2 February 2021

RE: EBA Discussion Paper on Management and Supervision of ESG Risks for Credit Institutions and Investment Firms (EBA/DP/2020/03)

The Shared Assessments Program appreciates the opportunity to submit comments to the EBA's Discussion Paper: *Management and Supervision of ESG Risks for Credit Institutions and Investment Firms*. We have provided feedback from our subject matter experts and membership.

For context, the Shared Assessments Program has been setting the standard in third party risk assessments since 2005. Shared Assessments, which is the trusted source in third party risk assurance, is a member-driven, industry-standard body which defines best practices, develops tools, and conducts pace setting research. Shared Assessments Program members work together to build and disseminate best practices and develop related resources that give all third party risk management stakeholders a faster, more rigorous, more efficient and less costly means of conducting security, privacy and business resiliency control assessments. More information on Shared Assessments is available at: http://www.sharedassessments.org.

On behalf of the Shared Assessments Program and its members, thank you for your time and consideration.

Sincerely,

Robin Slade
COO & EVP
The Santa Fe Group
Shared Assessments Program

3.2 Questions for consultation

Common definitions of ESG factors, ESG risks and their transmission channels (Chapter 4)

1. Please provide details of other relevant frameworks for ESG factors you use.

Response: Frameworks that are specifically relevant to ESG factors that we identify as key in this arena:

- **Financial Stability Board** (FSB) Task Force on Climate-Related Financial Disclosures.
- **World Economic Forum (WEF)** 2020 – Measuring Stakeholder Capitalism: Towards Common Metrics and Consistent Reporting of Sustainable Value Creation white paper.
- **Monetary Authority of Singapore** – Proposed Guidelines on Environmental Risk Management (Asset Managers) June 2020 Consultancy Paper P005-2020 and Response to Feedback Received December 8, 2020. In particular, Section 3.5.
- **COSO and the World Business Council for Sustainable Development**. Enterprise Risk Management: Applying ERM to Environmental, Social, and Governance Related Risks. October 2018.

Rationale: The COSO framework provides especially useful guidance for incorporating ESG into pre-existing ERM structures. This COSO resource demonstrates how to operationalize ESG in an operational risk environment. The WEF framework provides a particularly useful set of metrics designed to work across industries. Participants included Deloitte, EY, KPMG, PwC, who provide excellent guidance around repeatable, reliable, easy to use processes and metrics.

2. Please provide your views on the proposed definition of ESG factors and ESG risks.

Generally speaking, ESG risks have been accurately identified. We provide recommendations for the following two definitions: “Liability transmission channels/liability risks” and “counterparty.”

Rationale:
With reference to “Liability transmission channels/liability risks” definition:

- The definition in the paper: “risks posed by the exposure of institutions to counterparties that may potentially be held accountable for the negatively impact through their activities on the environment, the society and their governance factors.” Observations:
    - “Through their activities” is not an enforceable phrasing.
    - The open ended nature of the definition could result in a variety of interpretations that may not be aligned with the EBA’s intention.
    - The definition is not coherently written (typographically – see “…the negatively impact…”).

In the definition of “counterparty:”

- “Depending on the business activities, the concept of counterparty may be understood as a client (e.g. an entity, individual) or as an issuer (e.g. sovereign, entity). In the case of investment firms, the concept of counterparty may be less relevant as ESG risks may manifest through the assets they held as part of their investment activities in general.” Pg. 28. Observations:

- We suggest adding language to the effect that although ESG counterparty risk is critically important, ESG risks may also originate directly from the activities of the credit institution or investment firm.

3. Do you agree that, for the purpose of assessing their inclusion in institutions' and supervisors' practices from a prudential perspective, ESG risks should be approached primarily from the angle of the negative impacts of ESG factors on institutions' counterparties? Please explain why.

Response: We do agree, and suggest that the ESG activities of the institution itself should be considered in the normal course of business.

Rationale: Although ESG counterparty risk is critically important, ESG risks may also originate directly from the activities of the credit institution or investment firm and such risks should not be ignored.

4. Please provide your views on the proposed definitions of transition risks and physical risks included in section 4.3.

Response & Rationale: Generally speaking the definitions in this section are correct from our perspective; however, the consequences of the regulated entity itself should be part of any evaluation.

