

# ESG Risk Definition Policy

## Table of Contents

|   |    |
|---|----|
| 1. General.....   | 3  |
| 1.1 Personal scope .....                                    | 4  |
| 1.2 Objective scope .....                                   | 4  |
| 1.3 Abbreviations .....                                     | 4  |
| 1.4 Related Documents and References.....                   | 5  |
| 2. Overview of Roles and Responsibilities .....             | 7  |
| 2.1 Business Line Management as First Line of Defense ..... | 7  |
| 2.2 Control Functions as Second Line of Defense .....       | 7  |
| 2.3 Third Line of Defense.....                              | 7  |
| 3. ESG Objectives .....                                     | 8  |
| 3.1 Environmental Objectives .....                          | 8  |
| 3.2 Social Objectives .....                                 | 10 |
| 3.3 Governance Objectives.....                              | 12 |
| 4. ESG Risks .....  | 14 |
| 4.1 Definition of ESG Risks.....                            | 14 |
| 4.2 Conceptual Framework of ESG Risks .....                 | 14 |
| 4.3 Environmental Risk Drivers .....                        | 15 |
| 4.4 Social Risk Drivers.....                                | 16 |
| 4.5 Governance Risk Drivers .....                           | 17 |
| 5. Management of ESG Risks .....                            | 19 |
| 5.1 Identification of ESG risks.....                        | 19 |
| 5.2 Assessment of ESG Risk.....                             | 19 |
| 5.3 Risk Management & ICAAP.....                            | 20 |
| 6. Implementation of ESG Risks in business activities.....  | 21 |
| 6.1 Lending and daily banking activities .....              | 21 |
| 6.2 Investment products.....                                | 21 |
| 6.3 Operational activities of the Group .....               | 21 |
| 6.4 Supplier management of the Group.....                   | 21 |
| 7. Change Log .....   | 22 |

## List of Tables

|                                  |   |
|----------------------------------|---|
| Table 1: Related Documents ..... | 6 |
|----------------------------------|---|

# 1. General

The history of Erste Group began with its founding in 1819 following the years of economic crisis in the wake of the Napoleonic Wars. Its mission was described as follows: *"[Its] purpose is to provide [...] factory workers, peasants, or other industrious and economical minors or persons of full legal age with the means of gradually building up a small amount of capital out of their hard-won earnings, so they can spend it later in life for retirement, dowries, assistance in sickness, old age, or to achieve any praiseworthy objective".* .

The underlying idea of a savings bank – the promotion of a sense of savings and provisions for the future has basically remained unchanged up to the present day. Social responsibility of Erste Group and Erste Bank Hungary are strongly embedded into their foundations.

Today the society is confronted with other, but not less demanding challenges. Environmental pollution, exploitation of natural resources and “climate change” are threatening of its well-being. If the negative trend cannot be stopped society will face severe problems - social as well as economic ones. Two very prominent transformative initiatives have to be mentioned in this relation,

- The Global Risk Report 2020 of the World Economic Forum stated the first five most likely risk events connected to climate change or environmental degradation, driving the attention of many governments and supervisory bodies.
- The European Commission adopted Sustainable Finance Action plan provides an outlook for significant strengthening of prudential rules for climate and environmental risk management and supervision.

Erste Group and Erste Bank Hungary have an inherent responsibility for broader sustainability and ESG risks toward the society. ESG risks identification like potential environmental damages, severe negative social consequences or poor governance have been always an integral part of Erste Group and Erste Bank Hungary's business and risk management framework. It has always been very natural to assess credit, market, liquidity, operational or residual risk in case of any identified major exposure of the client behavior toward the mentioned ESG impacts.

Yet with the rising urgency and accelerating climate change, Erste Group and Erste Bank Hungary is ready to reformulate and manage the ESG risks in a more holistic approach, implement a systematic ESG data collection and integrate ESG risk in a pronounced way into the capital management framework.

As a consequence of strengthened ESG risk framework the clients of Erste Bank Hungary will be supported with adequate banking products and services on their path towards a future using less carbon-based technology and more energy supply from renewable sources, will be guided toward ethically sound business and operational models strengthening their long-term resilience and adequacy of shareholder returns.

## 1.1 Personal scope

Specific business areas involved in the work process to be listed on the cover page.

## 1.2 Objective scope

The policy provides definition of ESG risks of Erste Bank Hungary through positive impact aimed ESG objectives laying down the basis of business alignment with the UN Sustainable Development Goals (SDGs), and definition of ESG Risks, which are addressing the negative impacts and to be identified, assessed and mitigated through policies and procedures.

The definition of ESG risks laid down in this policy address all three impacted layers of the, eg. the business and operational activities of the Group risks of single clients, risk of the suppliers of the Erste Bank Hungary and ultimately also the risk of the Erste Bank Hungary as institution.

