

EBA REPORT ON UNDUE
SHORT-TERM PRESSURE
FROM THE FINANCIAL SECTOR
ON CORPORATIONS

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Executive summary

In February 2019, the European Banking Authority (EBA) received a call for advice as part of action 10 of the European Commission's action plan on sustainable finance. The call for advice relates to the third objective of the action plan, which is to foster long-termism, by asking the three European supervisory authorities (ESAs) to explore possible undue short-termism from the financial sector. The three ESAs have been asked to assess the extent to which short-termism is present and whether or not it can be considered a problem, on the basis of available data. Short-termism refers to the focus on short time horizons by both corporate managers and financial markets, prioritising near-term shareholder interests over long-term growth of firms.

This report takes into consideration three dimensions and perspectives that relate to short-termism: the banks' perspective, the corporates' perspective and the sustainable finance perspective. To achieve this, the EBA used qualitative and quantitative sources, including a review of the relevant academic literature, a questionnaire to a sample of institutions¹, direct engagement with competent authorities and supervisory experience, EBA supervisory reporting data on funding and the European Central Bank (ECB) public database on maturities of loans and securities.

The report includes important information from public sources as background and context. First, the overview of academic literature illustrates some evidence of the existence of short-termism in capital markets, while it provides balanced findings with regard to the relative roles of bank-based, as opposed to stock-based, financial systems in supporting short-termism. Second, while EU banks have adopted a diversity of business models, they apply an average 3- to 5-year time horizon for business planning and strategy-setting purposes. Time horizons are driven by a number of factors that potentially hamper the adoption of longer term strategies and activities. Furthermore, the traditional time horizons of European Union (EU) banks seem to not allow long-term and sustainability challenges, such as climate-related risks, to be fully taken into account and tackled.

On the asset side of institutions (potential short-term pressures exerted by banks on corporate clients), from a quantitative point of view, no particular short-term pressures are observed in the available data on maturities of loans and securities. From a qualitative point of view, the evidence suggests that banking practices that result in market incentives for longer term approaches exist. As a result it is observed that EU banks' provision of loans linked to ESG targets is developing, provision of long-term infrastructure finance remains significant, and EU banks are also increasingly developing products and services in the green finance area, thereby accompanying corporations in making sustainability-related investments and adapting to long-term challenges. Nonetheless, some caveats need to be kept in mind, such as the difficulty of disentangling supply and demand effects.

¹ To ensure interactions with the industry, the EBA has also held an industry round table in October, with the participation of EU banking associations, to discuss preliminary findings and potential policy recommendations.

On the liability side, and considering banks as financial corporations themselves that are subject to short-term pressures from shareholders and capital markets, no particular evidence of any short-term pressure on banks on the funding side is observable in the available data on funding maturities. Other short-term pressures that play a role for banks include pressures to pay dividends, shares buyback and the frequency of financial reporting to the market. At the same time, there have been calls for action addressed by a coalition of investors to the banking sector to better consider long-term risks and opportunities and lengthen their time horizons.

This report assesses whether or not banking regulations may play a role in exacerbating or mitigating short-termism. Changes in banking regulations since the financial crisis, notably on remuneration, have been designed specifically to counter undue short-termism, and the outcomes of these changes themselves are reflected in this report. The assessment of the role of some regulatory requirements finds that some regulations help mitigate short-termism (e.g. governance and remuneration, the net stable funding ratio (NSFR)), while other regulations (e.g. Basel III reforms on banks' infrastructure finance, accounting requirements) are not considered to be unduly exacerbating short-termism but will need to continue being assessed. Moreover, going forward, the limitations of using primarily historical data for modelling and calibration of prudential requirements and the benefits of incorporating an enhanced forward-looking perspective in regulation will be taken into account, notably as part of the incorporation of Environmental, Social and Governance (ESG) factors and risks in the banking prudential regulation.

Overall, the EBA analysis has identified limited concrete evidence of short-termism but cannot necessarily label it as 'undue'. This is at least partly due to methodological constraints, data availability and the inherent difficulty in measuring undue short-termism, especially with regard to short-term pressures exerted on corporates. This report has still flagged some areas where time horizons of institutions appear too limited and has recalled the role of banks' short-termism in the financial crisis.

On this basis, the report provides policy recommendations advocating that policy action should aim to provide relevant information and incentives to the banks to extend the time horizon in their strategies and governance. The EBA especially recommends that the European Commission and the EU legislators:

- **maintain a robust regulatory prudential framework;**
- **foster the adoption of longer term perspectives by institutions through more explicit legal provisions on sustainability;**
- **continue to enhance disclosures of long-term risks and opportunities by both corporations and banks; and**
- **improve information flows and data access and support the role of the banking sector in raising awareness on sustainability challenges and environmental, social and governance (ESG) risks.**

In addition to the framework applicable to the financial sector, the more general framework, non-prudential regulations and sets of incentives for market participants should also be considered by EU legislators, in order to promote an environment conducive to long-termism.

1. Introduction

1.1 Background

The European Commission's action plan on financing sustainable growth ('the Action Plan'), published in March 2018, aims to (i) reorient capital flows towards sustainable investment in order to achieve sustainable and inclusive growth; (ii) manage financial risks stemming from climate change, resource depletion, environmental degradation and social issues; and (iii) foster transparency and long-termism in financial and economic activity.

In February 2019, the EBA received a call for advice² as part of action 10 of the Action Plan. The call for advice relates to the third objective of the Action Plan, i.e. to foster long-termism, by asking the three ESAs to explore possible undue short-termism from the financial sector. In parallel the EBA has started to work on the second objective of the Action Plan, i.e. the management of ESG-related risks, has communicated its regulatory roadmap along with key policy messages and expectations, and will deliver a number of mandates following the revised Capital Requirements Regulation (CRR)/Capital Requirements Directive (CRD) package published in May 2019³.

The call for advice notes that putting the EU economy on a sustainable path and managing the transition towards a low-carbon economy requires that corporations consider and address relevant long-term risks and opportunities related to their business. Various studies suggest that decisions taken by companies today do not fully reflect these long-term aspects. One factor that may play a role in this regard is short-term pressure from the financial sector.

There are obstacles to developing sustainability in an environment where incentives, market pressures and the prevailing corporate culture presumably prompt market participants to focus on near-term performance at the expense of mid- to long-term objectives. This short-term focus could lead corporations to overlook long-term risks and opportunities, such as those related to climate change and other factors related to sustainability. Companies facing short-term pressure could, as a result, forgo investment opportunities in areas that are important for a successful transition towards a sustainable economy, as well as incurring greater risks than if a longer term perspective were adopted.

The three ESAs have been asked to assess the extent to which short-termism is present and whether or not it can be considered a problem. The call for advice asks the ESAs to investigate potential sources of short-term pressure from the financial sector on corporates and to assess whether or not these issues could be addressed by regulators and, if so, on which areas. Areas in existing regulations that contribute to mitigating undue short-termism or where the rules exacerbate short-term pressures should also be discussed.

This report discusses the issue of short-term pressures from a banking sector perspective⁴, while the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational

² See the official call for advice [here](#).

³ Based on the Action Plan and the revision of the banking package (CRR/CRD), the EBA has developed its own [action plan](#) to translate the received mandates into specific steps and publications

⁴ Payment institutions and electronic money institutions have not been included in the analysis.

Pensions Authority (EIOPA) are also answering the call for advice by delivering a report on the entities and activities in their remit.

1.2 Approach adopted by the EBA

1.2.1 Structure and data

a) Structure of the report

- **This first section** introduces the call for advice and highlights the several dimensions on which to assess the existence and impact of short-termism from a banking sector perspective.
- **The second section** outlines the potential presence of short-termism across its various dimensions and discusses potential drivers of short-termism. After applying some general considerations to the banking sector, the section looks into (i) potential short-term pressures exerted by banks⁵ on corporate clients and (ii) potential short-term pressures banks may be under themselves, from shareholders and capital markets.
- **The third section** discusses the role of some regulatory requirements in mitigating or exacerbating short-termism, by driving banks towards adopting a short- or long-term horizon. The regulatory requirements that have been considered are related to governance and remuneration, liquidity (the NSFR), the effect of Basel III reforms on infrastructure finance, and accounting, while the effect of some other pieces of regulation in potentially facilitating or hampering long-term finance is briefly discussed in Annex 5.
- **The fourth and final section** includes some recommendations, which focus on ways to incentivise banks to adopt a long-term perspective.

b) Data used for the analysis

For the purposes of developing this report, the EBA has based its analysis on qualitative and, when feasible, quantitative sources, in line with the call for advice. More specifically, the EBA has undertaken a review of the relevant academic literature, sent a questionnaire to a restricted sample of institutions⁶, liaised with competent authorities to discuss cases of short-termism based on supervisory experience, and used EBA reporting data on funding as well as the ECB public database on maturities of loans and securities. The data collected by the EBA under other programme areas for the purposes of mapping market practices of EU banks on the integration of ESG considerations in their operations have also been used (voluntary questionnaire sent to EU banks in June 2019, risk assessment questionnaire spring 2019).

However, it should be noted that data available for and relevant to assessing short-termism face several limitations: the particularity of the topic on the one hand (an assessment of short-term

⁵ In this report, the terms 'banks' and 'institutions' are used interchangeably.

⁶ To ensure interactions with the industry, the EBA also held an industry round table in October, with the participation of EU banking associations, to discuss preliminary findings and potential policy recommendations.

pressures that originate from banks and that are felt by corporates is inherently difficult to perform, due to, among other factors, the lack of harmonised/available indicators and the difficulty in drawing conclusions on short-termism from financial or banking quantitative data accessible to the EBA), and on the other hand the very limited number of banks that responded to the EBA's voluntary questionnaire on short-termism (eight banks replied, with only six submitting usable data). Answers to this questionnaire have been used in the analysis, but the institutions that responded should be considered case studies rather than representative of the entire banking sector. Another limitation, which applies to banks' provision of finance generally, is that a variety of factors warrant caution in interpretation, as it is difficult to distinguish between demand and supply effects or to clearly disentangle the effect of various (market) factors that drive business decisions, for instance on the maturities of debt instruments.

1.2.2 Scoping and definition issues

The topic of short-termism has been present in industry discussions for a while, albeit in a different context. Short-termism has been defined as one of the key culprits of the global financial crisis (too much focus on short-term profits by asset managers, investors and companies alike). This report now revisits the topic from slightly different angles, not only from the point of view of the financial crisis, but also from that of sustainable finance in the EU.

a) Definition of short-termism

In its general meaning, short-termism refers to the tendency to unduly discount outcomes that occur far in the future. Applied to the economic and financial sectors, short-termism is generally described as a tendency to place too much weight on short-run profitability at the expense of long-run resilience or growth that needs certain types of investment⁷. The definition of short-termism provided by the call for advice is 'the focus on short time horizons by both corporate managers and financial markets, prioritising near-term shareholder interests over long-term growth of the firm'⁸. As a result of short-termism, decision-making could be inconsistent, over-valuing short-term payoffs and passing up investment opportunities that could leave companies, economies and societies better off in the longer term.

b) The three dimensions of short-termism considered in the report

Short-termism works across various dimensions and sectors and can be analysed from different angles. Short-termism can originate from different sources and can put pressure on different agents in the economy, such as corporates (through potential pressure from funding sources), but also potentially financial institutions themselves. It is therefore helpful to describe the different dimensions of and perspectives on short-termism along which the assessment has been structured.

⁷ The [Kay Review](#), commissioned by the UK government after the financial crisis, provides the following definition: 'Short-termism in business may be characterised as a tendency to under-investment, whether in physical assets or in intangibles such as product development, employee skills and reputation with customers, and as hyperactive behaviour by executives whose corporate strategy focuses on restructuring, financial re-engineering or mergers and acquisitions at the expense of developing the fundamental operational capabilities of the business'.

⁸ Taken from J.W. Mason, *Understanding short-termism questions and consequences*, 2015

Dimension 1 – Short-termism within the financial sector – banks’ actions and strategic thinking (banks’ perspective)

The first dimension of short-termism relates to the banks themselves. The assumption is that some banks may conduct their activities focusing (only or too much) on a short time horizon. This is potentially associated with risks for the banks themselves, e.g. the search for profitability in the short run through unmanaged risk taking at the expense of the long-run resilience of the bank. Also in this first dimension falls any potential short-term pressure that banks, as financial corporations, may be under themselves from financial markets, for example funding pressures.

Adopting the banks’ perspective, this first dimension (short-termism in the banking sector) relates to the time horizon adopted by banks in their business activities, taking into account that different business models will drive the time horizon adopted by individual banks (e.g. investment versus development banks), and any short-term pressures that banks may be under themselves.

Short-termism on the part of institutions is also an important driver for the exercise of short-term pressures on corporates (see below).

Dimension 2 – Short-term pressures exerted by banks on corporates (corporates’ perspective), driven by banks’ activities in dimension 1

When considering potential short-term pressures exerted by banks on corporations, the key question is if and how banks, primarily in their role as lenders, could contribute to myopic decision-making by corporations and influence the behaviour of corporates’ executives to focus on short-term financial optimisation at the expense of longer term growth.

This second dimension of short-termism covers the pressures put on corporates by institutions and is essentially a corporates’ perspective. The assumption is that banks through their business practices provide distorted incentives and exert pressure on corporates to be profitable in the short term, while not incentivising corporates to pay attention to long-term growth and health.

These first two dimensions of short-termism overlap to some extent and are not clearly distinguished in the call for advice, which speaks about both short-term pressures *from* the financial sector (second dimension) and short-termism *in* the financial sector (first dimension). Short-termism of banks, which is understood as focusing on a short time horizon in business activities and strategic thinking, can also importantly be considered a driver of short-term pressures on corporations. For example, a bank that is focused on its short-term profitability is more likely to focus on the short-term horizon within the client relationship, and is more likely to pass on the focus on short-term performance and immediate profits to corporates, and less likely to support corporates in long-term projects. The EBA therefore sees the two dimensions as not entirely separate, but interlinked dimensions, which are recalled and indicated throughout the report for clarity.

Dimension 3 – Short-termism as an impediment to the incorporation of long-term and ESG considerations (sustainable finance perspective)

The third dimension that should also be taken into account relates to the consequences of short-termism and refers to the lack of consideration of long-term risks and opportunities linked to sustainability. The main concern mentioned in the call for advice on short-termism is that investments

in areas relevant to sustainable long-term development will be undersized. This third dimension is linked to the concept of sustainable finance.

Sustainable finance can be broadly understood as financing and related institutional and market arrangements that contribute to the achievement of strong, sustainable, balanced and inclusive growth, through supporting directly and indirectly the framework of the Sustainable Development Goals⁹. Sustainable finance also refers to the process of taking due account of ESG considerations in investment decision-making, which leads to increased investments in longer term and sustainable activities¹⁰.

Considering the sustainable finance perspective, this third dimension refers to short-termism as a failure to take into account all long-term costs and opportunities associated with ESG factors in business activities and risk management, thus preventing long-term sustainable investment and the transition to a sustainable economy.

To sum up, three dimensions have been included in the analysis of short-termism in this report: (i) the banks' perspective (the length of the time horizon in banks' activities, taking into account that this is likely to be a driver of short-term pressures towards corporates), (ii) corporates' perspective (pressures stemming from banks incentivising myopic decision-making) and (iii) the sustainable finance perspective (which focuses on the nature of activities financed and the integration of ESG factors).

The second dimension is probably the most relevant to the call for advice, but the two other dimensions also appear relevant because (i) the call for advice does not clearly differentiate between the first and second dimensions, (ii) the third dimension is relevant to the Action Plan and the broader objectives underlying the call for advice, and, more importantly, (iii) the dimensions are interlinked (by adopting a specific time horizon in their strategies or in their business activities, banks are more or less likely to generate short-term pressures towards corporations, which translate into the real economy's incorporation of ESG factors).

c) Links between short-/long-term finance and the three dimensions identified

At first glance, a key issue when assessing short-termism is the duration of activities and strategies. However, as highlighted in the high-level expert group (HLEG) report¹¹, short-termism should not be confused with short-term finance. Short-term finance – that is, financial assets, liabilities and other instruments with a short time horizon¹² – does not necessarily per se lead to short-term pressures, and in fact it addresses specific corporates' needs.

Short-term finance is necessary to finance needs that are of a short-term nature and is a form of finance needed to a certain degree at all times, whether there is long-term (and sustainable) finance or not. Furthermore, short-term bank financing can even be directed towards environmentally

⁹ Definition taken from the G20 Sustainable Finance Study Group's July 2018 *Sustainable Finance Synthesis Report*.

¹⁰ Taken from European Commission, *Action Plan: Financing Sustainable Growth*.

¹¹ High Level Expert Group on Sustainable Finance [report](#), 2018.

¹² This includes liquidity and treasury management, trade credit and short-term finance (such as treasury bills).

sustainable activities (e.g. a short-term loan to a green¹³ company). Hence, discouraging short-term financing would not necessarily (i) discourage short-termism or (ii) enhance sustainable finance.

Given that short-term finance is not necessarily a hindrance to long-term and sustainable finance, it then appears key for this analysis to take a slightly different angle and also look at the extent to which long-term finance is present in the market. That banks lend and invest in long-term assets or sustain long-term relations with corporates indicates that they do not tend to focus only on short time horizons or seek to influence corporates' executives to look for financial optimisation at the expense of long-term growth across the board.

At the same time, while the analysis related to long-term finance provides valuable indications, it does not allow the outright conclusion that no short-term pressures exist. Short-term pressures can exist alongside long-term finance (e.g. a bank may provide loans and funding with long maturities to a company for specific projects, and, at the same time, other business loans to the same company may still be linked to short-term objectives and conditions). Rather, reflecting on long-term finance allows the assessment of whether or not long-term objectives are also considered, without precluding the possibility or concluding that short-term pressures do not exist.

With regard to the sustainable finance dimension, one needs to note that, as highlighted by the HLEG, sustainability can be considered axiomatically linked to the long term, as the associated actions and investments require action with a long-term orientation. Nevertheless, this does not mean that all long-term investments are sustainable. Long-term bank financing can be directed to environmentally unsustainable activities (e.g. a 30-year bond to a polluting company). Therefore, considerations regarding long-term finance per se may not allow conclusions to be drawn on the actual use of funds and hence on the sustainable finance dimension.

Finally, it is crucial to keep in mind that 'short term' and 'long term' are contextual and relative notions. They can refer to very different time frames, depending on the sector and the context. Different sectors (corporations, banks, other market participants and sustainable development actors) may have different understandings and use different definitions and time horizons. In the context of banks' funding, for example (the banking sector perspective), the cut-off between short term and long term is set at 1 year. Other financial market participants follow different time horizons; e.g. the majority of respondents to a public survey conducted by ESMA considered that an investment period is defined as long term when it covers more than a 6-year horizon¹⁴. Yet again, for climate change scenarios (the sustainability perspective), longer time horizons such as 2050 are often used as reference points for long-term activities.

¹³ A caveat that applies to the use of 'green' in this report is that varying definitions or standards can be used by market participants or stakeholders for what constitutes a green asset, company or project. In this respect, the development of the EU taxonomy is likely to represent a major step.

¹⁴ For the purposes of its report to the G20 on long-term finance, the Organisation for Economic Co-operation and Development (OECD) has defined long term as maturities of at least 5 years. It also refers to sources of financing that have no specific maturity but are generally relatively stable over time. The OECD has launched a project on long-term investment, identifying a set of criteria for long-term investment by institutional investors: (i) productive capital, providing support for infrastructure development, green growth initiatives, small and medium-sized enterprise (SME) finance etc., leading to sustainable growth; (ii) patient capital that allows investors to access illiquidity premia, lowers turnover, and encourages less procyclical investment strategies and therefore a higher net investment rate of returns and greater financial stability; and (iii) corporate governance.

d) Summary of short-termism

Table 1 – Short-termism’s three dimensions and perspectives considered in the report

Dimension	1	2	3
Perspective	Banks	Corporates	Sustainable finance
Refers to	The time horizon used in banks’ thinking, activities and funding	(Funding) pressures for short-term profitability at the expense of long-term growth and resilience	Impediments or opportunities for the transition to a sustainable economy
Reason for considering long-term finance e.g. infrastructure finance	Indicator of long-term-oriented activity, potentially demonstrating that longer time horizons are also considered	Indicator of the availability of long-term funding that is necessary to enhance the business in the medium/long term	Indicator of the availability of long-term funding, but cannot necessarily be linked to sustainable projects
Relevant sections of the report and material considered in the analysis	<p>Section 2.1:</p> <ul style="list-style-type: none"> - Literature - Banks’ average time horizons <p>Section 2.2 (pressures exerted through lending and investing):</p> <ul style="list-style-type: none"> - Maturities of loans and securities - Infrastructure finance - Relationships with corporates <p>Section 2.3 (pressures felt through issuing):</p> <ul style="list-style-type: none"> - Funding (liabilities) - Other potential sources of short-term pressures <p>Section 3 (regulations):</p> <ul style="list-style-type: none"> - Governance and remuneration - Basel III reforms - NSFR - Accounting <p>Annex 5:</p> <ul style="list-style-type: none"> - Other regulations 	<p>Section 2.1:</p> <ul style="list-style-type: none"> - Literature <p>Section 2.2:</p> <ul style="list-style-type: none"> - Maturities of loans and securities - Infrastructure finance - Relationships with banks - Incentives provided by banks to corporates to achieve sustainability objectives 	<p>Section 2.1:</p> <ul style="list-style-type: none"> - Literature - Time horizons for sustainability challenges <p>Section 2.2:</p> <ul style="list-style-type: none"> - Incentives provided by banks to corporates to achieve sustainability objectives - Green finance <p>Annex 4:</p> <ul style="list-style-type: none"> - Green funding (green (covered) bonds)

2. Analysis of the potential presence of short-termism

This section aims to outline the potential presence of short-termism according to the three dimensions described in section 1 and discusses potential drivers of short-termism. It starts with some general background considerations relevant to the banking sector (section 2.1), and then continues by looking at potential short-term pressures exerted by banks on corporate clients (section 2.2), taking into account the opportunities and incentives provided by banks to corporations to invest in long-term (sustainable) activities. The section finally discusses the potential short-term pressures that banks may be under themselves, from shareholders and capital markets (section 2.3).

2.1 General background considerations on the banking sector

This section first gives an overview of the literature reviewed on short-termism (section 2.1.1) in financial markets, especially considering the role played by the nature of financial systems, then tentatively assesses the time horizons adopted by banks (section 2.1.2) and discusses their adequacy or mismatch with regard to the time horizons needed to address sustainability issues (section 2.1.3).

The literature overview considers the dimensions of short-termism in a comprehensive manner but deals primarily with the pressures of financial systems on corporates and the funding of sustainable projects (i.e. the second and third dimensions of short-termism), while the assessment of time horizons in banks' activities relates to the first dimension of short-termism (banks' perspective).

2.1.1 Literature overview on short-termism

a) Short-termism and capital markets

A range of evidence and arguments has been discussed in the literature on whether or not capital markets support short-termism. Although some empirical results suggest that capital markets reward management decisions that are consistent with long-term value creation¹⁵, the literature on short-termism that has been reviewed, emanating from the financial sector or operating within the financial sector, provides some evidence of short-termism.

Concerning short-termism within the financial sector (**first dimension**), it appears that too often capital market participants allocate capital based on short-term reasons to maximise short-term returns, and that short-term practices have been exacerbated over the recent period. One example mentioned in the HLEG report is that the average holding period of market-traded assets has become significantly shorter¹⁶.

¹⁵ Marginson, D. and McAulay, L., [Exploring the debate on short-termism: a theoretical and empirical analysis](#).

¹⁶ HLEG report, 2018.

Other studies have also reported evidence of corporate firms acting to accommodate short-term pressure from the capital markets (**second dimension**). Such actions may include a change in the firm’s dividend policy, or reducing spending on long-term value creation¹⁷. A number of surveys have shown that a majority of corporates’ executives felt increasingly pressured to deliver on short-term performance targets¹⁸.

Considering the sustainable finance perspective (**third dimension**), there is a strand of literature that provides evidence of the benefits of integrating ESG criteria into investment practices, which results in strengthening the resilience of investors’ portfolios in the long term, and this relationship is stronger if the investor is long-term oriented¹⁹.

b) Short-termism and the banking sector

The academic literature has investigated the idea that the nature of financial systems may vary between countries (bank-based systems as opposed to stock market-based systems), and may affect the time horizon of funding and the type of projects and loans funded. Findings are contrasted, especially depending on the dimensions considered in the analysis.

i. First and second dimensions – short-termism within the financial sector resulting in short-term pressures on corporates

The ‘varieties of capitalism’ approach²⁰ and the literature on the nature of financial systems draw a distinction between bank-based or insider systems and stock market-based or outsider systems. It is argued that stock market systems lead to a focus on short-term market price fluctuations and are more likely to lead to pressures for short-term profits, while bank-based systems are characterised by long-term client relationships and a longer term view of corporate success.

However, although the implications in this theoretical approach are that banks-based systems may be less prone to short-termism, caution is needed before drawing practical conclusions. This part of the literature suggests that a thorough and empirical analysis of the relative balance of short-termist and long-termist pressures on decision takers requires a holistic approach and needs to be rooted in detailed contextual approaches of a jurisdiction’s overall economic system. In addition, other approaches that shed a different light on the respective roles of investors and financial systems need to be taken into account (see below).

ii. First and third dimensions – banks’ and sustainable finance perspectives

¹⁷ Brunzell, T., Liljebloom, E., and Vaihekoski, M., [Short-term expectations in listed firms: the mitigating impact of large owners](#).

¹⁸ See, for example, Barton, D., and Wiseman, M., [Focusing capital on the long term](#), or CFA Centre For Financial Market Integrity (2006), [Breaking the short-term cycle](#).

¹⁹ Friede, G., Busch, T., and Bassen, A. (2015), ‘ESG and financial performance: aggregated evidence from more than 2000 empirical studies’, *Journal of Sustainable Finance & Investment*, 5(4); Gibson Brandon, R., and Krüger, P. (2018), *The sustainability footprint of institutional investors*, working paper, University of Geneva.

²⁰ See, for example, Hall, P.A., and Soskice, D. (2001), *Varieties of capitalism*, Oxford University Press, Oxford, UK.

Regarding the respective roles of investors, some studies²¹ distinguish indeed between two kinds of investors and include banks in the first category, characterised by a short-term vision driven by returns on investments in a reduced time, while the second type includes institutional investors that hold a large proportion of capital and have a longer term (investment) view and push for more sustainable decision-making.

Furthermore, other approaches have looked at the role played by the financial structure of a country (the relative role of banks versus stock markets) in determining how polluting a country's development path is. They suggest that banks may be less suited to financing green projects and reducing industrial pollution than stock markets are²². From a public policy and sustainable finance perspective, this part of the literature suggests that jurisdictions with a bank-based financial system should consider stimulating the development of stock markets, which could play an important role in fostering innovation that could lead to cleaner production processes within industries. In parallel, measures to ensure that credit markets more fully integrate ESG criteria when granting finance may be needed.

Overall, we may conclude that, while the literature seems to show some evidence of the existence of short-termism in capital markets, it provides balanced findings with regard to the respective roles of bank-based and stock-based financial systems in supporting short-termism.

However, it should be highlighted that (i) this summary is necessarily far from being exhaustive and (ii) findings should be interpreted with caution when considering the EU banking perspective, as most of the papers reviewed include in their analysis a variety of financial market participants and jurisdictions, and rarely deal only with EU banks.

Annex 1 provides more details on the literature overview and the references used.

2.1.2 Banking business activities: assessment of time horizons

This section considers the time horizons adopted by banks, highlighting the diversity of banks' business models. It falls under the first dimension of short-termism (banks' perspective).

