortages arising from short position due dates preceding long positions.

66. Where climate-related and environmental risks are material from a liquidity risk perspective, in addition to integrating these factors into the processes under subsections 65(a) to (b), the MNB expects this to be recorded in writing and to be traceable in other relevant internal policies.

6.6. Sensitivity-, scenario analysis and stress testing

67. In line with Section 86 of the MNB Recommendation No 27/2018 (XII. 10.), credit institutions are expected to assess climate-related and environmental risks – together with those

considered material – through sensitivity-, scenario analysis or stress testing. Credit institutions subject to the full SREP are expected to apply these methodologies concurrently.

68. 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[52]. The MNB expects credit institutions to take at least the following aspects when conducting sensitivity-, scenario analysis and stress testing as regards climate-related and environmental risks into account:
    a) how physical and transition risk may affect the credit institution;
    b) how climate-related and environmental risks might evolve under different scenarios, taking the features of this type of risk into account (uncertainty and non-linearity, probability that cannot be based on historical data, potentially extreme and widespread impacts[53]);
    c) how climate-related and environmental risks may occur in the short, medium and long term (at least 10 years), depending on the scenarios considered.

69. The MNB expects credit institutions to define their own risk profile and assumptions regarding its particular specifications, and to consider 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, the MNB recommends credit institutions to assume extraordinary but plausible developments of sufficient severity in terms of their impact on capital adequacy.

70. It is expected that credit institutions' stress testing policy will be reviewed regarding climate change-related and environmental risks.

7. SUPERVISORY EXPECTATIONS FOR DISCLOSURES

71. 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. The MNB expects credit institutions to start preparing for the new disclosure requirements, if they are subject to them. In conducting the data needs assessment and preparing the related plan under Requirement 29(a), credit institutions are expected to take into account ongoing EU regulatory work.

72. Under Article 8 of the Taxonomy Regulation, non-financial undertakings and financial corporations required to disclose non-financial information under Article 19a or Article 29a of

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

the Non-Financial Disclosure Directive[54] (hereinafter: "NFRD") are obliged from 1 January 2022 to provide additional transparency on the extent to which their activities are considered environmentally sustainable.

Credit institutions, that are required to disclose non-financial statement under Articles 19a or 29a of the NFRD[55] must disclose:

a) From 1 January 2022 to 31 December 2023, the data specified in Article 10(3) of the Disclosures Delegated Act,
b) From 1 January 2024, in addition to the information specified in Section a), the information specified in Article 10(5) of the Disclosures Delegated Act,
c) From 1 January 2025, in addition to Sections (a) to (b), they must comply with Article 9(3) of the Disclosures Delegated Act,
d) From 1 January 2026, in addition to Sections (a) to (c), they must apply points 1.2.3 and 1.2.4 of Annex V of the Disclosures Delegated Act.

The MNB points out that Articles 1(3) and 1(7) of the draft CSRD[56] will, inter alia, amend the personal scope of Articles 19a and 29a of the NFRD, which also implies an extension of the personal scope of Article 8 of the Taxonomy Regulation, and that credit institutions which are large companies and parent undertakings of large groups of companies from 1 January 2023 and also credit institutions which are small and medium-sized enterprises operating in the form of public limited liability companies from 1 January 2026 are expected to comply with Subsections 72(a) to (d).

In addition, the CSRD significantly expands the content of the sustainability report under Articles 19a and 29a of the NFRD, which will have to be disclosed by the undertakings concerned in accordance with the sustainability reporting standards referred to in Articles 19b or 19c of the NFRD. The MNB recommends to monitor on an ongoing basis the changes of the domestic legislation (Act C of 2000 on Accounting), which is expected to implement the provisions of the CSRD, .

73. Article 449a of the CRR requires large institutions[57] with securities traded on a regulated market to disclose information on certain ESG risks after 28 June 2022. EBA published the relevant draft implementing technical regulation on 24 January 2022[58].

The MNB notes that according to draft CRR 3, the personal scope of the article on ESG risk disclosure (Article 449a of CRR) is expected to be extended to all institutions from 1 January

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[54] 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.
[55] Credit institutions subject to Article 95/C of Act C of 2000 on Accounting (Accounting Act).
[56] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52021PC0189
[57] See CRR Article 4(146)
[58] https://www.eba.europa.eu/eba-publishes-binding-standards-pillar-3-disclosures-esg-risks

2025. Small and non-complex institutions[59] will be required to disclose ESG risks-related information on an annual basis, while other institutions on a semi-annual basis. In addition, institutions will be also required to report their ESG risk exposures to their supervisory authorities. Therefore, the MNB expects credit institutions to monitor the process of legislative changes and, if necessary, start the preparations to comply with the new requirements.

