BBVA
Creating Opportunities

BBVA response to EBA consultation on Pillar 3 disclosures for ESG risks

Question 1: Are the instructions, tables and templates clear to the respondents?

The instructions, tables and templates are more or less clear. Overall, the level of ambition of the consultation, tables and templates is excessive in terms of the level of details and micromanagement. Timing for the implementation and disclosing in 1Q23 the huge amount of information required is also extremely challenging. Our implementation depends on clients' disclosure and requires investing in IT. Furthemore, it is not clear enough to us if the GAR (templates 8 and 9) should be disclosed at an EU level only or also at a non-EU level, and for counterparties subject to the Article 8 of the Taxonomy or the Corporate Sustainability Reporting Directive (CSRD), at least until June 2024.

As it was aforementioned, the first full set of KPIs disclosures must be released to the stakeholders in 1Q2023. Credit entities will be able to provide end-2022 data for some economic activities and counterparties; however, end-2021 data could be needed when no 2022-data are available, which can make it difficult to compare or mislead stakeholders.

The use of proxies and disclosing information on a best effort basis can have an unintended effect in terms of lack of clarity, comparability and create some inconsistencies. Especially in the current nascent state of the art. Therefore, we suggest a staggered approach starting with an EU perimeter, for counterparties subject to the CSRD and on a flow basis.

Referring to Pillar 3 disclosures are on a consolidated basis, it is not clear enough to us how to provide off-balance sheet information in the templates.

Pushing hard and rushing can be a source of transition risk for banks. It seems that the EBA has even anticipated the BCBS, which is already analyzing and working on the possibility to embed ESG risks into the already existing Basel III prudential framework, through its Task Force on Climate-related Financial Risks (TFCR). The BCBS released recently two analytical reports on climate-related risk drivers, their transmission channels and measurement methodologies. They provide a conceptual foundation to identify potential gaps in the Basel Framework and consider measures to address them. Furthermore the BCBS is expected to launch a survey in the coming months.

Disclosure and reporting is maturing from an open topic based on market practices and private initiatives towards being embedded into the regulatory framework. Ensuring an adequate interaction between market and regulatory initiatives is a must. Banks are doing their best towards comprehensively disclosing our risk profile and to promote transparency in the financial markets.

Question 2: Do the respondents identify any discrepancies between these tables, templates and instructions and the disclosure requirements set out in the underlying regulation?

A discrepancy has been identified in terms of scope and timing mismatch between the banking entities and their counterparties: the EBA advice to the European Commission (EC) proposes that credit institutions and investment firms should report on a range of KPIs, including a GAR under the EU Taxonomy Regulation, that would include on a mandatory basis SME portfolios in the calculation. The proposal for the Corporate Sustainability Reporting Directive (CSRD) released on April 21st, suggests that listed SMEs would be required to start reporting three years after the revised CSRD enters into application, which will take place not earlier than in 2023 (implying first reporting in 2024) at best, meaning that the real data from CSRD-SMEs will not be available before 2027 at best (whereas the EBA proposal allows for the use of proxies only until the 30th of June 2024). Non-listed SMEs will not be mandated to report taxonomy aligned information as per the CSRD.

BBVA Creating Opportunities

Question 3: Do the respondents agree that the new draft ITS fits the purpose of the underlying regulation?

It's BBVA's understanding that the new draft ITS should reconsider some issues to better fit the purpose of the underlying regulation. i.e.: i) ESG risks Pillar 3 disclosures should be annual, biannual disclosure is not necessary, much less for the trading book. ii) The use of proxies and iii) the high dependency of credit entities on our counterparties could erode the adequacy of the new draft ITS fitting the purpose of the underlying regulation. iv) The GAR fits for mobilization purposes, to reflect the business model and to provide some useful information on the breakdown of EU taxonomy-aligned assets; however, it doesn't fit for ESG risk purposes:

- It's our understanding that the GAR doesn't properly fit in with prudential regulation because it isn't a risk metric, but rather a risk factor that should be analyzed together with other measures, in order to check whether there is a relation with risk (as per the *EBA Discussion Paper on management and supervision of ESG risks for credit institutions and investment firms*, which defines both, ESG factors and ESG risks). Therefore, we suggest the EBA to reconsider its inclusion in the P3 disclosures for ESG risks**.** In that vein, portfolio alignment methodologies seem more adequate.