Dimension 1 (banks' perspective)

a) Fundamental remarks

First, it should be recalled that different financial market participants apply and adopt different time horizons due to different business activities and funding structures. Typically most banks are thus not considered long-term investors. Long-term (institutional) investors are defined as investors that have long-term liabilities, such as insurance companies, pension funds and sovereign wealth funds that desire long-term assets to match such liabilities. Few of the types of banks' funding – retail deposits, corporate borrowings from other financial institutions and/or tradable securities – meet the long-term

²¹ For instance, Bushee, B.J. (2001), 'Do institutional investors prefer near-term earnings over long-run value?', *Contemporary Accounting Research*, 18(2), 207-246.

²² De Haas, R. and Popov, A., *Financial development and industrial pollution*, European Bank for Reconstruction and Development (EBRD) Working Paper No 217.

tenors of many long-term investments. Hence, due to the need to avoid excessive maturity mismatch, banks limit the proportion of capital allocated to long-term investments.

Second, banks have different business models. They engage strategically in different types of intermediation activities and select their balance sheet structure to fit their business objectives²³. The business models of EU banks may be classified on the basis of some key dimensions such as activities (type of activities the institution is engaged in and reflected mostly in the asset side of its balance sheet), funding (sources the institution uses to fund its activities) and legal structure (various characteristics of the institution related to its ownership and legal structure).

For illustrative purposes, Table 1 provides a granular classification of business models of EU banks²⁴.

²³ Typically, commercial retail-funded banks would be characterised by a high proportion of loans on the balance sheet and a high reliance on stable funding sources, including deposits. Commercial wholesale-funded banks would have higher proportions of interbank liabilities and wholesale debt. Trading or capital markets-oriented banks would hold a more significant proportion of their assets in the form of tradable securities and would be predominantly funded in wholesale markets, etc.

²⁴ See Cernov, M., and Urbano, T. (2018), [Identification of EU bank business models: a novel approach to classifying banks in the EU regulatory framework](#), EBA staff paper.

Table 1 - Credit institutions in the EU by business model category (data for 5 292 credit institutions at solo level as of 31 December 2015)

Business model category	Number of credit institutions	Total assets (million EUR)	Percentage of EU total number of credit institutions	Percentage of EU total assets	Average size of credit institution (million EUR)
Cross-border universal banks	82	13 793 148	1.5	39.2	168 209
Local universal banks	552	7 933 011	10.4	22.6	14 371
Consumer credit banks (including automotive banks)	87	366 676	1.6	1.0	4 215
Cooperative banks/savings and loans associations	3 019	3 263 615	57.0	9.3	1 081
Savings banks	734	1 872 002	13.9	5.3	2 550
Mortgage banks taking retail deposits	126	818 576	2.4	2.3	6 497
Private banks	139	361 267	2.6	1.0	2 599
Corporate-oriented	143	1 653 135	2.7	4.7	11 560
Custodian institutions (including central securities depositories (CSDs) that are subject to the CSD Regulation)	44	402 958	0.8	1.1	9 158
Institutions not taking retail deposits (including pass-through financing)	87	1 743 737	1.6	5.0	20 043
Other specialised banks	279	2 933 801	5.3	8.3	10 515
TOTAL	5 292	35 141 928	100.0	100.0	6 641

Source: EBA data collection on EU financial institutions.

Although less granular classifications may be possible²⁵, Table 1 above shows that there is a variety of business models across EU banks. This variety of business models is an important factor to take into account when considering banks' business activities and time horizons. For instance, while commercial retail-funded banks would be less exposed to short-term funding pressures from capital markets, banks with specialised business models, such as development banks, are likely to be more oriented towards long-term horizons than other banks. In addition, it should be kept in mind that different time

²⁵ For example, Ayadi and de Groen classify European banks into four business models, which they label as investment banks, wholesale banks, diversified retail and focused retail (Ayadi, R., and de Groen, P., 2014, *Banking business models monitor 2014: Europe*, CEPS Paperbacks).

horizons can obviously be applied in different parts or to different activities of the same bank, especially universal banks.

Box 1 – Long-termism and development banks²⁶

Development banks are publicly owned financial institutions with a specific development or policy mandate. These institutions can leverage finance from capital markets because of their strong credit ratings and the backing from their shareholders (governments), and in turn provide financing to support development outcomes. Development banks are not a homogeneous group, but include a broad range of institutions that, working in domestic or international contexts, cover a wide geographical range, and provide sovereign or private financing.

The business model of development banks is conducive to some form of long-termism:

- **First dimension:** due to their ownership structure and mandate, development banks have to consider a long-term time horizon in their activities and strategic objectives.
- **Second dimension:** development banks are not seeking short-term profit optimisation on the part of their clients but are focused on long-term value creation and are established financiers of long-term projects such as infrastructure.
- **Third dimension:** development banks, such as major multilateral ones, have made ambitious commitments to scale up climate action and increase their green and climate finance activities. Major multilateral development banks committed USD 35 billion in climate finance in 2017, representing a 28% increase from 2016. Some development banks have also adopted climate risk-screening tools and approaches to help identify the risk from future climate change on projects and to introduce adaptation measures into project design. The EBRD and the European Investment Bank (EIB), among other banks, have adopted shadow carbon prices and are using them as part of the investment decision-making process for selected projects.

An exhaustive analysis of short-termism in the EU banking sector would ideally require taking into account all business models, their key variables and how they influence the various dimensions of short-termism. Although this is not possible in this report, particularly due to the data limitations (see introduction), it should be emphasised that the report is not advocating one business model over another or asserting that some specific business models are, per se, conducive to undue short-termism. However, the diversity of business models is an important factor to take into account in the short-termism debate and in any policy action that may be taken.

In addition, it is worth recalling that, in the current European framework, business model analysis is one of the key elements of the supervisory review and evaluation process (SREP). According to the EBA SREP Guidelines²⁷, the key outcome of the business model analysis is the identification of business and strategic risks and the assessment of the institution’s business model’s viability and sustainability. In other words, while institutions may adopt different business models, all institutions should adopt a viable business model on the basis of its ability to generate acceptable returns over the following 12 months, and a sustainable strategy on the basis of its ability to generate acceptable returns over a

²⁶ Based on OECD (2016), [Green investment banks: scaling up private investment in low-carbon, climate-resilient infrastructure](#), OECD Publishing, Paris.

²⁷ EBA [Guidelines](#) on common procedures and methodologies for the SREP.

forward-looking period of at least 3 years, based on its strategic plans, financial forecasts and given the supervisory assessment of the business environment.

b) A tentative assessment of time horizons of and obstacles to a longer term orientation

Based on interactions with institutions, including the case studies mentioned in the introduction, and competent authorities, a tentative assessment of time horizons adopted by banks and of obstacles to the adoption of a longer term orientation is presented below.

i. Time horizons

The time horizon favoured and taken into account by EU banks for defining the business model and setting their strategy seems to be mostly around 3-5 years. This period has been the most common in the case studies analysed by the EBA and has been confirmed by several surveys undertaken at national levels, for instance related to climate-related risks' management. The 3-5 year period that is adopted for planning horizons can arguably be linked to some extent to supervisory requirements (e.g. the analysis of a business model's sustainability under the SREP, and the submission of plans on specific issues such as a 3-year non-performing exposure (NPE) reduction strategy).

Although the average business planning period of EU banks seems to be on average 3-5 years, other aspects, such as governance and risk management processes, may be of a more 'perpetual' nature and could be considered to be longer term. By contrast, some activities such as funding (1-3 years being the most cited answer in the case studies analysed by the EBA) and trading (from < 1 year to 3 years) seem to follow shorter time horizons, which is not surprising. It should be recalled that the above-mentioned activities include both short-term and longer term elements/targets and that the assessment relates to general tendencies.

As a result of data limitations, this assessment covers a limited number of activities and institutions. Some more details on the time horizons applied in banks' funding and in banks' relationships with corporates, including maturities of loans and securities, are, however, presented further below in the report.

ii. Drivers of time horizons and factors that may hamper a longer term orientation

A number of factors that drive time horizons and potentially hamper the adoption of a longer term orientation are mentioned by banks. First, profitability pressures and shareholders' interest are factors ranked highly as drivers of applying short-term time horizons in most of the institution case studies reviewed by the EBA. The short-term market pressures that banks may be under will be further discussed in section 2.3.

Second, accounting rules are also deemed by banks to be an important factor driving their time horizon and favouring a relatively short time horizon. Banks consider that accounting requirements unduly penalise long-term investments²⁸. This is discussed in section 3.4. Prudential regulatory and

²⁸ By comparison, when asked specifically about the accounting treatment foreseen under International Financial Reporting Standards (IFRS) 9, the majority of respondents to the ESMA public survey argued that it is not a decisive factor when deciding whether or not to undertake a new long-term investment or when triggering divestment. A majority of investors argued that other considerations play a much more significant role than accounting in making such types of investments.

supervisory requirements are also viewed as relatively important, e.g. banks have to develop several internal plans (the internal capital adequacy assessment process (ICAAP), funding plans, etc.) for which the common time horizon is 3 years; this is also the time horizon considered in the supervisory stress tests. The effects of some pieces of prudential regulation in driving banks towards shorter or longer time horizons are discussed further in section 3.

Third, more macroeconomic factors also appear to play a role, for example uncertainties about macroeconomic trends over a longer period and the effect of monetary policies in the current period. Some banks argue that, in a continuing low interest rate environment, a certain degree of pressure is put on institutions to restrict maturity transformation (difficulties in pricing long-term loans, for example). These tendencies could indicate a certain short-term pressure on the financial sector itself, rather than being generated or exerted by the sector.

Finally, the obligation to disclose to the markets financial information on a regular basis with a short time horizon perspective was not assessed in the case studies as a very important factor, but will be briefly discussed in section 2.3.2. Other factors mentioned by banks as drivers of time horizons are the availability of long-term funding (see section 2.3.1) at acceptable cost and their corporate social responsibility policies, as short-term exposures may be favoured when the bank has insufficient visibility of the sustainability strategy of a company.

Overall, this section has highlighted that, while EU banks have adopted different business models, the average time horizon for business-planning and strategy-setting purposes is around 3-5 years. Time horizons are driven by a number of factors that potentially hamper the adoption of longer term strategies and activities.

2.1.3 Is there a fundamental mismatch between banks' traditional time horizons and long-term sustainability considerations?

Dimensions 1, 2 and 3 (banks, corporates, sustainable finance)

Building on the above findings, it may be questioned if the current financial and strategic planning horizons of EU banks are sufficiently tailored to the integration of long-term challenges, such as those linked to the transition to a sustainable economy. As mentioned in the introduction, sustainability is axiomatically linked to the long term, as the associated actions and investments require action with a long-term orientation. From a sustainable finance perspective, the concern is that financial decisions may insufficiently take into account long-term, including ESG, considerations, since related risks are more likely to materialise over a longer time horizon than business-planning horizons.

The potential mismatch between time horizons of financial institutions and the materialisation of sustainability risks has been outlined over the recent years, e.g. by Mark Carney in his speech 'Breaking the tragedy of the horizons'²⁹, highlighting that the impacts of climate change will be felt beyond the traditional horizons of most actors, imposing a cost on future generations that the current generation has no direct incentive to fix. The question then arises of whether or not EU banks are also subject to this mismatch and sufficiently consider, for example, sustainability and climate-related risks.

²⁹ The speech can be accessed [here](#).

For the purposes of clarity, sustainability risk means an environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of an investment³⁰. Climate-related risks are risks that arise from the transition to a low-carbon and climate-resilient economy (including policy risks, legal risks, technology risks, market risks and reputational risks) and risks that arise from the physical effects of climate change (acute physical risks and chronic physical risks)³¹.

According to several surveys conducted on EU banks³², current business-planning horizons may represent an obstacle to the integration of long-term sustainability factors. In particular, the financial risks from climate change tend to be at least partially beyond banks' average maturity of assets and planning horizons, having on average a 3- to 5-year time horizon, i.e. before risks would be expected to be fully realised and prior to stringent climate policies taking effect³³. This can lead to the feeling that climate-related risks are not relevant or less relevant. According to a survey conducted by the EBA³⁴, the time horizon is the biggest challenge cited by banking institutions to implement sustainability factors in their business.

It should be emphasised that, from a banking perspective, even though the materialisation of sustainability risks may happen beyond the usual business planning horizons and/or the average maturity of balance sheets, there are good reasons for taking long-term issues into account.

First, banks can be engaged in long-term financing, for example loans with relatively long maturities, including to sectors that are vulnerable to the transition to a low-carbon economy and hence potentially subject to declining performance. Second, individual loans to sustainability risk-exposed customers may be only short in duration, but the overall client relationship is usually conceived for the long term. The relatively short maturity of funding granted does not mean that banks necessarily exit loans at maturity or end relationships with clients; renewal of exposures and refunding risks are significant tendencies. Third, market conditions may change and, even though exposures could to some extent be adjusted progressively, it is unlikely that if/when risks become perceptible (e.g. when climate change effects become more visible) each institution will be able to adjust their exposures at the same time and in an orderly fashion.

The fact that, fundamentally, the traditional time horizons of EU banks do not seem to allow sustainability challenges to be properly taken into account can be considered an element of short-termism of the banking sector (short-termism's first dimension), which is likely to entail adverse consequences for corporations. The insufficient integration of long-term and ESG factors into the

³⁰ 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, article 2

³¹ For the purposes of this report, this definition intentionally covers financial risks for companies (including banks) and excludes the risks posed to the climate. See the Financial Stability Board (FSB) Task Force on Climate-related Financial Disclosures recommendations or the European Commission 'Guidelines on reporting climate-related information'.

³² Prudential Regulation Authority (PRA) survey (see report 'Transition in thinking'), Hungarian survey, Autorité de Contrôle Prudentiel et de Résolution (ACPR) survey (see report 'French banking groups facing climate change-related risks').

³³ However, this does not exclude the possibility that climate-related risks may materialise in a shorter time horizon, including 3-5 years.

³⁴ Voluntary survey on integration of ESG factors by EU banks with 39 respondents – EBA staff paper to be published

financial and strategic planning of banks can arguably be an important driver of short-term pressures, with insufficient incentives provided to companies to adapt to long-term issues, which ultimately hamper the transition to a sustainable economy (short-termism's second and third dimensions).

The mismatch between traditional time horizons of banks and the horizon of sustainability risks is to some extent acknowledged by the industry. Furthermore, there seems to be a dynamic in the EU banking sector towards a greater recognition of these risks³⁵, and EU banks are increasingly developing policies and practices to support the transition of their clients towards sustainable activities (see section 2.2.1.d).

Overall, however, due to this fundamental mismatch in time horizons, the integration of sustainability into strategies and governance may need to be enhanced further and banks may need to be encouraged to lengthen the strategic planning horizon beyond the maturity of exposures. The process of integrating long-term considerations would benefit from being strengthened and could require policy action (see section 4 – EBA policy recommendation 2).

2.2 Potential short-term pressures exerted by banks, as lenders and investors

This section considers banks as providers of financial services and deals with their lending and investing activities. As stated in the introduction, given that short-term finance should not be confused with short-termism and taking into account the fundamental difficulties in assessing the potential exercise of short-term pressures, the long-term finance aspect is also considered through the opportunities and incentives offered to corporations to invest in long-term and sustainable activities.

Information gathered through the EBA surveys³⁶ and publicly available data are presented in this section, as well as public reports and literature regarding the relationships with corporate clients (section 2.2.1), the financing of infrastructure projects (section 2.2.2) and developments of green finance (section 2.2.3).

2.2.1 Relations with corporates

To understand what kind of opportunities and incentives banks provide to corporates in their business relationships, all the three dimensions introduced in section 1 will be considered.

First, it should be noted that theory and evidence suggest that firms match the maturity of their assets and liabilities. That is, companies tend to use long-term debt to finance investments such as equipment or research and development, and use short-term debt for payroll or inventory financing, for example. Matching the maturities of their debt with the life of their assets has been indicated to be one of the key decisions by corporates³⁷. Another aspect that is likely to play a role in pressures

³⁵ See for example the EBA staff paper on EU banks market practices in incorporating sustainability

³⁶ The two surveys mentioned in the introduction: questionnaire sent to a restricted sample of institutions on short-termism (see Annex 4) and the voluntary survey on mapping the integration of ESG factors (results are presented in the EBA staff paper mentioned above).

³⁷ [World Bank Group, Global financial development report 2015/2016: long-term finance.](#)

and incentives received by corporates relates to standardized loan covenants, especially in syndicated loans, but data available to investigate this issue was too limited.

Given that the maturities of funding available are crucial for the types of investments made by companies, especially with regard to long-term value creation investments, maturity of funding is discussed in section 2.2.1.a and section 2.2.2.b. This is followed by more qualitative considerations on the incentives provided by banks to corporates to achieve sustainability objectives (section 2.2.2.c). Annex 3 briefly discusses the outcomes of EBA surveys regarding the nature and duration of banks' relationships with corporate clients.

a) Maturities of banks' lending to corporates

Dimensions 1 and 2 (banks' and corporates' perspectives)

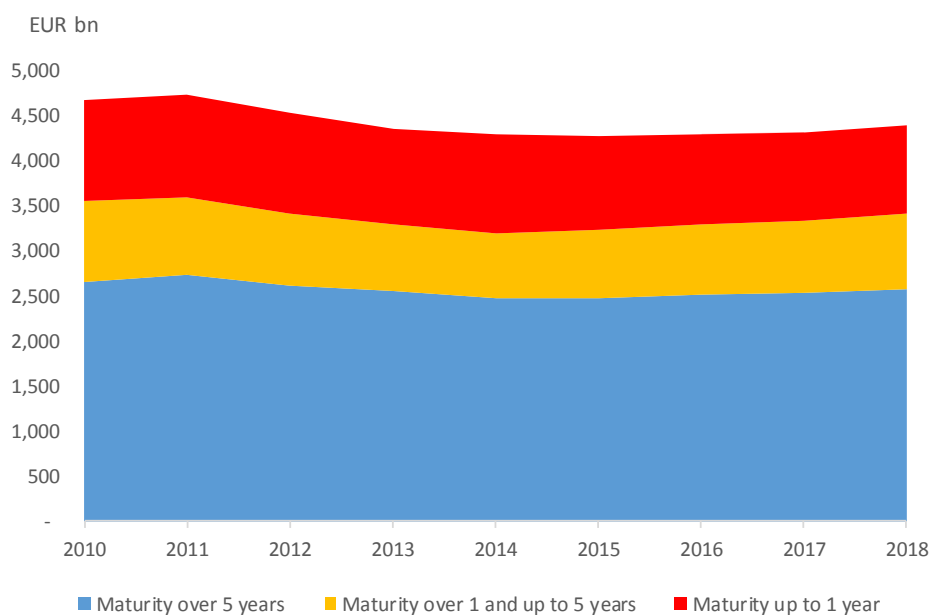
No quantitative information is available on the maturity of banks' lending activity to corporates for the EU as a whole from the EBA reporting data. The European Commission's Survey on the Access to Finance of Enterprises (SAFE)³⁸ shows that loan maturity for SMEs saw a net increase for the first time in 2015, after a few years of net changes equalling 0%. In 2018, 8% of the SMEs in the 28 Member States of the EU (EU-28) reported an increase in the maturity of available loans, 4% indicated that the maturity had decreased and the vast majority of SMEs indicated that there was no perceived change in loan maturities.

Data from the ECB statistical database on the maturity of bank loans to non-financial corporates for the euro area³⁹ shows that, within the euro area, almost 60% of bank lending to non-financial corporations (NFCs) has a maturity greater than 5 years as of end 2018, amounting to EUR 2 580 billion. Loans with maturities below 1 year stood at EUR 974 billion (or 22%), with loans with a duration of 1-5 years making up the remainder, amounting to EUR 843 billion. While the total value of loans from banks to corporates in the euro area has decreased slightly from EUR 4 693 billion in 2010 to EUR 4 397 billion at the end of 2018, the relative maturity composition has remained almost unchanged for the period.

³⁸ [SAFE survey](#).

³⁹ [ECB Statistics](#).

Figure 1 – Loans by banks to NFCs within the euro area: maturity breakdown between 2010 and 2018



Source: ECB Statistics, Money, Credit and Banking

Note: outstanding stocks at the end of the period. Loans from monetary financial institutions (MFIs) excluding the European System of Central Banks loans to NFCs. Data on banks and NFCs area available for the euro area only.

With the majority of loans to NFCs in the euro area having maturities longer than 5 years, and no changing trend observed over the last 8 years, no particular short-term pressures in banks' lending to corporates in the euro area can therefore be observed from the data at hand, based on aggregate maturity buckets⁴⁰. Importantly, it is not possible to disentangle the underlying demand and supply effects driving the lending pattern (see also further discussion in the next section).

The EBA analysis⁴¹ of six institution case studies provides some findings with regard to the trends in loan maturities anticipated by banks over the next decade, as well as the drivers behind loan maturities⁴²:

- All banks stated that they have a specific strategy for the maturities of their corporate loan portfolios. Some have pre-defined maturity limits for certain sectors, while others only stated that they have a broader strategy in place.
- Some banks indicated that they have ex ante limits on the maturities for corporate loans, namely 5-7 years or 5-12 years, and that they link pre-defined targets to loan and borrower

⁴⁰ Of course, aggregated data do not allow conclusions to be made on trends at the bank level. The data only provide an aggregate picture at the euro area level. This is the case for all aggregate data throughout the report. The statement on short-term pressures has to be interpreted in conjunction with the caveat outlined in section 1.2.2.c. Here, the judgement has been applied based on the relative value of loans within each of the pre-defined maturity buckets.

⁴¹ For a detailed outline of the survey questions, please see Annex 4.

⁴² As mentioned earlier in the report, responses were extremely limited (eight banks replied, with only six submitting usable data) and hence results do not allow conclusions to be drawn for the whole EU banking sector.

characteristics. For the project finance, infrastructure and SME sectors, only some banks indicated that they have pre-defined maturity targets.

- The current average maturity of corporate and SME loans was indicated as being in the 1-2 years or 3-5 years brackets for most banks providing answers. No bank indicated having average current maturities of less than 1 year or more than 10 years, for either portfolio.
- Generally, respondents did not observe an increase in maturities over the last 5 years. Only one bank indicated average maturities having increased slightly (by less than 6 months) across both the corporate and SME loan portfolio. Three banks indicated instead a decrease in average loan maturities in one of their portfolios. Trends expected over the next 10 years by responding banks are similar to those observed over the last 5 years. Generally, no major changes are foreseen by banks going forward, and maturity levels are predicted to be more or less stable.

Overall, from the limited sample analysed, average maturities of loans seem to be generally stable and range between 1 and 2 years or between 3 and 5 years for the majority of banks, and maturities of more than 10 years are not common⁴³. No short-term pressure in the form of expected decreases in maturities going forward are observed across the sample of banks.

From the data at hand and the analysis of the institution case studies, therefore, no particular short-term pressures were identified in banks' lending activities to corporates.

b) Corporates and capital markets (securities' maturities)

Dimensions 1 and 2 (banks' and corporates' perspectives)

While not strictly related to the banking sector, it is also worth looking at the financing by corporates through capital markets. In particular, how far banks contribute to the financing of corporates through capital markets is interesting for the discussion at hand. It should be underlined here that 'long-term debt securities' refer to securities maturing in 1 year or more.

Data from the ECB database suggest that non-financial corporates' outstanding stocks of securities issuances are dominated by listed shares, followed by long-term (> 1 year) debt securities. Outstanding debt securities issued by NFCs in the EU-28 stood at EUR 1 973 billion as of end 2018⁴⁴.

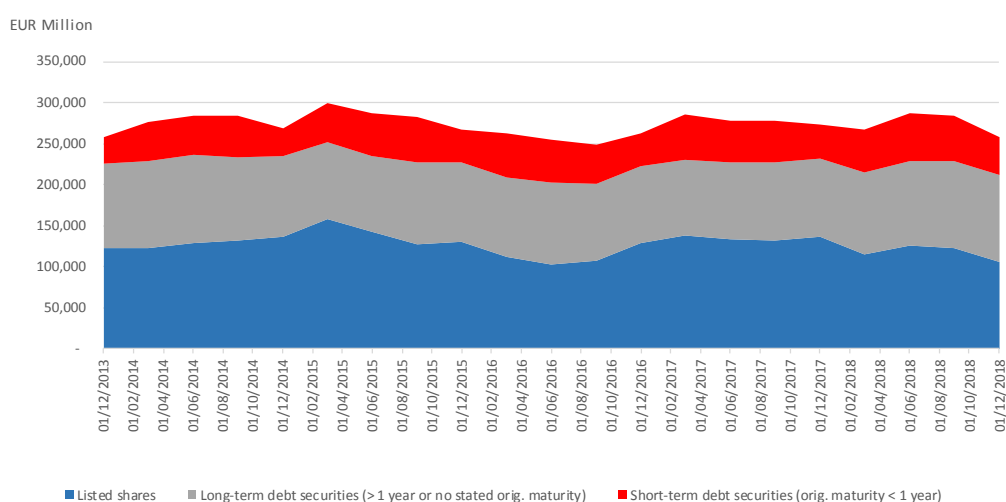
Listed shares account for 80% of total EU NFC securities as of end 2018, followed by long-term debt securities at 19%. The outstanding amount of long-term debt securities issued by NFCs dominated the debt security portfolio for the entire period between the end of 2015 and the end of 2018. At EUR 1 840 billion, the nominal value of outstanding long-term debt securities issued by NFCs dwarfs the EUR 132 billion in short-term debt securities outstanding, and is almost 14 times as high.

⁴³ Note that this reflects only data for the six responding banks. ECB data showed that the majority of loans have maturities of more than 5 years (see Figure).

⁴⁴ ECB Data: Securities Issues.

Banks themselves account for only a very small proportion of NFC’s securities issuances: statistics available on euro area bank⁴⁵ holdings of EU-28 NFCs securities show that they account for only 6% of the latter. Euro area banks’ holdings of EU NFC’s securities are around 40% in listed shares, 40% in long-term debt securities and just under 20% in short-term debt instruments (see Figure). Notably, however, banks’ holdings of short-term debt securities account for 66% of the total NFC short-term debt securities holdings. While euro area banks therefore do not seem to be very relevant for the securities issuance of NFCs in the EU, they do seem to hold a relatively large amount of NFCs’ short-term debt instruments.

Figure 2 – Securities issuance by NFCs resident in the EU, listed shares and debt securities, stocks at market value – holdings by euro area MFIs excluding central banks



Source: ECB securities holdings statistics
 Note: Data available only for euro area securities holders.

With maturities differentiated only between below and above 1 year, it is difficult to draw any conclusions from the data on any potential (short-term) pressures from euro area banks on NFCs in the debt securities segment. One can merely say that data do not suggest that there are immediate short-term pressures in the form of banks holding predominantly debt securities with maturities below 1 year. While banks account for the majority of total holdings of short-term debt, banks’ holdings are mainly in listed shares and long-term debt, with only a small fraction in short-term debt.

In particular, the analysis warrants mentioning that it is not possible to distinguish between supply and demand effects. As with well-known general lending debates, it is difficult to identify whether or not a lack of, for example, lending in the very long-term segment is driven by banks’ supply, or indeed by borrowers’ demand. To truly separate supply and demand effects, a survey of corporates would be necessary to understand whether or not corporates feel that there is an insufficient supply of long-term lending by banks or absorption of long-term debt in the markets. Such a survey is not available⁴⁶.

⁴⁵ Monetary financial institutions other than central banks. Note that data in this section come from ‘securities holdings’, focusing on euro area holders of securities issued across the EU. Data in the previous paragraph focus on EU securities issuers, regardless of the residence of the holder. Therefore, no direct comparison of the numbers is possible. Data for non-euro area banks are not available.

⁴⁶ This could be an area for further investigation by the European Commission. See section 4.5.

