AECM response to the EBA Consultation on draft guidelines on the management of ESG risks

The European Banking Authority (EBA) launched a public consultation on draft Guidelines on the management of Environmental, Social and Governance (ESG) risks. The draft Guidelines set out requirements for institutions for the identification, measurement, management and monitoring of ESG risks, including through plans aimed at addressing the risks arising from the transition towards an EU climate-neutral economy. The consultation runs until 18 April 2024.

Question 1: Do you have comments on the EBA's understanding of the plans required by Article 76(2) of the CRD, including the definition provided in paragraph 17 and the articulation of these plans with other EU requirements in particular under CSRD and the draft CSDDD?

The European Association of Guarantee Institutions (AECM) generally shares the EBA's understanding of prudential (transition) plans, which provides a comprehensive and necessary consideration of ESG risks as the EU transitions towards a climate-neutral and sustainable economy. However, the definition of plans should insist further on the necessity to align prudential (transition) plans with other EU requirements for small and non-complex institutions (SNCIs). Indeed, AECM members are most often SNCIs with a promotional role to catalyse long-term finance through guarantees, in support of the commercial banking sector. Guarantee institutions facilitate access to finance for SMEs while contributing to economic development at local and national level. Their SME clients still find it difficult to include ESG considerations in their activity, due to often limited resources and capacity. In that sense, our members try to support their clients in their sustainable transformation, faithfully to their promotional mandate. We are concerned prudential (transition) plans could harm the competitiveness of SNCIs such as promotional guarantee institutions. Our members should not be subject to multiple queries from their different counterparts due to conflicting objectives. EU regulatory requirements must be constantly streamlined and harmonised to avoid unwanted redundancy that could significantly impact SNCIs. Therefore, the AECM calls upon the EBA to find a balanced approach in drafting the guidelines on the management of ESG risks, which should accelerate a greening of our economy without harming its smallest players.

Moreover, regarding the provisions of paragraph 16 and 17, the EBA may also clarify the sectorial materiality concept – that should be determined not only by the alignment with the EU Taxonomy but also taking into consideration the financial materiality of the sectors / exposures (i.e., to avoid undue efforts drafting plans for sectors without a relevant financial exposure – on or off-balance sheet).

It should also be recognized that promotional banks and guarantee institutions perform a central role managing social goals at European level (e.g., regional cohesion) – thus, the climate (transition and physical principles) pillar should provide for exceptions (or limited ambition in terms of the targets) based on the institution's business model (in this case, justified by the social goals which are, most of the times, determined by European-led initiatives).

Finally, further clarifications should be given by the regulator on the harmonised definition and uses for these tools: both on the CSRD and Pillar 3 ESG disclosures there are requirements related to transition planning, as recognized by the EBA on the 'background notes' to this consultation. A harmonized (and single) framework should be applicable – it should be always risk driven, including all the details recommended by the CSRD and Pillar 3 and necessarily supported by business assessments/ projections. Herein, the EBA should clear avoid any practice of creating multiple plans depending on the applicable requirement.

Question 2: Do you have comments on the proportionality approach taken by the EBA for these guidelines?

A majority of AECM members are SNCIs, so the issue of proportionality is extremely important to us. We welcome specific provisions in the guidelines that enable SNCIs to implement less complex or sophisticated internal governance and risk management arrangements, relying on qualitative considerations and simplified methodologies. However, the proportionality approach can be further promoted, especially, for the CRD-based transition planning. The business model of national promotional banks will make it difficult to determine, objectively, the transition impacts resulting from their loans / guarantees – as such, the obligation of transition planning should be adapted, to incorporate additional simplifications for this type of institutions (e.g., being more flexible in terms of the targets' definition and minimum set of sectors – as it is suggested in the paragraph 36 for the portfolio alignment methodology).

Question 3: Do you have comments on the approach taken by the EBA regarding the consideration of, respectively, climate, environmental, and social and governance risks? Based on your experience, do you see a need for further guidance on how to handle interactions between various types of risks (e.g. climate versus biodiversity, or E versus S and/or G) from a risk management perspective? If yes, please elaborate and provide suggestions.

While recognising the individual importance of climate, environmental, social and governance risks, we welcome that the guidelines put emphasis on environmental and social risks, which yield the highest impact on the financial stability of institutions, and that requirements on governance risks are kept to a minimum, as they are traditionally well identified and managed (e.g., through the credit rating models where the governance, internal control framework and overall strategy are usually assessed).

Moreover, AECM members would like to insist that their SME clients have often little data on their environmental, social and governance performance, so here again the interaction between EU requirements, such as CSRD and CSDDD, should be consistent and compatible. The availability of reliable, adequate, low-cost data is a major prerequisite for the development of an ESG risk management framework, which is particularly challenging for SNCIs. While data availability has indeed improved with the progressive implementation of the EU sustainable finance framework, it is still nowhere near as granular and quantitative as financial reporting.

Question 4: Do you have comments on the materiality assessment to be performed by institutions?

AECM welcomes the reduced frequency of the materiality assessment of ESG risks for SNCIs. However, ESG risks materiality assessments should focus primarily on the financial materiality of ESG risks rather than on the environmental and social materiality. While we support the concept of double materiality, environmental and social materiality is particularly hard to assess for guarantee institutions that have almost exclusively SME clients. For our members, which operate with very limited resources, it would be incredibly difficult for them to understand and assess their SME client's economic and financial impact. Especially as SMEs might just report voluntarily and thus no individual data of each client are available. Furthermore, the impact of individual clients is questionable and thus proxies and estimates should play a major role to avoid overburdening SNCIs and SMEs to collect data with great effort due to the trickle-down effect that exceed the usefulness of having it on a detailed level.

