

Banco Santander, S.A. Hong Kong Branch

(A public limited liability company incorporated in Spain)

ENVIRONMENTAL, SOCIAL AND CLIMATE CHANGE RISK MANAGEMENT DISCLOSURE

For the year ended 31 December 2022

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I. INTRODUCTION

Sustainable Banking in Santander follows a top-down approach. Strategy, governance, risk management and targets/metrics are originated at headquarters' Board level, cascading down to the entire organization, as disclosed in Santander Climate Finance Report¹.

This document aims to explain how "ESCC" risk management is locally executed in Banco Santander S.A., Hong Kong Branch.

II. STRATEGY

Responsible and Sustainable Banking in Santander is at the centre of the Group's strategic agenda, and it comprises several initiatives, projects and working streams. Santander's Hong Kong Branch fully aligns with this strategic agenda for achieving the purpose of promoting sustainable and inclusive growth by focusing on three strategic pillars:

- Support Climate Transition - Deliver our Net zero ambition by 2050 helping our customers in their transition to a sustainable and low carbon economy by originating EUR 230 Bn green finance before 2030.
- Contribute to generating positive society return.
- Embed ESG and Climate Change risk management across the organization by incorporating ESCC in behaviours, policies, processes, and governance. As such we have developed our key "ESCC Policy" which focuses on how we plan to achieve our ambitious targets with a focus on the main carbon-intensive industries (O&G, Power, M&M & Soft Commodities) and includes criterion to:
 - Cut financing to clients engaged in coal mining and/or producing energy from coal fired plants (more than 10% of its revenues) by 2030; and
 - Limiting exposure to unconventional O&G activities; conflict minerals, deforesting or biodiversity harmful activities or protected areas.

In terms of execution of the Group strategy in Santander Asia, we use two main lines of action:

- Onboarding new clients fully aligned with our ESCC Policy and increasing coordination with Global ESG Solutions team to grow local origination of sustainable finance in accordance with EU and internal taxonomies.
- Developing a dedicated local ESCC Risk team. This team coordinates the application of different policies and assesses how clients/ESG sensitive, or related transactions are aligned to Santander Group commitments and policies. It also conducts regulatory self-assessments and gap analysis to ensure Santander policies adhere fully to Local law and regulations.

¹ <https://www.santander.com/content/dam/santander-com/en/documentos/informe-anual-de-sostenibilidad/2021/ias-2021-climate-finance-2021-en.pdf>

III. GOVERNANCE

In Santander Hong Kong Branch, the **Executive Committee ("ExCo")** acts as the Branch main governance body. Its powers refer to decision-making and monitoring regarding businesses, strategy, governance, risks, finance, accounting, workforce decisions, technology systems, operational matters, and escalation to Group when deemed appropriate.

The ExCo is informed and reviews the most relevant elements of Santander Group sustainability agenda and discusses strategic impact on Santander Hong Kong's business. In March 2022, the Risk team presented an "ESG & ESCC STRATEGY PAPER", which outlines the main elements of Responsible and Sustainable Banking at Santander, assesses its impact in Hong Kong Branch operations and proposes lines of actions to locally execute Group's agenda, commitments, and policies.

APAC SCIB Executive Risk Forum ("ERF") is the highest Risk decision forum in Santander's APAC region. It is chaired by the Regional CRO and includes all the ExCo members. This decision body concentrates all sanctioning authorities related to Risk Management (that can be further delegated in other forums as appropriate). Its main functions are:

- Ensure the effectiveness of the Risk governance, Risk control environment and Risk function in general (**Risk Governance & Organization**).
- Define Risk Appetite, Strategy and Management Limits (**Risk Appetite and Strategy**).
- Discuss, approve, or reject client and business proposals that imply any form of risk taking with potential financial impact for the Branch and/or Region (Credit, Market, or Investment risk). For every business proposal exceeding delegated risk authorities, the ERF shall escalate for further advice to Global Forums (**Risk Underwriting**).
- Oversee and monitor the evolution of SCIB Asia and its Branches Risk profile considering all Risk Factors (Credit, Market, ESG, Non-Financial) (**Risk Oversight and Monitoring**).
- Approve management and mitigating actions as well as build provisions when deemed necessary according to Group's Policies and regulations applicable (**Risk Mitigation**).

ERF is the most actively involved governance body when it comes to ESCC Risk Management. This Forum has reviewed and approved the local transposition of 1) E&S Risk Management Policy (that sets out the principles and criteria that apply across the Group when financing E&S sensitive sectors) and 2) Environmental and Social Risk Screening Policy (sets out roles & responsibilities in assessing ESCC Risks).

- These policies have been embedded in Santander Asia credit and risk oversight processes and it is responsibility of ESCC Risk team to ensure they are applied properly.
- The local adoption of these policies implies that:
 - E&S considerations are included on client pre-assessment conducted for new client selection
 - Clients' E&S qualitative reviews are included in credit rating papers
 - ESG Risk Team green light is required for ESG certain transactions (usually subject to Equator Principles), and

- Client's alignment to Santander Global E&S policies/commitments is assessed annually. This exercise is coincidental with the approval of credit limits and misalignment with group policies may impact the risk appetite with certain clients, via a global tiering exercise. This is a global exercise coordinated by global teams with direct participation of local ESG Risk responsible.