The European Commission's SAFE⁴⁷ provides, however, some insights, showing that SMEs prefer debt financing over equity financing, and they have more difficulties in accessing the markets to obtain finance than large corporates. EU SMEs are more confident when talking with banks about financing and obtaining the desired results (68%), including maturity of loans, than when talking to equity investors and venture capital firms (23%). These proportions have been rather stable since 2014.

In summary, no particular short-term pressures from banks are observed in the capital markets, with no evidence of banks holding predominantly debt with maturities below 1 year.

c) Incentives to achieve sustainability objectives

Dimensions 2 and 3 (corporates' and sustainable finance perspectives)

Banking practices that result in incentives or pressures not to focus on short-term profit optimisation but on sustainability objectives have also been observed during the research.

First, it has been found in the literature that lenders to some extent price the corporate social responsibility (CSR) risks of their borrowers into the interest rates they offer⁴⁸ and that borrowers' ethical behaviour leads lending banks to loosen financing conditions when setting loan rates⁴⁹. This is consistent with studies confirming that CSR can have a strong effect on default risk reduction⁵⁰ and that this could to some extent alleviate the (potential) pressure put on corporates for short-term financial targets.

However, other studies find no conclusive evidence that company-level sustainability influences the interest rates charged to borrowing companies by banks⁵¹, and it has also been found that low-quality borrowers that engage in CSR spending may face higher loan spreads and shorter maturities, whereas lenders are indifferent to CSR investments by high-quality borrowers⁵². This may show the predominance of purely (short-term) financial-linked considerations. Furthermore, taking into account that the studies reviewed do not necessarily apply to the EU banking sector, it is difficult to draw conclusions here on the types of incentives provided to corporations by EU banks.

Some other practices have nonetheless developed over the recent years.

i. Sustainability improvement loans

⁴⁷ See [here](#).

⁴⁸ Goss, A., and Roberts, G.S. (2011), 'The impact of corporate social responsibility on the cost of bank loans', *Journal of Banking & Finance*, 35(7), 1794-1810.

⁴⁹ Kim, M., Surroca, J., and Tribo, J.A. (2014), 'Impact of ethical behavior on syndicated loan rates', *Journal of Banking & Finance*, 38, 122-144.

⁵⁰ For example, Sun, W. and Cui, K. (2014), 'Linking corporate social responsibility to firm default risk', *European Management Journal*, 32(2), 275-287.

⁵¹ For example, Hoepner, A., Oikonomou, I., Scholtens, B., and Schroder, M. (2016), 'The effects of corporate and country sustainability characteristics on the cost of debt: an international investigation', *Journal of Business Finance & Accounting*.

⁵² Goss, A. and Roberts, G.S. (2011), 'The impact of corporate social responsibility on the cost of bank loans', *Journal of Banking & Finance*, 35(7), 1794-1810.

Recently there has been a growth in ‘sustainability improvement loans’ or ‘ESG-linked loans’, which tie the interest rate and/or covenants of a loan to the borrowing company’s performance on specified ESG metrics. These sustainability performance indicators range from ESG ratings to carbon footprint improvements and may be assessed based on external ESG ratings, achievement of internal sustainability targets or the borrower’s listing in a sustainability index.

Individual banks, or a consortium of several banks, may issue such loans, and they may be relevant to a wide range of corporations, as the financial incentives may be tailor-made, based either on how the company compares with peers or on the company’s progress. In addition, in contrast to asset-based green bonds and loans, sustainability improvement loans look at the performance of the borrowing company as a whole and generally do not set a requirement on the use of proceeds⁵³.

The justifications for offering sustainability improvement loans where banks accept lower interest rates may be driven by the expectation that borrowers will be protected against sustainability-related financial risk, a reward for socially responsible activities as part of a banks’ sustainability strategy, a way of winning (and keeping) business and/or reputational benefit⁵⁴.

By incentivising the achievement of sustainability objectives, this type of instrument may alleviate the (potential) short-term pressures exerted on corporates for short-term financial optimisation, as they are required to consider other factors linked to longer term drivers of value creation. In other words, even though financial considerations are obviously not absent, sustainability improvement loans can be considered a practice opposed to short-termism.

Sustainability improvement loans remain limited at this stage but are growing fast⁵⁵. In addition, in March 2019, three industry associations⁵⁶ published the Sustainability Linked Loan Principles, voluntary guidance to be applied to these instruments and contingent facilities. It can be expected that the ESG-linked loans will grow in popularity following the publication of these guidelines, in the same way that the development of applicable standards by the International Capital Market Association has supported green, social and sustainability bond markets.

ii. Awareness building and policies to support the transition of corporates

Based on industry surveys⁵⁷, EU banks are increasingly working to support the transition of their corporate clients towards sustainable business models with a focus on increasing their long-term value. Such practices can be observed across the whole value chain – from research and advisory, to corporates’ financing as well as investor solutions and services – and include:

⁵³ Thomä, J., Caldecott, B., Ralite, S. (2019), *Sustainability improvement loans: a risk-based approach to changing capital requirements in favour of sustainability outcomes*.

⁵⁴ Ibid.

⁵⁵ Global issuance of loans linked to ESG criteria grew more than seven-fold in 2018 to USD 37 billion, according to [Bloomberg NEF data](#).

⁵⁶ The Loan Market Association, the Asia Pacific Loan Market Association and the Loan Syndications and Trading Association.

⁵⁷ For example, the Global Financial Markets Association (GFMA) survey in June 2019 and the EBA survey mapping the integration of ESG factors by EU banks.

- identifying corporates' impacts and the environmental and social challenges they face (usually as part of due diligence processes), and understanding their sustainability roadmaps;
- training business relationship managers on sustainability and/or providing them with specific ESG expertise;
- educating clients on climate-related risks and ESG investment opportunities (research seminars, workshops, sustainability updates and white papers);
- specifically engaging with clients that operate in high-ESG risk and high-carbon industries (working towards emission reductions and investment in low-carbon technologies, imposing restrictions or not establishing new relationships);
- increasing the integration of ESG aspects when offering advice in relation to products and services and offering dedicated sustainable products (see section 2.2.3 regarding green finance).

Overall, this section has outlined that the analysis of quantitative data (maturities of loans and securities) does not allow the conclusion that EU banks exercise undue short-term pressures on corporates. From a qualitative point of view, banking practices that result in incentives to focus on sustainability objectives are developing. It remains, however, difficult to assess the extent to which these activities are performed, especially if one tries to balance them with the (potential) pressures for short-term financial targets. Nonetheless, banks' role in helping clients better understand sustainability considerations and as a result in fostering long-termism appears key and could be further encouraged by regulators, and further supported by information sharing by the public sector (see section 4 – policy recommendation 4).

2.2.2 Banks' infrastructure finance

This section looks into the provision of infrastructure finance by banks as part of the assessment related to long-term finance. Infrastructure projects are usually long term, and the availability of long-term funding is key for investing in such projects. The section includes first the quantitative observations on the recent developments in banks' lending, covering the first two dimensions of short-termism (section 2.2.2a), and then briefly considers sustainable infrastructure finance, in relation to the third dimension of short-termism (section 2.2.2b).

Some important caveats should, however, be underlined with respect to the relevance of infrastructure finance for the short-termism discussion: similarly to general lending debates, it is difficult to distinguish between the supply and demand drivers; a bank engaged in infrastructure finance may still exert other kinds of short-term pressures (even for the largest bank lenders, infrastructure finance corresponds to only a small part of their total balance sheet); long-term assets can also be traded within short time horizons; and, concerning recent developments in lending, infrastructure projects are not necessarily 'sustainable'.

a) Recent developments in banks' lending

Dimensions 1 (banks' perspective) and 2 (corporates' perspective)

According to research on banks' lending⁵⁸ and infrastructure finance⁵⁹ (the latter including but not limited to the EU), the total volume of infrastructure finance provided by the financial sector has grown steadily, after an intermittent slowdown during the global financial crisis. There has been a pickup in recent years, particularly marked in North America and Europe.

Regarding European financing providers – the top providers being banks – their relative importance at the global level, though still high at 50%, has declined, whereas the role of financing providers from North America and Asia Pacific has increased. This shift is driven by a general increase in the size of the market rather than a reduction in the absolute volumes by European financing providers.

In recent years, in the EU and more broadly in advanced economies, the relative proportion of banking finance has fallen commensurate with the increase in market-based finance, particularly in the later stages of the investment life cycle. Non-bank investors, with generally longer investment horizons, have essentially replaced some part of bank financing with a growing number of pension funds, insurers and sovereign wealth funds that are attracted to the long-term returns on infrastructure projects. The analysis suggests that an indirect consequence of this could be a better diversification of exposures across the financial system and a better alignment of providers and users of finance that is based on respective risk-bearing capacity.

However, in the EU and at the global level, (i) banks remain the primary providers of infrastructure finance and (ii) they have not reduced lending to this sector in absolute terms, as bank lending has followed a fairly flat trend in recent years, especially for project finance, after a drop around the time of the financial crisis. Banks remain the main source of infrastructure finance, drawing on (among other factors) their expertise in credit origination and monitoring. In addition, although non-bank finance has increased mostly through bond issuance, it has also increased through co-investment models of institutional investors with banks, which also puts into perspective the relative decrease in banks' financing.

The analysis at the global level points also to shorter average maturities of infrastructure loans provided by global systemically important banks (G-SIBs). This is consistent with the analysis conducted for EU banks, which showed that bank financing had shifted towards smaller and somewhat shorter projects (the median length went down from 30 years to 25 years). The overall decrease of bank loan maturities is driven by a decline in the proportion of very long-dated bank loans (with maturities above 14 years)⁶⁰.

⁵⁸ London Economics Europe (2016), *Impact of the Capital Requirements Regulation (CRR) on the access to finance for business and long-term investments*, November. This study assesses whether or not increased minimum capital requirements affect bank lending, using data from a broad sample of banks in Europe, including for the period since the entry into force of the CRR on 1 January 2014.

⁵⁹ FSB (2018), [Evaluating the effects of regulatory reforms on infrastructure finance](#). The focus is on infrastructure finance provided fully or partly by the financial sector. This part accounts for a relatively small proportion (e.g. around 5-10%) of global spending on infrastructure investments. The analysis covers both corporate and project debt financing (loans and bonds).

⁶⁰ Infrastructure financing being a sub-sector of NFCs, and section 2.2.1 on maturities of loans and securities looking at NFC financing in general and for the euro area only, different trends are observed on maturities.

Box 2 – Analysis of institution case studies (EBA questionnaire) with regard to infrastructure finance

The analysis of institution case studies provides balanced findings with regard to the volume of exposures to infrastructure projects. Some banks note that there have not been large changes over recent years in terms of volume but that the nature of the projects financed has changed and will continue to transform due to market developments and banks’ internal policies (e.g. growth from renewables or energy efficiency-related projects, while exposure to less sustainable projects could decrease). Banks expect a non-significant increase of exposures to infrastructure projects in the next 10 years.

Asked which factors have the biggest impact on the financing of infrastructure projects, banks cited client demand as the most important driver, while monetary policies, business objectives, and competition with institutional investors with different regulation and banking prudential regulations were also mentioned. The impact of Basel III reforms on infrastructure finance will be further discussed in section 3.

b) Sustainable infrastructure finance

Extending to dimension 3 (sustainable finance perspective)

As mentioned above, even though banks state that the focus on projects’ sustainability has increased over the last few years and will continue to increase, not all infrastructure projects are necessarily sustainable. Given this, the above considerations on banks’ lending provide insights into the ability of banks to engage in long-term activities (considering the caveats mentioned) and the ability of corporations to fund long-term investments, but do not permit conclusions to be drawn on the opportunities or impairments to a transition towards a sustainable economy.

In this respect, data on EU banks’ financing of purely sustainable infrastructure projects are scarce. In global markets, bank loans are a critical source of finance for new sustainable investments. In terms of overall volumes, bank lending is the largest source of sustainable investment finance. Based on a study by the United Nations Environment Programme Finance Initiative (UNEP-FI), whether through corporate lending or specialised lending, banks provide, for example, roughly 80% of green infrastructure finance across the G20 countries⁶¹.

However, when considering the needs of sustainable infrastructure finance for the transition towards a sustainable economy, and expanding the analysis to all types of investors, current levels of investment in the EU do not appear sufficient. The Commission has assessed that an annual investment gap of almost EUR 180 billion needs to be filled to achieve EU climate and energy targets by 2030, and the European Investment Bank has assessed that the overall investment gap in transport, energy and resource management infrastructure has reached an annual figure of EUR 270 billion⁶².

⁶¹ Robins, N., and McDaniel, J., (2016), [Greening the banking system: taking stock of G20 green banking market practice](#). The definition of ‘green’ for this assessment may differ from the definition that will result from the classification of activities currently performed at the EU level (‘the taxonomy’), due to the timing of the study (2016, when the taxonomy did not exist) and different geographical coverage.

⁶² See EIB (2016), *Restoring EU competitiveness*. The estimate, until 2020, include investments in modernising transportation and logistics; upgrading energy networks; increasing energy savings; renewables; and improving resource management, including water and waste.

Based on work undertaken by multilateral organisations⁶³, at the global level, current investments in sustainable, low-emission and resilient infrastructure are progressing but also fall short on delivering the services needed for sustainable development. It is likely that bank financing has an important role to play in filling this investment gap for sustainable infrastructure projects. At the EU level, the Capital Markets Union project and the Commission’s action plan on financing sustainable growth aim, among other things, to address this issue and reorient capital flows.

Another aspect to take into account with regard to the contribution of infrastructure projects for the transition to a sustainable economy relates to the assessment of environmental and social risks attached to specific projects. In this respect, EU banks engaged in large project-related corporate loans regularly point to their endorsement of the Equator Principles, international voluntary guidelines that guide banks in incorporating environmental and social risks into the assessment of credit and operational risks in large infrastructure investment projects⁶⁴.

To sum up, EU banks’ provision of infrastructure finance remains significant, despite a decrease in the relative proportion of bank financing and shorter average maturities. This does allow the conclusions to be drawn, however, that short-termism is absent and that significant levels of investment gaps for sustainable projects remain to be filled.

2.2.3 Sustainable and green finance

Dimensions 1, 2 and 3 (banks’, corporates’ and sustainable finance perspectives)

This section does not provide a detailed study of sustainable and green finance but includes elements linked to the short-termism discussion. Providing green finance⁶⁵ does not mean that banks will not exert any kind of short-term pressures on corporations; however, this is one growing activity where banks’ role in driving corporations to consider and address long-term risks and opportunities related to environmental challenges (i.e. one of the main concerns behind short-termism) is expected to be key.

Over the past years, several new initiatives and financial products have been introduced to expand sustainable finance, but the deployment of a sufficient volume of private capital still faces some barriers. These include the lack of internalisation of environmental and social factors (i.e. not factoring the sustainability-related outcomes into the risk/return profiles of investments), the lack of general clarity in identifying green investments, information and analytical capacity gaps, and a misalignment in return horizons, as some projects would deliver their financial and sustainable benefits over longer periods of time than those generally considered. The Commission’s Action Plan aims to address these

⁶³ For example, OECD work on approaches to mobilising institutional investment for sustainable infrastructure.

⁶⁴ The Equator Principles were established in 2003 and are based on the environmental and social criteria of the International Finance Corporation. The principles recommend, for example, the assignment of a risk category to the projects to be financed, based on variables such as the socio-environmental characteristics of the country, the industrial sector and the characteristics of the project. It should, however, be noted that a decision to finance can be made irrespective of the categorisation.

⁶⁵ The volume of green finance is not easy to quantify due to the use of varying definitions of what constitutes a green asset. The sources mentioned in this section could not rely on a common legal definition of a green asset, and market participants were relying on various internal or external standards. In this respect, the development of the EU taxonomy is likely to represent a major step.

issues. The section below discusses the recent activity of the banking sector with relevance to corporates' financing.

Currently, the private sector financing of sustainable projects has been largely originated by banks in the form of loans. As mentioned above, in terms of overall volumes, bank lending is the largest source of sustainable investment finance, and it has been assessed that banks provide roughly 80% of sustainable infrastructure finance.

However, given that there is a general maturity mismatch between many (long-term) sustainable investments and many banks, due to banks' funding structure, other (long-term) actors also play important roles. For example, venture capital and private equity firms have to some extent the ability to act and invest for the long term, due to their strategic objectives and funding structures (which may be longer term than those of banks), while institutional investors can finance or refinance the sustainable loans through a range of debt capital market products⁶⁶.

Regarding the EU banking market more specifically, there is a significant rise in the current and planned offering of green financial products and services. Based on data gathered by the EBA on a sample of 62 EU banks⁶⁷, 90% of the participating banks have or are planning to develop products and/or services based on environmental considerations⁶⁸. Several motivations explain why EU banks are entering this market, such as the opportunity to increase their brand image, to strengthen relationships with eco-friendly clients and to improve their market share and increase future profits.

EU banks have started to enlarge their offers in several traditional banking segments, including corporate banking. This includes the following for the latter:

- Project finance is offered for low-carbon technologies and infrastructure, for example for sustainable energy infrastructure, green transport projects, and water and waste projects.
- General corporate financing is offered to companies in sectors that are required for and support the low-carbon transition. This includes green loans, which are lending facilities whose proceeds are used exclusively for eligible green activities. The green loan market is still at an early stage of development, and the volume of green loans is not easy to quantify due to the use, up until now, of varying definitions of what constitutes a green asset. In this respect, the EU taxonomy and the publication in 2018 of the Green Loan Principles are likely to represent major steps for the green loans market.
- Climate-related advice is given to help corporate clients manage climate-related risk.

In the sample of 62 participating banks, 57% are or will be investing in green project finance, while only 12% are looking into green venture capital and private equity. In addition, 50% of the banks are looking into different green products to invest in. EU banks are also the main underwriters of green bonds (including but not limited to corporate bonds), as they represent seven of the top 10 green bond underwriters worldwide in 2018⁶⁹.

⁶⁶ See the G20 Sustainable Finance Study Group's 2018 *Sustainable finance synthesis report*.

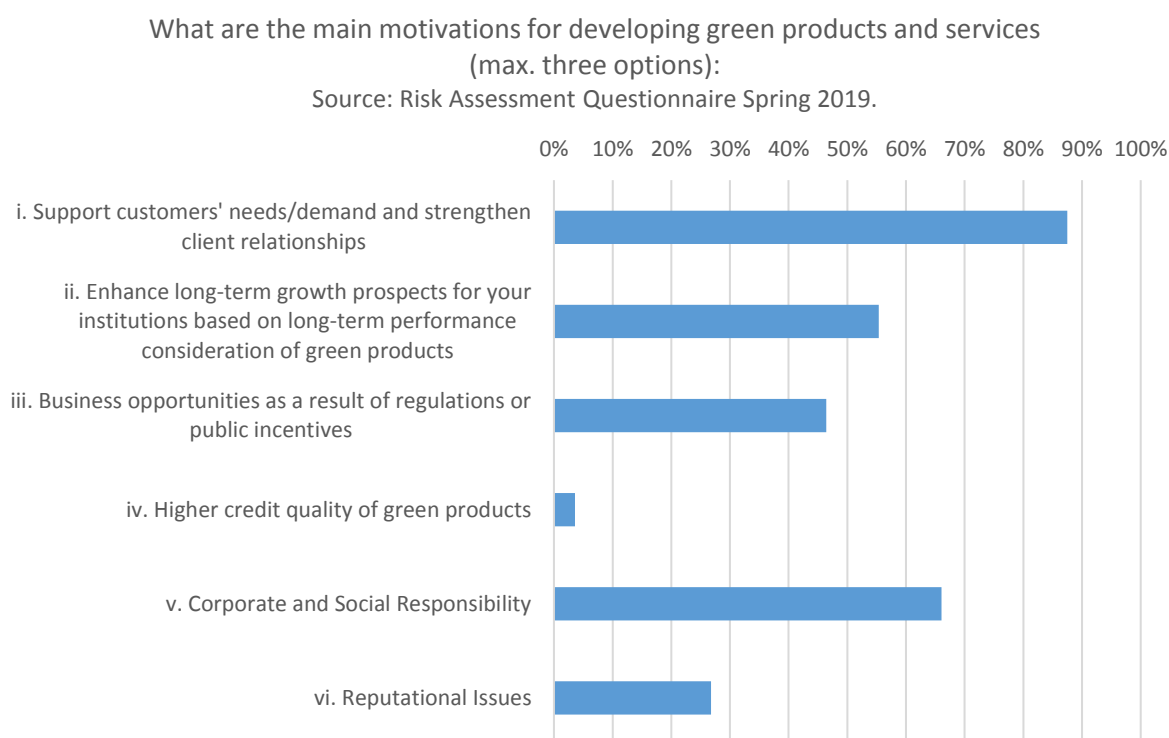
⁶⁷ [Risk Assessment Questionnaire \(RAQ\), spring 2019](#). The RAQ is conducted by the EBA on a semi-annual basis. Answers to the questionnaire were provided by 62 European banks and 18 market analysts.

⁶⁸ 79% consider developing products and services based on social criteria and 63% based on governance considerations.

⁶⁹ Thomson Reuter's 2018 [green bond underwriter league](#) table.

The main stated motivations for developing green products and services relate first to customer support and the need to strengthen client relationships, while two thirds of respondents highlighted their corporate and social responsibility. A majority of banks also mentioned that the development of green products will enhance the long-term growth prospects of the bank, while the credit quality of green products ranks far below.

Figure 3 – Main motivations of EU banks for developing green products and services



For banks that have not developed green products, the main barriers mentioned to entering the green finance market are the low volumes and lack of customer interest (83%), while other barriers include lack of incentives (50%), lack of understanding and research (17%), lack of sufficient data to develop green products (17%) and no historical evidence of performance of green financing products (16%). However, in spite of these barriers, most analysts expect the proportion of green assets and liabilities in the overall balance sheet of the banks to increase, albeit slightly, over the next year.

Overall, although the provision of sustainable and green finance faces some barriers, EU banks are increasingly developing products and services in this area, thereby contributing to corporations' sustainability-related investments and the adaptation to long-term challenges. However, this analysis does not allow the conclusion that there are no funding gaps and that all corporates' needs are covered.

2.3 Potential short-term pressures that banks themselves may be under

This section now considers banks as financial corporations that could themselves be subject to short-term pressures from capital markets. This may also indirectly drive pressures placed by banks on

corporate clients. The potential short-term pressures on banks through the maturity of funding instruments are assessed in section 2.3.1, and other factors, such as disclosure to the market or payment of dividends, in section 2.3.2. This section 2.3 falls under dimension 1 of the report’s short-termism discussion.

Dimension 1 – banks’ perspective

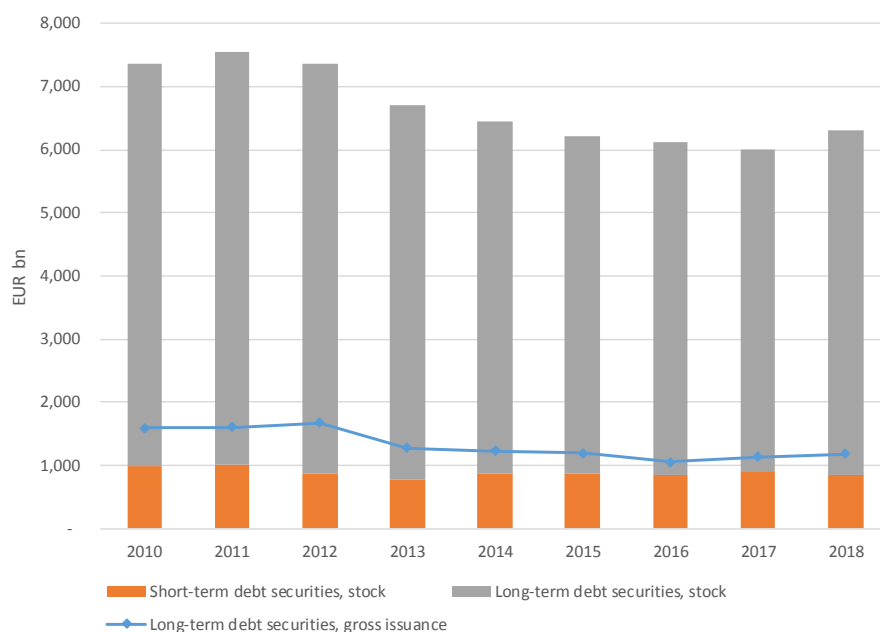
2.3.1 Funding

In what follows, we make use of the EBA’s supervisory reporting data and the ECB’s publicly available data. In short, no particular evidence of any short-term pressure on banks on the funding side is observable from the data at hand. Funding plans and historical issuance volumes show the majority of banks’ debt securities issuance to be in the long-term segment (understood as over 1 year).

a) Banks’ historical securities issues

No historical issuance data are available in the EBA (funding plan) data. We therefore used the ECB public data in the analysis of historical developments.

Figure 4 – Securities other than shares issued by banks



Source: ECB Statistical Warehouse, Financial markets and interest rates (non-Economic and Monetary Union (EMU) data taken from the Financial Markets Survey).

Note: Non-EMU data have been taken from the ECB’s Financial Markets Survey. The sample of banks varies over time, as data are not available for all countries for the whole period. However, the picture and trend do not change significantly when adjusting for a constant sample. Stock figures will be affected not only by issuance volumes and redemptions, but also by revaluations and other changes, which may include changes to the sector of certain issuers. An issuer may acquire a banking licence, for example, that leads to a reclassification and to the outstanding debt securities of this issuer starting to be counted as part of other MFIs. Figures depict securities issues by ‘other monetary financial institutions’, which according to the ESA in 2010 include deposit-taking corporations, except the Central Bank, as well as money market funds.

The ECB statistical database defines short-term securities (other than shares) as securities with a maturity of less than 1 year. Long-term securities (other than shares) are defined as securities with maturities beyond 1 year⁷⁰.

Market-based funding occurs predominantly at more than 1 year. Long-term debt securities account for the vast majority of debt securities outstanding for banks in the EU as of end 2018. The proportion of the EU aggregate has remained stable at just under 87% since 2010.

Figure 4 shows the developments for the EU as a whole between 2010 and 2018. While the level of outstanding stock has decreased for both long-term and short-term debt securities (by around 14% for both), the relative proportions of the two remained stable. Outstanding long-term debt securities saw a slight increase of 7% between 2017 and 2018.

One cannot, therefore, find immediate short-term pressures on banks, if these are defined as banks' debt stock being predominantly at maturities below 1 year. The above analysis shows that the vast majority of banks' outstanding debt has maturities above 1 year; however, no further differentiation is available for the maturities above 1 year, which would allow more definitive conclusions.

b) EBA funding plans – banks' forecast issuance volumes

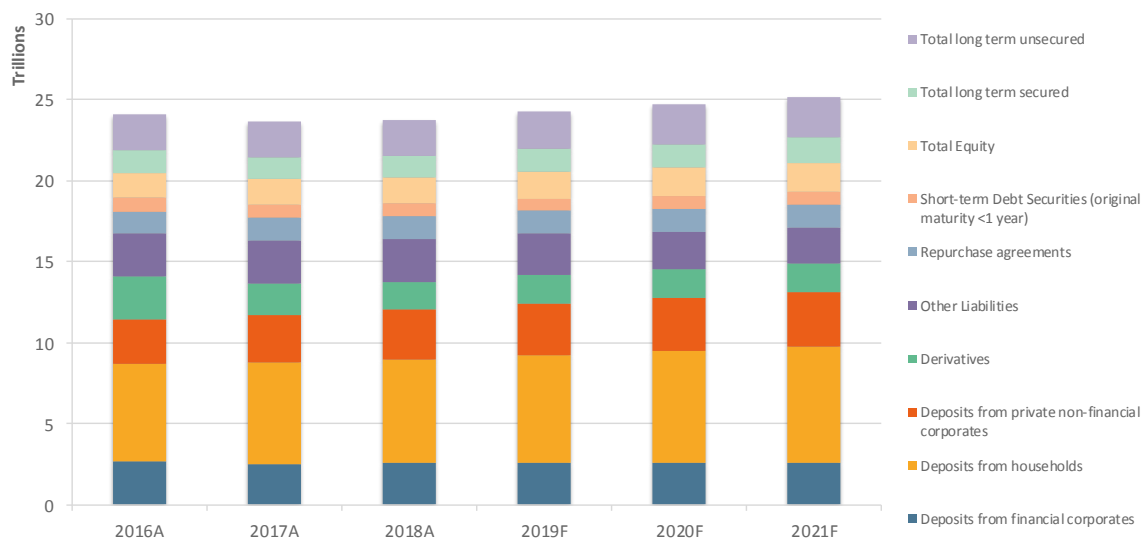
Since 2017, the EBA has published a thematic report on funding plans and asset encumbrance on an annual basis. The report provides insights into, inter alia, banks' funding plans, including the composition of funding and the maturity spectrum. The following summary reflects the analysis of the latest funding plan report, published in September 2019⁷¹.