5. Please provide your views on the proposed definition of social risks and governance risks. As an institution, to which extent is the on-going COVID-19 crisis having an impact on your approach to ESG factors and ESG risks?

Response: The definition of "Social Risks" is directionality correct at a high level but is incomplete. The definition should be expanded to recognize the reality that ESG risks may stem directly from the activities of credit institutions and investment firms.

Rationale: The definition should drill down to provide an overview of key areas that underlie the term. The European Commission's Action Plan: Financing Sustainable Growth language frames its reference of human capital and community with the critical words "investment in," which we think is extremely important. On balance we like the EU Commission's factors and suggest they be incorporated into an EBA definition of social risks.

The current COVID-19 environment illustrates how all three components of ESG risk may interact to heighten the impact if these risks where considered individually. In practice, the likely cascading of ESG risks suggests that impacts are best considered in tandem.

6. Do you agree with the description of liability transmission channels/liability risks, including the consideration that liability risks may also arise from social and governance factors? If not, please explain why.

Response: We do agree with this statement.

7. Do the specificities of investment firms compared to credit institutions justify the elaboration of different definitions, or are the proposed definitions included in chapter 4 also applicable to them (in particular the perspective of counterparties)? Please elaborate on the potential specificities of investment firms in relation to ESG risks and on how these specificities, if any, could be reflected in this paper.

Response: We do not see the need to define metrics by type of firm based on the type of business activities.

Rationale: There is no functional difference in how these terms will be applied by each type of entity.

Quantitative and qualitative indicators, metrics and methods to assess ESG risks (Chapter 5)

8. Please provide your views on the relevance and use of qualitative and quantitative indicators related to the identification of ESG risks.

Response: Qualitative and quantitative indicators will be relevant and used to mitigate ESG risks. Incremental changes in metrics will occur as new technologies are developed to better mitigate ESG risks and government related goals and policies adapt. The time horizon mismatch noted in paragraph 93d may be very significant as policies change, especially in regard to climate related factors.

Organizations will utilize qualitative and quantitative indicators similar in scope to those provided in the Discussion Paper to drive their ESG efforts. Supervisors should assure that credit institutions and investment firms understand how specific metrics foot to overarching goals and should examine the extent to which metrics are effectively utilized in programs designed to mitigate specific ESG risks. With reference to measures that can support better outcomes, as noted in paragraph 101 (page 54), consistent, updated ESG taxonomies will clearly improve responses to ongoing ESG challenges.

Rationale: Qualitative and quantitative indicators must foot to the mitigation of ESG risks and firms should assure that improvements to the metrics they utilize will lead to the desired outcome. Credit institutions should document how a specific metric relates to an overarching ESG goal and verify that measures accurately display progress to that goal.

In some situations, supporting one ESG goal may have an undesirable impact on another. Credit institutions, investment firms and regulators should be prepared to resolve such instances when they occur.

Wherever possible, stakeholders should come together to harmonize ESG terms and metrics. A common taxonomy is key to setting expectations in the field and will become even more important as continuous ESG risk monitoring tools develop. Standardized taxonomies will increase the capacity to identify, respond to, and report on ESG issues.

9. As an institution, do you use or plan to use some of the ESG indicators (including taxonomies, standards, labels and benchmarks) described in section 5.1 or any other indicators, inter alia for the purpose of risks management? If yes, please explain which ones.

Response: Yes, we expect these indicators, as described in Section 5.1, to be used for the purpose of risk management.

Rationale: Our UK/EU members do indicate that ESG risk metrics are important to them going forward and that they will be keeping a close eye on the final form of the EBA metrics to see how they can utilize those measures. Also, our mostly United States based members will utilize these ESG indicators over time. Carefully considered EBA guidance will be helpful to all supervised organizations in developing their ESG risk frameworks.

10. As an institution, do you use or plan to use a portfolio alignment method in your approach to measuring and managing ESG risks? Please explain why and provide details on the methodology used.

Response: Yes, we expect the portfolio alignment method to be utilized in measuring and managing ESG risks.

Rationale: The approaches are not mutually exclusive. We believe our members will utilize multiple approaches to optimize understanding of ESG risks in their portfolios.

11. As an institution, do you use or plan to use a risk framework method (including climate stress testing and climate sensitivity analysis) in your approach to measuring and managing ESG risks? Please explain why and provide details on the methodology used.