## 1.3 Abbreviations

| Abbreviation                | Text  | Comment  |
|-----------------------------|---|--|
| CO <sub>2e</sub> -emissions | Carbondioxyde equivalent emissions                              | Carbon-Dioxide (CO <sub>2</sub> ) is known as one of the main drivers for increasing the average temperature on earth, but there are other green-house-gas emissions which for simplicity reasons are converted to the CO <sub>2</sub> equivalent levels.          |
| cr360                       | Credit360 Ltd., Compass House Vision Park, Cambridge cb249bz UK | Provider of Erste Group's sustainability data software.  |
| GSO                         | Group Sustainability Office                                     | B-1 under the CEO of EGB   |
| SCMS                        | Supply Chain Management System                                  | The management of upstream and downstream value-added flows of materials, final goods, and related information among suppliers, company, resellers, and final consumers.   |
| UNEP FI                     | United Nations Environment Programme Financial Initiative       | United Nations Environment Programme Finance Initiative (UNEP FI) is a partnership between UNEP and the global financial sector to mobilize private sector finance for sustainable development.<br><a href="https://www.unepfi.org/">(https://www.unepfi.org/)</a> |
| PCAF                        | Project for Carbon Accounting Financials                        | An industry-led partnership to facilitate transparency and accountability of the financial industry to the Paris Agreement ( <a href="https://carbonaccountingfinancials.com/">https://carbonaccountingfinancials.com/</a> )                                       |
| SBT                         | Science Based Targets   | The SBTi is a partnership between CDP, the United Nations Global Compact (UNGC), World Resources Institute (WRI) and the World Wide Fund for Nature  |

|  |  |   |
|--|--|---|
|  |  | (WWF) to help companies set ambitious emission reduction targets. ( <a href="https://sciencebasedtargets.org/">https://sciencebasedtargets.org/</a> ) |
|--|--|---|

## 1.4 Related Documents and References

| Ref | Document (name/title)   | Link or Detail  |
|-----|---|---|
| 1   | Our Common Future   | Report of the World Commission on Environment and Development (UN Brundtland Commission in 1987)<br><br><a href="http://www.un-documents.net/our-common-future.pdf">http://www.un-documents.net/our-common-future.pdf</a><br>Chapter 2: Towards Sustainable Development - Section IV<br>Conclusion.   |
| 2   | Paris Agreement COP21   | Paris Climate Conference (COP21) in December 2015 195 countries adopted the first-ever universal, legally binding global climate deal to limit increase of global warming to 1.5°C<br><br><a href="https://unfccc.int/process-and-meetings/the-paris-agreement/what-is-the-paris-agreement">https://unfccc.int/process-and-meetings/the-paris-agreement/what-is-the-paris-agreement</a>                     |
| 3   | Communication from the Commission on the Green Deal, COM(2019) 640 final  | <a href="https://ec.europa.eu/info/publications/communication-european-green-deal_en">https://ec.europa.eu/info/publications/communication-european-green-deal_en</a>   |
| 4   | Code of Conduct of Erste Group  | <a href="https://intranet.ersteopen.net/Portal.Node/strict/groups/About_us/SF_IDENTITAET/999_Code_of_Conduct/Code_of_Conduct.en.html">https://intranet.ersteopen.net/Portal.Node/strict/groups/About_us/SF_IDENTITAET/999_Code_of_Conduct/Code_of_Conduct.en.html</a>   |
| 5   | Ethical and Environmental Code of Conduct for Suppliers of Goods and Services   | <a href="https://cdn0.erstegroup.com/content/dam/at/eh/www_erstegroup.com/de/%C3%9Cber%20uns/Erste%20Group%20Procurement/termsandconditions-guidlines/CoC%20for%20Suppliers_EN_V1.0.pdf?forceDownload=1">https://cdn0.erstegroup.com/content/dam/at/eh/www_erstegroup.com/de/%C3%9Cber%20uns/Erste%20Group%20Procurement/termsandconditions-guidlines/CoC%20for%20Suppliers_EN_V1.0.pdf?forceDownload=1</a> |
| 6   | Discussion Paper on management and supervision of ESG risks for credit institutions and investment firms (EBA/DP/2020/03) | <a href="https://www.eba.europa.eu/calendar/discussion-paper-management-and-supervision-esg-risks-credit-institutions-and-investment">https://www.eba.europa.eu/calendar/discussion-paper-management-and-supervision-esg-risks-credit-institutions-and-investment</a>   |

|   |  |   |
|---|--|---|
| 7 | Global Risk Report 2020                                | <a href="https://www.weforum.org/reports/the-global-risks-report-2020">https://www.weforum.org/reports/the-global-risks-report-2020</a>   |
| 8 | Commission action plan on financing sustainable growth | <a href="https://ec.europa.eu/info/publications/sustainable-finance-renewed-strategy_en#action-plan">https://ec.europa.eu/info/publications/sustainable-finance-renewed-strategy_en#action-plan</a> |

Table 1: Related Documents

## **2. Overview of Roles and Responsibilities**

ESG risks are by nature materializing through an ultimate financial impact on companies, consumers or underlying assets, either because of necessary investments and associated capital expenditures, damages by extreme weather or through changing consumer behavior toward the higher added value goods.