The report notices overall an increase in long-term funding, and less reliance on short-term funding in 2018 and beyond. The latest funding plan report suggests a reversal in 2018 of the declining liabilities trends observed previously. Banks increased their liabilities (in line with assets) and expect to continue to do so for the forecasting period. In particular, long-term liabilities and client deposits from households and NFCs continued to expand in 2018, while reliance on short-term debt securities, repurchase agreements, derivatives and other liabilities as sources of funding, and the proportion of each of these in the overall composition of liabilities has decreased. Within the long-term segment, the proportion of unsecured funding has increased (as a percentage of total funding), while the proportion of secured funding (as a percentage of total funding) has declined somewhat.

⁷⁰ See Section 5 of the [User guide to the update of securities issues statistics under the amended Guideline ECB/2014/15](#).

⁷¹ [EBA Report on Funding Plans – August 2019](#).

Figure 5 – The overall composition of actual and planned liabilities

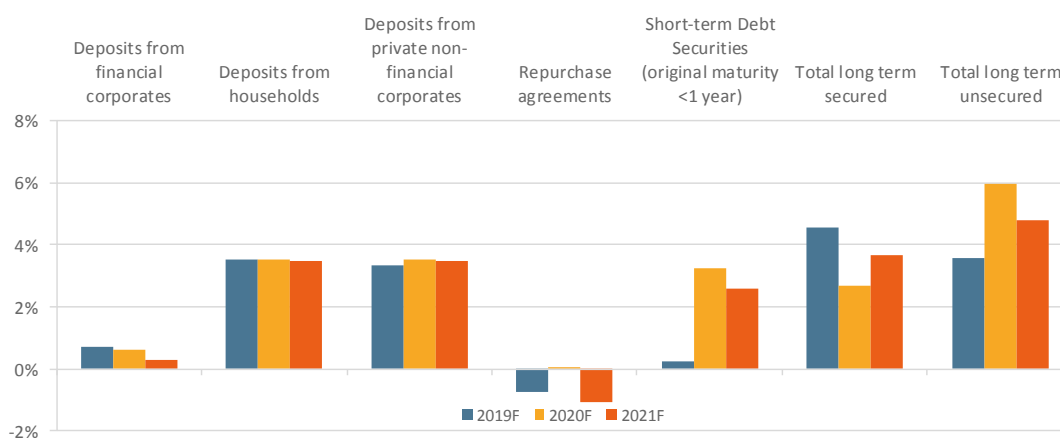


Source: EBA report on funding plans – August 2019

Market-based funding accounted for 24.5% as of end 2018. Of this, the vast majority is made up of long-term debt instruments, which accounted for just over 20% of total liabilities as of end 2018. Short-term debt instruments accounted for only a little over 4% as of end 2018 (deposits accounted for around 68%) (see Figure).

The trend of growing liabilities is expected to continue over the forecasting period: in particular, between 2018 and 2021, long-term unsecured debt instruments are expected to exhibit the highest growth rate of all liabilities, growing by almost 15% and bringing the proportion of long-term debt instruments up to 21% by 2021 (up from 20% in 2018). Short-term debt is expected to grow at a much lower rate of 6% over the next 3 years (see Figure .)

Figure 6 – Growth of selected liability classes



Source: EBA Report on Funding Plans – August 2019

In terms of costs, however, the majority of banks expect a reversal of the trend of decreasing funding costs. Prices for long-term debt instruments are expected to increase in 2019, on average by 8 basis points. Combined with the increase in issuance volumes in the years ahead, this might be due to the need to issue minimum requirement for own funds and eligible liabilities (MREL)-eligible instruments and raises some concerns regarding the capacity of banks to raise their funding at reasonable spreads. Even if costs for market-based funding stay under control in 2019 (for which funding plan data show low levels of debt issuance volumes), costs are likely to go up in future years, when issuance volumes are expected to rise.

From the funding plan data to date, no particular short-term pressure is apparent, with banks’ funding expected to expand in the long-term segment in particular. It should be noted, however, that banks’ projections on funding were made before the ECB announced the launch of a new series of targeted longer term refinancing operations (TLTRO) (namely TLTRO III) starting in September 2019. It is therefore likely that banks have made some adjustments to their plans since submitting data for this funding plan report.

c) Banks’ liabilities: average maturities⁷²

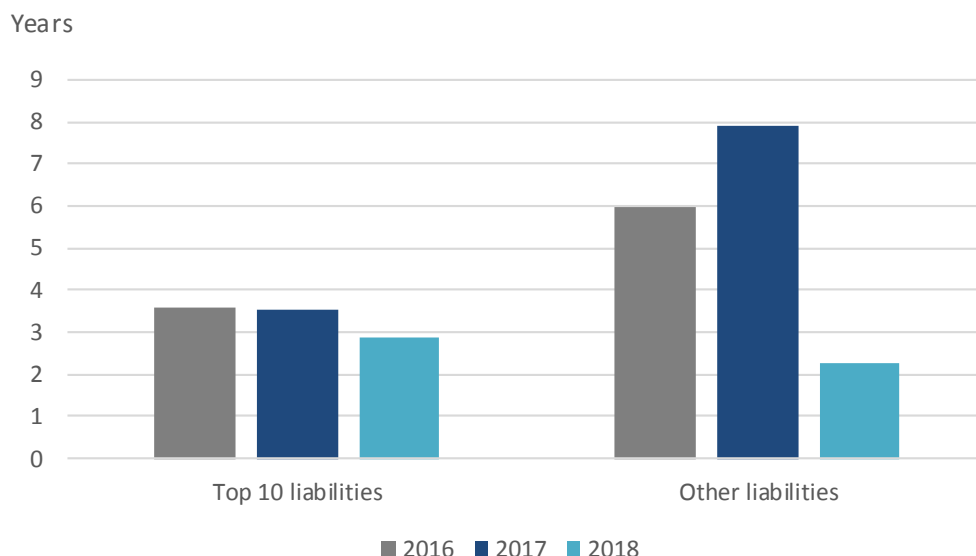
EBA reporting data show average original maturities of the 10 largest counterparties decreasing slightly between 2016 and 2018, for the EU as a whole. The average original maturities of the 10 largest counterparties stood at 2.9 years in 2018 for the EU as a whole (down from 3.6 years in 2016). Large differences, of course, exist between countries.

For liabilities other than the top 10 counterparties, the EU weighted average stood at 2.3 years in 2018 (down from almost 6 years in 2016, and almost 8 years in 2017). This is the result of both actual

⁷² EBA reporting data: COREP Table 67.00a – Concentration of Funding by Counterparty.

substantial decreases in country average original maturities and smaller exposure amounts in some countries with longer maturities, which have a disproportionate impact on the weighted average. The simple average has remained fairly constant in comparison, at 2.5 years in 2018 and 2.7 years in 2016, suggesting that much of the change or the high average figure in 2016 was driven by banks that had relatively large amounts of ‘other exposure’ and at the same time relatively long maturities.

Figure 7 - Banks’ top 10 liabilities, and liabilities other than the top 10, original maturities (EU weighted averages)



Source: EBA Reporting Data, common reporting (COREP) Table 67.00a: Concentration of funding by counterparty
 Note: EU weighted averages present the averages of the country figures, weighted by countries’ exposure amounts. Country averages of maturities in turn are already weighted by the exposure amounts of each bank.

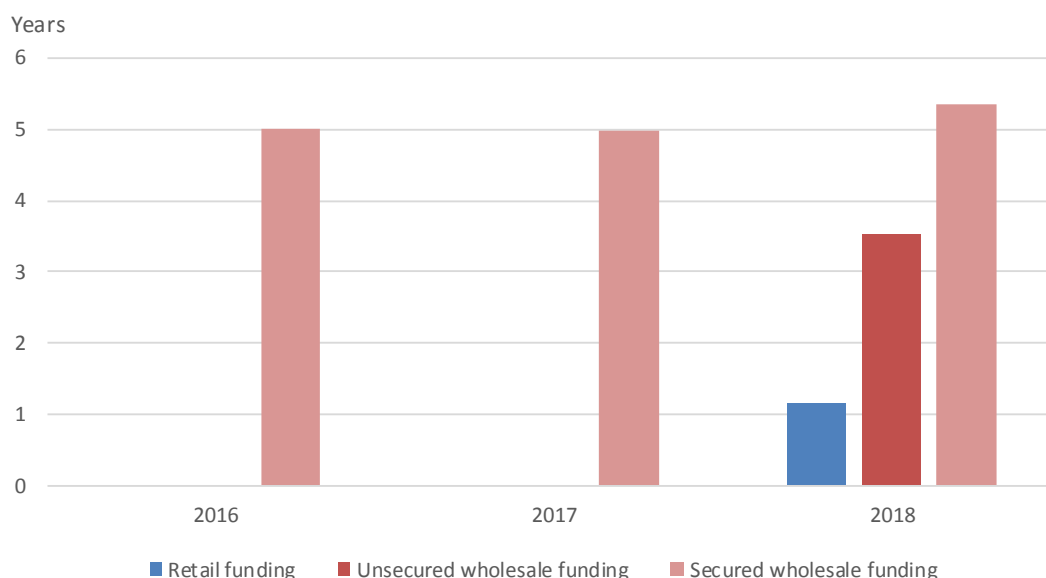
From the above, a slight decrease in average original maturities of banks’ liabilities can be observed.

d) Bank funding by product types

To understand better the various funding types, their proportion in funding and their respective original maturity profiles, COREP data on the concentration of funding by product type are used. These provide information on the types of funding for all products that are greater than 1% of total liabilities.

Secured wholesale funding makes up the largest portion of banks’ funding, and average maturities were 5.6 years in 2018, which showed no major change since 2016 (when they stood at just a little over 5 years). These maturities are the longest when comparing wholesale versus retail funding. For retail funding original maturity, averages are substantially lower, at 1.15 years in 2018. Average original maturities for unsecured wholesale funding stood at 3.5 years in September 2018 (note that, for retail funding and unsecured wholesale funding, data are available only for 2018).

Figure 8 – Original maturities, EU averages by funding type



Source: COREP Table 68.00: Concentration of funding by product type

Note: For retail funding and unsecured wholesale funding, no data are available for before 2018. EU averages exclude subsidiaries, to avoid double counting. These figures are not directly comparable with figures in the previous section, as they include all liabilities accounting for more than 1% of total liabilities (the previous section showed top 10 exposures versus other funding).

In summary, from the data presented above, it seems difficult to establish clear short-term pressures on banks’ funding on aggregate in the EU. Although average original maturities have decreased somewhat for the EU as a whole, it seems that, when looking at short-term versus long-term in a narrower sense (less than 1 year versus more than 1 year), banks’ outlook and historical issuance on debt securities is positive and shows a clear dominance of instruments with maturities longer than 1 year. As in previous sections, the caveat about the definition of short-term versus long-term applies, and the results of the above need to be interpreted with care.

In relation to the third dimension of short-termism (sustainable finance), Annex 4 describes EU banks’ green funding practices and opportunities (green bonds and green covered bonds).

2.3.2 Other potential short-term pressures originating from capital markets

This section looks into short-term pressures, coming from capital markets and shareholders that banks could be subject to. The assumption is that banks are under pressure from asset owners and investors to maximise near-term returns, which may lead to strategies that promote short-term goals over longer term objectives.

In this respect, it is worth recalling that it has been argued⁷³ that the short-term pressures placed on directors of financial institutions, as a result of demands of shareholders for unsustainable and ever increasing earnings growth, were an important driver in precipitating the financial crisis of 2007-2009.

Similarly to other corporations, banks are vulnerable to short-term pressures through pressures to maximise shareholder value with distributions of dividends (section 2.3.2.a) and share repurchases (section 2.3.2.b), while the frequency of disclosures to markets (section 2.3.2.c) can also play a role. At the same time, investors seem to exert an increasing pressure upon banks to take into account long-term and sustainability risks in their strategy and business (section 2.3.2.d).

a) Payment of dividends

A degree of pressure on the banks' management bodies to generate and increase profitability is likely to be usual, as most banks are private and profit-seeking companies. Thoroughly assessing banks' differences from other corporations would require a dedicated analysis, but some preliminary remarks can be made based on a literature review.

First, banks are known for paying relatively high dividends in volume, and it has been found that dividends play a more important role for banks than for NFCs⁷⁴ (however, that research applied to US companies). At the EU level and compared with net incomes, banks listed in the S&P Europe 350 show slightly lower ratios of dividends as a proportion of net income than the average of other economic sectors⁷⁵ (see Table).

Second, a number of academic studies have looked at banks' pay-outs during the financial crisis of 2007-2009⁷⁶, especially in the USA⁷⁷, and found that, despite mounting losses, many of the largest US bank holding companies kept dividends constant, and in some cases even increased them, until the end of 2008. Banks tend to be reluctant to cut dividends, fearing that dividend reductions would lead to uncertainty about their fundamentals, and cause subsequent refinancing problems, which could be seen as short-term pressures (or at least concerns over short-term pressures) from shareholders and markets.

This part of the literature is consistent with the idea that signalling through dividends is important for banks and that banks feared adverse reactions to dividend cuts during the crisis. However, it has also been argued that, while banks may still have feared such a reaction in the crisis, concrete evidence on this signalling argument is mixed⁷⁸.

⁷³ For example, Keay, A., 'Risk, shareholder pressure and short-termism in financial institutions: does enlightened shareholder value offer a panacea?'

⁷⁴ Floyd, E., Li, N., and Skinner, D.J. (2015), 'Payout policy through the financial crisis: the growth of repurchases and the resilience of dividends', *Journal of Financial Economics*. The research compares the pay-out policy of banks and non-financial firms in the USA from 1980 to 2012.

⁷⁵ Saking, M.E. (2017), [Share repurchases in Europe: a value extraction analysis](#).

⁷⁶ Cziraki, P., Laux, C. and Loranth, G. (2016), 'Understanding bank payouts during the crisis of 2007-2009', Centre for Economic Policy Research (CEPR) Discussion Paper 11453.

⁷⁷ Acharya, V.V., Gujral, I., Kukarni, N., and Shin, H.S. (2012), 'Dividends and bank capital in the financial crisis of 2007-2009', National Bureau of Economic Research (NBER) Working Paper No 16896.

⁷⁸ Cziraki, P., Laux, C., and Loranth, G. (2016), 'Understanding bank payouts during the crisis of 2007-2009', CEPR Discussion Paper 11453.

Another aspect that could be taken into account relates to impacts and consequences of banks breaching their maximum distributable amount (MDA)⁷⁹. At the current stage this is difficult to factually directly link to any short-term pressures on banks. However, banks reaching their MDA trigger face restrictions on, inter alia, payments to shareholders and additional tier 1 (AT1) coupon payments. This could imply pressure from capital markets on banks that are breaching or are close to breaching their MDA and may specifically also lead to short-term pressures.

However, it should be recalled that the new Pillar 2 (P2) framework in Europe has resulted in more transparency; many banks are publishing P2 requirements (P2R) and buffer requirements. This improved transparency should generally result in better information for investors and hence no last-minute surprises in capital markets for banks and investors, which should dampen any negative impact on banks' access to the capital markets.

Further analysis of the role of payment of dividends in putting banks under short-term pressures would need to take into account the diversity of business models, types of ownership, the horizon of the investor, the triggers behind their horizons, etc.

b) Share buybacks

By providing short-term boosts to stock prices, share buybacks are an instrument that could be used to deliver short-term profit to shareholders, possibly to the detriment of long-term investment. The drivers behind share buybacks or their legitimacy are not discussed here⁸⁰, but some recent trends are highlighted below.

It should be recalled that, since the mid-1980s, corporations have increasingly turned to share buybacks rather than dividends as a way to return cash to shareholders. Share repurchases have now overtaken aggregate dividends as the main form of corporate pay-out in the United States. The active use of share repurchases started much later in Europe. However, it has been found that, although share repurchases remain concentrated in a smaller number of companies and they are only performed occasionally, large European companies have also been increasingly focused on corporate distributions, possibly at the cost of decreasing investment in productive resources and employment opportunities⁸¹.

Regarding specifically EU banks listed in the S&P Europe 350, they engage in share repurchasing while displaying slightly lower ratios of share repurchases and dividends as a proportion of net income than the average of other economic sectors (see Table). Four EU banks were among the top 30 share repurchasing companies in Europe in the period 2000-2015.

⁷⁹ As per Article 141 of the CRD, banks face restrictions on bonus payments, paying dividends and AT1 coupon payments in case they reach (or would reach after distributions) their MDA trigger. The latter is defined as Pillar 1 + P2R + combined buffers and excludes P2 guidance.

⁸⁰ The drivers behind share buyback are debated. The ECB monthly bulletin, May 2007, article, 'Share buybacks in the euro area', finds that the upturn in share buybacks between 1998 and 2005 appears to have been driven partly by exceptionally strong profitability among euro area firms. It is also possible that part of the increase in euro area firms' share buyback activities may have been linked to the 'signalling hypothesis', which suggests that management may use share buybacks as a means of signalling improved future earnings and profitability to the markets. Finally, euro area firms that had undertaken share buybacks had, on average, invested less than firms not undertaking any share buybacks.

⁸¹ Saking, M.E. (2017), [Share repurchases in Europe: a value extraction analysis](#).

Table 2 – Industry group average share repurchases and dividends and total share repurchases and dividends as a proportion of net income, based on 298 S&P Europe 350 companies, 2000-2015

Global Industry Classification Standard industry group	Number of firms	Average repurchase per company 2000-2015 (EUR MM)	Average repurchase per company per year (EUR MM)	Average dividend per company 2000-2015 (EUR MM)	Average dividend per company per year (EUR MM)	Repurchases/net income	Total distributed/net income	(TD+RP)/NI
Banks	27	2 457	154	15 712	982	0.09	0.57	0.65
Diversified financials	12	5 972	373	6 135	383	0.43	0.44	0.86
TOTAL	298	3 171	198	9 660	604	0.19	0.58	0.77

Source: CapitalIQ and company annual reports, in *Share repurchases in Europe: a value extraction analysis*, 2017

c) Quarterly reporting to markets

Quarterly earnings reports and guidance and more generally high reporting frequency are among the most discussed mechanisms associated with capital markets that are exerting pressure on managers to pursue short-term goals. The concern is that investors will be driven not by corporate long-term goals but by short-term financial figures, thus incentivising short-termism. A key underpinning of this concern is that investors might sell their shares if the company misses its quarterly earnings target. This could make companies prioritise quarterly earnings over long-term goals, such as innovation or human capital investment⁸².

As mentioned earlier in the report, a number of surveys⁸³ have found evidence that quarterly earnings reports are in many cases driving actions and investment decisions. Many executives would delay or cancel new long-term projects and investments to reach quarterly targets, even with the knowledge that it would hamper longer term value creation⁸⁴. Such results, also found in other research papers⁸⁵, are examples of where quarterly issuances of financial reporting drive short-term pressures to meet investor demands and hinder longer term, sustainable growth and investment.

However, assessing the impact of quarterly reporting on EU banks’ strategies would require further analysis. Limited evidence in this respect has been gathered through the EBA’s analysis of several institution case studies, where banks have been asked to rate the relevance of the frequency of disclosure of financial information to the markets for their activities. The most common answer was that banks consider this frequency quite relevant – highlighting that there has been an increased

⁸² Edmans, A., (2017), ‘The answer to short-termism isn’t asking investors to be patient’, *Harvard Business Review*, July.

⁸³ For example, McKinsey surveys in 2015/2016.

⁸⁴ As an illustration, a [survey conducted in 2005](#) of more than 400 financial executives showed that 80% of the respondents would reduce spending in the areas of research and development, advertising and maintenance in order to meet short-term targets; and 50% indicated that they would indeed delay new projects, even if at the expense of new value creation.

⁸⁵ FCLT Global, [Moving beyond quarterly guidance: a relic of the past](#).

weight placed on the reporting of company performance on a quarterly basis – but not as driving the business. As stated earlier, this does not allow conclusions to be drawn for the whole EU banking sector.

d) An increasing pressure on banks to account for long-term and sustainability risks?

Finally, when considering the pressures exerted on banks, and the incentives provided to them, by capital markets and investors, it should also be noted that there have been calls for action addressed to the banking sector to consider long-term risks and opportunities and to establish practices that (i) reduce their vulnerability to climate change and (ii) accelerate the transition to meet the targets of the Paris Agreement and the UN Sustainable Development Goals. This call for long-termism suggests that banks are also, to some extent, expected by capital markets to lengthen their time horizons, which may mitigate some short-term pressures for short-term financial optimisation at the expense of long-term goals.

While the focus of much climate-related investor engagement to date has been on high-carbon industries, some coalitions of investors⁸⁶ indeed argue that there is a strong and complementary case for engaging with the banking sector. Given the sector's systemic importance to the global economy, and how its alignment with pathways to limit global warming could significantly help investors reduce exposure to climate risks at a portfolio-wide level, investors may be interested in ensuring that banks are fully integrating long-term sustainability considerations.

In addition, investors are becoming increasingly concerned about the quality of climate-related disclosures by banks. Some investors have encouraged banks to report against the recommendations of the Financial Stability Board's Task force on Climate-related Financial Disclosure. In September 2017, over 100 institutional investors, with nearly USD 2 trillion in assets under management⁸⁷, wrote to the 62 largest global banks calling for a strengthening of climate-related disclosures (see also, on long-term related disclosures, section 4 – policy recommendation 3).

Overall, the literature review and available evidence suggest that non-bank-specific drivers (dividends, share buyback, reporting to the market) may play a role in exerting short-term pressures, while at the same time banks seem to be under increasing pressure to take account of long-term sustainability challenges. However, precisely assessing if the short-term pressures that banks themselves may be under is 'undue' proves difficult due to data limitations.

⁸⁶ Share Action, 'Banking on a low carbon future', investor report. See also the report 'Getting to green'.

⁸⁷ Coordinated by Share Action and Boston Common Asset Management.

3. Regulations

The call for advice asks the ESAs to identify the areas in existing regulations that contribute to mitigating undue short-termism or where the rules exacerbate short-term pressures. This section will focus on areas included in the banking regulation.

As an introductory comment, the European prudential regulation is primarily calibrated based on historical data. The EBA is aware that the latter may not be a sufficient indicator to assess future or unprecedented changes. As a result, going forward, the need to enhance a forward-looking perspective for example in calibration of prudential requirements and modelling approaches will be considered to ensure that there is no bias towards unsustainable financing, notably as part of the work of incorporating ESG factors and risks in the banking prudential regulation.

The European prudential regulation is also a risk-based capital regime where capital requirements reflect the underlying risks of institutions' assets and activities. Under this approach, as a general rule, longer maturities correspond to higher risk and consequently higher capital requirements. Both intuition and empirical evidence indicate that long-term credits are riskier than short-term credits, due to higher uncertainties and more likely downgrades. The EBA supports the maintenance of such a risk-based regime; as a consequence, the fact that, all other things being equal, capital requirements should generally increase with maturity is not considered to promote undue short-termism.

Nonetheless, as highlighted by the HLEG in its final report, some stakeholders have expressed concerns that some aspects of prudential regulation could be drivers of short-termism and procyclical, thereby making the pursuit of long-term objectives more difficult. Conversely, it could be argued that prudential regulation aims to reinforce the resilience of institutions in the longer term and thereby could drive them towards longer time horizons.

This section will therefore look at the role played by some banking regulatory requirements in driving institutions towards shorter or longer time horizons. Governance and remuneration requirements (section 3.1), the NSFR (section 3.2), the effect of Basel III reforms on infrastructure finance (section 3.3) and accounting rules (section 3.4) are especially discussed.

By nature, banking regulatory requirements affect primarily the first dimension of short-termism considered in this report (banks' perspective) but, as highlighted above, this dimension can also have important implications for the exercise of pressures on corporates as well as for the financing of sustainable projects.

3.1 Governance and remuneration

This section discusses how recent changes in governance (section 3.1.1) and remuneration (section 3.1.2) requirements have sought to affect the time horizons considered by institutions within their business strategy and internal policies, also recalling the various past instances of weak

governance and remuneration practices that undermine risk management and provide short-term incentives.

3.1.1 Governance

a) Background

During the period that led up to the financial crisis, weaknesses in corporate governance in a number of institutions contributed to excessive and imprudent risk-taking in the banking sector, which led to the failure of individual institutions and systemic problems. There was overall too little concern for the long term and, as the United Kingdom (UK) Kay Review stated, the ‘failed banks were characterised by acute short-termism and serious hyperactivity’⁸⁸.

The very general provisions on institutions’ governance and the non-binding nature of a substantial part of the corporate governance framework, based essentially on voluntary codes of conduct, did not sufficiently facilitate the effective implementation of sound corporate governance practices by institutions.

In some cases, the absence of effective checks and balances within institutions resulted in a lack of effective oversight of management decision-making, which exacerbated short-term-oriented and excessively risky management strategies. The principle-based and therefore not sufficiently clear role of competent authorities in overseeing corporate governance systems in institutions did not support the sufficient supervision of the effectiveness of the internal governance processes and made it difficult to enforce supervisory measures in this area.

In order to address the detrimental effect of poorly designed corporate governance arrangements on the sound management of risk, CRD III and CRD IV have introduced new requirements⁸⁹ to ensure effective oversight by the management body and the promotion of a sound risk culture at all levels of credit institutions and investment firms. They have also strengthened the mandates of competent authorities to monitor the adequacy of internal governance arrangements, taking into account the nature, scale and complexity of institutions’ activities. These new provisions clarify the responsibilities of the management body; strengthen the fit and proper requirements, including that members must be able to commit sufficient time; and strengthen the oversight by the supervisory function, including the implementation of the institution’s risk strategy. They have been further elaborated in EBA guidelines⁹⁰.

b) Effects on short-termism/long-termism

Some of the new regulatory requirements⁹¹ aim specifically at addressing short-termism. For instance, the management body’s responsibilities now clearly include setting, approving and overseeing the implementation of the overall business strategy and the key policies of the institution, by taking into account the institution’s long-term financial interests. The management body is also responsible for the use of appropriate incentives to align risk-taking behaviour with the institution’s long-term interest including by the specific framework for risk takers’ remuneration (see further below).

⁸⁸ See the report published [here](#).

⁸⁹ Chapter 2, Section 2 of Directive 2013/36/EU on arrangements, processes and mechanisms of institutions.

⁹⁰ Revised [EBA Guidelines on internal governance](#) and EBA/ESMA [Guidelines on suitability assessments](#).

⁹¹ See the CRD IV provisions and the EBA guidelines mentioned above.

Moreover, the oversight by the supervisory function has been strengthened, ensuring in particular a higher level of scrutiny regarding the implementation of an appropriate risk strategy.