Furthermore, as the main and sole local approval body of client's annual limits and relevant transactions, the ERF is informed and discusses ESCC implications at client-individual level.

On a portfolio level, ERF is regularly informed about the "Branch Risk Profile". The Risk Oversight team, in coordination with its global peers, conducts a periodic & holistic exercise that assesses top risks and profiles different risks typologies (Credit, Market, Liquidity, Structural, Counterparty Credit risk, ESCC, Model, Macro, etc.). Accordingly, a set of ESCC-related metrics/KPIs are monitored monthly. Beyond this exercise, a specific "Climate Change Materiality Assessment" is conducted twice per year and presented to the ERF (applying Headquarters' defined methodology to local portfolios).

The oversight activity of ERF is further developed at the **Risk Control Forum (RCF)** (organically subordinated). Chaired by the CRO and composed by all the Risk Management Heads, this forum receives monthly updates of the Branch Risk Profile, and it develops in-depth analysis of certain topics. For example, ESG related topics considered of interest (policies, controversies) have been subject of presentations or commentary in this committee.

On a more technical level, clients' risk assessment is reflected in a credit rating paper, in which ESCC qualitative information is required. To this aim, **Local Rating Forum** is the body that ensures ESCC assessment is conducted and local ESCC Risk responsible is a member of this forum.

IV. RISK MANAGEMENT

Sustainability agenda, commitments, policies and ESCC risk management in general have been integrated locally into the risk management process following a client-centric logic and comprising the following steps:

1. Client Selection (Onboarding / KYC process)

Santander Asia operations are exclusively focused on Corporate and Investment Banking. This segment works following a client centric approach with low-moderate risk profile. Prospect clients are identified/selected and proposed to be included in the so-called "MRG closed List". The list is revised annually following budgeting exercise. New entrants are required to comply with certain criteria in terms of financial metrics and geographic fit. New prospects are decided locally and ratified globally. In discussing new prospects, a pre-screening is conducted. ESCC considerations and alignment with Santander commitments are considered as part of this exercise and it is for the local ESCC Risk Team to validate that pre-assessment.

2. Risk Assessment (Rating)

There is mandatory ESCC section in Santander's Credit risk rating papers. Currently, this assessment is purely qualitative and has no impact in probabilities of default or final rating. Credit analysts are responsible for elaborating a discussion about clients' business, which includes an ESCC section. The local ESCC responsible (a member of the rating forum) is required to validate the information and analysis provided.

It is worth mentioning Santander Head Office is coordinating a working group to develop a methodology for quantitative rating specifically for Environmental, Social and Climate Change Risk, leveraging on data provided by external sources (MSCI and S&P).

3. Risk Appetite and Management limits setting

Clients' limits are reviewed annually. Alignment with Santander E&S policies is a crucial part of this process. This assessment is performed following the ESCC Risk Management Policy (M&M, O&G, Soft Commodities and Power) by completing an industry specific questionnaire (responsibility of the Relationship Manager, 1LOD) although final version needs to be reviewed and validated by the local ESCC responsible (2LOD), before being sent to the Global team for final validation.

Assessments of corporate clients in other sensitive sectors are also conducted on ad-hoc basis driven by controversial/negatives news or ESG related issues. Management actions can be put in place, if necessary, after analyzing the case.

For industries subject to the Policy, a tiering process is performed to define the maximum risk appetites. Tiering is a global exercise that is applied to all Santander SCIB clients that operates in industries where the group has set clear reduction targets following NZBA and based on an industry approach. Local ESCC Risk team is directly involved in the tiering assessment process, which follows a dual approach: 1) Alignment with SAN pathway and 2) Transition plan assessment overlay. However, final decision lies within global ESCC risk team, given the global nature of CIB clients. Clients are rated and then assigned to one of four possible tiers; logically weakest tier anticipates a reduced risk appetite being set on a global portfolio basis.

4. Transaction booking

ESCC considerations are included at transaction level in 2 ways:

- From Risk perspective, focus is set on project-related deals under the scope of Equator Principles IV (mainly Project Finance). Local ESCC Risk assesses (in collaboration with the Global Team) transactions under Equator Principles and conformity is required to obtain final approval.
- Secondly, "labelling" of sustainable financing (Green, Social or Sustainable linked) is undertaken. Santander has developed a Sustainable Finance Classification System ("SFCS") with sole purpose to label transactions according to the European Union and Santander's (internal) taxonomy. To that effect, a "Global Panel" assures classification is properly applied across the Group; Local ESCC Risk is an invitee to Panel discussions whenever local transactions are involved¹.

5. Monitoring (both client level and portfolio)

Portfolio monitoring is embedded in local risk management through two basic tools: Branch Risk Profile and Client Materiality Assessment.

- For branch risk profile, ESCC monthly monitoring focuses on exposures subject to E&S policy, and concentration ratios are reported. The analysis lies on ESCC risk responsible, and it is integrated in the overall profile assessment of the branch. This exercise is presented once a month in the RCF and "key take aways" and an executive summary is made available for ERF Members.

¹ <https://www.santander.com/content/dam/santander-com/en/documentos/informe-anual-de-sostenibilidad/2022/ias-2023-sustainable-finance-classification-system-sfcs-en.pdf>

- A client level Climate Change materiality assessment is conducted annually, following a corporate methodology that it is applied to local portfolios. The analysis is conducted by local ESCC responsible, and it is presented both to RCF & ERF.