These changes consequently translate to impacts on existing risk categories, mostly as impacts into credit risk with higher defaults due to incremental stress on financials, or into market and liquidity risk driven by changing sentiment of certain commodities and labels, or eventually into operational risk by reputational events or liabilities of conduct.

The management of ESG risks follows the well-established roles and responsibilities of the first, second and third line of defense in all impacted risk categories.

### **2.1 Business Line Management as First Line of Defense**

Similarly, to the case of other risk types, the Business Line Management (BLM), as First Line of Defense (1st LoD) is responsible for managing ESG risks in the day-to-day operation in the area of their responsibility within the defined risk appetite.

### **2.2 Control Functions as Second Line of Defense**

Control functions are the independent risk management functions which develop, implement and in certain cases operate risk management framework. These risk management functions complement the business line management's risk management activities through its risk steering and reporting function.

### **2.3 Third Line of Defense**

Verification functions are the auditing functions ensuring an independent assessment over the framework as well as functionality of the implementation.






### 3. ESG Objectives

Erste Bank Hungary adopting the standards if Erste Group put forward a set of most impacting environmental, social and governance objectives. Through these objectives the Erste Bank Hungary is striving for positive impact in its sustainable finance activities and simultaneously strengthening the mitigation efforts of negative impacts of relevant ESG Risk Drivers (see further).





The ESG objectives of Erste Bank Hungary are strongly aligned with the objectives of EU Green Deal as well as with the relevant 17 Sustainable Development Goals set by United Nations General Assembly.





#### 3.1 Environmental Objectives

Our 8 environmental objectives are addressing the urgency to prevent climate change, the necessity to prevent further environmental degradation.

| Objective  | Description and reason   | UN SDGs  |
|--|--|--|
| <b>Clean energy &amp; energy security</b>        | <p>Production and use of energy across economic sectors account for more than 75% of the EU's greenhouse gas emissions. By 2050 at least 60% of primary energy sourcing has come from low carbon technologies.</p> <p>Future power sector shall be clean, relying largely on renewable sources, or decarbonized fuels, at the same time, the energy supply needs to be secure and affordable and therefore European energy market needs strong integration, interconnectedness and digitalization.</p>   | <br>   |
| <b>Resource &amp; energy efficient buildings</b> | <p>The construction, use and renovation require significant energy and mineral resources (e.g. sand, gravel, cement). Buildings account for 40% of energy consumption, while majority of building stock remains obsolete, the annual renovation rate is between 0.4 to 1.2% on EU level.</p> <p>Renovations, performance certification, efficient thermal characteristics, smart meters and appliances on heating, cooling, lighting, hot water and other load would significantly reduce energy consumption, and clean energy sourcing reduces the GHG emissions.</p> |   |
| <b>Smart mobility and transportation</b>         | <p>Transport accounts for a quarter of the EU's greenhouse gas emissions, and still growing. By 2050 transport emissions need to reduce by 90%.</p> <p>75% of inland freight carried today by road should shift onto rail and inland waterways. This will require increased capacities of railways and inland waterways. New sustainable mobility services emerge that can reduce congestion and pollution in urban areas. Ramp-up</p>   | <br> |