Members of the management body should possess sufficient knowledge, skills and experience, and those aspects should cater for their ability to take into account long-term considerations that will be included in the business strategy, its policies and the day-to-day management of the institution. For instance, among the skills of members of the management body that institutions should consider when performing the internal suitability assessments is their strategic acumen, i.e. if an individual is capable of developing a realistic vision of future developments and translating this into long-term objectives, for example by applying scenario analysis.

These requirements have to be implemented by institutions and, as part of the supervisory processes⁹², competent authorities should identify the extent to which institutions comply with the applicable EU requirements regarding sound internal governance arrangements. Competent authorities should assess whether or not an institution's internal governance arrangements are adequate for and commensurate with the institution's risk profile, business model, nature, size and complexity. Competent authorities should establish if there are material risks posed by poor internal governance arrangements and their potential effect on the sustainability of the institution.

The improved fit and proper requirements⁹³, the diversity of management bodies and the requirement that members must be able to commit sufficient time should improve the leadership, decision-making and management quality. In particular, independent challenge by the supervisory function should contribute to an orientation towards the longer term, as their remuneration is normally not dependent on the institutions' performance.

Overall, the clarification of the management bodies' responsibilities and the strengthened oversight by the supervisory function of the management body should contribute to strategies that take greater account of the longer time horizon.

3.1.2 Remuneration

The structure of remuneration packages – such as the portion of variable remuneration compared with the fixed remuneration, the applicable deferral periods and the amount of variable remuneration paid in the form of long-term deferred instruments, as well as the potential application of malus and clawbacks⁹⁴ – creates incentives and influences the time horizon of institutions' staff decision-making.

a) Background

If a bonus or income system is linked, directly or indirectly, to the recent or short-term income of the financial institution, or to a recent transaction, without adjustments that take into account the long-term risks or subsequent losses, it is likely that staff will have a bias towards focusing on short-term returns over long-term returns. The financial crisis has exposed such flaws and revealed a link between

⁹² For more details, see the EBA [Guidelines](#) on common procedures and methodologies for the supervisory review and evaluation process (SREP).

⁹³ See Article 91 of the CRD and the EBA/ESMA guidelines referenced above.

⁹⁴ Clawback relates to the recovery by an employer of vested compensation that has already been paid.

some banks' remuneration policies and excessive short-term risk-taking, with reward systems designed to provide incentives for taking undue short-term risks rather than taking a longer term view.

Some of the bad practices highlighted by the financial crisis were connected to short-term bonuses not being aligned with the long-term sustainability of banks' business models, and the pursuit of high-risk strategies that shareholders either encouraged or did not actively discourage, because such strategies could bring high returns on equity in the short term.

In some cases, board members and some employees sought higher salaries that were guaranteed by hitting short-term targets⁹⁵, e.g. with compensation of loan officers and chief executive officers based on current-year loan volume, earnings or stock price. Cash bonuses awarded on the immediate results of a transaction and paid out instantly meant that individuals often paid little or no regard to the overall long-term consequences and future profitability. At the same time, not meeting the short-term objectives did not pose any risk for the staff's bonuses received for previous short-term periods.

The remuneration practices and the bonus culture in the banking sector have been seen as drivers of the banking crisis. Both the Counterparty Risk Management Policy Group and the Financial Stability Forum (FSF) have concluded that remuneration structures in the banking sector encouraged excessive risk-taking in certain parts of the industry. The FSF charged that 'compensation schemes in financial institutions encouraged disproportionate risk taking with insufficient regard to longer term risks'⁹⁶.

Lessons learned from the financial crisis were that the most extreme forms of poor short-termist practices are where bonuses are very large multiples of base salary, so that they drive an individual's behaviour; where bonuses are based on short-term indicators (such as 1 year's profit or revenue) without taking account of risk; and where bonuses are paid in cash and immediately.

Overall, the remuneration practices before the crisis incentivised short-termism, while overlooking long-term actions. As a result, international and EU regulators have taken measures to ensure that the structure of bonuses encourages a better balance between the short and the long term, to apply the principles of the long-term incentives more widely across the organisation and to avoid undue emphasis on short-term delivery at the expense of long-term performance.

b) Effects on short-termism/long-termism

The remuneration requirements introduced in the post-crisis regulatory framework aim to ensure that remuneration policies provide the right incentives and are aligned with the long-term interests of the institutions.

i. General requirements

The CRD and the EBA Guidelines on sound remuneration policies and practices⁹⁷ specify clear principles on the structure of remuneration policies. In particular, remuneration policies should be aligned with the long-term interests, business strategy, objectives and values of the institution. Similarly, the remuneration committee that significant institutions have to establish and which is

⁹⁵ Dignam, A., *Remuneration and riots: rethinking corporate governance reform in the age of entitlement*.

⁹⁶ Financial Stability Forum (2008), *Report of the Financial Stability Forum on enhancing market and institutional resilience*, April.

⁹⁷ EBA [Guidelines on sound remuneration policies and practices](#).

responsible for the preparation of decisions should take into account the long-term interests of shareholders, investors and other stakeholders in the institution, and the public interest.

To set the appropriate incentives for long-term-oriented and prudent risk-taking, the EBA guidelines require that the remuneration policy and practices need to be transparent for staff, regarding the fixed remuneration, the variable remuneration and the award criteria used. The assessment of the performance-based component of remuneration should be based on long-term performance and take into account the current and future risks associated with that performance.

In that regard, the EBA guidelines recall that internal (e.g. profits) and external (e.g. share price) variables come with both advantages and disadvantages that should be balanced carefully by institutions. Internal performance measures are able to generate more involvement of staff members but can create distorted outcomes on a short-term basis. External performance measures are less subject to the risk of manipulation, although, for example, attempts to artificially increase the stock price can still occur. Every criterion used has its risks, limitations and advantages. Institutions need to weigh them carefully when determining the performance and risk criteria and need to use an appropriate mix.

ii. Specific requirements for material risk takers

Stricter requirements apply for categories of staff whose professional activities have a material impact on the risk profile of institutions, including senior management, risk takers, staff engaged in control functions and any employee receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers. This applies especially to the variable component of their remuneration.

First, the assessment of performance for the purpose of calculating and adjusting the variable remuneration should follow certain rules. The assessment should be set in a multi-year framework in order to ensure that the assessment process is based on longer term performance and that the actual payment of performance-based components of remuneration is spread over a period that takes account of the underlying business cycle of the institution and its business risks. In this regard, according to the institution case studies analysed by the EBA, the average multi-year period used in the performance and risk measurement process seems to be around 3-5 years, but some institutions use shorter periods (1-2 years and 2-3 years).

In addition, with regard to performance criteria, risk adjustments are necessary and operating efficiency indicators (e.g. profits, revenues, productivity, costs and volume metrics) or some market criteria (e.g. share price and total shareholder's return), being very short-term and therefore not sufficient to capture all the risks of the identified staff member's activities, require additional risk adjustments.

Second, a substantial portion, and in any event at least 40%⁹⁸, of the variable remuneration component is deferred over a period that is not less than 3-5 years and is correctly aligned with the nature of the business, its risks and the activities of the member of staff in question. Deferral, combined with the possibility of applying a malus, encourages stable consistent profitability, in contrast to the one-off gains that are based on more risky strategies. A deferral schedule is therefore

⁹⁸ In the case of a variable remuneration component of a particularly high amount, at least 60% of the amount should be deferred.

key to ensuring risk alignment effects in a remuneration package, and it allows parts of the remuneration to be adjusted for risk outcomes over time through ex post risk adjustments.

The ratio of deferred variable remuneration to total variable remuneration and the length of the deferral period need to be tailored to the long-term impact of the category of identified staff throughout the business cycle. Remuneration payable under deferral arrangements should not vest faster than on a pro-rata basis. The variable remuneration, including the deferred portion, is paid or vests only if it is sustainable according to the financial situation of the institution as a whole, and is justified on the basis of the performance of the institution, the business unit and the individual concerned.

Without prejudice to the general principles of national contract and labour law, the total variable remuneration should generally be considerably contracted where subdued or negative financial performance of the institution occurs, taking into account both current remuneration and reductions in pay-outs of amounts previously earned, including through malus or clawback arrangements.

Third, the CRD also stipulates that a substantial portion, and in any event at least 50%, of any variable remuneration should consist of shares or equivalent ownership interests, subject to the legal structure of the institution concerned or share-linked instruments or equivalent non-cash instruments, in the case of a non-listed institution. This is especially on the basis that paying bonuses in cash instead of non-cash instruments leads to an emphasis on short-term profits rather than the value of the institution in the long run.

Fourth, the proportion of variable remuneration is limited, with a maximum ratio of variable to fixed remuneration of 100% (or 200% with shareholders' approval, where implemented by the Member State). The amount of fixed remuneration must be sufficiently high to ensure that the reduction of the variable remuneration down to zero would be possible. Staff should not be dependent on the award of variable remuneration, as this might otherwise create incentives for short-term-oriented excessive risk-taking, including the mis-selling of products. While this limits the incentives that could lead to short-term-oriented behaviour, it also makes staff decision-making more objective, as they depend less on bonuses.

Finally, competent authorities should assess the compliance of institutions with the above-mentioned requirements. They should, among other things, review (i) the time horizon of the applicable deferral and retention schedules and how it relates to the business cycle of an institution and (ii) the combination of shares or equivalent ownership interests (or share-linked and equivalent non-cash instruments) that the institution uses, to ensure that it adequately reflects the long-term interests of the institution.

c) Outcome and way forward

Overall, the requirements described above have led to new structures of remuneration with incentives for adopting a longer time horizon, especially for material risk takers (or 'identified staff').

Following the introduction of the bonus cap, the average effective ratio of variable to fixed remuneration for all identified staff has regularly decreased, from 65.5% in 2014 to 57.1% in 2016

(62.2% in 2015⁹⁹). The average ratio of variable to fixed remuneration for all high earners in the EU¹⁰⁰ fell from 123% in 2014 to 118% in 2015, 104% in 2016 and 101% in 2017¹⁰¹. However, in the business area of asset management, the average ratio of variable to fixed remuneration was 402% in 2017, still far exceeding the maximum ratio of 200%. Several Member States allow the application of waivers for staff in this business area, although CRD IV does not explicitly set out this possibility.

In terms of deferral, as mentioned above, the application of deferral arrangements is a precondition for a long-term alignment of remuneration incentives with an institution’s risk profile and for the application of ex post adjustments to variable remuneration. A significant portion of variable remuneration of identified staff is now deferred, as shown in Table 3.

Table 3 – Ratio of deferred variable remuneration to total variable remuneration for identified staff (%)

Business area	2014	2015	2016
Management body supervisory function	58.05	67.56	59.42
Management body management function	66.14	71.36	66.76
Investment banking	67.90	69.48	60.16
Retail banking	44.00	46.75	44.78
Asset management	55.99	55.13	47.51
Corporate functions	51.20	52.09	44.59
Independent control functions	44.32	47.33	40.50
All other	61.52	56.78	53.48

Source: EBA benchmarking report 2016

As mentioned above, mechanisms to defer or clawback bonus payments for material risk takers can be important tools to help discourage excessive risk-taking and short-termism. However, their use is sometimes hampered by some legal difficulties for firms in implementing or applying such tools. Clawback especially is generally subject to stronger procedural and substantive legal safeguards. In jurisdictions where there is no legal tradition of using clawback or similar tools, or because of general labour law considerations, the possibility of using clawback may be more challenging¹⁰².

In addition, on average, 55.55% of the 2016 variable remuneration was paid out in instruments. Institutions tend to award instruments at the minimum level required under the applicable legislation. Only members of the management body and staff in investment banking received in 2016 a bigger portion of remuneration in non-cash instruments.

Overall, this section has highlighted that changes in banking regulation on remuneration since the crisis have been designed specifically to counter undue short-termism. The outcomes of these

⁹⁹ EBA [report](#) on benchmarking remuneration policies 2016.

¹⁰⁰ Staff earning EUR 1 million or more per financial year.

¹⁰¹ EBA [report](#) on high earners 2017.

¹⁰² See FSB reports on the implementation of remuneration standards, for example [here](#). This could be an area for further investigation by the Commission.

changes illustrate that the requirements introduced in response to identified deficiencies have changed the policies and practices of institutions and have contributed to mitigating short-termism within institutions.

However, the supervisory framework for remuneration practices was still, until recently, not sufficiently harmonised; in particular, the application of deferral and pay-out in instruments differs significantly among Member States and among institutions. This is mainly due to differences in the national implementation of CRD IV, which in many cases allows waivers of these provisions when certain criteria are met¹⁰³.

It should be noted that the revised version of the CRD introduces new provisions in this respect. It stipulates that, while all institutions should in general be required to apply all the remuneration principles to all of their identified staff, small institutions and staff with low levels of variable remuneration can be exempted from the principles on deferral and pay-out in instruments, as in those cases the cost of applying the requirements exceeds the prudential benefits. The directive introduces some criteria for identifying those small institutions as well as low levels of variable remuneration to ensure supervisory convergence, while still offering some flexibility for Member States.

Going forward, it should also be noted that credit institutions that provide portfolio management and financial advice should include in their remuneration policies information on how their remuneration policies are consistent with the integration of sustainability risks, and should publish that information on their websites¹⁰⁴.

For an analysis of the remuneration rules for fund managers (the Undertakings for Collective Investment in Transferable Securities Directive, the Alternative Investment Fund Managers Directive, ESMA guidelines), please refer to the ESMA report¹⁰⁵.

3.2 Liquidity requirements – net stable funding ratio

3.2.1 Background

The NSFR was introduced in the December 2010 Basel III agreement, and was revised in 2014 to focus its calibration on the riskier types of funding profile employed by banks, while improving alignment with the liquidity coverage ratio (LCR) and reducing cliff effects. It became a minimum standard in 2018. The NSFR was introduced to mitigate dependency on short-term funding.

Before the financial crisis, banks relied too much on short-term funding raised in wholesale markets to finance their long-term activities, meaning that long-term assets growth was not accompanied by a similar increase in stable funding sources. When short-term funding became unavailable, institutions were either forced to request emergency liquidity assistance from central banks or engage in ‘fire sales’ of assets, with the ultimate consequence of driving a number of them into insolvency.

¹⁰³ The EBA has analysed national implementation and has published the results together with its Opinion on the application of proportionality.

¹⁰⁴ Article 5 of the Regulation on sustainability-related disclosure in the financial sector.

¹⁰⁵ ESMA has also assessed the remuneration of directors in listed companies.

The NSFR standard agreed by the Basel Committee on Banking Supervision (BCBS) has been implemented in the EU in CRR2, with some adjustments, partly recommended by the EBA’s NSFR report, aimed at taking on board EU specificities, and it will apply from June 2021.

3.2.2 Effects on short-termism and long-termism

a) Mitigation of dependency on short-term funding

To mitigate dependency on short-term funding, the NSFR requires banks to ensure that exposures are matched with stable funding sources, thereby aiming to prevent liquidity crises. The NSFR is a piece of regulation that contributes to the mitigation of short-term pressures that capital markets can potentially exert upon banks, as it requires institutions to use more stable sources of funding on an ongoing basis.

b) Effects on long-term finance

On the other hand, it has been argued¹⁰⁶ that the NSFR could contribute to exacerbating short-termism in banks’ lending activities. Relative to the pre-crisis framework, the NSFR could at first sight be seen as creating a disincentive to undertake longer term lending because it requires stable/long-term funding, generally of a higher cost, to support that lending.

It should be recalled that the NSFR assigns banks’ assets into buckets, to determine a total amount of required stable funding (RSF). Banks’ sources of funding are also bucketed to determine a total available stable funding (ASF). A bank must have ASF equal or greater than its RSF over a time horizon of 1 year, to comply with the minimum NSFR of 100%. Loans with remaining maturity over 1 year would be expected to be subject to an RSF factor between 65% and 100%, depending on the type of loan.

It is therefore true that the NSFR makes it generally more expensive for a bank to fund a long-term (understood as over 1 year) loan with stable/long-term funding (generally subject to an ASF factor of between 90% and 100%, depending on the type of liability), rather than with less stable/short-term (i.e. less than 1 year) funding, which is generally subject to an ASF factor of between 0% and 50%, depending on the tenor and type of liability.

However, a higher funding cost is an expected effect of the reform, which seeks to reduce over-reliance on short-term funding for maturity transformation purposes and to cover funding risk. Moreover, the NSFR aims to ensure an appropriate funding structure in a 1-year time horizon and therefore does not differentiate by term for assets or liabilities with maturities of 1 year or greater – for example, it does not make a 15-year loan less attractive than a 10-year loan. Given this, the NSFR still permits a significant degree of maturity transformation.

All in all the EBA report¹⁰⁷ on the NSFR calibration in the EU in December 2015 did not find strong statistical evidence suggesting a detrimental effect of the NSFR on bank lending. Overall, the EBA takes the view that the NSFR is a necessary piece of regulation to mitigate short-termism, while not discouraging long-termism.

¹⁰⁶ For instance Wyman, O. (2016), [Interaction, coherence and overall calibration of post crisis Basel reforms](#).

¹⁰⁷ EBA (2015), [Report](#) on the NSFR calibration.

3.3 Impact of Basel III reforms for infrastructure finance

As highlighted above, this report looks into infrastructure projects because they are long-term driven and can indicate if banks are willing to lend on a long-term horizon, but some caveats have to be kept in mind before drawing conclusions on short-termism (it is difficult to distinguish between the supply and demand drivers, infrastructure projects are not necessarily ‘sustainable’, a bank doing project finance may still exert other kinds of short-term pressures on other corporations (or to the same corporate) and long-term assets can be traded).

3.3.1 Background

The impact of regulatory capital ratios on bank lending has been widely discussed in other places and this section does not aim to reopen this discussion. It focuses on the impact of Basel III reforms for infrastructure finance, not by discussing the proper calibration of risk weights and capital requirements for infrastructure finance, but by mentioning the criticisms that have been directed at recent international and EU reforms and by summarising the findings of recent studies on the topic, especially from the Financial Stability Board (FSB).

Over the last few years the impact of G20, Basel III and CRR reforms on long-term investments and especially on infrastructure projects has been discussed. As a reminder, Basel III reforms include higher capital and liquidity requirements for banks and higher loss absorbency requirements for G-SIBs. The initial Basel III package was agreed in 2010, and the finalised one was agreed in December 2017. The initial phase of Basel III left the underlying credit risk weights for different exposure types unchanged, while increasing the amount and quality of regulatory capital required.

The initial Basel III reforms do not specifically target the provision of infrastructure finance. However, it has been argued that an unintended consequence of Basel III financial regulations has been to make it harder for banks to finance long-term infrastructure projects than before¹⁰⁸.

Those potential detrimental effects could be especially relevant in the context of sustainable finance. It has been argued that Basel III may have unintentionally constrained the ability of banks to provide long-tenor debt financing to capital-intensive renewable power infrastructure projects¹⁰⁹. In its final report, the HLEG raised its concerns over the potentially detrimental impact of prudential requirements on long-term projects, noting that ‘there is consistent feedback from banks that the current capital framework charges some “traditional”, non-complex lending operations and long-term exposures more than is warranted by risk considerations. This is particularly a concern with calibrations for project financing, specialised lending and mortgage lending’¹¹⁰.

¹⁰⁸ Financial Stability Forum, International Monetary Fund and World Bank (2012), *Identifying the effects of regulatory reforms on emerging market and developing economies: a review of potential unintended consequences – report to the G20 Finance Ministers and Central Bank Governors*, prepared by the Financial Stability Board in coordination with staff of the International Monetary Fund and the World Bank; OECD (2013), *The role of banks, equity markets and institutional investors in long-term financing for growth and development*.

¹⁰⁹ Ang, G., Röttgers, D. and Burli, P. (2017), [The empirics of enabling investment and innovation in renewable energy](#), OECD Environment Working Papers, No 123, OECD Publishing, Paris.

¹¹⁰ [HLEG report](#), page 67

When asked if there are existing policies in place that disincentivise the scaling up of sustainable finance activities, institutions also mention¹¹¹ that some sustainable finance asset classes, such as long-term infrastructure projects with extended maturities, attract relatively punitive capital treatment, which may make it challenging for institutions to support some sustainable finance transactions.

3.3.2 Effects on short-termism/long-termism

The claims and concerns over the potentially detrimental effects of Basel III reforms for infrastructure finance, including for sustainable long-term projects, need to be assessed against the actual requirements of the prudential framework – in particular, the claim that exposures with extended maturities are subject to particularly punitive requirements is not supported by the regulatory framework¹¹² – and the findings of recent impact assessments.

As mentioned in section 2.2.2, at the EU level, the impact of the CRR on the access to finance for long-term investments has been assessed in some studies. For instance, the main findings of London Economics Europe in 2016¹¹³ were that there is no clear evidence of a relationship between increases in the capital requirements under the CRR and bank financing of infrastructure through project finance.

At the international level, the FSB has undertaken work on financial regulatory factors affecting the supply of long-term investment finance, including reports to the G20 in 2013¹¹⁴ and 2014¹¹⁵. A key conclusion of those reports was that it remained too early to fully assess the impact of reforms on the provision of long-term finance.

In its latest report on the topic¹¹⁶, the FSB assesses the impact of Basel III (capital and liquidity requirements) and over-the-counter (OTC) reforms¹¹⁷ on infrastructure finance. The focus is on

¹¹¹ *GFMA Sustainable Finance Survey report*, June 2019.

¹¹² Depending on the approach, the prudential rules for calculating capital requirements for credit risk are the following:

- standardised approach – risk weights for exposures do not depend on their maturity;
- foundation IRB approach – in the risk weight function the maturity parameter is fixed at 2.5 years, regardless of the actual maturity;
- advanced IRB approach – in the risk weight function the maturity parameter is capped at 5 years, hence the risk weight of an exposure with 6 years of maturity is the same as for a similar exposure with 20 years of maturity;
- slotting approach for specialised lending under the IRB approach – there are only two sets of risk weights: lower (preferential) for exposure with remaining maturity lower than 2.5 years and higher (normal) for all other exposures.

¹¹³ London Economics Europe (2016), *Impact of the Capital Requirements Regulation (CRR) on the access to finance for business and long-term investments*, November. This study assesses whether or not increased minimum capital requirements affect bank lending, using data on a broad sample of banks in Europe, including for the period since the entry into force of the CRR on 1 January 2014.

¹¹⁴ See [here](#).

¹¹⁵ See [here](#).

¹¹⁶ FSB (2018), *Evaluating the effect of financial reforms on infrastructure finance*.

¹¹⁷ OTC derivatives reforms aim at higher bank capital requirements for derivatives-related exposures, mandatory central clearing of standardised derivatives, and higher margin requirements for non-centrally cleared derivatives.

infrastructure finance provided fully or partly by the financial sector. This part accounts for a relatively small proportion (e.g. around 5-10%) of the global spending on infrastructure investments. The analysis covers both corporate and project debt financing (loans and bonds).

Overall, empirical analysis and other qualitative sources suggest that the effect of G20 financial reforms on infrastructure finance has been of a second order relative to other factors, such as the macro-financial environment. The analysis does not identify a significant effect of the initial Basel III reforms on volumes or prices, but finds that the reforms have contributed to shorter average maturities of infrastructure loans provided by G-SIBs. In addition, bank-provided infrastructure finance does not seem to have been affected disproportionately compared with other types of bank lending. Similarly, it is found that OTC derivatives reforms did not materially affect the provision of infrastructure finance through changes in the availability and cost of hedging.

Entering into more details, the empirical analysis indicates that different Basel III regulations only had a limited effect on the aggregate availability of infrastructure finance. Specifically, Basel III capital standards (i.e. risk-based tier 1 capital and the leverage ratio) are not found to reduce infrastructure finance volumes of banks for which regulation is more binding significantly more than other banks. Likewise, there is no negative differential impact on volumes for those banks that are more constrained by liquidity reforms. This result holds across a wide range of empirical specifications and at different levels of aggregation, i.e. for overall infrastructure finance and for project finance only.

For banks with weaker liquidity profiles, there is some indication that regulation has contributed to reduced average maturities of their infrastructure loans. G-SIBs, which represent the vast majority of top 20 infrastructure finance providers during 2005-2017, have also reduced maturities more than other banks¹¹⁸. This effect is driven by a combination of factors, including regulation, and is reflected in a decrease of loans with the longest maturities. However, a reduction in lending maturity, especially for banks assumed to be most affected by liquidity regulation, is not necessarily unintended, given that one of the objectives of the liquidity reforms was to reduce maturity mismatch.

In addition, the FSB has found no results to suggest that the benefits from enhanced resilience – as estimated at an aggregate level in Basel III ex ante studies – do not apply in the narrower context of infrastructure finance. Indeed, the analysis shows that the top bank providers with the lowest capitalisation during the crisis reduced their infrastructure lending volumes more than other banks.

3.3.3 Going forward, need to implement a revised EU prudential framework adequately calibrated to the particular characteristics and risks of infrastructure finance, in line with EBA recommendations, and to continue assessing the effects of reforms

The Basel III reforms finalised in December 2017 will change the credit risk weights for specific asset classes, including for project finance under the standardised approach. The use of internal ratings-based (IRB) approaches for credit risk is also constrained (e.g. by introducing input floors for loss given default (LGD) estimates and changes to the recognition of eligible collateral), and an ‘output floor’ is

¹¹⁸ For volumes and prices, G-SIBs do not exhibit a different pattern from all other banks.

introduced such that modelled outputs could not diverge too far on aggregate from outcomes under the standardised approach.

The finalisation of Basel III also introduced changes to the credit conversion factors (CCFs) used to convert off-balance-sheet items into credit exposure equivalents¹¹⁹. These changes are due to be implemented in 2022, while jurisdictions have the option of phasing in the output floor over a 5-year period.

The effect of these changes for infrastructure finance assets will depend on, among other things, the financing instrument used and the prudential approach followed for calculating capital requirements. Concerning the standardised approach for project finance, where an issue-specific credit rating is unavailable or cannot be used, the approach has been made more risk sensitive, to reflect the quality of the project and the change in credit risk profile as a project matures from the construction to the operational phase. Second, all of the IRB approaches that were permissible for project finance under Basel II, including advanced IRB and slotting, will remain available. However, some additional constraints, such as LGD input floors under the advanced IRB approach, have been introduced.

The EBA has provided its advice to the Commission regarding the implementation of the final Basel III reforms in the EU¹²⁰. The EBA has considered the fact that the revised CRR framework introduces a new infrastructure-supporting factor. In order to encourage private and public investments in high-quality infrastructure projects that contribute to environmental objectives, CRR2 indeed stipulates that infrastructure projects in the pre-operational and operational phase can benefit from a 25% reduction of the associated own funds requirements, subject to criteria presented in Article 501a.

CRR2 stipulates that the Commission should review the application of this provision in order to assess its impact on the volume of infrastructure investments by institutions; the quality of investments, having regard to the EU's objectives to move towards a low-carbon, climate-resilient and circular economy; and its adequacy from a prudential standpoint. The Commission should also consider whether or not the scope of those provisions should be extended to infrastructure investments by corporates.

The EBA has recommended¹²¹ that, given that the Basel III proposal for specialised lending project finance is a similar mechanism to the CRR2 supporting factor for infrastructure lending, the final Basel III framework for specialised lending should be implemented in the EU. As the risk sensitivity of the IRB approach already implies a differentiation of the weighting of infrastructure lending exposures, no further adjustment is needed.

¹¹⁹ Since the loan finance for infrastructure projects is typically drawn down in stages, part of a bank's total commitment may remain undrawn. The CCFs for undrawn commitments of banks with an original maturity of more than 1 year will be decreased from 50% (for banks adopting the standardised approach to credit risk) and 75% (for banks adopting the slotting and F-IRB approaches) in Basel II to 40% in Basel III. The finalised Basel III also disallowed internal estimation of CCFs for banks adopting the A-IRB approach for non-revolving commitments. In future, these banks will be required to use the prescribed 40% CCF. Internal estimates of CCFs for revolving commitments will continue to be permitted, subject to some additional constraints.