Response: Yes, we expect the risk framework method to be utilized in measuring and managing ESG risks.

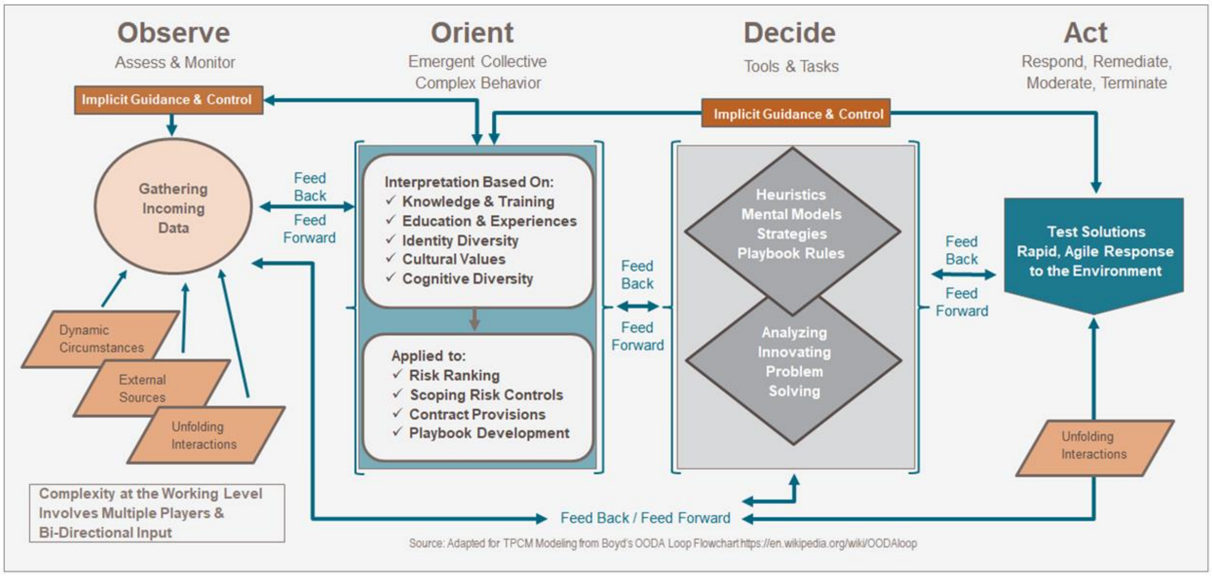
Rationale: The approaches are not mutually exclusive. We believe our members will utilize multiple approaches to optimize understanding of ESG risks in their portfolios.

12. As an institution, do you use or plan to use an exposure method in your approach to measuring and managing ESG risks? Please explain why and provide details on the methodology used.

Response: Yes, we expect the exposure method to be utilized in measuring and managing ESG risks.

Rationale: The approaches are not mutually exclusive. We believe our members will utilize multiple approaches to optimize understanding of ESG risks in their portfolios. With reference to the exposure method, there are an increasing number of approaches that link Key Performance Indicators (KPIs) to specific sets of risks to begin to facilitate a quantitative understanding of the combined impact of various ESG risk factors. We expect that KPIs will be examined using enhanced continuous monitoring processes to achieve a robust analysis of those components. In the form provided in this paper, Figure 7 does not reflect a comprehensive process as called out in the title of the figure "Comprehensive approach to the assessment of financial services ESG risks" (Source: EBA Discussion Paper 30 October

2020). If you want to depict a comprehensive process, we suggest a revised diagram. **Please see the pdf attachment (Comprehensive Risk Assessment Processes Schematic) uploaded with this response in question 12** for a figure that provides a similar cyclical version of the concept in the broader risk management sense.



13. As an institution, do you use or plan to use any different approaches in relation to ESG risk management than the ones included in chapter 5? If yes, please provide details.

N/A.

14. Specifically for investment firms, do you apply other methodological approaches, or are the approaches described in this chapter applicable also for investment firms?

N/A.

15. Please provide your views on the extent to which smaller institutions can be vulnerable to ESG risks and on the criteria that should be used to design and implement a proportionate ESG risks management approach.

