Response of Nedcommunity to the European Banking Authority consultation on the Draft Guidelines on the management of ESG risks

17 April 2024

Nedcommunity, the Italian association of non-executive and independent directors, is pleased to provide with its comments the online consultation entitled "*Draft Guidelines on the management of ESG risks*" (the "**Consultation**") published by the European Banking Authority on 18 January 2024.

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CRD-based (transition) plans

The long-term nature and the profoundness of the transition process towards a climate-neutral and sustainable economy may entail significant changes in the business models of institutions and in the types and levels of risks they are confronted with. As a result, according to Article 76(2) of the CRD, institutions shall set out specific plans to monitor and address the financial risks arising from the transition and process of adjustment to the relevant Member States and Union regulatory objectives in relation to ESG factors, as well as, where relevant for international active institutions, third country objectives. Article 87a(5) subparagraph 2 of the CRD also states that, where relevant, the methodologies and assumptions sustaining the targets, the commitments and the strategic decisions disclosed publicly by institutions under Directive 2013/34/EU, or other relevant disclosure and due diligence frameworks, shall be consistent with the criteria, methodologies, assumptions, and targets used in the plans to be prepared in accordance with the CRD.

Several EU legislative initiatives such as the Corporate Sustainability Reporting Directive (CSRD) and the proposal for a Corporate Sustainability Due Diligence Directive (CSDDD) also include provisions related to plans, commonly called transition plans, that should be disclosed and/or developed by sets of non-financial and financial corporates to ensure that their business model and strategy are compatible with the transition. In addition, the European Commission's (EC) recommendation of June 2023 on facilitating finance for the transition to a sustainable economy includes non-binding recommendations to undertakings on the use of transition plans.

These guidelines deal with CRD-based plans and provide a common understanding of what a risk-based (transition) plan entails in the prudential space, while ensuring interoperability with other legislative initiatives and EC's recommendations to the largest possible extent.

Plans under non-prudential regulations, such as CSRD and CSDDD, focus on the compatibility of business models of undertakings with the 1.5-degree pathway and the objective of the EU to achieve net-zero greenhouse gas emissions by 2050 or on the due diligence policies, processes and activities conducted to identify and address actual or potential adverse impacts from institutions' activities. Plans under CRD on the other hand are focused on (prudential) risks; they constitute a new risk management tool through which institutions should understand, assess and manage the risks stemming from their activities and exposures in view of the process of adjustment towards the regulatory sustainability objectives of the jurisdictions they operate in, or broader transition trends towards a sustainable economy. In the EU, relevant objectives related to ESG factors include the climate targets for 2030 and 2050 included in the European Climate Law, i.e. respectively the reduction of the level of greenhouse gas emissions by 55% compared to 1990 and achieving net-zero emissions.

These guidelines do not require CRD-based plans to set out an objective of fully aligning with Member States or Union sustainability objectives or one specific transition trajectory.

CRD-based prudential plans aim at ensuring that institutions comprehensively assess and embed forward-looking ESG risks considerations in their strategies, policies and risk management processes, including by taking a long-term perspective and with a view to ensuring their soundness and resilience to the risks faced. Hence, the goal, focus and contents of CRD-based (transition) plans may have some specificities compared to non-prudential transition plans. At the same time, by incentivizing institutions to develop their understanding of, and strategic response to, (prudential) risks arising from the transition process, the elaboration of plans under CRD may also support institutions in addressing other requirements, such as CSDDD requirements and CSRD disclosure requirements on business strategies and transition plans. As recognized by the EC's recommendation on transition finance, sound transition planning can help undertakings minimise the strategic and financial risks associated with the transition and provide clarity on their business strategy.

It is also important to bear in mind that the goal of prudential plans is not to force institutions to exit or divest from carbon intensive sectors but rather to stimulate institutions to proactively reflect on technological, business and behavioral changes driven by the sustainable transition, the risks and opportunities they entail, and prepare or adapt accordingly through structured transition planning, including by engaging with and where needed supporting their clients, notwithstanding other mitigation actions consistent with sound risk management.

Moreover, CRD-based plans are closely related to the policy proposals included in the EBA report on ESG risks management and supervision, which recommended institutions to integrate ESG risks into their processes, including by extending the time horizon for strategic planning to at least 10 years, at least qualitatively, and by testing their resilience to different scenarios.