In addition, further clarification should be provided on the concept of "quantitative views" for the materiality. It is our understanding that, at the materiality assessment stage, a quantitative view may be, for instance, an "exposure at risk" and not necessarily a P/L or capital / RW impact. Thus, clear differentiation should be promoted between the assessment of risks (using qualitative and quantitative views) and risk quantification/measurement (which should be obviously based on a capital or liquidity impact measurement).

Question 5: Do you agree with the specification of a minimum set of exposures to be considered as materially exposed to environmental transition risk as per paragraphs 16 and 17, and with the reference to the EU taxonomy as a proxy for supporting justification of non-materiality? Do you think the guidelines should provide similar requirements for the materiality assessment of physical risks, social risks and governance risks? If yes, please elaborate and provide suggestions.

The specification of a minimum set of exposures is a delicate matter, especially for SNCIs. In order to set a minimum set of exposures for a materiality assessment, institutions need the capacity to develop methodologies to translate already limited data into tangible risk-data, which is particularly demanding for SNCIs with limited access to data. In that sense, for institutions not subject to EU taxonomy, reference to existing information, proxies and estimates for reporting on the ESG risks of SME portfolios should be deemed adequate. Once again, the Guidelines should ensure safeguards for smaller institutions to assess materiality in a proportionate and accessible manner.

The use of the EU Taxonomy may be a requirement for justifying the non-materiality but should not be limited to that. Taxonomy may be used in combination with additional tools (e.g., CPRS) given the lack of information on Taxonomy performance, especially for SMEs. In addition, the materiality of the exposure should always be a relevant driver for the materiality assessment and for the transition planning obligations (i.e., sectors that are not material for the institution's business model should not be part of the transition plan).

Finally, further guidance on the assessment of physical, social, and environmental risks is welcomed – these are overarching risk factors, not specific to any individual business model or institution, therefore all the guidance received will promote the market practices' robustness.

Question 6: Do you have comments on the data processes that institutions should have in place with regard to ESG risks?

For SNCIs, ESG assessment methodology and data collection capacities are two distinct challenges. In terms of data processes, it is always a challenge for smaller institutions to collect data from their SME clients, as they rely mostly on sector-specific estimates and averages. The assessment is thus not always accurate for each company. Henceforth, the Guidelines should aim to provide additional guidance to SNCIs with limited data for their assessment of financial impacts stemming from ESG factors. In other words, the EBA should help smaller institutions by setting a clear framework for the management of ESG risks that is not detrimental when data is either lacking or inaccurate.

Question 7: Do you have comments on the measurement and assessment principles?

AECM members recognise the need to quantify environmental, social and governance risks, but the proposed risk assessment/measurement methods are only applicable to environmental risks. Social and governance risks are lacking guidance/requirements in terms of quantification. The EBA should clarify the approach for measuring these risk categories.

In addition, it should be clear that risk measurement is intrinsically related to the impacts of the ESG risk factors on credit, concentration, operational, market or liquidity risk rather than an individual quantification/ measurement at "ESG level".

Question 10: Do you have comments on the ESG risks management principles?

The guidelines state that institutions should develop a robust and sound approach to managing and mitigating ESG risks over the short, medium and long term, including a time horizon of at least 10 years. A time horizon of 10 years or longer is feasible and adequate for many institutions. However, promotional banks and guarantee institutions members pursue business models and funding mandates that are characterised by shorter terms and observation periods. This also applies to the period typically considered in the risk management process for material risks. We therefore propose that the wording here be adapted to a long time horizon so that a suitable definition can be made for the institutions on the basis of the business model and the respective funding mandate.

Question 15: Do you have comments on section 5.6 – consideration of ESG risks in credit risk policies and procedures?

The guidelines state that for the purposes of integrating ESG risks in credit risk policies and procedures as set out in paragraph 56 of the EBA Guidelines on loan origination and monitoring, institutions should ensure prudent and clear processes to identify, measure, manage, mitigate and monitor the impacts of ESG risks. It should be recognized that promotional banks and guarantee institutions perform a central role managing social goals at European level – thus, the climate (transition and physical principles) pillar should provide for exceptions regarding mitigation based on the institution's business model. We therefore propose that the wording here be adapted to processes to identify, measure, manage, and monitor the impacts of ESG risks.

About us

The 46 members of the **European Association of Guarantee Institutions (AECM)** are operating in 32 countries in Europe. They are either private/mutual sector guarantee schemes or public promotional institutions or banks. Their mission is to support SMEs in getting access to finance. They provide guarantees to SMEs that have an economically sound project but do not dispose of sufficient bankable collateral. This so-called SME financing gap is recognised as market failure. By guaranteeing for these enterprises, guarantee institutions effectively address this market failure and facilitate SMEs' access to finance. The broader social and economic impact of this activity includes the following:

- Job creation and preservation of jobs by guaranteed companies
- Innovation and competition: crowding-in of new ideas leading to healthy competition with established market participants
- Structure and risk diversification of the European economy
- Regional development since many rural projects are supported
- Counter-cyclical role during crises

AECM's members operate with counter-guarantees from regional, national, and European level. At the end of the year 2022, AECM's members had about bEUR 267 of guarantee volume in portfolio, thereby granting guarantees to around 5.2 million SMEs. AECM's members are by far the most important counterparts of the EIF concerning EU counter-guarantees, handling EU (counter-)guarantees from the very beginning in 1998.

Furthermore, AECM's work is strongly supported by its 5 partners.

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