Response and Rationale: To the extent that smaller institutions have less diversified, more geographically concentrated portfolios, they could be more vulnerable to ESG risks. A portfolio analysis could rapidly identify these risks.

16. Through which measures could the adoption of strategic ESG risk-related objectives and/or limits be further supported?

Response: As noted in the Discussion Paper, paragraph 101 (page 54), a unified ESG taxonomy can support harmonization of criteria and responses to potential and actual disruptions. A common taxonomy is key to setting expectations in the field and to fostering consistent continuous monitoring practices.

Rationale: Harmonization of ESG metrics across international jurisdictions is essential for organizations with widespread operations. Financial services regulators should come together to formally designate a specific forum (e.g. the Financial Stability Board, which has already published on climate-related disclosures) to develop a comprehensive set of ESG metrics, incorporating input from recent World Economic Forum (WEF) efforts.

17. Please provide your views on the proposed ways of how to integrate ESG risks into the business strategies and processes of institutions.

Response: Integration of ESG risks into business strategies and processes should include consideration of the impact of increasingly useful applications to deal with exposure method analysis.

Rationale: There are an increasing number of approaches that link KPIs and specific risks to allow for achieving a quantitative impact for ESG factors. These are not static measures, and should be reviewed periodically (e.g. continuous monitoring). For ESG risks, techniques do exist for monitoring KPIs. Exposure methodology has enough footing in emerging technology/continuous monitoring to provide such input for analysis with increasing ease and with a wide geographic scope.

18. Please provide your views on the proposed ways how to integrate ESG risks into the internal governance of institutions.

Response: We acknowledge the value of the COSO approach to integrating ESG risks into the internal governance of organizations (COSO and the World Business Council for Sustainable Development. Enterprise Risk Management: Applying ERM to Environmental, Social, and Governance Related Risks. October 2018. See chart "Example responsible, accountable, consulted informed RACI matrix" on page 103 of COSO report, appendix V in the document – attached as a pdf to this response and included in the full response pdf under our response to question 18).

Rationale: It is incumbent on boards to conduct oversight and ensure that ESG risks are properly incorporated into its organizational structures, processes, and operations. Boards should regularly evaluate the effectiveness of ESG efforts.

Governance structures should clearly identify ESG roles and responsibilities for the examination and management of ESG risks. COSO's model suggests that either the ERM Manager or the Chief Risk Officer (CRO) be the focal point for designing and implementing ESG program elements. In addition, skill sets should be commensurate with the roles assigned. Without an adequate cadre of ESG practitioners, effective risk management cannot take place.

103 (107 of 120) 75%

Appendix V: Example responsible, accountable, consulted, informed (RACI) matrix

The following is an example of a RACI matrix highlighting some common roles within an organization and their involvement throughout the ERM process.

ERM components	Board and sub-committee	Executive committee	ERM Director or CRO	Risk owners (includes sustainability for ESG-specific risks)	Sustainability practitioners
Governance and Culture	Accountable for setting the tone for governance, culture and risk appetite	Responsible for design and facilitation of the end-to-end ERM process	Responsible for design and facilitation of the end-to-end ERM process and lifecycle	Informed of the ERM process to support management of ESG issues	Informed of the governance model and process to support management of ESG issues
Strategy and Objective-Setting	Consulted and made aware of significant changes to the internal and external environment	Accountable for setting the business strategy, objectives and risk appetite	Responsible for facilitating the process for examining the business context and strategy	Consulted on the internal and external changes to identify shifts that may result in risks	Consulted on the internal and external changes and ESG-related impacts and dependencies
Performance: **Identify risks that will impact the business strategy and objectives**	Consulted and made aware of the critical risks impacting the strategy and approve selected risk responses	Accountable for identifying and disclosing the material risks that will impact the business strategy	Responsible for facilitating the process for identifying business impacts	Responsible for supporting risk identification and understanding	Consult with risk owners to support identification and understanding of ESG-related risks
Performance: **Assess and prioritize the severity of identified risks**		Accountable for assessing and prioritizing key risks and opportunities	Responsible for leveraging tools for risk assessment and prioritization	Responsible for assessing the risk severity on the business and strategy	Consult with risk owners on the tools and knowledge to support quantification and prioritization of ESG-related risks
Performance: **Develop and implement responses to prioritized risks**		Accountable for appropriate allocation of resources to manage prioritized risks	Responsible for coordinating the development of risk responses for each risk area	Responsible for developing appropriate responses to address the risk and implement the response	Consult with risk owners to develop responses to prioritized risks
Review and Revision	Consulted on the status of risks and the ERM process	Accountable for monitoring the ERM activities and ensuring risks stay within the company risk appetite	Responsible for developing a consolidated view of metrics to monitor risks	Responsible for developing metrics to monitor risks and business context for when the risk shifts outside tolerance levels	Consulted on appropriate metrics for monitoring ESG-related risks and determine aspects to report on to internal and external stakeholders
Information, Communication and Reporting	Consulted on ERM activities and processes disclosed externally	Accountable for communications of ERM activities and processes internally and externally	Responsible for developing internal and external communications on ERM activities and processes	Responsible for providing inputs for internal and external communications on ERM activities and processes	Consulted on the inputs for internal and external communications on ESG-related aspects of ERM activities and processes