- The GAR stand-alone should be complemented with some metrics to capture transitioning financing, at activity level and at companies' level (i.e.: it does not consider assets that have become or that are in the process to become more energy efficient if they don't fulfill the requirements of the EU Taxonomy Regulation). Furthermore, it doesn't seem to consider the banks' strategy and financing efforts in sustainability.

- The GAR should only be calculated for flow business. Stock could mislead stakeholders because the contribution to sustainability relies on the new origination and in its progress. In addition to that, it is virtually impossible to gather reliable stock figures.

- The perimeter of the GAR should be limited to EU exposures, to companies subject to Article 8 of the EU Environmental Taxonomy and the CSRD. Otherwise, it would be impossible to gather the information in a solid and comparable way.

Question 4: Do the respondents agree that the tables with qualitative information proposed capture properly the information that institutions should provide?

One the one hand, the qualitative tables proposed could mislead the stakeholders due to their free formats and some duplicity or overlapping with the TCFD Recommendations and the information that will be required per the CSRD. i.e.: strategy and risk management.

On the other hand, the tables with qualitative information can enhance the ESG disclosures.i.e.: the social dimension of customer protection and labour relations, which are not covered by the TCFD Recommendations or the CSRD.

Therefore, the EBA P3 ESG Risks disclosures should aim at jointly minimizing the duplicity and overlappings and maximizing the aforementioned enhancement, without imposing an extra burden for the credit entities. We suggest that P3 ESG risks disclosures should be the reference document and compile all the relevant information, instead of referring to the other documents and their links, to

BBVA
Creating Opportunities

avoid overkilling stakeholders with a bunch of multiple references to better understand and take their decisions.

Question 5: Regarding template 1 – 'Banking book - Climate change transition risk: Quality of exposures by sector', do the respondents agree with the proposals in terms of sector and subsector classification included in the rows of the template and the identification of the most exposed sectors in columns f to k and p to u?

Firstly, we would like to highlight the fact that exposures to sectors are linked to average weighted PDs. That could lead stakeholders to misinterpretations and to draw some wrong conclusions that do not rely on solid empirical evidence. Please, note that the NGFS acknowledged that it was not possible to reach a strong conclusion on a risk differential between green and brown assets in its May 2020 "Status Report on Financial Institutions' Experiences: from working with green, non green and brown financial assets and a potential risk differential". Indeed, a new questionnaire study on risk differentials was launched last April.

Secondly, there seems to be an excess of granularity that would not add much value and that would not reconcile with other financial reports to be sent to the supervisors. i.e.: sectoral finrep doesn't match with the sectoral breakdown proposed in template 1.

Last but not least, the aforementioned timing mismatch between credit entities disclosures and our counterparties should also be noted.

Question 6: Do the respondents agree with the proposal included in templates 1 and 3 to disclose information on scope 3 emissions and with the transitional period proposed?

We neither agree with the proposal included in templates 1 and 3 to disclose information on scope 3 emissions nor with the transitional period proposed. It isn't possible and disclosing the total scope 3 exposure to all sectors doesn't make sense given its difficulty, at least in this current nascent stage.

GHG emissions should be focused on those activities that are more relevant and where methodologies are already available or will be (available). We propose to focus only on those sectors included in *UNEP FI Guidelines for Climate Target Setting for Banks* (agriculture; aluminium; cement; coal; commercial and residential real estate; iron and steel; oil and gas; power generation; and transport)

We suggest the EBA reconsider the use of proxies to non-EU exposures, given their heterogeneity and their difficult comparison, that could be misleading and even to stigmatize some sectors and credit entities.

We agree with template 3 only for an EU perimeter.

Question 7: Do respondents agree that information in terms of maturity buckets by sector proposed in template 2 is relevant to understand the time horizon of when the institution may be more exposed to climate change transition risk?

It is our understanding that [<= 5 years] and the [> 5 year <= 10 years] are the most relevant buckets for transition risks. The rest of the buckets don't seem material, therefore we are not sure if it makes sense asking for those data with that level of granularity.

Question 8: Do respondents agree that information in terms of alignment metrics and relative scope 3 emissions proposed in template 4 is relevant to understand and compare the transition risk phased by institutions? What are the respondents' considerations with regard to the alignment metrics proposed and the sectors that should be covered by this disclosure? Do respondents agree with the transitional period proposed?