¹²⁰ EBA [report](#), impact study and recommendations.

¹²¹ See the report referenced above.

The European Commission has asked the EBA to provide additional analysis to increase the risk sensitivity for specialised lending, considering the possible criteria for differentiating between different qualities of specialised lending exposures, and reviewing the appropriateness of the input floors provided by the Basel III standards for own-estimated LGD.

This section has highlighted that material negative effects of banking financial reforms on infrastructure finance are therefore not clearly evidenced to date. This conclusion is consistent with the observation from the literature and feedback from market participants that non-regulatory factors, such as the macro-financial environment, government policy and institutional factors, are more important drivers (or impediments). Going forward, the effects of reforms should continue being assessed and the EU legislators will have to implement a revised prudential framework that is adequately calibrated to the particular characteristics and risks of infrastructure finance, taking into account the EBA’s recommendations.

3.4 Accounting

This section looks into the role of accounting rules in potentially incentivising short-termism or disincentivising long-term investments. The focus here is on the effect of accounting rules on banks, whereas ESMA has considered more generally the role of fair value in better investment decision-making¹²².

The HLEG noted in its final report that ‘there is considerable disagreement among interested parties on the appropriate accounting treatment for long-term investments, in particular on whether long-term assets on investors’ balance sheets should be valued based on the currently prevailing (daily) market prices – also known as “mark-to-market” valuation or “fair value” accounting ... The debate is mainly around equity, equity-type and listed credit instruments on the balance sheets of long-term investors, such as non-financial corporations, insurance companies and banks.’¹²³

3.4.1 Background

Based on the EBA analysis of institution case studies, banks mention accounting rules as an important factor in driving their time horizon and overall view them as hampering a longer term orientation in their activities. It is argued that there is an undue volatility imported from the market into the financial statements and that its related impact on long-term investing may become even more critical under the new International Financial Reporting Standards 9 (IFRS 9) standard.

Some of the criticisms expressed by banks (some of which have also been expressed elsewhere¹²⁴) are summarised below:

- The new standard encourages short-termism by requiring expected credit loss (ECL) provisions for some exposures (those in stages 2 and 3 of the impairment model) to be calculated for the full life time instead of a 1-year period, as in the prudential framework for IRB banks. Consequently, for long-term assets, IFRS 9 requires more provisioning and generates more

¹²² See ESMA report (<https://www.esma.europa.eu/>)

¹²³ [HLEG report](#), page 56

¹²⁴ For example European Parliament [report](#) on International Accounting Standards (IAS) evaluation.

capital volatility coming from both (i) the parameters' sensitivity to the macroeconomic conditions and (ii) the hypothetical assumptions used in the scenarios.

- It incentivises financial institutions to provide only short-term financing to weaker corporates, since institutions want to avoid cases of exposures deteriorating down to stages 2 and 3, which would mean recognising lifetime (as opposed to 12-month for stage 1 exposures) ECLs for the respective financial instrument. This is thought to affect especially commercial banks and the financing of SMEs, as medium- and long-term loans, especially for SMEs, are more exposed to the risk associated with the transition to stage 2.
- It distorts the performance, failing to reflect the actual business model regarding long-term investments. For instance, while the track record of realised gains and losses is a key indicator of the performance of these activities, fair value accounting would not allow their faithful representation in the results, and the use of non-IFRS measures to reflect such information is too burdensome.
- The accounting treatment of equity may negatively affect long-term investment due to equity instruments being accounted for at fair value, with changes in the fair value being recognised in profit and loss (unless an irrevocable election is made, on an instrument-by-instrument basis, at initial recognition to recognise changes in fair value in other comprehensive income), regardless of the business model.

3.4.2 Effects on short-termism/long-termism

The above-mentioned concerns over the role of IFRS 9 in potentially supporting short-termism should be balanced against its benefits for financial stability in the longer term. IFRS 9 addresses the 'too little, too late' issue, which prevailed in the global financial crisis, whereas under the previous International Accounting Standards (IAS) 39, the impairment losses for credit risk that were recognised were not sufficient to cover the losses when these occurred. As mentioned in the EBA Guidelines on expected credit losses¹²⁵, the ECL model should result in the earlier recognition of credit losses, and in this respect IFRS 9 is expected to address some prudential concerns and contribute to financial stability.

It should be recalled that ECL accounting models also serve the purpose of attenuating the reliance on short-term considerations. Credit institutions should consider a wide range of information when applying ECL accounting models, such as information about past events, current conditions and forecasts of future economic conditions. Forward-looking information, including macroeconomic factors, is indeed critical for the timely recognition of credit losses.

The forward-looking ECL model is indeed meant not only to reflect the evolution of the real economy, as happened under incurred loss accounting, but to anticipate a significant proportion of the losses, contributing to a smoothing of the business cycle¹²⁶. Although the use of point-in-time estimates for ECLs could generate more volatile outcomes than through-the-cycle estimates, this volatility should not be judged as negative per se.

¹²⁵ EBA [Guidelines](#) on expected credit losses.

¹²⁶ European Systemic Risk Board [report](#) on IFRS 9 expected credit losses (ECL) cyclical behaviour.

The ECL model is also more aligned with existing regulatory practices (for credit institutions using an IRB approach), which require the calculation of ECLs rather than incurred credit losses in order to determine institutions' regulatory capital requirements, notwithstanding other differences between the accounting and regulatory frameworks (such as point-in-time use of estimates).

Some studies¹²⁷ have also argued that the benefits of fair value measurement for all investors outweigh the often cited concerns and that its application is required by investors. Fair value information can be relevant to short-term and long-term investors, as the latter have to monitor the value of their investment assets on an ongoing basis, even when they choose to hold such assets for long periods. The similarity in the information required for fundamental valuation, irrespective of the investment horizon, can also highlight the difficulty in distinguishing long-term from short-term investing for accounting purposes and the inappropriateness of making a 'business model-based' distinction for determining whether or not to apply fair value measurement to financial assets.

Finally, the impact on investor and issuer behaviours, including the impact on lending practices, will probably depend on several additional factors other than IFRS 9, such as market competition and changes related to regulation and the state of the economy. Those factors may be stronger drivers of changes in practices and behaviours than those related to the application of IFRS 9¹²⁸.

3.4.3 Going forward, need to continue assessing the impact of IFRS 9 and monitor its implementation

The impact of the introduction of IFRS 9 on the types and duration of products offered in the market, as well as the impact on long-term investments, are aspects that merit assessment in the longer term by all interested parties. According to the second impact assessment of IFRS 9, conducted by the EBA in 2017, institutions seemed less concerned at that stage of implementation of IFRS 9 about the impact on lending practices, while equity instruments (including long-term ones) were considered to be of limited relevance to banks, based on the data collected from the sample¹²⁹.

However, it should be acknowledged that, besides the possible changes that the new ECL model may introduce in the lending practices (e.g. price, maturity or collateralisation of the products), the new impairment model may have other consequences for banks' behaviours. These are aspects to be considered after the implementation of IFRS 9.

In addition, the European Commission has issued two requests for advice to the European Financial Reporting Advisory Group (EFRAG) to assess the impact of IFRS 9 financial instruments on equity investments and to investigate potential alternatives to fair value accounting for equity and equity-type instruments held for the long term.

Finally, it should be noted that, from a broader financial market perspective, neither the public survey nor the collection of evidence from literature undertaken by ESMA has highlighted that fair value measurement results in distortions of the investment process that trigger undue short-term pressures in financial markets. Fair value is deemed to be a relevant measurement basis for both managers and investors, and there is no evidence yet on the consequences of the implementation of IFRS 9 on long-term investment practices. Moreover, it was highlighted that the selection of investment horizons

¹²⁷ CFA Survey, [Fair value accounting & long-term investing in Europe](#).

¹²⁸ EBA [advice](#) to EFRAG on IFRS 9 endorsement.

¹²⁹ EBA second [impact assessment](#) of IFRS 9.

does not depend fundamentally on corporate reporting and most notably on fair value measurement for equity and equity-like instruments, as provided for in IFRS 9. Therefore, ESMA has not identified any need to amend existing requirements in this area to address concerns about undue short-termism.

Overall, while there are recurrent concerns over the effect of IFRS 9 and fair value on the provision of long-term finance, including from banks to corporates, the role of IFRS 9 in exacerbating short-termism should not be overestimated, given especially its expected benefits for financial stability, but, going forward, it is important to continue assessing its impact and monitor its implementation¹³⁰.

Annex 5 briefly discusses the role of some other pieces of regulations (covered bonds, green bonds, European Secured Notes, non-performing loans, leverage ratio) either in potentially favouring or in hampering long-term bank financing.

¹³⁰ In this regard, the EBA has [published](#) its IFRS 9 roadmap, providing a comprehensive overview of planned monitoring activities on IFRS 9 implementation. The EBA has also launched an IFRS 9 benchmarking exercise with a sample of institutions, aimed at analysing the different modelling practices followed by institutions and how IFRS 9 implementation affects the amount of ECLs in terms of own funds and regulatory ratios.

4. Policy recommendations

The call for advice stipulates that the report should include recommendations building upon the evidence found, assessing if there is a need for policy action and in which specific areas.

The EBA analysis has identified some limited concrete evidence of short-termism, while not necessarily labelling it as ‘undue’. This is at least partly due to methodological constraints, data availability and the inherent difficulty in measuring undue short-termism, especially with regard to short-term pressures on corporates (see introduction). In addition, the report has flagged some areas where time horizons of institutions appear still too limited (see section 2.1.3) and has recalled the role of banks’ short-termism in the financial crisis (see section 3).

On this basis, the EBA therefore recommends that, in addition to keeping a robust regulatory prudential framework (section 4.1), policy action should aim at providing relevant information and incentives for the banks to extend the time horizon in their strategies and governance (section 4.2)¹³¹. Efforts towards enhancing the transparency of long-term risks and opportunities should be pursued by both banks and corporates (section 4.3), while information flows, data access and the role of the banking sector in raising awareness of sustainability challenges and ESG risks should be facilitated and supported (section 4.4).

Such recommendations aim to strengthen the resilience of the banks and promote sound strategies and practices in both short- and longer term horizons and, as a result, be conducive to long-term sustainable finance.

4.1 Policy recommendation 1

4.1.1 Maintain a robust regulatory prudential framework

The EBA recommends that the European Commission and the EU legislators, the European Parliament and the Council continue to have as a key regulatory priority a safe and stable financial system, as the latter is critical to foster an environment that is more conducive to long-termism and to support longer term investment and decision-making. This entails maintaining a robust regulatory framework and keeping a cautious approach to banking prudential regulation, including when pursuing the objective of mitigating short-term pressures on corporates from the financial sector or to promote sustainable finance. In this context, while the potential unintended consequences of financial regulations and regulatory reforms on the supply of sustainable investment financing should be carefully monitored, the EBA will assess whether or not a dedicated prudential treatment of exposures that is related to assets or activities associated substantially with environmental and/or social objectives would be justified.

4.1.2 Rationale

¹³¹ This is also in line with the third main objective of the Action Plan, which is to foster transparency and long-termism in financial and economic activity, under which falls the current call for advice.

As highlighted in section 3, there seems to be little evidence that prudential rules lead to short-termism on the part of institutions (and by extension would facilitate the exercise of short-term pressures on corporates), and there is some evidence that some pieces of regulation can help in mitigating short-termism or incentivising long-termism. Furthermore, it should be recalled that the most important contribution of financial regulation to long-term finance is to promote a safe, sound and resilient financial system. Financial stability is indeed a prerequisite to any type of investment, including investment in activities that contribute to ESG objectives.

On the contrary, as highlighted during the last financial crisis, too weak prudential supervision and requirements are more likely to be associated with the pursuit by institutions of short-term strategies, a culture focused on short-term profits, short-termist funding strategies and insufficient incentives to protect the institution in the long term.

Vulnerable structures are more focused on the shorter term. Although this would require further analysis, the most fragile EU banks, which had to address several critical challenges since 2008, have tended to focus on a rather short time horizon (driven by liquidity constraints, restructuring plans, reduction of non-performing loans (NPLs)) to recover¹³². Obviously, the focus on short-term recovery is necessary, but it de-prioritises the development of longer term strategies and relationships with corporates.

Post-crisis reforms have sought to make banks more resilient and therefore put banks in a better position to provide services in the long run. As highlighted by ex ante and ex post impact assessment studies of the effects of core G20 reforms, net overall benefits can be expected from an enhanced financial system, especially thanks to the reduced likelihood and severity of financial crises. Hence prudential requirements should not be lowered with a view to solving the issue of short-termism; on the contrary, keeping a cautious approach to banking regulation will be a driver of long-termism.

This does not prevent policy-makers and regulatory agencies from continuously monitoring the potential unintended consequences of financial regulations and regulatory reforms on the supply of bank lending and in particular on sustainable investment financing. Accordingly, regular ex ante and ex post impact assessments of reforms are necessary¹³³. In this regard, as mentioned earlier in this report, the EBA believes that, among other things, a continued assessment of IFRS 9 impact and the effect of capital requirements on long-term and infrastructure finance is necessary.

In addition, following Article 501c of the CRR, the EBA will assess whether or not a dedicated prudential treatment of exposures related to assets or activities associated substantially with environmental and/or social objectives would be justified. The EBA will submit a report on its findings to the European Parliament, to the Council and to the Commission by June 2025.

As part of the monitoring of the effects of financial regulations and the assessment of the prudential treatment for assets associated with environmental and/or social objectives, the EBA will consider the fact that using primarily historical data to assess future performances may not be a sufficient indicator, taking into account the likelihood of unprecedented disruptions e.g. caused by climate change. As a result, going forward, the need to enhance a forward-looking perspective for example in calibration

¹³² Some of the reasoning is further elaborated on in Annex 3 (NPE backstop).

¹³³ For example see the EBA [advice](#) on the implementation of the final Basel III framework.

of prudential requirements and modelling approaches will be investigated to ensure that there is no bias towards unsustainable financing.

4.2 Policy recommendation 2

4.2.1 Foster the adoption of longer term perspectives by institutions through more explicit legal provisions on sustainability

The EBA recommends that the European Commission and the EU legislators integrate further sustainability considerations in directives and regulations applicable to the banking sector (e.g. CRD and CRR), in particular those related to the provisions on governance and risk management. These provisions should be extended by the introduction of requirements to implement long-term sustainable business strategies, and the incorporation of environmental, social and governance risks, including climate-related risks, into the requirements on risk management. Such provision would contribute to a deeper understanding of the long-term potential impact of climate change and ESG factors more generally by the financial institutions, which then could indirectly facilitate the financing of sustainable activities and the transition towards a sustainable economy.

4.2.2 Rationale

The report has flagged some areas where time horizons of institutions may appear too restricted, in particular concerning climate-related risks. In order to appropriately deal with the latter, a long-term perspective is necessary on the grounds, among others, that (i) an enhanced risk management framework needs to incorporate a comprehensive set of (long-term) risks, (ii) success in transitioning to a world with manageable levels of climate change is likely to be a determinant of financial stability in the long run¹³⁴, and (iii) although the impacts of climate change are already felt today, major impacts can be expected in periods that are beyond the current planning horizons of financial institutions, especially banks.

With regard to sustainability challenges more generally, a long-term perspective in strategies, governance and risk management of institutions is necessary in order to fully assess what those challenges entail: what risks and opportunities may arise, which companies and sectors are or are not well positioned, which assets may become stranded, and what will be the investment needs in different areas of society. In this regard, there is merit in incentivising institutions to consider further long-term risks, including sustainability risks, as they are typically of a long-term nature and hence might be missed if institutions focus on a shorter horizon.

Increased awareness of the potential impact of climate risk on the financial sector has in particular led to several initiatives by standard-setters, central banks and supervisors. Among others, the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) highlighted the need for comparable and consistent disclosures about the risks and opportunities of climate change, and issued recommendations to this effect in June 2017.

In addition, under the auspices of the Network for Greening the Financial System (NGFS), a group of central banks, supervisors and international organisations agreed in October 2018 that it is within the mandates of central banks and supervisors to ensure that the financial system is resilient to climate-

¹³⁴ NGFS [report](#) 2019.

related risks. The NGFS, of which the EBA is a member, has released a first comprehensive report in April 2019 with a set of recommendations for policy-makers¹³⁵.

At the EU level, as mentioned in the introduction, the EBA has communicated to the EU banking sector some key policy messages and expectations. As laid down in the revised EBA founding regulation, the EBA will also take into account sustainable business models and the integration of ESG factors, when acting within its scope of action and when carrying out its tasks. Furthermore, the revised CRR/CRD framework includes a number of mandates for the EBA in the area of sustainable finance. In particular, under Article 98 of the CRD, the EBA will assess the potential inclusion in the review and evaluation process performed by competent authorities of ESG risks¹³⁶. The EBA will submit a report on its findings to the Commission, the European Parliament and the Council by June 2021. On the basis of the outcome of its report, the EBA may, if appropriate, issue guidelines regarding the uniform inclusion of ESG risks in the supervisory review and evaluation process performed by competent authorities.

The potential inclusion of ESG risks in supervisory processes is expected to foster the adoption of longer term perspectives by institutions. However, the EBA considers that incorporating sustainability more clearly in the level-1 provisions that are applicable to the banking sector proves necessary. In this respect, while the EBA will also consider the time horizon dimension in its upcoming report on ESG risks, some areas where legal requirements could be introduced to broaden the horizon of institutions and to set out expectations for the inclusion of more long-term thinking are outlined below.

a) Strategies

Institutions should be required in Directive 2013/36/EU (the CRD), for example as part of the ‘General principles’ of ‘Arrangements, processes and mechanisms of institutions’ (Chapter 2, Sub-section 1 of Section II), to adopt long-term strategies that account for ESG considerations and climate-related risks, and clearly identify targets, taking into account both current risks and those that can plausibly arise in the future.

While this should not prevent institutions from staying flexible and conducting short-term activities and pursuing short-term goals where relevant, setting such long-term strategies should help institutions to identify the actions required today to mitigate current and future financial risks. A bank could for example assess the need to adjust its business model, not only on the basis of short-term results but also based on a more high-level longer term future scenario and strategy. The provision of green finance or other types of dedicated ESG finance should also be part of the strategy, where appropriate, i.e. depending on strategic business choices.

Acting proactively in incorporating the ESG considerations into business strategies, and forward-looking approaches that aim to build resilient and sustainable business models in long-term time horizons should be understood, if appropriately designed, as tools that mitigate the potential impact

¹³⁵ Ibid.

¹³⁶ The EBA's assessment will comprise at least the following: (i) the development of a uniform definition of ESG risks; (ii) the development of appropriate criteria for the assessment of the impact of ESG risks on the financial stability of institutions in the short, medium and long term, including stress-testing processes and scenario analyses; (iii) the arrangements and strategies to be implemented by the institutions to identify, assess and manage ESG risks; and (iv) the analysis methods and tools to assess the impact of ESG risks on lending and financial intermediation activities of institutions.

of environmental and social risks, and in particular the transition risks and physical risks related to climate change.

The long-term focus of institutions could be demonstrated through, among other things, long-term planning horizons, future-oriented key performance indicators and targets that measure long-term value creation.

b) Governance

Institutions and competent authorities should ensure that organisational governance structures facilitate the implementation of such long-term strategies. Although the current prudential framework (the CRD, EBA guidelines) already provides to some extent a basis for this, governance requirements could be clarified and enhanced further.

For example, governance arrangements of institutions (Chapter 2, Section II, Sub-section 3 of the CRD) could require that the management bodies be granted oversight of the ESG strategies, understand and assess the financial risks from climate change, oversee these risks within firms’ overall business strategies and develop approaches with a sufficiently long-term view of the financial risks and opportunities that can arise beyond standard business-planning horizons.

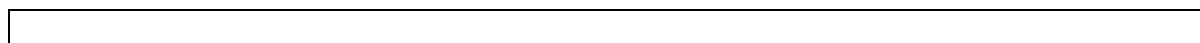
The interplay between cultural drivers, some of which may be conducive to short-termism, and governance frameworks should also be considered by institutions and, in that regard, they could be required to take stock of any internal pressures and conditions they themselves create that either hamper or stimulate a long-term perspective. The types of leadership, decision-making, values and behavioural norms in institutions influence the governance framework and should be appropriately tailored to encourage long-termism at all levels¹³⁷.

c) Risk management

In addition, the incorporation of environmental, social and governance risks, including with regard to climate-related risks, into the requirements on risk management should be considered, for example in the provisions on ‘Technical criteria concerning the organisation and treatment of risks’ (Chapter 2, Section II, Sub-section 2 of the CRD). New tools to enhance risk management frameworks and to help foster long-term-driven governance and inform the long-term strategy should be developed and used by institutions. This includes further work on long-term and sustainability risk assessments – risk management practices on ESG factors are developing but are often at early stages and heterogeneous¹³⁸ – and a more systematic approach for banks in assessing the impact of climate change and the transition to a lower carbon economy.

Internal scenario analyses should especially include a longer term assessment of the institution’s exposure to a range of different climate-related scenarios. The aim of such analyses should be not to build a precise forecast, but to explore the resilience and vulnerabilities of an institution’s business model and inform strategic planning and decision-making.

Box 3 - Climate-related risk scenario analysis



¹³⁷ See FSB [report](#) on governance frameworks to mitigate misconduct risks.

¹³⁸ See, for example, [summary](#) of EBA/EBF workshop on sustainable finance.

Climate related-risks are long-term, non-linear risks that may alter many sectors (through policy changes, changes in consumer preference, development of new technologies, etc.) and have the potential to impact financial markets and individual institutions. These unconventional risks could develop non-linearly over the long term and may not be adequately captured by traditional approaches. In this respect, the use of scenario analysis and the incorporation of a long-term time horizon to assess the potential impact of risks, with a view to informing the business strategy, should be fostered.

Forward-looking assessments of climate-related risks face several challenges, such as the uncertainty of the timing and materialisation of the risks, the long-term horizon of the expected impact, and the choice of the appropriate discount rate and the timing of policy and technological development-related events. Scenario analyses can, however, be used to gauge how certain potential future scenarios – ranging from business-as-usual scenarios to low-carbon (< 2°C change) scenarios, where the transition to a low-carbon economy occurs in an orderly manner, or not – will affect an institution. According to the FSB TCFD, companies, including financial institutions, should disclose the underlying assumptions associated with the climate-related scenarios used.

4.3 Policy recommendation 3

4.3.1 Continue to enhance disclosures of long-term risks and opportunities by both corporations and banks

The EBA recommends that the European Commission and the EU legislators continue setting up a framework for enhanced and, whenever possible, standardised disclosure of long-term risks and opportunities, including ESG-related information, by both corporations and banks. Enhancing the extent to which banks and non-financial companies integrate forward-looking, long-term and ESG factors and risks into their disclosure has the potential to reorient decision-making and lengthen time horizons. Policy actions should be focused on setting principles or requirements that can ensure comparability, relevance and reliability of disclosures, while striking the right balance between EU efforts and the international dimension of financial markets. Specific actions could include amending the Non-Financial Reporting Directive (NFRD) to extend the scope of companies that are required to disclose information; allow for the development of binding measures including – while not limited to – those on climate-related information, by making (some parts of) the Commission’s guidelines on climate-related reporting mandatory; promoting effective and consistent oversight of the application of the requirements; and supporting easier access to relevant data at the EU level.

4.3.2 Rationale

The Action Plan intends to address the short-term market pressures that may make it difficult to lengthen the time horizon in corporate decision-making, notably by increasing transparency. The objective is to enhance non-financial information disclosure, in particular regarding sustainability-related activities, so that investors, whether institutional or retail, can make better informed and more responsible investment decisions.

To that end, Directive 2014/95/EU on the disclosure of non-financial information requires large public-interest entities to disclose material information on key ESG aspects and how risks stemming from them are managed. Furthermore, the Commission published in June 2019 non-binding guidelines on

corporate climate-related information reporting, in order to provide guidance to companies on how to disclose climate-related information, in line with the FSB TCFD recommendations.

The guidelines provide companies with practical recommendations on how to better disclose the impact that their activities are having on the climate, as well as the impact of climate on themselves in return. They are addressed to companies that fall within the scope of the NFRD¹³⁹. However, they may also be useful for other companies that wish to disclose climate-related information. Given the systemic importance of the financial sector in enabling the transition to a low-carbon and climate-resilient economy, the non-binding guidelines provide further specific guidance for banks. These guidelines propose disclosures that are conducive to long-termism, e.g. a description of the company's processes for identifying and assessing climate-related risks over the short, medium and long terms, and a description of the definitions used for 'short, medium and long terms'¹⁴⁰.

In parallel, the regulation 2019/2088 on sustainability-related disclosures in the financial services sector has been published in December 2019¹⁴¹. This regulation aims to strengthen protection for end-investors and improve disclosures to them. The SFDR sets out ESG disclosure requirements for a broad range of financial market participants (including credit institutions providing portfolio management), financial advisers (including credit institutions providing investment advice) and financial products. For example, financial market participants should publish on their websites information on their policies on the integration of sustainability risks into their investment decision-making process and investment advice.

In addition, CRR2 includes in Article 449a the requirement that large institutions that have issued securities admitted to trading on a regulated market of any Member State must disclose information on ESG risks as part of their Pillar 3 reports, including physical risks and transition risks. Following the mandate in Article 434a of CRR2, the EBA is developing implementing technical standards applying all the disclosure requirements in Titles II and III of Part 8 of the CRR2, including the ESG-related disclosure requirements.

The EBA considers that the initiatives cited above are necessary and that increased transparency should be a key priority. Given that, at the current juncture, the relevance of the reported non-financial information remains a challenge and that, for example, sustainability performance metrics are rarely disclosed and lack comparability when they are, policy action should continue to promote comparable, reliable and relevant disclosures of long-term risks and opportunities by both non-financial corporations and banks. Through enhanced transparency of long-term issues, corporate managers and financial institutions should be incentivised not only to focus on short-term financial performance, but also to take account of opportunities and risks stemming from long-term considerations.

¹³⁹ EU rules on non-financial reporting apply to large public-interest companies with more than 500 employees. This covers approximately 6 000 large companies and groups across the EU, including listed companies, banks, insurance companies and other companies designated by national authorities as public-interest entities.

¹⁴⁰ Another example is a description of the principal climate-related risks that the company has identified over the short, medium and long terms throughout the value chain, and any assumptions that have been made when identifying these risks.

¹⁴¹ https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2019.317.01.0001.01.ENG&toc=OJ:L:2019:317:TOC

A significant part of such long-term considerations deals with ESG factors. Good-quality ESG disclosure can help counter undue short-termism by complementing the information provided through traditional financial metrics with information on the management of ESG factors that typically affect a company's future resilience and ability to create value over the long term. To adequately report on sustainability matters, companies need to take a longer term perspective than they normally do for financial reporting¹⁴².

The EBA is aware of the gaps in data and methodologies that may in some cases make it difficult to present quantitative information about long-term and sustainability risks. However, the EBA believes that efforts towards improved qualitative and quantitative disclosures on long-term issues should be pursued by both financial institutions and non-financial corporates, while public authorities should play a facilitating role by supporting easier access to relevant data (see policy recommendation 4).

With regard to institutions, the technical standard implementing the disclosure requirements of CRR2 will include ESG risks and as such will consider the time horizon dimension. The EBA considers that institutions should already pay attention to a number of existing sources that are relevant today and will be used to inform the EBA's work on Pillar 3 standards on ESG-related disclosure, such as the Commission's non-binding guidelines on non-financial reporting and the ongoing work on an EU taxonomy, and that institutions should already consider disclosing some simple metrics¹⁴³.