Against this background, CRD-based (transition) plans, or prudential (transition) plans, can be understood as the overview and articulation of the strategic actions and risk management tools deployed by institutions, based on a forward-looking business environment analysis, to demonstrate how an institution ensures its robustness and preparedness for the transition towards a climate and environmentally resilient and sustainable economy. Prudential (transition) plans aim at ensuring that institutions identify, measure, manage and monitor ESG through setting targets and milestones at regular time intervals.

These plans should be embedded in the institutions' strategy and risk management and address the risks arising from the structural changes that may occur within the industries and counterparties institutions are exposed to, according to the transition pathways and adaptation frameworks compatible with the legal and regulatory objectives of the Member States, EU, and where relevant other jurisdictions in which they operate.

These guidelines refer to transition planning as the internal strategic and risk management processes undertaken by institutions to prepare for a transition to a more sustainable economy and implement their transition-related strategy.

Acknowledging the fast-evolving developments related to transition plans and the need to preserve the responsibility of management bodies to set the overall business strategies and policies, these guidelines focus on processes and principles with an overview of the main features and core expectations of sound risk-based prudential (transition) plans while leaving flexibility and responsibility to institutions as to specific details and individual internal strategies.

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*?.

> We have no comments on the above mentioned EBA's understanding. However, we believe that the Guidelines should mention that the management body has to be actively involved in the decision-making process related to ESG risks, starting from scenario analysis and the early stage of the definition of the business plan. Establishing appropriate reporting guidelines and rules may help boards and management to act according to rules and in compliance with the market and regulators' expectations, assuming that proportionality is taken into proper consideration.

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Proportionality

The guidelines have been drafted taking into account the proportionality principle set out in Article 87a(2) of the CRD. Since these guidelines cover internal governance and risk management arrangements of institutions, including CRD-based prudential (transition) plans, they will apply in accordance with the general principle of proportionality applicable to internal governance and risk management arrangements, as laid out in Title I of the EBA guidelines on internal governance.

The guidelines take into account that smaller institutions may not be immune to ESG risks, for example due to potential concentrations of exposures in ESG-sensitive economic sectors or geographical areas prone to physical risks. All institutions should therefore implement ESG risks management approaches that reflect the materiality of ESG risks associated with their business model and scope of activities.

These guidelines establish in Section 4.1 that institutions should rely on their materiality assessments of ESG risks to design and implement proportionate strategies, policies, processes and systems. These guidelines also take into account that small and non-complex institutions (SNCI) may implement less complex or sophisticated arrangements, such as through a higher extent of qualitative considerations and/or estimates and proxies as well as less numerous and less granular methodologies, provided that this does not put at risk their ability to manage ESG risks in a sufficiently safe and prudent manner and in line with their materiality assessment.

All references to institutions should be understood as encompassing both SNCIs and other institutions, unless the guidelines introduce differentiated specific provisions.

2) *Do you have comments on the proportionality approach taken by the EBA in these guidelines?*

> We have no comments on the proportionality approach drafted in the guidelines.

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Environmental risks and ESG risks

As reflected in the CRD provisions and in line with the sequenced approach adopted under other EBA regulatory products on ESG risks such as the Implementing Technical Standards on Pillar 3 disclosures, the guidelines put emphasis on environmental risks while still containing some minimum requirements on the remaining categories of ESG risks.

While institutions are more advanced on the measurement and assessment of climate-related risks, it is important that institutions progressively develop tools and practices that aim at assessing and managing the impact of a sufficiently comprehensive scope of environmental risks, extending beyond climate-related ones, such as risks stemming from degradation of ecosystems and biodiversity loss, as well as of other ESG factors.

In addition, it should be kept in mind that institutions can be impacted by (so-called 'financial materiality') or have an impact on (so-called 'environmental and social materiality') environmental and social risks through their core business activities, i.e. their lending to counterparties and their investments in assets. On the financial materiality side, the economic and financial activities of counterparties or invested assets can be negatively impacted by environmental or social factors, affecting the value of such activities which might translate into a financial impact on the institution. On the environmental and social materiality side, the economic and financial activities of counterparties or invested assets can have a negative impact on environmental and social factors, which could in turn translate into financial impact on the institution. The assessment and management of environmental and social risks should take both of these dimensions into account to the extent that they affect the financial risks institutions are exposed to.

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.*

We have no comments on the approach above described.

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Materiality assessment

As part of the reference methodology for institutions' identification and measurement of Environmental, Social and Governance (ESG) risks to be included in their strategies and internal procedures, institutions should provide for regular performance of a materiality assessment of ESG risks. That assessment should be performed at least every year or, for small and noncomplex institutions (SNCI), every two years or more frequently in case of a material change to their business environment in relation to ESG factors,such as significant new public policies or shifts in the institution's business model, portfolios and operations.