|  |   |   |
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|  | <p>production of sustainable alternative transport fuels and recharging / refueling stations for zero- and low-emission vehicles.</p>   |   |
| <p><b>Resource depletion &amp; waste management</b></p>                          | <p>From 1970 to 2017, global extraction of materials tripled, while 50% of total greenhouse gas emissions and 90% of biodiversity loss and water stress come from resource extraction and processing of materials, fuels and food.</p> <p>Energy-intensive industries, such as steel, chemicals and cement, are indispensable, but will need to transform toward decarbonized technologies.</p> <p>Resource-intensive sectors such as textiles, construction, electronics and plastics will need to adopt biodegradable and bio-added plastics, limit the use of single use plastics, and microplastics with special impact area of packaging.</p> <p>Circular economy is based on 'sustainable products' with designed reduction and reusing materials before recycling, and offering to end users a choice of reusable, durable and repairable products. Boost the market of secondary raw materials with mandatory recycled content (for instance for packaging, vehicles, construction materials and batteries). To simplify waste management for citizens and ensure cleaner secondary materials for businesses. Ensure a safe, circular and sustainable battery value chain, including to supply the growing market of electric vehicles.</p> |   |
| <p><b>Pollution prevention, preservation of water and maritime resources</b></p> | <p>The natural functions of ground and surface water must be restored. This is essential to preserve and restore biodiversity in lakes, rivers, wetlands and estuaries. Citizens and environment need better protection against pollution of large industrial plants, better prevention of industrial accidents, pollution from urban runoff and from particularly harmful micro plastics and hazardous chemicals, including pharmaceuticals.</p>   |    |
| <p><b>Protective land use, forestry</b></p>                                      | <p>Food production results in air, water and soil pollution, contributes to the loss of biodiversity and climate change, and consumes excessive amounts of natural resources, while an important part of food is wasted. At the same time, low quality diets contribute to obesity and diseases such as cancer.</p> <p>Shifting the focus from performance toward eco-schemes as precision agriculture, organic farming, agro-ecology, agro-forestry and stricter animal welfare standards including managing and storing carbon in the soil, and improved nutrient management to improve water quality and reduce GHG emissions. Ambition to reduce significantly the use of chemical pesticides, fertilizers and antibiotics. Organic farming will lead to innovative ways to protect</p>   |    |


|                                   |  |  |
|-----------------------------------|--|--|
|                                   | <p>harvests from pests and diseases and improve the sustainability of the food system. Food production will need to adopt in verticals toward eco-friendly packaging, local storage and distribution.</p> <p>Forested area needs to improve, both in quality and quantity. Sustainable re- and afforestation and the restoration of degraded forests can increase absorption of CO2 while improving the resilience of forests and promoting biodiversity and circular bio-economy.</p> |  |
| <b>Protection of biodiversity</b> | <p>Erosion of biodiversity is caused primarily by changes in how land and sea are used, direct exploitation of natural resources, and with climate change as the third most important driver of biodiversity loss.</p> <p>Damaged ecosystems need restoration to good ecological status, including carbon-rich ecosystems, also attention to green cities and increase biodiversity in urban spaces. Enforcement of protection and restoration areas covered by the Natura 2000.</p>   | <br>     |
| <b>Animal welfare</b>             | <p>Fundamental Treaties of the European Union recognize animals as sentimental beings and encores animal welfare requirements into the EU legislation.</p> <p>Animal welfare shall be promoted in agriculture, fisheries, transport, internal market, research and technological development respecting the rights of the animals Freedom from hunger and thirst, discomfort, pain, injury and disease, fear and distress and rights to express of normal behavior.</p>                | <br> |

### 3.2 Social Objectives

Our 7 social objectives are addressing positive business ethical values together with the respect for human rights to promote well-being of our counterparts, societies and communities. Our aim is to address issues of inequality, inclusiveness, labor relations and fair treatment of customers. Through our objectives we aim to invest into human capital and communities.






| Objective           | Description and reason  | UN SDGs   |
|---------------------|---|---|
| <b>Human rights</b> | <p>Many regions or sectors are prone to abuse of basic human rights, repressions, forced or bonded work.</p> <p>Our actions shall never undermine human rights which we ensure not just within our company but also within in all entities along the supply chain. We comply with all recognized labor standards,</p> |  |

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|  | believe in the right to life and liberty, the right to work and education, freedom of opinion and expression without discrimination.  |   |
| <b>Healthcare, education and job safety</b>                          | <p>Many companies or sectors are exposed to use of hazardous materials, machinery, pollutants, ergonomic or mental damages like extreme stress situations. Many of the incident and injuries can be prevented by proper training and safety measures.</p> <p>We are committed to protect our employees' health and safety and have a care about the workforce of our customers as well as suppliers. Our employee's mental and physical health is supported by a variety of measures offered by our health centers such as preventative medical examinations and contact to mental health experts. We are committed to develop our employees' professional and interpersonal skills to ensure that they are well prepared to perform professionally and in a socially responsible manner.</p> | <br>  |
| <b>Diversity and equal opportunity</b>                               | We believe in diversity and equal opportunities among the workforce and strive for an increase in women in leadership. Our financial products are offered to everyone without discrimination. We can combat inequality through our daily business by benefitting financially or socially disadvantaged groups of the population.  | <br> |
| <b>Employee attraction, relations and retention, employee rights</b> | It is important to offer fair and balanced working conditions to all employees. That means a clear communication and responsible way of managing restructurings, but as well as career management and employability opportunities. Trade union rights and the freedom of assembly shall be guaranteed to all employees.   |    |
| <b>Customer engagement &amp; financial literacy</b>                  | Company shall strive to reflect the customer needs, complains and suggestions in the products and services. Product and services shall be offered without any discrimination by availability or product/service conditions. Whenever financial products are in question, financial literacy shall be promoted as key factor in creating understanding, equal opportunities, economic prosperity and social inclusion.   |    |
| <b>Product integrity safety and liability</b>                        | Products shall meet or exceed our customers' expectations for performance, quality and safety, there shall be remediation process for quality issues, proper handling of complaints and reporting on the problem handling process. The products shall be always complemented by proper information and shall be not exceed the possible understanding of the customers on the product purpose and risks associated.   |    |