With regard to non-financial corporations, the EBA recommends that policy-makers continue to move forward on setting up an ambitious framework for enhanced and, whenever possible, standardised disclosure of long-term risks and opportunities. In order for institutions to conduct long-term analysis, there must also be sufficient corporate disclosure to build this on. Enhanced disclosures by corporates would enable banks to better assess the level of preparedness of counterparties to address the challenges posed by ESG factors and make their lending and investment decisions accordingly.

In general, EU lawmakers should:

- a. look into how EU legislation can more efficiently promote comparable, reliable and relevant disclosure;
- b. consider how to strike the right balance between the EU leading the efforts to improve ESG disclosures and acknowledging the international reach of financial markets and the need to cater for disclosure requirements that can be comparable in a global perspective; and
- c. promote effective and consistent oversight of the application of the requirements, e.g. by ensuring that relevant authorities have enforcement powers that allow them to verify the correct application of ESG disclosure requirements and that are homogeneous across the EU.

Specific policy actions could include extending the scope of companies under the NFRD; exploring the possibility of the EU adopting one or more disclosure frameworks to fulfil the NFRD requirements; requiring independent verification of the contents and the consistency of ESG disclosure; and allowing for the development of binding measures that cover (i) key general principles underpinning high-quality information and (ii) a limited set of specific disclosure requirements, and as part of this reflecting on which parts of the Commission's guidelines on climate-related reporting could be made

¹⁴² For example, when disclosing information about climate-related risks, companies should consider longer time horizons than they traditionally use for financial risks.

¹⁴³ <https://eba.europa.eu/eba-pushes-early-action-sustainable-finance>

more binding. In parallel, the Commission could assess the feasibility of promoting the adoption of a single set of international standards for ESG disclosures, in order to achieve more complete standardisation at the international level in the medium term.

4.4 Policy recommendation 4

4.4.1 **Improve information flows and data access and support the role of the banking sector in raising the awareness of corporates, SMEs and retail clients regarding sustainability challenges and ESG risks**

The EBA recommends that the European Commission take steps to create a framework that would be conducive to the integration of the long-term time horizon dimension in relationships between banks and corporates. In particular, the role of the banking sector in raising the awareness of its clients regarding sustainability challenges and ESG risk could be supported by the Commission through actions aimed at facilitating information flows and access to data, for example by the creation of platforms.

4.4.2 **Rationale**

As mentioned earlier in this report, there is growing evidence that sustainability matters are material to a company's financial returns and that long-term ESG issues have the potential to translate into financial risks. It is therefore important that as part of standard banks'/corporates' relationships, but also, in general, banks' relationships with clients, including SMEs and retail clients, discussions on long-term challenges and ESG analysis should be increasingly included.

The EBA has already encouraged institutions to act proactively in incorporating the ESG considerations into their business strategies, risk management, internal controls frameworks and decision-making processes¹⁴⁴. By doing this, banks will enhance their risk management frameworks, identify which clients will continue to be relevant to the changing mix and exposure of their portfolios, and already indirectly raise awareness among their clients about long-term and ESG issues.

However, further measures to facilitate the integration of the long-term time horizon dimension into banks'/corporates' relationships, and to support the role of the banking sector in raising the awareness of its clients regarding sustainability challenges and ESG risks, could be undertaken by the European Commission. The banking sector, which finances around 70% of the EU economy, plays a crucial role in achieving sustainable long-term objectives and in financing the transformation towards a sustainable economy. Although they do not supplant corporates' responsibilities in setting and conducting the business, banks have a role to play in supporting corporates in building their sustainability strategies. Most companies are indeed at different stages in their transition journey towards low-carbon and sustainable activities, and banks'/corporates' relationships can be a key driver in this transition¹⁴⁵.

¹⁴⁴ See the EBA roadmap. In addition, the consultation paper on the EBA Guidelines on loan origination and monitoring also provides that institutions should incorporate climate-related and ESG risks in their credit risk policies and procedures, for the purposes of loan origination and monitoring.

¹⁴⁵ The 'Principles for responsible banking' are in this regard a welcome initiative and will need to be concretely implemented.

A range of non-regulatory actions could be taken by the European Commission, with a view to creating a framework that would be conducive to smooth information flows about and awareness of long-term ESG challenges. This could in particular include the development, at the EU and/or national levels, of structured platforms or networks for exchanges between a range of stakeholders, including banks and corporates. This kind of platform already exists in some EU countries and could usefully be replicated in other Member States and set up at the EU level.

Such dedicated structures should help in sharing expertise (e.g. on the financial relevance of ESG factors in general and for specific sectors), facilitating information flows (e.g. on the financial instruments that could incentivise corporates to shift towards the adoption of sustainable business models) and raising awareness (e.g. on the benefits of long-term thinking/actions and the costs of short-termism). Banks' role in performing neutral risk assessments should not be impeded, but such structures should contribute to a better understanding across sectors of the long-term risks and opportunities that could affect the robustness of corporates' business models.

Similarly, with a view to facilitating information flows across sectors, improving the availability of data that is of relevance for long-term and ESG issues should also be looked into. In this respect, the Commission could consider (i) promoting initiatives from the private sector that would aim to facilitate data access and comparability (e.g. industry associations' benchmarks), (ii) setting up a centralised database at the EU level on environmental data that could be used for financial purposes and (iii) improving the communication channels between the public and private sectors in order to facilitate the dissemination of information, especially on the public regulatory roadmaps and long-term governmental policies, for example related to the implementation of the Paris Agreement.

For instance, improved communication of the potential impact of the intended nationally determined contributions on industries and services in each EU country, and for the EU as a whole, would facilitate long-term risk analysis and disclosure and, more generally, support a better understanding within the financial and corporate sectors of the transition and provide incentives for longer term thinking.

In the same spirit, the NGFS has recommended that the appropriate public authorities share data of relevance to climate risk assessment and whenever possible make them publicly available in a data repository (for example physical asset-level data, physical and transition risk data, and financial assets data).

4.5 Final comments on recommendations

First, as stated earlier in the report, there are some areas where the EBA would see merit in initiatives conducting further research and/or facilitating the investigation of short-termism. This includes further analysis, e.g. from academics on the role of shareholder pressures and quarterly reporting in potentially exerting short-term pressures upon EU banks. In addition, to better assess corporates' views and disentangle supply and demand effects, a survey of EU corporates could be appropriate, e.g. to assess perceptions of the level of supply of long-term lending. Furthermore, there would be merit in considering developing a cross-sectoral framework to structure the assessment and promotion of long-term perspectives, i.e. a set of general principles, definitions and, where appropriate, metrics, in order to facilitate monitoring the market practices of the EU financial sector and help to identify deviations from EU objectives or unwanted trends.

Second, the above recommendations aim to ensure that banks' strategies, operations and relationships with corporates integrate the longer term horizon. Nevertheless, it should be acknowledged that additional, more general, non-bank-specific measures are likely to be necessary to invigorate a long-term perspective in the financial sector, including the banking sector, and the way it interacts with corporates. In this respect, the general economic framework in which banks operate and different sets of incentives for market participants should be considered by the EU legislators, to create an environment that is conducive to long-termism and to increase the rate of adoption of long-term thinking, not only in areas within the EBA's remit.

Indeed, while there are many reasons why banks should already shift towards more long-term thinking and (sustainable) investment¹⁴⁶, institutional and market arrangements¹⁴⁷ may, in the current state of play, not be sufficiently tailored to long-termism. Despite the superior outcome of long-term considerations for individuals, society and the economy as a whole, it can therefore be argued that there is a need to consider and, where necessary, review all the sets of incentives, institutional norms and non-prudential regulations that may still favour short-term time horizons.

Areas that may deserve consideration include developments of sustainability and credit ratings¹⁴⁸ (this should improve the information flow between corporations and banks, drive concrete incentives for banks through pricing and contribute to a more sustainable allocation of capital); corporate governance and the possible need to clarify the rules according to which directors are expected to act in the company's long-term interest¹⁴⁹; fiscal measures such as taxation, which could have a direct effect on companies' costs, demand for funding products and risk/return profiles; credit-enhancing mechanisms to lower the risk and decrease the cost of long-term initiatives; and the education of all market participants about the benefits of long-term thinking and the costs of short-term thinking, etc.

¹⁴⁶ Certain activities becoming stranded assets going forward, and outdated business strategies and investments, among other things, could all dent profits in the long term when taking into account the sustainability aspect. It can therefore be argued that the incorporation of long-term considerations (e.g. ESG) and long-term finance in many cases are aligned with profit maximisation, by financing projects that are value creating and sustainable. Furthermore, the increasing need for long-term financing, increasing political pressure and society's awareness of environmental issues are dynamics that will arguably be factored in by banks in their strategy and lending decisions alongside capital considerations.

¹⁴⁷ Some potential market failures may include mispricing long-term risks or information asymmetry regarding the outcome of sustainable investments.

¹⁴⁸ Following action 6 of the Action Plan, ESMA has assessed current practices in the credit-rating market, analysing the extent to which ESG considerations are taken into account, and has included environmental and sustainability information in its guidelines on disclosure for credit-rating agencies. In addition, the Commission is undertaking a comprehensive study on sustainability ratings and research.

¹⁴⁹ See action 10 of the Action Plan.

Annexes

Annex 1. Summary of sections, data sources and main findings

Sections	Data sources ¹⁵⁰	Main findings
Background considerations for the banking sector		
2.1.1 Literature overview	Academic papers referenced in footnotes 151 to 164 – see Annex 2	Some evidence of short-termism within the financial sector and of short-term pressures on corporates, but the scope of institutions in the papers is rarely limited to EU banks. Contrasting findings on the respective roles of bank-based and stock-based financial systems in supporting short-termism.
2.1.2 Banking business activities: assessment of time horizons	- EBA survey to institutions on short-termism - EBA survey to institutions on the integration of ESG factors - OECD, Green Investment Banks (2016)	Business models and types of banking activities heavily influence time horizons. Banks’ business planning periods and strategy setting mostly follow an average 3- to 5-year time horizon.
2.1.3 Mismatch between traditional banks’ time horizons and long-term ESG challenges	- EBA survey on integration of ESG factors - EU competent authorities’ surveys on climate-related risks	There is a potential fundamental mismatch between banks’ traditional time horizons and long-term sustainability considerations. The process of integrating long-term and sustainability considerations in banks’ strategies, governance and risk management needs to be strengthened.
Potential short-term pressures exerted by banks as providers of financial services		
2.2.1a Banks’ lending to corporates	- Survey on the Access to Finance of Enterprises (SAFE) - ECB statistical database	Considering maturities of loans, no particular short-term pressures observed in the available data in the form of decreasing maturities.
2.2.1b Banks’ holdings of corporates’ securities	- SAFE - ECB statistical warehouse	Considering maturities of corporates’ debt, no particular short-term pressures from banks observed in the capital markets.

¹⁵⁰ Please also refer to footnotes throughout the report.

2.2.1c Incentives provided by banks to corporates to achieve sustainability objectives	<ul style="list-style-type: none"> - Academic papers referenced in footnotes 48 to 54 - Bloomberg NEF data - EBA survey on integration of ESG factors 	Banking practices that result in incentives to focus not on short-term financial optimisation but on sustainability objectives are growing, even though one cannot conclude that short-term pressures are necessarily absent.
2.2.2 Banks' infrastructure finance	<ul style="list-style-type: none"> - London Economics Europe, <i>Impact of the CRR on the access to finance for business and long-term investments</i> (2016) - FSB, <i>Evaluating the effects of regulatory reforms on infrastructure finance</i> (2018) 	<p>EU banks' provision of long-term finance in the form of infrastructure finance remains significant, despite a decrease in the relative share of bank financing and shorter average maturities.</p> <p>This suggests that banks also lend over long-time horizons, but it is not possible to conclude that short-termism is absent.</p>
2.2.3 Sustainable and green finance	<ul style="list-style-type: none"> - UNEP-FI, <i>Greening the banking system: taking stock of G20 green banking market practice</i> (2016) - OECD, <i>Progress update on approaches to mobilising institutional investment for sustainable infrastructure</i> - EBA risk assessment questionnaire 	<p>EU banks are developing products and services for corporates in the sustainable and green finance areas, thereby contributing to corporations' sustainability-related investments and adaptation to long-term challenges.</p> <p>This does not mean that all corporates' needs are necessarily covered.</p>
Potential short-term pressures exerted on banks, as financial corporations		
2.3.1 Banks' funding (liabilities)	<ul style="list-style-type: none"> - EBA supervisory reporting data - EBA report on funding plans - ECB statistical warehouse 	From the data analysed, it is difficult to establish clear short-term pressure on banks' funding in the EU.
2.3.2 Other short-term pressures emanating from capital markets	Reports and academic papers referenced in footnotes 73 to 86	Difficult to draw conclusions about the exercise of short-term pressures on EU banks, but non-bank-specific drivers may play a role (e.g. dividends, frequency of market reporting).
The effect of some pieces of banking regulation with regard to short/long-termism		
3.1 Governance and remuneration	<ul style="list-style-type: none"> - CRD provisions and EBA guidelines (internal governance, fit and proper, SREP, remuneration policies and practices) - EBA report on benchmarking remuneration policies (2016) and report on high earners (2017) 	Post-crisis legal and regulatory requirements have changed the policies and practices of EU banks and positively influence the length of time horizon of institutions' staff decision-making.

	<ul style="list-style-type: none"> - FSB reports on the implementation of remuneration standards 	
3.2 NSFR	<ul style="list-style-type: none"> - Oliver Wyman, <i>Interaction, coherence and overall calibration of post crisis Basel reforms</i> (2016) - EBA report on the NSFR calibration (2015) 	<p>No strong statistical evidence suggesting a detrimental effect of NSFR on bank lending.</p> <p>The NSFR mitigates dependency on short-term funding.</p>
3.3 Impact of Basel III reforms on infrastructure finance	<ul style="list-style-type: none"> - FSB, IMF and WB, <i>Identifying the effects of regulatory reforms</i> (2012) - OECD, <i>The role of banks, equity markets and institutional investors in long-term financing</i> (2013) - OECD, <i>The empirics of enabling investment and innovation in renewable energy</i> (2017) - London Economics Europe, <i>Impact of the CRR on the access to finance for business and long-term investments</i> (2016) - FSB, <i>Evaluating the effect of financial reforms on infrastructure finance</i> (2018) - EBA report on the impact study and recommendations on Basel III implementation (2019) 	<p>It has been argued that Basel III has made it harder for banks to fund long-term infrastructure projects.</p> <p>Material negative effects of Basel III reforms on infrastructure finance are, however, not clearly evidenced to date.</p> <p>Going forward, it is still necessary to continue assessing the effect of reforms, and EU legislators will have to develop an EU prudential framework adequately calibrated to the particular characteristics and risks of infrastructure finance.</p>
3.4 Accounting requirements	<ul style="list-style-type: none"> - European Parliament report on IAS evaluation (2016) - EBA Guidelines on expected credit losses (2017) - European Systemic Risk Board report on IFRS 9 ECL cyclical behaviour (2019) - CFA survey fair value accounting (2013) - EBA advice to EFRAG on IFRS 9 endorsement (2015) - EBA second impact assessment of IFRS 9 (2017) - EBA IFRS 9 roadmap (2019) 	<p>There are recurrent concerns over the effect of IFRS 9 and fair value on the provision of long-term finance, including from banks to corporates.</p> <p>The role of IFRS 9 in exacerbating short-termism should not be overestimated, given especially its expected benefits for financial stability.</p> <p>Going forward, it is necessary to continue assessing impact and monitor implementation.</p>

Annex 2. Literature overview on short-termism

This annex includes and complements section 2.1.1 of the report.

a) Short-termism and capital markets

A range of evidence and arguments has been discussed in the literature on whether or not capital markets support short-termism. Although some empirical results suggest that capital markets reward management decisions that are consistent with long-term value creation¹⁵¹, the literature on short-termism that has been reviewed, emanating from the financial sector or operating within the financial sector, provides some evidence of short-termism.

Concerning short-termism within the financial sector (first dimension), it appears that too often capital market participants allocate capital based on short-term reasons to maximise short-term returns, and that short-term practices have been exacerbated over the recent period. One example already mentioned in the HLEG report is that the average holding period of market-traded assets has become significantly shorter. The average holding of equities in the EU has fallen from about 8 years two decades ago to just 8 months today. It is reported that, on average, equity managers turn over their entire portfolio in 20 months¹⁵². The rise of and the prominent role played by ‘activist’ investors can be seen as evidence of trends that encourage short-term behaviours at the expense of long-term thinking, which then translates into pressure on companies to deliver on short-term performance targets¹⁵³.

Other studies have also reported evidence of corporate firms acting to accommodate short-term pressure from the capital markets (second dimension). Such actions may include paying a larger cash dividend or repurchasing more shares, i.e. they may lead to a change in the firm’s dividend policy, or to reducing spending on long-term value creation¹⁵⁴. A number of surveys have shown that a majority of corporates’ executives (i) felt increasingly pressured to generate short-term results, (ii) would reduce spending in long-term areas (e.g. research and development) in order to meet short-term targets, (iii) would delay new projects to demonstrate strong financial performance even if at the expense of new value creation, and (iv) consider at the same time that being able to use a longer time horizon would positively affect their performance¹⁵⁵. Such results are examples of cases where the focus of financial actors on short-term horizons and strategies may hinder longer term sustainable growth and investment.

Considering the sustainable finance perspective (third dimension), there is a strand of literature providing evidence of the benefits of integrating ESG criteria into investment practices, which results in strengthening the resilience of investors’ portfolios in the long term. The relation between ESG

¹⁵¹ Marginson, D., and Mcaulay, L., [Exploring the debate on short-termism: a theoretical and empirical analysis](#).

¹⁵² HLEG report, 2018.

¹⁵³ [Long-termism versus short termism: time for the pendulum to shift?](#)

¹⁵⁴ Brunzell, T., Liljebloom, E., and Vaihekoski, M., [Short-term expectations in listed firms: the mitigating impact of large owners](#).

¹⁵⁵ See, for example, Barton, D., and Wiseman, M., [Focusing capital on the long term](#), or [CFA Centre For Financial Market integrity \(2006\), Breaking the short-term cycle](#).

criteria and corporate financial performance is found by a high number of researchers¹⁵⁶, while other studies¹⁵⁷ confirm that investor performance and sustainability seem to be positively related, and that this relationship is stronger if the investor is long-term oriented.

However, it should be highlighted that (i) this summary is necessarily far from being exhaustive, and (ii) findings should be interpreted with caution when considering the EU banking perspective, as most of the papers reviewed include in their analysis a variety of financial market participants and jurisdictions, and are rarely dedicated to EU banks only. Furthermore, even though banks participate in capital markets, the EBA has focused its analysis on bank-specific findings.

b) Short-termism and the banking sector

The academic literature has investigated the idea that the nature of financial systems may vary across countries (bank-based systems as opposed to stock market-based systems), and may affect the time horizon of funding and the type of projects and loans funded. Findings are balanced, especially with regard to the dimensions considered in the analysis.

iii. First and second dimensions – short-termism within the financial sector resulting in short-term pressures on corporates

The ‘varieties of capitalism’ approach¹⁵⁸ and the literature on the nature of financial systems draw a distinction between bank-based or insider systems and stock market-based or outsider systems, establishing that the former may be less prone to short-termism. Each of the approaches proceeds from certain hypothesised structural features of financial systems to potential differences in the way that financial functions are performed, with implications for the short-termism discussion.

A distinction is made between coordinated market economies and liberal market economies. The latter are equity-based, with large stock markets, and actors invest more extensively in switchable assets (i.e. assets whose value can be realised if diverted to other purposes). It is argued that stock market systems lead to a focus on short-term market price fluctuations and are more likely to lead to pressures for short-term profits.

Coordinated market economies on the other hand are credit based, with an important role for banks through long-term client relationships and through banks often taking a direct role in corporate decision-making and a longer term view of corporate success. Firms and other actors in coordinated market economies should be more willing to invest in specific and co-specific assets (i.e. assets that cannot be readily turned into another purpose and assets whose returns depend heavily on the active cooperation of others)¹⁵⁹. Access to long-term ‘patient capital’ is complementary to labour market coordination based on the long-term retention of a skilled workforce and to investment in generating long-term returns.

¹⁵⁶ Friede, G., Busch, T., and Bassen, A. (2015), ‘ESG and financial performance: aggregated evidence from more than 2000 empirical studies’, *Journal of Sustainable Finance & Investment*, 5(4).

¹⁵⁷ Gibson Brandon, R., and Krüger, P., 2018, *The sustainability footprint of institutional investors*, working paper, University of Geneva.

¹⁵⁸ See, for example, Hall, P.A., and Soskice, D. (2001), *Varieties of capitalism*, Oxford University Press.

¹⁵⁹ Ibid.

Although in general the bank- versus stock market-based literature points to a more patient long-term approach in the bank-based systems, caution is needed before drawing practical conclusions. The two models (coordinated market economies and liberal market economies) are at the poles of a spectrum, i.e. there are significant and complex variations across countries or jurisdictions, which do not always correspond to simple two-way ideal type divisions.

In addition, the literature points to a variety of factors that may play a role in driving time horizons, such as the institutional complementarity between labour markets and financial markets. It is also worth noting that in those approaches (varieties of capitalism, bank based/stock market based) the decision-making processes and incentives to fund long-term investments are mediated by patterns of corporate governance and the relative significance attached by key players in the governance system to long- and short-term outcomes. In this regard, it should be recalled that ‘fostering sustainable corporate governance’ is also included in action 10 of the Action Plan, alongside ‘attenuating short-termism in capital markets’.

Overall, although the implications in this theoretical approach are that bank-based systems may be less prone to short-termism, this part of the literature suggests that a thorough and empirical analysis of the relative balance of short-termist and long-termist pressures on decision takers requires a holistic approach and needs to be rooted in detailed contextual approaches of a jurisdiction’s overall economic system.

In addition, other approaches that shed a different light on the respective roles of investors and financial systems need to be taken into account (see below).

iv. First and third dimensions – banks’ and sustainable finance perspectives

Regarding the respective roles of investors, some studies¹⁶⁰ distinguish indeed between two kinds of investors and include banks in the first category, characterised by a short-term vision driven by returns on investments in a reduced time, while the second type includes institutional investors that hold a large proportion of capital and have a longer term (investment) view and push for more sustainable decision-making.

Furthermore, other approaches have looked at the role played by the financial structure of a country (the relative role of banks versus stock markets) in determining how polluting a country’s development path is. They suggest that banks may be less suited to financing green projects and reducing industrial pollution than stock markets.

Potential reasons for this may be that banks are to some extent technologically conservative – they may fear that funding new (and possibly cleaner) technologies erodes the value of the collateral that underlies existing loans, which mostly represent old (and less energy-efficient) technologies¹⁶¹ – but also relate to the short-time horizon banks adopt, i.e. the loan maturity, which may make them less interested in whether or not assets will become less valuable in the more distant future (after the loan has been repaid).

¹⁶⁰ Bushee, B.J., (2001), ‘Do institutional investors prefer near-term earnings over long-run value?’, *Contemporary Accounting Research*, 18(2), 207-246.

¹⁶¹ Minetti, R. (2010), ‘Informed finance and technological conservatism’, *Review of Finance*, 15, 633-692.

Empirically, it has been found¹⁶² that growing credit markets are associated with higher levels of CO₂ pollution, while larger stock markets are associated with substantially less CO₂ emissions. When adding gross domestic product per capita, while the economies of richer countries generate more per capita pollution, the effect of credit markets in increasing CO₂ emissions and the reverse impact of stock markets remain.

De Haas and Popov¹⁶³ find evidence that credit markets promote a reallocation of investment towards more polluting sectors and that the ‘cleaning effect’ of stock market development is caused by faster green innovation in the more polluting industries. Their research shows that the evolution of financial structure (stock markets catch up with credit markets only at later stages of development) helps to explain the non-linear relationship between economic development and environmental quality that has been documented previously¹⁶⁴.

From a public policy and sustainable finance perspective, this part of the literature suggests that jurisdictions with a bank-based financial system should consider stimulating the development of stock markets, which could play an important role in fostering innovation that could lead to cleaner production processes within industries. In parallel, measures to ensure that credit markets integrate further ESG criteria when granting finance may be needed.

¹⁶² De Haas, R. and Popov, A., *Financial development and industrial pollution*, EBRD Working Paper No 217.

¹⁶³ Ibid.

¹⁶⁴ Grossman, G.M. and Krueger, A.B., 1995, *Economic growth and the environment*, NBER Working Paper No 4634.

Annex 3. Long-term considerations in banks' relationships with corporates

This annex includes some qualitative considerations on the nature and duration of banks' corporate client relationships, relying on EBA surveys. This relates to dimensions 1 and 2 (banks' and corporates' perspectives).

The nature and duration of banks' corporate client relationships can be considered as a driver of short- or long-termism, as banks engaging in long-term relationships will arguably be less likely to exert short-term pressures on their clients for short-term profit optimisation at the expense of long-term value creation. Banks' relationships with corporates are usually maintained for the minimum of the loan maturity, which can vary significantly (from 1-year short-term financing up to more than 20-year long-term project financing).

However, based on EBA surveys, banks are also generally seeking to build long-term business relationship with corporate clients, beyond the maturity of an individual loan. Banks may favour long-term relationship with corporates, even in the absence of long-term loans/financing needs, for a number of reasons, such as (i) a long-term relation enables a bank to propose an appropriate product range, including cross-selling products or restructuring loans, and (ii) as the administrative cost of opening a new corporate relationship has risen in recent years, e.g. due to anti-money laundering/combatting the financing of terrorism requirements, such cost can better be amortised on the basis of an enduring commercial relationship.

At the same time, the preference for long-term relationships should not be overstated. Relationship time horizons are specifically set depending on the financial sustainability of counterparties, and the ability of customers to service their loans is obviously key. This could differ largely, depending on the business/sectors and the intrinsic risk profile of the counterparty. Appetites for long-term engagement may also evolve, depending on economic cycle and market conditions (see drivers of time horizons in section 2.1.2).

Banks have set up different practices for maintaining long-term relationships as well as for actively promoting the long-term growth and healthiness of corporate clients, such as (i) a strategy to support, monitor and anticipate customers' needs throughout their activity cycles, (ii) long-term loans/financing, (iii) close coordination and ongoing discussions and (iv) strategic steering of customers' business.

Another aspect that could deserve further analysis relates to the criteria used by banks when entering into a new business relationship, especially the balance between short-term and long-term criteria. Based on the institution case studies analysed by the EBA, banks state that, when they perform the assessment of a new business transaction, they consider the long-term growth, strategy and business orientation of corporate clients, especially for medium- and long-term project financing. Long-term prospects of the client (based on industry trends, geographical footprint and competitiveness in the target market) are seen as key inputs of the credit risk assessment, which could drive banks – and indirectly corporates through oriented incentives – towards some form of long-termism. However, due to data limitations, caution with interpretation is needed.

Annex 4. EU banks' green funding practices and opportunities (green bonds and green covered bonds)

Green bonds

In addition to green loans, green bonds represent a major segment of the green EU finance market, and more and more EU banks are active in this segment, both as issuers and as investors. This annex focuses on the issuing side, as a complement to section 2.3.1 and in relation to the sustainable finance perspective.

Green bonds are debt issued to finance or refinance projects, assets or business activities with an environmental benefit. The use of bonds to finance low-carbon and climate-resilient activities is not new. However, since 2007 a bond market specifically labelled 'green' has emerged, based on standards established by industry and associations. Similar to conventional bonds, green bonds could also be issued by any type of issuers and in different structures.

The global green bond market has been growing fast, although issuances remain small in the context of the overall multi-trillion-dollar bond market. With a cumulative issuance totalling EUR 122 billion, Europe is the largest regional market¹⁶⁵¹⁶⁶. European green bond issuances started with the EIB raising funding for climate-related projects in 2007/08. Since then, European issuers have issued green bonds in a variety of debt formats, currencies and tenors. However, most EU green bonds are typically senior unsecured or senior secured notes with a medium-term tenor.

