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IMPLEMENTATION OF ESG PRINCIPLES IN THE BANKING SECTOR OF POLAND AND UKRAINE

ESG principles have already become a part of the reality of the operations of financial institutions in Poland. Implementing the Paris Agreement, the Green Deal, together with other political declarations, paves the path to achieving climate neutrality of the European economy, including a zero-carbon EU by 2050.

EU Taxonomy defines six main environmental objectives: Mitigation and adaptation to climate change, sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control, and protection and restoration of biodiversity and ecosystems [1].

To realise these goals, a redirection of capital flows towards more sustainable investments is needed. This is reflected in the current and emerging regulatory requirements and ESG guidelines for the European financial sector, which pressure the industry to play a leading role in financing the “green transition”.

The current macroeconomic and geopolitical situation, including Russia’s aggression in Ukraine and the associated sanctions already visible in energy prices and further economic and social consequences that are difficult to predict, creates additional challenges on the road to a ‘green Europe’. The increase in the price of raw materials, including fossil fuels, may accelerate the pace of transformation and provoke an active search for sustainable solutions. More and more financial sector participants confirm ESG transformation as an additional opportunity and are integrating sustainability goals and actions into their business strategies.

Banks play a significant role in redirecting finance from carbon-intensive sectors of the economy to more sustainable ones, not only through appropriate product offerings or raising customer awareness, but also by actively supporting their customers’ transformation.

Banks have shifted the switch of economic tracks, as Przemek Gdański, CEO of BNP Paribas Bank Polska, mentioned.

“The implementation of ESG requirements is a historic change for the Polish, European and global economy”. Turning the switch to a new track requires the involvement and cooperation of a great many institutions, including banks. Their role, as the main financiers of the transition, is crucial.

Most banks in Poland have recognised this potential. They use a variety of indicators for both environmental, social, and corporate governance aspects to establish and implement their sustainability strategies.

The implementation of supervisory guidelines and the development of a green product offering are the priority areas on which banks plan to focus their activities in the future and the implementation of the adopted ESG strategy (fig.1) [2].

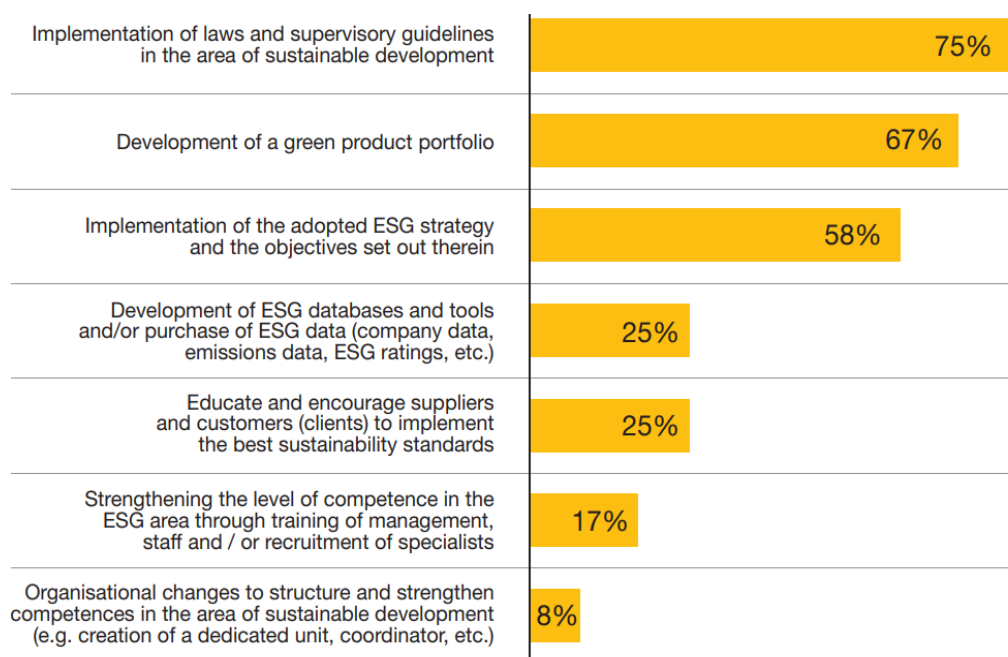


Figure 1. ESG strategy prospects

Among the most popular approaches were policies limiting funding for activities considered controversial in the context of sustainable development (for example, those in carbon-intensive sectors or those related to the arms industry), implemented by 92% of the banks.

Large banks directly supervised by the ECB mainly use indicators such as carbon footprint, external ESG assessment/rating, and, more often than in the case of Polish banks, the green asset ratio (GAR). More than half of the banks also included the organisation’s energy and water consumption (67% and 50% of banks, respectively). In terms of metrics related to product offerings, the number/value of green/sustainable products (67% of banks) was frequently cited.