|   |  |   |
|---|--|---|
| <b>Advertising &amp; marketing ethics</b> | The company shall act responsible manner when creating marketing campaigns. By maintain ethics, honesty, simplicity and accessibility in advertising leads to create a stronger, trust-based relationship with customers. Marketing campaigns shall be based on respect and do not include images or messages which are offensive or libelous. Furthermore, our marketing materials are clear, balanced, trustworthy and not misleading. |  |
|---|--|---|

### 3.3 Governance Objectives

Our 8 governance objectives are promoting important set of values for rule of law and practices as responsible corporate citizen.

| <b>Objective</b>                           | <b>Description and reason</b>  | <b>UN SDGs</b>  |
|--|--|---|
| <b>Management and ownership structure</b>  | Ownership structure and effective balance between shareholders, management, employees and creditors. Transparent ownership structure with visibility of the controlling shareholders and proper representation of the shareholders rights on the company management.   |    |
| <b>Corporate governance procedures</b>     | The management board manages the company taking into account the interest of shareholders and the employees as well as public interests. Decisions by the board are taken in compliance with the articles of association and its internal rules as well as the Statement of Purpose. Taking into consideration the size and complexity a proper audit and internal control system to be in place. Independence of board members in audit, remuneration, risk management is critical. |  |
| <b>Executive and employee compensation</b> | Transparent remuneration policy and principles. Proper balance between short term motivation and long-term responsibility. Employee and executive remuneration in the benchmark of industry standard.  |  |
| <b>Supply chain standards</b>              | Supply chain standards, and supply chain code of conduct representing environmental, social and governance objectives aligned with the company values. Due diligence process of supplier screening.  |  |
| <b>Anti-competitive practices</b>          | Company shall not create exposure by anti-competitive practices in marketing, products, services, and shared platforms. Any action of the company in the direction of misusing market dominance toward customers, competitors and third-party suppliers.   |  |

|  |  |   |
|--|--|---|
| <p><b>Bribery, corruption &amp; ethics</b></p>   | <p>Corporate corruption can have devastating economic consequences for individuals, organizations, and national and international economies. Institution shall maintain strict anti-corruption and bribery policies, prevent the payment and acceptance of bribes or facilitation payments. Institution shall have and encourage all employees to disclose any issues of concern for which we offer a whistle-blowing program.</p> |  |
| <p><b>Political lobbying &amp; donations</b></p> | <p>Political lobbying and influences are creating acting against commitments of fair and competitive market conditions. Companies shall disclose information on their preferences, donations or any other forms of privilege provided to politically exposed persons, associations or communities.</p>   |  |
| <p><b>Tax &amp; Financial transparency</b></p>   | <p>Institution shall provide fair, accurate and relevant information on their financial wellbeing, sources of revenues and costs, liquidity and liability structure. Transparency on the financial information is an essential precondition of trust and reliability. Institution shall provide information on the principles of taxation and material transfer pricing policies.</p>  |  |

## 4. ESG Risks

ESG factors as environmental, social or governance characteristics may have a positive or negative impact on the financial performance or solvency of an entity, sovereign or individual. For the purpose of risk definition this policy focus on the negative impacts outlined as ESG risk drivers and risk events.

### 4.1 Definition of ESG Risks

ESG risks arise as negative financial impact from the materialization of negative environmental, social or governance events.

#### *ESG risk types*

*Environmental risks* are those posed by the exposure to climate or environmental degradation related risk events. Environmental risks usually materialize through *physical risk* or damages (like impact of extreme weather events), or through *transitional risk* creating additional costs and capital expenditure need (by legislation, technology standards, or market conformity and customer preferences), or in some cases damages through *liabilities* (for negative impacts by products, policies or pollution events). Physical risks can demonstrate through events of *acute physical risks* (most prominently weather-related events or *chronic physical risks* (arise from longer-term changes in the climate, such as reduced water availability, biodiversity loss and changes in land and soil productivity).

*Social risks* are mostly those which materialize due to poor standards of respecting elementary rights, inclusiveness, or ineffective labor relations and unfair-, untransparent or malleus customer practices. Social risks materialize mostly through damages in reputation, ineffective or even disrupting operations or loss of critical labor force, and finally through financial claims and *liabilities* due to improper practices.

