LMA | Loan Market Association

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European Banking Authority
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Sent via online submission

Dear Sirs

The European Banking Authority (EBA) discussion paper on management and supervision of ESG risks for credit institutions and investment firms (the Consultation)

The Loan Market Association (the LMA) welcomes this opportunity to inform the EBA's ongoing work related to the fulfilment of its mandate to assess whether a dedicated prudential treatment of exposures related to assets or activities associated substantially with environmental/social objectives would be justified as a component of Pillar 1 capital requirements.

The LMA is the trade body for the EMEA syndicated loan market and was founded in December 1996 by banks operating in that market. Its aim is to encourage liquidity in both the primary and secondary loan markets by promoting efficiency and transparency, as well as by developing standards of documentation and codes of market practice, which are widely used and adopted. Membership of the LMA currently stands at over 750 organisations across over 65 jurisdictions and consists of banks, non-bank investors, law firms, rating agencies and service providers. The LMA's overall mission is to act as the authoritative voice of the EMEA loan market vis à vis lenders, borrowers, regulators and other interested parties.

The LMA is strongly committed to supporting the development of green and sustainable finance markets throughout EMEA. The LMA's recent work in green and sustainable finance has focused on developing consistent market standards and guidelines. Through its Green Loan Principles and the Sustainability Linked Loan Principles, the LMA has sought to provide its members with high-level frameworks with which to align their loan products and through which it is hoped that the integrity of these loan products will be preserved.

We have focused our response on Chapter 7 – ESG factors and ESG risks in supervision, and wholly support the EBA's view that ESG factors and considerations should be fully integrated into the business model analysis. Whilst we do not believe further action in this area is currently required, as explained more fully in our answers below, even if this were not the case, given the ongoing COVID-19 crisis, we do not believe now is the time to introduce any changes that might restrict a bank's ability to lend and support companies through the crisis, particularly small and medium enterprises (**SMEs**). The global environment is one where banks need to be equipped to support corporates, from investment grade to SMEs, through the crisis, as well as being able to support sustainable investments so that we can achieve our 2030 and 2050 climate targets.

Question 22. Please provide your views on the incorporation of ESG factors and ESG risks considerations in the business model analysis of credit institutions.

Credit institutions already incorporate ESG factors (considered as drivers of existing credit, market and operational risks) and ESG risks (defined as credit/market/operational risk events triggered or aggravated by ESG factors) considerations into their business model analysis when making investment decisions, for example when undertaking credit appraisals, and ensure these risks are priced accordingly. Their due diligence processes allow credit institutions to take a long-term view on how potential borrowers are responding to ESG factors and the strategic measures they are putting in place. Furthermore, credit institutions will also take into account other impacts, such as consumer views on climate change and how this may impact appetite going forward.

Question 23. Do you agree with the need to extend the time horizon of the supervisory assessment of the business model and introduce as a new area of analysis the assessment of the long term resilience of credit institutions in accordance with relevant public policies? Please explain why.

At present, the supervisory assessment toolbox does not specifically identify and address long-term ESG risks, such as those associated with climate change. However, this does not mean that credit institutions are failing to factor these in internally. That said, a lack of data and methodologies for quantifying long-term ESG risks, a lack of a risk-oriented taxonomy or common definition of ESG assets and, as a result, a lack of evidence of a risk differential between ESG assets, all significantly impede the ability of credit institutions to extend the time horizon of the assessment of the business model.

We would therefore welcome the EBA offering and promoting clarity around these issues. As the exercise is very complex and embeds many uncertainties, we believe that this new area of analysis of the assessment of the long term resilience of credit institutions in accordance with relevant public policies should be carried out on a very modest 'test and learn' approach.

Question 24. Please provide your views on the incorporation of ESG risks considerations into the assessment of the credit institution's internal governance and wide controls.

Credit institutions have, in the main, already taken steps to incorporate ESG factors and risks into their internal governance framework, as required of them by their stakeholders. Shareholders and employees are very active in driving the ESG agenda and would expect to see ESG risk-specific considerations included in a credit institution's overall internal governance framework, the functioning of its management body, corporate and risk culture, remuneration policies and practices, internal control framework, risk management framework and information systems. We would therefore welcome the EBA's strategy to exercise proportionality in this area, as the market is driving credit institutions, and corporates more broadly, to take ESG risks into account when producing their internal governance and wider control frameworks.

Question 25. Please provide your views on the incorporation of ESG risks considerations in the assessment of risks to capital, liquidity and funding.

The current macroprudential policy toolbox does not specifically identify and address the incorporation of ESG risks. However, as mentioned above, we strongly believe it's too early for imposing capital requirements, due to lack of data and methodologies for quantifying risks and calibrating prudential requirements, a lack of a risk-oriented taxonomy or common definition of ESG risks and, as a result, a lack of evidence of a risk differential between ESG assets and other types of assets. Also, at inception, the inclusion of these factors in the Supervisory Review and Evaluation Process (**SREP**) should primarily focus on qualitative aspects rather than quantitative ones, starting first with environmental factors. In addition, it should be done in proportion to the financial risk that the ESG topics represent for an institution.

Furthermore, there are already generic provisions in place which require credit institutions to take into account all material risks and, accordingly, we believe these provisions would technically cover ESG risks.

Finally, regarding the assessment of ESG factors impacts to liquidity and funding, the current analysis is less mature than for the other risks. Given that analysis in this area is less mature, we think incorporation of ESG risks considerations in the assessment of risks to capital, liquidity and funding should not be addressed at this stage and any decision should be deferred at least until the analysis of ESG risks has evolved further.

Question 27. Are there other important channels (i.e. other than the ones included in chapter 7) through which ESG risks should be incorporated in the supervisory review of credit institutions?

We believe that the current supervisory review framework is adequate, with credit institutions already taking ESG risks into account. We would welcome the EBA increasing education in this area, particularly for the small credit institutions who might not have access to the larger advisory teams which other credit institutions are able to benefit from.

Conclusion

As a final overarching point, we would encourage recognition that, ultimately, any new measures must be taken to encourage growth, not curtail it, especially given that the global economic situation remains fragile. Whilst targeted and proportionate regulation to guard against excessive risk in the financial system is welcome, this must ultimately be balanced against the need to bring about a healthy economic recovery. We do believe that credit institutions have already taken it upon themselves to integrate ESG risks considerations within their business model analysis, and we would encourage the EBA to continue to let credit institutions take responsibility for their own regulation in this space, with the EBA to provide guidance and education as required.

Next Steps

We would be pleased to discuss any aspect of the above with you in more detail. If we can be of any further assistance, please do not hesitate to contact me by email at gemma.lawrencepardew@lma.eu.com or on +44 (0)20 7006 1372. We would also be pleased to meet to discuss the above at your convenience.

Yours faithfully,

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