At present, EU banks have issued mainly senior unsecured bonds to fund mortgage lending programmes for energy-efficient homes and commercial properties, but also residential mortgage-backed securities and covered bonds. European financial institutions have issued mostly shorter dated bonds (up to 5 years) than non-financial corporates (5-10 years) and sovereigns (15 years and above)¹⁶⁷.

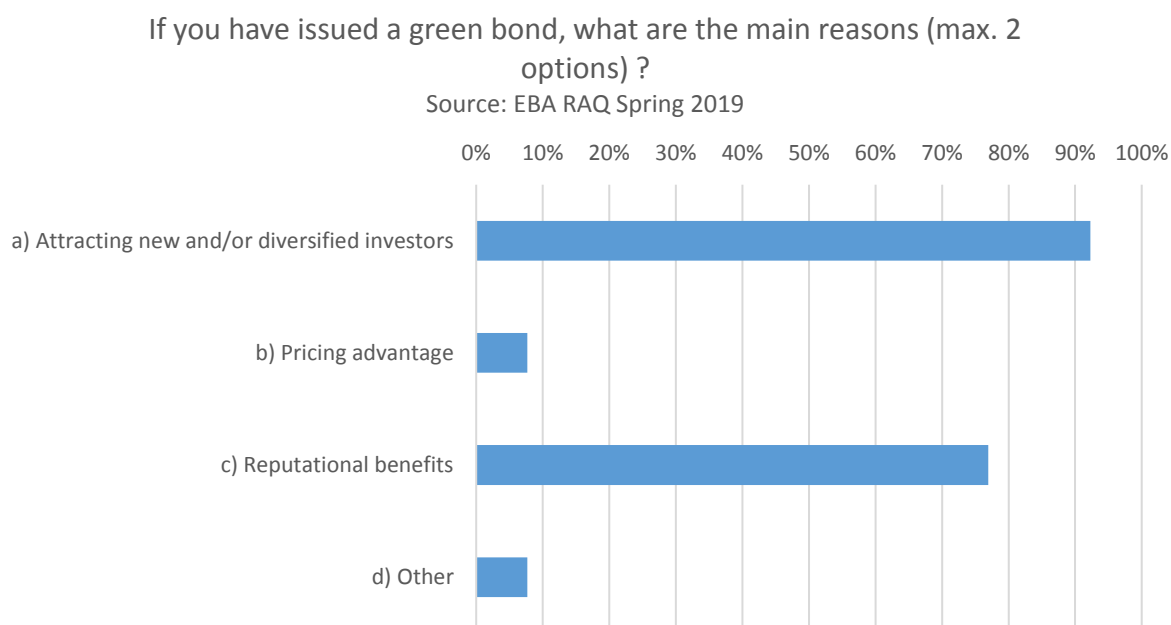
Based on the EBA risk assessment questionnaire, more than 40% of the 62 participants have already issued a green bond (of which more than 80% were in the form of an ordinary green bond and 11% in the form of a green covered bond) or are considering issuing a green bond. By far the main reasons behind the issuance are to attract new and/or diversified investors and reputational benefits, rather than pricing advantage.

¹⁶⁵ Climate Bonds Initiative (2018), [The green bond market in Europe](#).

¹⁶⁶ Although there are significant differences in the green bond market development within Europe mainly due to the differences in the national bond market developments and political support for green bonds from governmental authorities.

¹⁶⁷ Climate Bonds Initiative (2018), [The green bond market in Europe](#).

Figure 9 – Main reasons of EU banks for issuing green bonds



For those that have not issued a green bond, reasons are balanced between the lack of definition of what qualifies as green (34%), lack of investor appetite (31%), the increased costs and absence of pricing advantage (29%) and insufficient transparency and data quality issue (20%).

Green covered bonds

The covered bond market has been an efficient source of long-term funding in Europe, in particular for real estate and public infrastructures. Covered bonds are regulated securities with high credit ratings and lower funding costs than unsecured debt, thanks to a dual recourse structure whereby investors have a claim over a dedicated pool of assets, as well as a general claim over the issuer. Banks are the sole issuers of covered bonds. The advantage for banks issuing covered bonds is that they can access large amounts of funding and at lower prices than unsecured funding. This enables them to provide their clients with lower interest rates for loans that are eligible under a national covered bond framework.

Covered bonds in Europe also benefit from preferential regulatory treatment compared with other asset classes, reflecting the low-risk profile of the instrument. For example, under the Bank Recovery and Resolution Directive, covered bonds are exempt from bail-in. They also benefit from low capital risk weights under the CRR and under Solvency II, which grants them low-risk spread factors. In addition, covered bonds are classified as highly liquid assets in the LCR.

The EU green covered bond market started in 2015, and since then it has been expanding continuously¹⁶⁸. According to S&P Global Ratings¹⁶⁹, although the green covered bond market is relatively small in the broader covered bond market, its growth potential is significant. It is expected

¹⁶⁸ Climate Bonds Initiative and HSBC (2018), [Bonds and climate change – the state of the market](#).

¹⁶⁹ S&P Global Ratings (2018), [What’s behind the rise of green covered bond issuance?](#)

that green covered bond issuances will rise due to a number of factors, including (i) regulators pushing for green finance, (ii) banks focusing increasingly on underwriting the financing of green assets while improving the identification of the green assets in lending portfolios, (iii) initiatives aimed at improving transparency and disclosure around green lending and (iv) the potential expansion of the covered bond model to new asset classes. It is also believed that in the medium term investors' demand for green covered bonds will intensify.

The publication of the Commission Technical Expert Group's report on a proposal for an EU green bond standard is also expected to lead to new market developments (see Annex 5 below).

Annex 5. Effects of other pieces of regulation on banks' long-term finance

A high number of regulations may potentially affect banks' abilities to engage in long-term finance. While necessarily non-exhaustive, this annex briefly discusses the role of some pieces of regulations, other than those discussed in section 3 of the report, either in potentially favouring or in hampering long-term bank financing.

1. Some upcoming or potential regulations may favour banks' long-term finance

The debate around the effect of regulations in mitigating or exacerbating short-termism should include the regulations that exist but also the regulations that do not exist or are not yet in force. This first part, therefore, briefly mentions three areas where regulation could have the potential to facilitate safe long-term investment.

a) The new framework for covered bonds

Covered bonds are debt securities issued by a credit institution and collateralised against a high-quality pool of assets to which investors have a preferential claim in the event of default of the issuer. This is one of the main funding instruments of EU banks and the EU economy, widely used across EU Member States and one of the cornerstones of the Capital Markets Union project. Covered bonds will now benefit from comprehensive legislation that enhances and harmonises covered bonds across the EU.

Based on EBA recommendations, a directive on covered bonds has been agreed by EU lawmakers, which lays down the conditions that these bonds have to respect in order to be recognised under EU law. Amendments to the CRR (conditions for preferential treatment) have also been defined. The new regulatory framework will enter into force 2 years after the publication in the *Official Journal*. Standardisation of covered bonds has the potential to increase the ability of credit institutions to engage in long-term finance.

b) European Secured Notes and EU infrastructure bond

The EBA has responded to a call for advice¹⁷⁰ from the European Commission on European Secured Notes (ESNs), which required the EBA to (i) assess whether or not a dual recourse instrument, similar to covered bonds, may provide a useful funding option to banks engaged in lending to SMEs and infrastructure projects and (ii) determine an appropriate EU framework and regulatory treatment for this new product. This contribution provides input into the European Commission's considerations on the further development of the Capital Markets Union project and can also be considered for the purposes of incentivising prudent long-termism.

SME ESNs, similarly to covered bonds, could be structured as a dual recourse instrument. As a result of the high-risk profile of SME exposures, the EBA has suggested (i) a more restrictive framework, especially with respect to the coverage, the liquidity and the disclosure requirements, and (ii) strict eligibility criteria at both loan and pool level and a minimum level of over-collateralisation of at least 30%. In terms of capital requirement, it is advised that no preferential treatment (i.e. similar to

¹⁷⁰ EBA [report](#) on ESNs.

covered bonds) be granted. However, a differentiated risk weight treatment compared with unsecured notes could be considered, subject to certain considerations.

The EBA does not recommend the creation of an infrastructure ESN. A dual recourse structure for infrastructure loans is not appropriate, given the lack of granularity in a cover pool, the complexity of the loan structures, and the specific and different nature of infrastructure projects, which make it very difficult to create a high-quality dynamic cover pool of infrastructure loans. The EBA has, however, recommended that the European Commission investigate the case for a new distinct asset class for high-quality project finance loans in the form of a standardised EU infrastructure bond. Further EBA work would be needed to specify the features and the applicable framework for this potential new product.

c) An EU green bonds standard

The Technical Expert Group (TEG) on sustainable finance published in June 2019 a report on an EU green bond standard, recommending that the European Commission create a voluntary EU green bond standard. Although not specific to banks, standardisation of EU green bonds has the potential to boost the green bond market, allowing banks to scale up green investment.

The TEG report proposed criteria for issuing green bonds, including by establishing a link to the classification of activities under the taxonomy proposal, in order to determine which climate- and environmentally friendly activities should be eligible. The TEG also recommends that, as part of the mandate under Article 501 of the CRR, the EBA may also assess the possibility of developing a segment of high-quality EU green bonds that would define the conditions to be met in order to possibly benefit from a preferential prudential treatment.

The EBA stands ready to further discuss its role in this area and the scope of the mandate with the European Commission.

2. Discussion of other regulation that may hinder long-term finance

This second part briefly discusses other regulations, which the banks in the case studies analysed by EBA suggested may hinder long-term finance.

a) Leverage ratio

The leverage ratio introduced by the BCBS in 2014, and finalised under Basel III in December 2017, came in response to the excessive leverage of institutions witnessed during the financial crisis. Excessive leverage occurred, despite banks' reported capital positions (on the basis of risk-based capital ratios) being sound. The ensuing pressure on banks to deleverage, and the self-enforcing downward spiral in asset prices that followed, required a measurement in addition to the standard risk-based capital ratios, one that looks at leverage in a transparent and simple manner. As a result, the leverage ratio was introduced, providing a measurement of banks' (tier 1) capital levels relative to their exposures, regardless of risk attributes of the latter.

In accordance with the CRR/CRD IV, the leverage ratio and its underlying components have been reported to competent authorities since 2014 and have been included in the SREP. Since 2015, banks have been required to disclose their leverage ratio. With the full implementation of CRR2, the leverage

ratio 3% minimum will apply as a Pillar 1 measure, with a specific surcharge for global systemically important institutions¹⁷¹.

Generally, the leverage ratio should be viewed in the light of its broad objective of keeping in check banks' leverage levels, which should be achieved by banks upholding lending profiles in line with their overall strategies and capital positions. There is no intention or component within the calculation to dissuade institutions from holding long-term assets. Notably, as stated in section 3.3, Basel III capital standards (i.e. risk-based tier 1 capital and the leverage ratio) are not found to reduce infrastructure finance volumes for banks for which regulation is more binding significantly more than for other banks, even though infrastructure projects are inherently of longer maturity.

Furthermore, several analyses were performed on the impact of the leverage ratio as part of the EBA calibration report on the leverage ratio from August 2016¹⁷². Results generally seem to indicate that the leverage ratio would not affect lending in the longer maturity spectrum specifically, nor may it have a countervailing effect:

- i) On the basis of an empirical study on the risk-based tier 1 ratio and the leverage ratio, it is expected that the combined application of both requirements will reduce the overall cyclicity of capital requirements, because the leverage ratio limits the expansion of exposures on the basis of low risk estimates during booms, while risk-based requirements will curb risk-taking in high-risk environments. In the context of long-term (sustainable) finance, reduced cyclicity of capital requirements and hence lower chances of a capital requirement-driven need for banks to deleverage, there may indeed be less reason for banks to keep the maturities of their assets low.
- ii) The results of a simulations-based analysis, estimating the impact of potential adjustment actions that firms that do not meet the leverage ratio might take, suggest that the potential impact of introducing a 3% leverage requirement would be relatively moderate on the provision of financing by credit institutions. In addition, given its non-risk-weighted nature, it would be reasonable to assume that, in order to comply with the leverage ratio by reducing exposures, banks reduce assets with low risk weights first. In fact, where risk-based capital requirements tend to be higher for higher maturities, the leverage ratio could have a countervailing effect.
- iii) A further study suggests that the positive effects of an increase in capital (and the leverage ratio), by reducing the probability of distress, significantly outweigh the negative effects of the study's observed moderate increase in risk-taking for leverage-constrained banks. Theory suggests, and the study confirmed, that banks constrained by the leverage ratio have an incentive to increase risk, since it is costly to hold more capital. With both a leverage and risk-weighted capital requirement in place, whether or not a bank will increase its risk-taking will

¹⁷¹ The leverage ratio puts more emphasis on balance sheet size than on balance sheets' risk characteristics. One bank in the case studies analysed by the EBA argued that this could lead to banks decreasing the length of their maturities up front, in an effort to shrink their balance sheet size. This would imply a detrimental effect of the introduction of the leverage ratio on banks' lending maturities. However, as demonstrated by the experiences in the financial crisis and as substantiated in work performed by the EBA and the BCBS, it is necessary to have in place a backstop on banks' leverage levels, with the intended effect that certain banks build up additional capital. If there are cases in which a balance sheet reduction may be induced by the leverage ratio, the EBA cannot see a reason why this would affect the long-term maturity segment only or specifically.

¹⁷² [EBA calibration report on the leverage ratio](#).

depend on whether it is constrained by the former or the latter¹⁷³. The leverage ratio should therefore lead to more stable credit institutions overall. This could in turn lead to a lower probability of episodes of deleveraging and hence a more stable provision of finance in the long term.

b) Non-performing exposures backstop

In June 2019, new legislation¹⁷⁴ became effective regarding a prudential backstop for the minimum loss coverage of NPEs on banks' balance sheets. After an initial grace period, a bank must set aside more capital according to a step-up formula for NPEs (as per the definition in the new regulation). If a bank's capital levels fall below this amount, deductions from own funds will be made.

The proposed legislation differentiates between the secured and the unsecured part of a loan. For the unsecured part of the loan, due to the lack of collateral, a stricter calendar is applied, with the unsecured part of the loan being required to meet 100% of the minimum loss coverage within 3 years, while for the secured part of the loan this can be achieved over 7-9 years, depending on the type of collateral. Export credit agency-covered exposures are granted a grace period of 7 years (after this, 100% loss coverage needs to be achieved).

This could arguably lead to unsecured and longer term lending being less favoured by banks, due to the higher credit risk for both of these lending products than for lending with shorter maturities secured by high-quality collateral inherent in the construction of the NPE backstop. However, for banks with a well-functioning credit risk management framework, this should arguably already be the case today¹⁷⁵.

Inherently, all other things being equal, long-term and unsecured investments may be more risky than secured short-term exposures. Nevertheless, the overall risk profile and nature of the investment also needs to be considered long term, and/or unsecured exposures may imply a lower risk of becoming non-performing than a shorter term and/or secured investment of a different nature.

The new legislation is a crucial milestone in the efforts to decrease NPL levels across the EU and avoid significant increases of NPLs in the future. While the EBA acknowledges that the NPE backstop may present some additional incentives for banks to give secured over unsecured loans, and at shorter over longer maturities¹⁷⁶, banks make lending decisions according to profits, strategy and risk considerations, among other things. As an example, in the transition to a greener and more sustainable economy, banks would need to take into account the risk of lending to high CO²-emitting activities, which may become obsolete and unprofitable and thereby turn into NPEs. Moreover, collateral provided by such borrowers arguably runs a higher risk of becoming 'stranded assets', which would in turn force the bank to decrease the value of such collateral.

¹⁷³ For more details, see the [EBA calibration report on the leverage ratio](#).

¹⁷⁴ Regulation (EU) 2019/630 of the European Parliament and of the Council of 17 April 2019, amending Regulation (EU) No 575/2013 as regards minimum loss coverage for non-performing exposures.

¹⁷⁵ Notably, it could be argued that here green-related activities may be disproportionately affected, since they are often long term (thereby also representing a high credit risk).

¹⁷⁶ The design of the backstop does not distinguish between different types of NPEs, treating going and gone concern debtors alike in the backstop calculations. This may be unduly penalising ailing but still viable firms in the context of banks' decisions on lending and maturities.

Overall, the EBA takes the view that this new legislative proposal, which provides for higher provisions for riskier exposures, in line with the common risk-based approach, is necessary and does not exacerbate undue short-termism.

Annex 6. Questionnaire addressed to a restricted sample of institutions (case studies on short-termism)

We use the conventions and definitions of the EBA FINREP Reporting¹⁷⁷. We differentiate between corporate and SME loans. Unless explicitly stated, ‘corporate loans’ do not cover trade finance, corporate real estate or project finance.

Institutions have been invited to respond to this questionnaire on a voluntary and best-effort basis.

The questions below aim at taking into account the banks’ views and practices on the issue of short-termism, both as (i) providers of financial services and as (ii) financial corporations that could themselves be subject to short-term pressures by capital markets or stakeholders.

Questionnaire

A – Time horizon driving business activities

1. What time horizon do you favour and take into account in the following areas and business activities?

Please tick one time horizon per category.

	Less than a year	One to three years	Three to five years	Five to ten years	Ten to fifteen years	Fifteen years or longer	Not applicable
Strategy-setting							
Business model							
Profitability							
Corporate loans ¹⁷⁸ origination							
SME loan origination							
Funding							
Investment							
Trading							
Other – please specify							

¹⁷⁷ <https://eba.europa.eu/risk-analysis-and-data/reporting-frameworks/reporting-framework-2.8>

¹⁷⁸ The FINREP definition of non-financial corporations is ‘corporations and quasi-corporations not engaged in financial intermediation but principally in the production of market goods and non-financial services according to the ECB BSI Regulation’. Corporate loans that are the most short-term by nature, e.g. short-term trade finance, should be disregarded for the purpose of this question. The aim of this question is to get a general picture of the time horizon considered for general lending to corporates.

If deemed appropriate or needed, provide details in relation to your answers.

2. Among the following list of factors that may hamper a longer term orientation in the activities of your institution, please indicate the relevance of each factor (applying a ranking between 1-12, 1 implying the highest relevance):

If specific factors are not relevant, these do not have to be included in the ranking (i.e. the rankings scale does not have to go up all the way to 12).

- Monetary policies
- Non-prudential regulation and/or other public policies and decisions
- Prudential regulation
- Macroeconomic factors
- Profitability and shareholders' interests
- Business objectives and strategy
- Competitive and market pressures
- Client demand
- Reporting requirements
- Remuneration schemes
- Accounting rules
- Other: please specify the factor and its relevance

Please briefly specify in more detail the factors you have identified as most relevant.

3. What is the average multi-year period used by your institution in the performance and risk measurement process followed for the purposes of calculating and adjusting the variable remuneration component?

- 1-2 years
- 2-3 years
- 3-5 years
- 5-7 years
- 7-10 years
- > 10 years.

B - Relations with corporates

4. Please briefly explain what are your policies for maintaining long-term relationships with corporates. Please specify if they differ across sectors and types of corporate clients. Where possible, provide some evidence in relation to your institution's long-term relationships with corporates, e.g. if you have assessed the average time period during which relationships are maintained, taking into account revolving loans. In case no long-term relationships are maintained, please clarify.
5. Do you consider the long-term growth, strategy and business orientation of corporate clients as criteria when evaluating a new business transaction (loan, financing of a project)?

Yes/No/Other (please specify).

6. If you actively promote the long-term growth and soundness of corporate counterparties, what are the main tools you use to do so:
- a. Long-term loans/financing
 - b. Close coordination and discussions with clients
 - c. Strategic steering
 - d. Other: please specify

C - Credit risk assessment policies and practices

7. What is the time horizon taken into account in the credit analysis process of corporates, e.g. what is the time period considered when assessing the (future) financial situation of a potential corporate borrower?

2 answers maximum

- e. less than a year
 - f. one to three years
 - g. three to five years
 - h. five to ten years
 - i. more than ten years
 - j. a time period aligned with the potential duration of a loan
 - k. a time period inferior to the potential duration of a loan
 - l. a time period superior to the potential duration of a loan
8. Some corporates may need/strive to invest in long-term value drivers – including innovation, human capital, environmental adaptation etc. – to meet sustainability goals. While contributing to environmental and social objectives, those investments may entail higher costs (and potentially lower profitability) in the short to medium term. Please briefly describe how your institution considers such long-term oriented investments in the credit assessment process. (e.g. how much weight is placed on long-term benefits versus short-term profitability aspects.)

D - Average loan maturities and infrastructure projects

9. Do you have a specific approach or strategy regarding the maturity of corporate loans in your portfolios?

Yes/No

Please provide details if needed

10. How do you originate most loans with a long economic maturity (at least 10 years):
- On a revolving basis
 - With regular termination options
 - Other.
11. Do you have in place ex ante limits on maturities for specific portfolios or sectors?
Please indicate the limits (if any) per loan category.

- a. Corporate loans
- b. Project finance
- c. Infrastructure loans

12. What is the current average maturity of your corporate loan portfolio?

- < 1 year
- 1-2 years
- 3-5 years
- 5-7 years
- 7-10 years
- > 10 years.

13. What is the current average maturity of your SME loan portfolio

- < 1 year
- 1-2 years
- 3-5 years
- 5-7 years
- 7-10 years
- > 10 years.

14. On a best-effort basis,

i. over the last 5 years, how has the average maturity of corporate loans in your portfolios evolved

- a. increasing slightly (by less than 6 months)
- b. increasing (by 6-24 months)
- c. increasing significantly (by more than 24 months)
- d. no (notable) change
- e. decreasing slightly (by less than 6 months)
- f. decreasing (by 6-24 months)
- g. decreasing significantly (by more than 24 months)

Please briefly explain, where possible and if relevant, if there is a specific corporate loan sector or type of transaction in which the development has been significantly different from the above trend.

ii. in the next 10 years, how do you expect the average maturity of corporate loans to evolve

- a. increasing slightly (by less than 6 months)
- b. increasing (by 6-24 months)
- c. increasing significantly (by more than 24 months)
- d. no (notable) change
- e. decreasing slightly (by less than 6 months)
- f. decreasing (by 6-24 months)
- g. decreasing significantly (by more than 24 months)

Please briefly explain, where possible and if relevant, if there is a specific corporate loan sector or type of transaction in which your expectations are significantly different from the above trend.

15. Among the following list of factors that may have an impact on the maturity of corporate loans, please indicate the relevance of each factor, ranking the factors between 1-12, 1 presenting the highest relevance.

If specific factors are not relevant, these do not have to be included in the ranking (i.e. the rankings scale does not have to go up all the way to 12).

- Monetary policies
- Non-prudential regulation and/or other public policies and decisions
- Prudential regulation (e.g. compliance with the LCR)
- Macroeconomic factors
- Profitability and shareholders' interests
- Business objectives and strategy
- Competitive and market pressures
- Client demand
- Reporting requirements
- Remuneration schemes
- Accounting rules
- Other: please specify the factor and its relevance

Provide details if needed

16. Do you have a specific approach or strategy regarding the lending to infrastructure projects?

Yes/No

Please provide details if needed, describing e.g. if there are certain specific projects especially in terms of sustainability considerations that you assess more favourably, or if you have credit risk related concentration or other limits in relation to lending in infrastructure projects?

17. On a best-effort basis,

- over the last 5 years, how has your exposure towards infrastructure projects evolved
 - a. increasing slightly (+ 0-5%)
 - b. increasing (5%-20%)
 - c. increasing significantly (20% or more)
 - d. no (notable) change
 - e. decreasing slightly (0-5%)
 - f. decreasing (5%-20%)
 - g. decreasing significantly (20% or more)

Please briefly explain if your exposures towards projects that aim at reaching sustainability objectives have evolved differently

- in the next 10 years, how do you expect your exposure towards infrastructure projects to evolve
 - a. increasing slightly (0-5%)

- b. increasing (5-20%)
- c. increasing significantly (20% or more)
- d. no (notable) change
- e. decreasing slightly (0-5%)
- f. decreasing (5-20%)
- g. decreasing significantly (20% or more)

Please briefly explain if you expect different evolution with regard to projects that aim at reaching sustainability objectives.

18. Among the following list of factors that may have an impact on your financing of infrastructure projects, please indicate the relevance of each factor, ranking the factors between 1-12, 1 presenting the highest relevance.

If specific factors are not relevant, these do not have to be included in the ranking (i.e. the rankings scale does not have to go up all the way to 12).

- Monetary policies
- Non-prudential regulation and/or other public policies and decisions
- Prudential regulation
- Macroeconomic factors
- Profitability and shareholders' interests
- Business objectives and strategy
- Competitive and market pressures
- Client demand
- Reporting requirements
- Remuneration schemes
- Accounting rules
- Other: please specify the factor and its relevance

Provide details if needed.

E – Time horizon and investment strategies

19. Please briefly provide qualitative information on the time horizon considered within your investment strategies, especially with regard to your sustainable finance related investment strategy.

20. On a best-effort basis

- what is the average holding period of assets in your trading book?
- over the last 5 years, how has the average holding period of assets in your trading book evolved
 - a. increasing slightly (by 0-5%)
 - b. increasing (by 5-20%)
 - c. increasing significantly (by over 20%)
 - d. no notable evolution
 - e. decreasing slightly (by 0-5%)
 - f. decreasing (by 5-20%)

- g. decreasing significantly (by over 20%)

Please briefly explain the main drivers behind the development (e.g. market pressure, competitive pressure, profitability, etc.)

- in the next 10 years, how do you expect the average holding period of assets in your trading book to evolve
 - a. increasing slightly (by 0-5%)
 - b. increasing (by 5-20%)
 - c. increasing significantly (by over 20%)
 - d. no notable evolution
 - e. decreasing slightly (by 0-5%)
 - f. decreasing (by 5-20%)
 - g. decreasing significantly (by over 20%)

Please briefly explain the main drivers behind these expectations (e.g. market pressure, competitive pressure, profitability, etc.)

21. Among the following list of factors that may have an impact on your investment/divestment decision and the holding period of your trading book assets, please indicate the relevance of each factor, ranking the factors between 1-13, 1 presenting the highest relevance.

- Monetary policies
- Non-prudential regulation and/or other public policies and decisions
- Prudential regulation, including compliance with the LCR
- Macroeconomic growth
- Profitability and shareholders' interests
- Business objectives and strategy
- Competitive and market pressures
- Client demand
- Reporting requirements
- Speculative purposes
- Hedging purposes
- Impact investment
- Other: please specify the factor and its relevance

F - Short-term performance pressures felt by banks on the funding side

22. Do you consider your institution being subject to short-term market pressures (on the funding side)?

Yes/No. Provide details if needed.

23. How relevant is the frequency of disclosure of financial information to the markets to your business activities:

- a. very relevant
- b. quite relevant
- c. quite relevant but not driving the business
- d. somewhat relevant
- e. not relevant

Provide details if needed

24. What are the factors that you consider most relevant regarding the short-term pressures put on your institution by capital markets, especially in relation to your funding needs? Please rank the factors between 1-12, 1 presenting the highest relevance.

- Monetary policies
- Non-prudential regulation and/or other public policies and decisions
- Prudential regulation
- Macroeconomic factors
- Profitability and shareholders' interests
- Business objectives and strategy
- Competitive and market pressures
- Client demand
- Reporting requirements
- Remuneration schemes
- Accounting rules
- Other: please specify the factor and its relevance

G – Regulation

25. Have you identified any provision in prudential or conduct regulation that could create undue short-term pressure in the financial sector? Please kindly specify which particular regulation you refer to, explain the problem and any potential actions you would see to overcome this undue pressure.

H - Open question

26. Do you have any comments or thoughts on the issue of short-termism and the potential undue pressures exercised by banks on corporates or felt by banks through capital markets or stakeholders? Please provide links to any relevant material/publications of your institution.



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