*Governance risks* are prominently those related to poor or untransparent company governance measures, missing or weak code of conduct including lack of substantiated polities on anti-money laundering, bribes and corruption, or tax citizenship. Governance risk can arise also from governance events from poor management of critical supply chain. Materializing governance risks can significantly damage faith and trust of customers and investors, and potentially leading to loss of revenue, higher funding costs or penalties and such affecting its ability to conduct business over the longer-term.

### 4.2 Conceptual Framework of ESG Risks

#### *Application of ESG Risks*

Given the nature of business and operational activities of Erste Bank Hungary, the ESG Risks shall be considered on all three layers, eg. its client, its suppliers, and last but not least also on the level of Erste Bank Hungary as institution.

#### *Risk Drivers and Risk Events*

In our framework we developed a set of *ESG Risk Drivers* to identify the high level negative ESG impact areas and we defined concrete *ESG Risk Events* through which we understand the transmission or crystallization of the negative impacts.

### Double Materiality

In our approach we cover both the *financial materiality* as negative impact due to the risk event on the company (like the extreme weather damages), as well as the *environmental-social materiality* as a negative impact by the consequence of company acting (like increased costs due to high level of pollution or CO2 emission activities).

### Differentiation of ESG risk per customer segment

In our concept, the ESG Risks are differentiated by industry sectors, as we understand a differentiated level of exposure primarily by the location and nature of activities, but also by complexity and public importance of the company.

### ESG Risk integration into Erste Bank Hungary Risk Inventory

In our approach ESG risks are considered as transversal type. ESG risks are therefore not defined as separate risk categories but integrated into the existing risk categories.

## 4.3 Environmental Risk Drivers

| Risk Driver               | Risk Event  | Transmission channel  | Double Materiality | Risk type      |
|---------------------------|---|---|--------------------|----------------|
| Climate change            | Air pollution, greenhouse gas emission  | Increased capital expenditures, increase costs of carbon tax or energy trading certificates   | Enviro             | Transition     |
|                           | Energy efficiency   | Higher operational costs, capital expenditure to refit of increasing standards  | Enviro             | Transition     |
|                           | Physical risks (extreme weather events)   | Damages and disruptions (production, suppliers), increased climate adaptation expenditures or fall in customer demand, capital loss, revenue loss | Financial          | Acute Physical |
| Environmental degradation | Exposure to unconventional mining practices (Arctic exploration, tar sand, deep sea mining) | Controversies, negative customer's and investor's sentiment, loss of revenue and increase financing cost  | Enviro             | Transition     |
|                           | Excessive use of resources (water, raw materials)   | Exposure to raw material costs, controversies, risk of higher costs, regulatory limits, loss of revenue   | Enviro             | Transition     |

|                       |   |   |                   |                    |
|-----------------------|---|---|-------------------|--------------------|
|                       | Illegal fishing vessels, controversial practices or aquaculture techniques                                  | Controversies, negative customer's and investor's sentiment, loss of revenue and increase financing cost  | Enviro            | Transition         |
|                       | Water pollution by improper treatment of hazardous materials or waste disposal                              | Controversies loss of revenue and increase financing cost; damages by polluted water, increased costs     | Financial /Enviro | Chronical Physical |
|                       | Soil pollution by waste or hazardous materials, excessive fertilization, or soil erosion                    | Controversies loss of revenue and increase financing cost; damages by soil erosion, increased costs       | Financial /Enviro | Chronical Physical |
|                       | Deforestation and unconventional site clearance   | Controversies, negative customer's and investor's sentiment, loss of revenue and increase financing cost  | Enviro            | Transition         |
|                       | Impacts on World Heritage Sites, Natura 2000 or other protected areas or threatened species (IUCN Red List) | Controversies, negative customer's and investor's sentiment, loss of revenue and increase financing cost  | Enviro            | Transition         |
| <b>Animal welfare</b> | Controversial living conditions, transportation and use of chemicals/medicines (overuse of antibiotics)     | Controversies, negative customer's and investor's preference, loss of revenue and increase financing cost | Enviro            | Transition         |
|                       | Lack of anesthetic or distress reduction techniques   | Controversies, negative customer's and investor's preference, loss of revenue and increase financing cost | Enviro            | Transition         |
|                       | Use of wild subjects for biochemical testing  | Controversies, negative customer's and investor's preference, loss of revenue and increase financing cost | Enviro            | Transition         |