The MNB draws attention to the disclosure obligation under Article 435 of the CRR, under which credit institutions are required to disclose their risk management objectives and policies for each risk category, including ESG risks, to the extent that the information required to be disclosed under Article 449a of the CRR is considered material.

74. The MNB considers it as good practice if
    a) credit institutions subject to Section 95/C of Act C of 2000 on Accounting disclose their annual report, including the non-financial statement pursuant to Section 95/C, or the non-financial statement part of its annual report pursuant to Section 95/C;
    b) a credit institution not subject to an obligation under Section 95/C of Act C of 2000 on Accounting, Article 8 of the Taxonomy Regulation or Article 449a of the CRR also voluntarily complies with all or part of the disclosure rules referred to in Sections 63 to 64 and 65(a);
    c) credit institutions request an auditor's review of the information to be disclosed under Sections 63 to 64 and 65(a), whether by statutory requirement or voluntarily.

75. 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, considering the expectations set out in the MNB Recommendation No 7/2022 (IV. 22.). In this context, credit institutions are also expected to assess compliance with the materiality criterion about climate-related and environmental risks on a regular basis, but at least annually. MNB draws attention to the fact that, due to the long-term nature of these risks, credit institutions should not consider climate-related and environmental risks as immaterial.

76. Where a credit institution does not consider climate-related and environmental risks to be material in relation to its own operations and activities, the MNB expects the credit institution to document this decision with qualitative and quantitative information supporting the assessment. In line with the MNB Recommendation No 7/2022 (IV. 22.), it 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.

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[59] See CRR Article 4(145)

77. When credit institutions disclose data, metrics and targets that are considered material with regard to climate-related and environmental risks, the MNB expects credit institutions to provide market participants with a comprehensive view of the credit institution's climate-related and environmental risks and risk profile. In this regard, the MNB expects the followings:
    a) Credit institutions shall disclose or refer to methods, definitions and criteria concerning the disclosure of data, metrics and targets that are considered material for climate-related and environmental risks.
    b) The disclosure should also cover substantial changes in climate change related and environmental risk exposures between reporting periods and the appropriate responses by senior management or the management body.
    c) The information disclosed should provide sufficient qualitative and quantitative information about the credit institution's processes and procedures aimed at identifying, measuring and managing climate-related and environmental risks.
    d) Approaches to disclosure should be sufficiently flexible to show how senior management and the management body assess and manage climate-related and environmental risks within the organisation.

78. MNB considers it to be a good practice for credit institutions to contribute to climate-related and environmental sustainability 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[60].

79. 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.

8. CLOSING PROVISIONS

80. 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.

81. In line with the general European supervisory practice, during its audit and monitoring activity

[60] 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.

the MNB monitors and assesses compliance with the recommendation by the financial organisations supervised by it.

82. The MNB highlights that credit institutions may make the contents of the recommendation part of their policies. In such case, the financial entity 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.

83. The MNB expects the credit institutions concerned to apply points 1-21, 22(a), 27, 30(a), 35, 37(a), 38(a), 39, 41(a), 44(a), 45-48, 51, 52, 62(a)-(b) and 71 of this recommendation from 15 September 2022.

84. The MNB expects the financial institutions concerned to apply points 22(b) to (e), 28, 30(b), 31 to 33, 37(b), 38(b), 41(b), 49, 53(a), 58, 59, 60(a), 61 and 62(c) of this recommendation from 1 July 2023.

85. The MNB expects the financial institutions concerned to apply points 23, 24, 29, 30(c), 34, 36, 37(c)-(d), 38(c), 40, 41(c), 42, 43, 44(b), 50, 53(b)-(c), 54-57, 60(b)-(d), 63-70 and 75-78 of this recommendation from 1 January 2025.

86. The MNB expects the relevant financial institutions to apply Sections 72 and 73 of the recommendation by the deadlines set out in the respective sections.

87. The MNB Recommendation No 5/2021. (VI. 15.) on climate-related and environmental risks and the integration of environmental sustainability considerations into the activities of credit institutions will be repealed on 15 September 2022.

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