19. Please provide your views on the proposed ways how to integrate ESG risks into the risk management framework of institutions.

Response & Rationale: Integrating ESG risks into the risk management framework of any organization starts at the governing board level and requires structures that clearly identify ESG risk roles and expectations. At the governing board level, parsing ESG program elements to specific committees – (e.g. risk, audit, public responsibility, risk and cybersecurity, human resources) will help insure ongoing appropriate focus on ESG issues. Companies with comprehensive enterprise risk management structures will have a head start on this process. In companies with less developed risk structures and understanding of ESG risks, boards should reach out to external experts for guidance and recruit risk personnel who can lead a drive to process maturity. Boards should authorize regular independent evaluations of ESG risk effectiveness to ensure that programs are operating appropriately.

ESG risk practitioners must have appropriate skill sets to ensure that issues are correctly addressed and that ESG risks are considered in various planning exercises (product development, strategic planning, etc.). Embedding ESG risk management into organization-wide processes requires an ongoing management commitment and periodic, regular program evaluation.

20. The EBA acknowledges that institutions' approaches to environmental, and particularly climate-related, risks might be more advanced compared to social and governance risks, and gives particular prominence in this report to the former type of risks. To what extent do you support this approach? Please also provide your views on any specificities associated with the management of social and governance risks.

Response: We agree that institutions may have more maturity around environmental risks, making this a reasonable component around which to base management of other ESG risks. However, any EBA guidance should not focus on the prominence of environmental risks over social and governance risks in a manner that might imply that environmental risk is more important in any way than social or governance risks.

We recommend including the more precise core metrics and exposures as included in the World Economic Forum (WEF) 2020 – Measuring Stakeholder Capitalism: Towards Common Metrics and Consistent Reporting of Sustainable Value Creation white paper). For example: impacts for training; number of jobs added; pay equality range of remuneration in priorities areas – women/men; and wage level percentages – such as ratio of standard entry level compared to local minimum wage.

Rationale: Regarding management of social and governance risks, the importance of these metrics is being reinforced by emerging news reports on forced labor, minimum age, workplace safety, and other indicators in social risks (as aligned with EBA indicators on page 149 of the Discussion Paper). With regard to both social and governance risks, with indicators such as data privacy, the EU has a strong benchmark of standards. The conclusion is that a clear end goal has to be established when discussion on metrics takes place and their application to measure activities. For example, the metric of "Engagement in poverty reduction/aid programmes" relative to the factor "poverty/famine" and the indicator "Engagement in poverty reduction/aid programmes", where the metric of engagement is not enough to determine whether there is a positive effect on reducing poverty and famine.

With reference to the WEF metrics, the value of these metrics is that they are more finely honed and are tied to a specific, measurable outcome.

21. Specifically for investment firms, what are the most relevant characteristics or particularities of business strategies, internal governance and risk management that should be taken into account for the management of the ESG risks? Please provide specific suggestions how could these be reflected.

Response & Rationale: The same risk management construct is required regardless of the type of firm. The accommodation for the risks and the impacts of the potential risks are different for the two types of firms based on their book of business and that firms' known and potential ESG vulnerabilities; however, the same analysis and judgment is required by both types of firms for robust management around ESG risks.