#### 4.4 Social Risk Drivers

| Risk Driver         | Risk Event                                    | Transmission channel  | Double Material   |
|---------------------|---|---|-------------------|
| <b>Human rights</b> | Rights of freedom                             | Operations from regions under ban of UN HRC or under EU sanction  | Financial /Social |
|                     | Child labor, forced labor & human trafficking | Controversies, negative customer's and investor's preference, loss of revenue and increase financing cost | Financial /Social |



|   |   |   |                   |
|---|---|---|-------------------|
|   | Poor conditions on healthcare, education and job safety                                       | Disruptive environment exposed to social unrest, damages and disruptions in production                    | Financial /Social |
|   | Differentiation in conditions, compensation, segregation                                      | Controversies, negative customer's and investor's preference, loss of revenue and increase financing cost | Financial /Social |
| <b>Workers rights</b>                       | Violation of workers' rights (collective bargaining, association, working hours, etc)         | Controversies, negative customer's and investor's preference, loss of revenue and increase financing cost | Financial /Social |
|   | Poor worker safety record, forced labor conditions, child labor                               | Controversies, negative customer's and investor's preference, loss of revenue and increase financing cost | Financial /Social |
| <b>Customer protection and conduct risk</b> | Exposure to liability by consumer protection, consumer rights and wrong customer preference.  | Controversies, negative customer's and investor's preference, loss of revenue and increase financing cost | Financial /Social |
|   | Exposure to damages caused by products, services, increased legal charges against the company | Legal liability by the damages, loss of customer preference, increased costs and loss of revenue          | Financial /Social |
|   | Weak personal data security and privacy protection  | Losses incurred as a result of legal proceedings associated with user privacy                             | Financial /Social |
|   | Claims of unfair and misleading promotion   | Controversies, loss of customer preference, loss of revenue   | Financial /Social |

## 4.5 Governance Risk Drivers

| <b>Risk Driver</b>               | <b>Risk Event</b>  | <b>Transmission channel</b>   | <b>Double Material</b> |
|----------------------------------|--|---|------------------------|
| <b>Poor corporate governance</b> | Nontransparent ownership, management, competency of the board is not in line with ESG. | Changes enforced by the market, confidence and market sentiment issues. Financing costs increase. | Financial /Governance  |
|                                  | Unclear corporate governance structure of key decision holders and control functions.  | Changes enforced by the market, confidence and market sentiment issues. Financing costs increase. | Financial /Governance  |

|  |  |   |                       |
|--|--|---|-----------------------|
|  | Loss of employee engagement, high staff turnaround and eroded new employee attraction.       | Impact on quality, flexibility, innovation, loss of competitiveness, exposure to liabilities              | Financial /Governance |
|  | Missing or unclear supply chain standards, the standards do not specify ESG principles.      | Controversies, negative customer's and investor's preference, loss of revenue and increase financing cost | Financial /Governance |
| <b>Weak Corporate ethical standards</b>      | Missing or insufficient principles for anti competitive practices, exposure to controversies | Controversies, negative customer's and investor's preference, loss of revenue and increase financing cost | Financial /Governance |
|  | Exposure to illegal and unethical payments   | Controversies, negative customer's and investor's preference, loss of revenue and increase financing cost | Financial /Governance |
|  | Exposure to controversies, bipartisan or political preferences                               | Controversies, negative customer's and investor's preference, loss of revenue and increase financing cost | Financial /Governance |
| <b>Non transparent corporate citizenship</b> | Exposure to misconducts on transfer pricing, related parties, financial disclosures          | Controversies, hidden tax obligations, loss of revenue, increasing financing cost, cumulated tax deficits | Financial /Governance |

## 5. Management of ESG Risks

ESG risks identification is an integral part of Erste Bank Hungary business and risk management framework. It is a very natural part of counterparty assessment in credit, market, liquidity, operational or residual risks. Yet Erste Bank Hungary is still developing a more explicit approach toward ESG Risks in line with the rising climate urgency and in accordance to the supervisory guidance from ECB and EBA.

### 5.1 Identification of ESG risks

The ESG Risk identification process of the Erste Bank Hungary is developing in an industry sector differentiated approach, reflecting on the relevance of an individual ESG risk events for a given sector. The relevance level is determining if the risk factor is considered for the given sector within the ESG risk assessment process or in case of high relevance it is to be reflected in clear limitations within the *Responsible Finance Policy*.

### 5.2 Assessment of ESG Risk

#### *ESG Risk exposure of client & transaction*

ESG Risk screening for new a credit related transaction is to be based (starting with 1.7.2021) on an internal ESG scorecard. The scorecard identifies if a deep dive ESG risk assessment shall be concluded. Structurally the scorecard reflects a differentiated relevance of ESG risk events by industry sectors (see above).

In ESG Risk assessment approach EBH considers a *proportionality principle* and therefore individual client assessments to be applied on the large corporate and commercial real estate segments.

For investment products the ESG screening is based on ESG rating and customized, proprietary information from external ESG rating agencies and data providers.

#### *ESG risk collateral*

The consideration of ESG factors will have an increasing influence on future development of market values for real estate and other assets. By this, it will also have a direct impact on the values of the collateral portfolio and recoveries from collateral liquidation.