Climate risk is a key ESG factor in Polish banks’ lending processes, with physical risk being more frequently considered than transformation risk across all customer segments. Poland’s geographic location and temperate climate limit physical risk analyses to a few relevant factors (mainly floods, droughts, fires). This is particularly evident in strategic, corporate, and SME lending, where physical risk assessment benefits from established tools and long-standing experience, especially regarding flood risk. In the mortgage sector, physical risk is also more prominent,

though only one-third of banks incorporate it into their evaluations. Additionally, other environmental risks, such as biodiversity concerns, are mainly considered for strategic clients. Transformation risk, although significant in Poland and raising many questions as to the detailed legal solutions (including taxation) in the EU and their impact on the Polish economy, still requires the development of methodologies and tools. Overall, while Polish banks have developed strong capabilities for assessing physical climate risks, further advancements are needed to effectively integrate transformation risk and broader environmental factors into lending decisions.

At this point, half of the Poland banks surveyed are not taking action at all to identify the impact of biodiversity risks. This result is not surprising, as the available instrumentation for identifying and estimating biodiversity risks is only just taking shape and the main focus of banks is still on climate risk issues.

According to the Green Finance in Poland – 2024 survey, Polish banks consider the availability of information and the quality of ESG data on their counterparties to be the biggest challenge to integrating ESG into the risk assessment process, the poor quality of counterparty disclosures, and the awareness of ESG factors.

ESG risk assessment results are used in the lending process, reflecting the need for banks to comply with the EBA expectations expressed in the EBA Guidelines on loan origination and monitoring. This situation may be due not only to strategies related to sustainable financing, but also to responses to regulatory requirements - according to the Methodology of the Supervisory Review and Evaluation Process (2023), during the qualitative analysis of the business model (including in the assessment).

The vast majority of Polish banks (83%) plan to expand their offerings in 2023/2024 with new sustainable finance loan products. Only one bank declared no activity in this area. Polish banks primarily plan to implement loans for investments aimed at meeting the environmental objectives set out in the Taxonomy, such as climate change mitigation or adaptation (83%), pollution prevention or the transition to a circular economy, or water protection (42%).

Polish commercial banks are taking extensive action to adapt to the new ESG reporting rules, which proves their high level of professionalism and responsibility. They attach great importance to compliance with international standards, transparency, and stakeholder engagement, allowing them to manage sustainable development issues and ESG reporting effectively. An additional confirmation of this professionalism is the introduction of external ESG attestation already in reporting during the last year [3].

In line with ESG principles, Ukraine pays considerable attention to the development of sustainable finance as an important factor in ensuring the ESG principles in the macro- and microeconomy. The NBU has developed a Roadmap to define the NBU's actions aimed at creating a reliable, predictable and stable regulatory framework for the development of sustainable finance in Ukraine, setting a realistic timeframe and covering the need to ensure the consistency and adaptability of the banking system and non-bank financial institutions to changes.

An environmental and social risk management system has to be integrated into the general risk management system of a financial institution ensuring the ongoing identifying, measuring, monitoring, controlling, reporting, and mitigating such risks

that arise at the stages of preparation and implementation of projects fully or partially funded by financial institutions, as well as in the actual operations of such institutions.

Banks and all the financial institutions are required to disclose information on their economic sustainability, the impact of their activities on the environment, and the reputational and financial risks arising from the environmental “footprint” of their operation.

The NBU surveyed 33 of the largest banks about their approaches to climate risk management - almost three-quarters of them considered that climate change is already affecting their activities. However, only about a third of the surveyed banks have advanced in managing these risks and integrated them into their risk management systems, primarily credit and operational risks. The integration of climate risks into credit risk assessment remains weak: they do not affect the terms of contracts and the assessment of credit risk parameters.

The introduction of ESG principles is an important step not only for the sustainable development of the Ukrainian financial sector but also for the country's integration into the European economic space. To support banks in implementing these changes, the World Bank, together with the NABU and the NBU, plans to organize a series of training events (seminars, webinars, etc.). Participation in these events will allow Ukrainian banks to receive methodological guidelines for improving the systematic assessment of environmental and social risks. The World Bank also plans to involve experts from the International Finance Corporation (IFC) in the training.

In conclusion, it should be noted that Polish banks have proactively integrated ESG principles into their operations, aligning with international standards and preparing for upcoming European Union regulations. For instance, major banks such as BNP Paribas Bank Polska, ING Bank Śląski, Santander Bank Polska, and PKO Bank Polski have been publishing ESG reports for several years, adhering to frameworks like the Global Reporting Initiative. In Ukraine, the focus on ESG principles has been shaped by the ongoing conflict and its impact on the country's infrastructure and economy. The National Bank of Ukraine (NBU) has outlined a Sustainable Finance Development Policy aimed at integrating ESG criteria into the financial sector by 2025. This policy encompasses implementing ESG factors in corporate governance, environmental and social risk management, and mandatory sustainability disclosures by financial institutions.

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