We broadly agree with the alignment metrics proposed and the sectors that should be covered by this disclosure. We suggest replacing "H49.3 Other Passenger land transport" by Autos Original Equipment Manufactures (OEMs), or by shipping and aviation.

Question 9: Regarding the same template 4, what are the respondents' considerations with respect to the choice of the 2 degrees reference scenario, would respondents opt for a different scenario?

The selection of a 2 degrees scenario has surprised us. We would have expected a 1.7ºC or a 1.5º scenario, which are more aligned with the current state of the art, and with the net zero compromises made by the EU and by 43 banks from 23 countries in the Net-Zero Banking Alliance.

Also regarding template 4, we suggest adding a new column considering data quality. On the fact if the data has been directly provided by clients, or it is a proxy, or it has been obtained on a best effort basis.

Question 10: Do respondents agree that information proposed in template 5 is relevant to understand the level of climate change transition risk and that information on exposures towards the most polluting companies is a good complement to the sectoral information included in other templates? Specific feedback is sought on possible alternative formats for the presentation of the information required in template 5. In particular, the EBA seeks feedback on whether aggregate information on exposures towards the top 20 polluting companies in the world, at EU level or at member state level, instead of company-by-company information, would be sufficient to understand how climate-change transition risk may exacerbate the exposition of institutions to credit risk. Feedback is also sought on the specific information that a template on aggregate exposures should include to be meaningful, including possible "buckets" of information on exposures (e.g. exposures towards top 5 polluting firms, next top 5 and so on, or other alternative presentations).

We think that neither information proposed in template 5 (Exposures in the banking book to top carbon-intensive firms) nor information on exposures towards the most polluting companies, providing the name of each company, are a good complement to the sectoral information included in other templates. It can be extremely controversial at least for these two reasons:

> i) The source of the data. What if clients don't agree with the provided estimated data that has not been provided by them. In addition to that, it is not clear if data would be provided at a group level or at an individual counterparty level.
>
> ii) Could this raise confidential or legal issues with our counterparties and clients?

It is our understanding that in case the EBA decides to maintain this template it would be preferable to do it on an aggregated and anonymized basis.

Question 11: What are respondents' view on the way template 6 reflects how the trading book of institutions may be impacted by climate change transition risk? Do respondents agree that the threshold proposed to determine which institutions have to disclose this template is the appropriate threshold? Feedback on whether there are alternative ways to present information on the trading book that may allow for a better understanding of how climate change transition risk may impact the trading portfolio.

NA

Question 12: Do respondents agree that the information included in template 7 is appropriate to understand how and to what extent the institution may be exposed to climate change physical risk and that the differentiation between a simplified and an extended template is necessary in the short/medium term?

Differentiation between simplified and extended templates is necessary and welcome. Some information related for example to stages does not seem so relevant.

Question 13: Regarding template 7, specific feedback is asked regarding the methodologies and data sources that institutions may use to identify the relevant geographies. Feedback is also required on the content and disclosures proposed in the extended version of the template and on the transitional period proposed.

Methodologies and data sources concerning physical risk are under development.

Question 14: Regarding templates 8 and 9, do respondents consider that this template should be enriched including information not only on assets aligned with the taxonomy but also in the interest income generated by those assets? Do respondents agree with the timeline proposed and transitional period proposed for the disclosure of these templates?

Regarding templates "Assets for the calculation of the Green Asset Ratio" (Template 8) and "GAR KPI" (Template 9):

- The GAR doesn't properly fit in with prudential regulation because it isn't a risk metric, but rather one risk factor that should be analyzed with others in order to check whether it has an impact on risk (as per the *EBA Discussion Paper on On management and supervision of ESG risks for credit institutions and investment firms*, which defines both, ESG factors and ESG risks). Furthermore, it does not reflect the banks' strategy, transition paths and financing efforts in sustainability. It should be complemented with metrics to capture transitioning financing, at activity level and at companies' level.
    - It isn't the most suitable tool for risk purposes or assessing the pathway on the transition to net zero. There are three ways of measuring alignment, from the easiest to the most complex: financial ratios, sectoral alignment and temperature metrics.
    - Metrics for transition climate risk based on portfolio alignment methodologies seem preferable. The GAR doesn't have a holistic view in terms of risks (having a narrow focus on climate-related risks): there might be some "green" loans with a higher credit risk than average non-"green" loans (average PDs are requested, therefore it is expected to be reflected in comparisons).
- The GAR should only be calculated for flow business. Stock doesn't make sense because it offers a static picture and it is impossible to gather reliable stock figures. Furthermore, the contribution to sustainability relies on the new origination and in its progress. There are loans

in which sustainability considerations will be taken into account and which will make a significant impact on the transition.