Erste Bank Hungary defines criteria that have to be considered in the valuation of collateral starting 1.7.2021. Whereas the assessment of ESG risks of residential real estate collateral focuses mainly on energy efficiency and other environmental impacts like contamination, flood, avalanche or seismic risks, several additional factors have to be taken into consideration for commercial real estate (i.e. energy efficiency, water efficiency, construction working condition, sub-contractor selection, etc.). The extent of needed information is dependent of the type of the real estate asset.

#### *Portfolio risk assessment*

On portfolio level the main ESG risk is obviously the transitional risk driven by changing legislation, evolving conformity policies and responsive public demand connected to the global warming. In first approximation the transitional risk can be associated with the intensity or absolute level of CO<sub>2</sub>e emissions given by additional carbon cost measures in the future.

Therefore, the EBH is allocating substantial efforts to develop a carbon footprint calculation methodology using as reference the Partnership for Carbon Accounting Financials (PCAF) standards. Clustering the established carbon intensity levels will provide a heatmap over the status of relevant portfolio.

#### *Portfolio targets alignment*

Given by the nature of the Group business activities, we consider transparency and simplicity as key values to address our long term ESG profile and communicate on alignment to widely accepted targets.

A relevant portfolio level ESG target shall be derived from the Paris Agreement on the green-house-gas reduction goals and limitation of global climate warming to max 2° C or comfortably at 1,5° C.

The efforts of EBH are therefore concentrated to establish the carbon footprint over its credit portfolio and consequently to apply for the Science Based Targets (“SBT”) approach and calibrate toward the Paris Agreement global warming limits of 1,5° C.

### **5.3 Risk Management & ICAAP**

Integrating ESG risks into the ICAAP framework increases Erste Bank Hungary’s resilience to these risks and improves EBH’s ability to manage them. In this light, Erste Bank Hungary has incorporated a qualitative statement in form of a key risk principle in its Risk Appetite Statement as part of the guidelines for managing ESG risks. Furthermore, EBH has defined in the Group Risk Strategy for each element of the ESG risks principles, which aim to reflect their importance and to raise the awareness, while supporting the implementation of safe and prudent ESG risks management.

ESG risks are included in the regular process of risk identification forming a part of EBH risk inventory. By their nature, ESG risks have been categorized as transversal risks in EBH’s risk taxonomy, having impact on existing risk types of EBH. This way of categorization enables EBH to assess and manage ESG risks in a consistent way. Details on the risk inventory and the taxonomy are defined in the ICAAP Policy.

## 6. Implementation of ESG Risks in business activities

Erste Bank Hungary is continuously investing its efforts and capacities into the development of sustainable finance propositions. The efforts are concentrated not only to provide the choice for the customers and investors, but also to ensure a safe and transparent approach toward the ESG financing.

### 6.1 Lending and daily banking activities

Majority of ESG Risks materialize within the lending activities with impact on main risk categories. Therefore, starting with 1.7.2021, EBH intend use an internal ESG scorecard-based assessment approach for any new loan origination in large corporate segments. The governance structure of the risk acceptance in case of elevated ESG risk is governed by the customary authorization level of the given risk category framework (credit, market, operational risks).

Besides the assessment at new lending origination, the EBH also considers ESG risks coming from any business engagement with potentially controversial or critical fields of activities and with possibly severe impact on the environmental or social wellbeing. For these cases EBH apply exclusion criteria or other similar limitations which are governed by the publicly available *Responsible Financing Policy*.

Social and Governance risks coming from EBH's business activities toward clients, employees and other stakeholders are guided by the *Code of Conduct of Erste Group (1.4, Ref 4)*.

### 6.2 Investment products

For investment products majority of ESG Risk management efforts are concentrated on proper selection of underlying assets and the proper investors protection.

ESG risk assessment in case of investment products relying on ESG rating and proprietary information provided by the ESG rating agencies on the particular investees or indexes. For Bonds with assets allocated from the portfolio of EBH the ESG risk assessment is in line with the rules of ESG risk for lending and daily banking activities.

### 6.3 Operational activities of the Group

Operational activities of the EBH are related mainly to operation of headquarter buildings, IT infrastructure, paper consumption as the major raw material use and in limited extent the business travels. The environmental objectives are declared and managed according to the internal *Policy Framework for Erste Bank Hungary Zrt. Environmental, Energy & Climate Strategy*.

### 6.4 Supplier management of the Group

Risks related to the supply chain of EBH are guided by the *EG Ethical and Environmental Code of Conduct for Suppliers of Goods and Services (1.4, Ref 5)*.

## 7. Change Log

| Version History | Approval Date | Section(s) | Changes  | Author(s)    | Approved by              |
|-----------------|---------------|------------|----------|--------------|--------------------------|
| 1.0             | 2021.03.09    |            | Original | Anikó Molnár | EBH<br>Managing<br>Board |