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

Response: The structure and ongoing incorporation of ESG factors in the firm's long-term strategies, risk appetite framework, and operational elements is critical to effectively managing the long term health of the institution and, therefore, must be an essential component of business model analysis for credit institutions.

Rationale: Section 7.5.2, paragraph 340-345 discusses the importance of applying valuation of exposure by stranded assets and other ESG factors. With regard to the ESG factors listed in paragraphs 302-303, these factors may be more important when dealing with environmental issues in particular. Social and governance issues may not reflect the same types of geographic constraints that are described in 302.

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.

Response: Yes, we do agree with the need to extend the time horizon as described in paragraph 305 and elsewhere in this Discussion Paper. We believe that will be a challenging undertaking.

Rationale: The caveat with extended time frames is the need to assume that ESG-related targets will change in response to market forces, including environmental and socio-political forces, which may in fact be at cross purposes. Indicators, such as mandates for electric cars, will have significant impact on markets in ways that do exhibit the need for supervisors to evaluate long-term strategies and ESG risk-related objectives and/or limits. Valuation factors would be responsive to these types of changes and would need to be viewed over the long term by supervisors.

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.

Response & Rationale: Although it is very important for a regulator to assess how well a credit institution has incorporated ESG risks into its risk culture and its organization's controls, it is equally important that governing boards charter regular independent evaluations to assess the effectiveness of ESG controls and the integration of ESG elements into organizational planning processes. Such evaluations should not be limited to consideration of ESG counterparty risks but should also consider how credit and investment firms conduct their own business. Regulators should develop common templates across international jurisdictions as soon as is practicable.

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

Response: It is critical for ESG risk considerations to be taken into account in the assessment of risks to capital, liquidity, and funding. A portfolio alignment method would be the first go-to methodology to identify this type of risk and how those factors touch business operations. That method may then be used in concert with the other methods identified in the Discussion Paper.

Rationale: A review of the control framework around ESG risks should drive the institution's credit strategy. The stranded assets discussion in 7.5.2, paragraphs 341-345 is very relevant in long-term planning. Changes to value of markets, such as oil and gas, will of course exert significant impact on business models where the primary draw to the business is based on a commodity where long-term values are unclear and may decline precipitously.

26. If not covered in your previous answers, please provide your views on whether the principle of proportionality is appropriately reflected in the discussion paper, and your suggestions in this respect keeping in mind the need to ensure consistency with a risk-based approach.

Response: We generally agree with the discussion and perspective expressed in paragraphs 149, 207, and 276.

Rationale: With regard to smaller institutions, those firms may have less diversified, more geographically constrained portfolios, and in some circumstances may be more vulnerable to ESG risks. However, some smaller firms may also be less well-equipped to identify and remediate those risks because they lack appropriate resources (e.g. sustainability practitioners, as noted in the COSO document referenced in our response to question 1, Appendix V). While the negative systemic impact may be less with smaller institutions, the overall impact may still be significant enough to warrant a response by supervisory authorities.

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?

Response: The paper correctly identifies physical, transition, reputation, and liability risks as market risks for both credit institutions and investment firms. These are all key risks that we agree are channels that supervisors could utilize effectively for review of credit institutions.

In particular, the following should remain in EBA guidelines. As noted in section 7.5.3 paragraphs 346-349, a firm should have documented, ESG-related criteria and policies for investment and lending to indicate that the institution is "carefully reflecting on its market exposures, even in cases where the appropriate data are not available." Where "no data is available," it would be difficult to reflect on the market exposure of a risk; therefore, that phrase might be replaced with "…where the quantitative impact of a risk may not be precisely defined."

Rationale: The other content in section 7 reflects the same type of care being taken in examining the ESG factors defined within the paper. “The use of scenario analysis and stress testing is very relevant when assessing the resilience of credit institutions against specific scenarios.” As noted in these conclusions and recommendations, it is essential that the EBA “capture these risks in dedicated guidelines and, based on the recognised materiality of the ESG risks, these risks should be introduced in the CRD and IFD.”

Annex 1

28. As an institution, do you use or plan to use some of the indicators and metrics included in Annex 1? If yes, please describe how they are used in relation to your ESG risk management approach.

NA

29. If relevant, please elaborate on potential obstacles, including scope of applicability, granularity and data availability, associated with the indicators and metrics included in Annex 1.

NA