- Some more time to implement and disclose the GAR is necessary. Its implementation depends on clients' disclosure and requires investing in IT. Reporting in the 1Q23 is extremely challenging particularly given investments on infraestructures and the adaptation of internal processes needed to properly comply with this disclosure. In that vein, two issues are worth to be highlighted:
    - The perimeter of the GAR should be limited to EU exposures, to companies subject to Article 8 of the EU Environmental Taxonomy and the Corporate Sustainability Reporting Directive (CSRD). Otherwise it would be impossible to gather the information in a solid and comparable way.
    - Scope and timing mismatch between financial institutions and their counterparties needs to be considered. i.e.: the EBA advice to the European Commission (EC) proposes that credit institutions and investment firms would report on a range of KPIs, including a GAR under the Taxonomy Regulation, that would include, on a mandatory basis, SME portfolios in the calculation. The EBA recommended that banks be allowed to use estimated data for such portfolios until 30 June 2024, followed by the reporting based on the "real data". According to the proposals published last 21 April the EC [link], listed SMEs will not be expected to report sustainability information until the year of 2027 and the rest might not be sufficiently encouraged to do so at all, considering that the standard is recommended as voluntary.
- In any case, if a ratio is to be introduced, it would be more appropriate to follow a similar approach as to the one used when introducing the LCR and NSFR, in which a QIS was previously performed and banks had time (around 1 year) to prepare their disclosures, given the risks to financial stability, the banking sector's investability, etc. No prior quantitative impact study (QIS) has been performed and analyzed before this initiative in order to have a better comprehension of the banks' readiness to face the market disclosure of such an indicator and the impact on the market.

Last but not least, incorporating the Do Not Significant Harm (DNSH), the Minimum Social Safeguards (MSS) and the stock to our systems will also be a challenge.

Question 15: Specific feedback is required from respondents on the way template 10 is defined, and on whether there is additional information that should be added. Feedback is sought on alternative disclosure formats that may contribute to a more standardised and comparable disclosure.

We welcome template 10 as it is important to reflect other climate mitigation actions. Having said that, we would really appreciate the EBA allowing certain flexibility, as the recent staff paper *Testing capacity of the EU banking sector to finance the transition to a sustainable economy* by the EBA also seems to suggest. In that vein, some common guidelines and content could be considered in order to provide comparable disclosures:

a) Green loans with use of proceeds in line with the Green Loan Principles but not taxonomy compliant (activities not covered yet or not meeting the TSC).
b) KPI linked loans with climate targets: the amount not included in template 1 could be considered here (i.e.: a KPI linked loan to an undertaking that has A% of turnover under EU taxonomy will be included here with the "100-A%"). They could be differentiated

BBVA
Creating Opportunities

   i) Those that have net zero climate targets in line with EU climate targets
   ii) Those that have climate targets but not net zero
c) ESG linked loans as they promote embedding sustainability into decision-making of the undertakings, including climate action. It should account the amount not included in template 1 (i.e.: a KPI linked loan to an undertaking that has A% of turnover under EU taxonomy will be included here with the “100-A%”)
d) Brokered green bonds. It should include the total amount intermediated by the bank in green bonds issuance according to the Green Bond Principles and where the bank plays a bookrunner role
e) Brokered KPI linked bonds. It should include the total amount intermediated by the bank in KPI linked bonds issuance according to the Sustainability-Linked Bond Principles and where the bank plays a bookrunner role.
f) Other green financing.

Question 16: Finally, respondents feedback on whether the draft ITS should include a specific template on forward looking information and scenario analysis, beyond the qualitative information currently captured in the tables and templates under consultation and the information required in template 4.

Information about the different scenarios used by the entities under the different analysis could be interesting.