The ESG risks materiality assessment should be performed as an institution-specific assessment which should consider the potential effects of ESG risks on all conventional financial risk categories to which institutions are exposed, including credit, market, liquidity, operational, reputational, business model and concentration risks. ESG risks materiality assessments should provide institutions with a view on the financial materiality of ESG risks for their business model and risk profile. They should be consistent with and integrated into other materiality assessments conducted by institutions, such as those made for the purpose of the Internal Capital Adequacy Assessment Process (ICAAP).

Institutions' internal procedures should provide for assessing the materiality of ESG risks across short (i.e. less than 3 years), medium (3 to 5 years) and long-term time horizons, including a time horizon of at least 10 years.

With a view to comprehensively capturing potential impacts of ESG risks, inputs and factors considered in the materiality assessment should include at least the following: a) the consideration and use of both qualitative and quantitative elements and data; b) the assessment of the impact of ESG risks on the most significant activities, services and products; c) with regard to environmental risks, the assessment of both transition and physical risk drivers, including through a review of the main economic sectors that assets being financed support or that the institution's counterparty has as its principal activity, and geographical areas in which collaterals are located. The assessment of transition risk drivers should take into account changes in policies, technologies and market preferences, as well as the extent to which institutions' most critical counterparties or, in the case of significant SME or real estate portfolios, average of counterparties may diverge from transition objectives of the jurisdictions where they operate; the assessment of physical risk drivers should take into account the level of both acute and chronic physical events associated with different transition pathways and climate scenarios.

The materiality assessment should use a risk-based approach that takes into account the likelihood and the severity of the materialization of the risks.

Institutions should at least consider their exposures towards sectors that highly contribute to climate change as specified in Recital 6 of Commission Delegated Regulation (EU) 2020/1818 i.e. the sectors listed in Sections A to H and Section L of Annex I to Regulation (EC) No 1893/200615 as materially subject to environmental transition risks.

By way of derogation from paragraph 16, institutions may consider some of the sectoral exposures referred to in paragraph 16 as not materially subject to environmental risks provided that they are able to justify it, such as when those sectoral exposures show a high level of alignment with Regulation 2020/852 (EU taxonomy).

Institutions should document as part of their ICAAP their ESG risks materiality assessments, including methodologies and thresholds used, inputs and factors considered and main results and conclusions reached.

4) *Do you have comments on the materiality assessment to be performed by institutions?*

We have no comments on the materiality assessment above mentioned.

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 nonmateriality? 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.*

We have no comment on question 5).

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Identification and measurement of ESG risks

Data process

Institutions' internal procedures should provide for the implementation of sound systems to collect and aggregate ESG risks-related data across the institution as part of the overall data governance and IT infrastructure and should have in place arrangements to assess and improve ESG data quality.

Institutions' internal procedures should first build on available ESG data, including by regularly reviewing and making use of sustainability information disclosed by their counterparties, in particular in accordance with the Directive 2013/34/EU17 or made available by public bodies.

Institutions' internal procedures should include the implementation of an approach to engage with their clients and counterparties as part of their new and existing business relationships with a view to capturing relevant ESG-related information, such as by designing specific questionnaires to be filled out at the time of credit origination and during periodic reviews, taking into account the size, complexity and ESG profile of their counterparties.

Institutions' internal procedures should provide for gathering information needed to assess the current and forward-looking ESG risk profile of counterparties, by aiming at collecting client and asset-level data. That data should, for large corporate counterparties as defined by Article 3(4) of Directive 2013/34/EU, include at least the following, where applicable:

a. For environmental risks:
   i. geographical location of key assets and exposure to environmental hazards (e.g. floods, water stress, soil erosion) at the level of granularity needed for appropriate physical risk analysis,
   ii. current and forecasted greenhouse gas (GHG) scope 1, 2 and 3 emissions in absolute and/or intensity such as per million-euro revenues or per units of production,
   iii. material impacts on the environment, including climate change and biodiversity, and related mitigation or adaptation policies,
   iv. dependency on fossil fuels, either in terms of economic factor inputs or revenue base,
   v. energy and water demand and/or consumption, either in terms of economic factor inputs or revenue base,
   vi. energy performance certificates and score in kWh/m² for real estate exposures,
   vii. adherence to voluntary or mandatory climate and environmental reporting,
   viii. litigation risk including imminent, pending or completed litigation case related to environmental issues,
   ix. forward-looking adaptive capacity, including transition plans prepared by non-financial corporates in accordance with Article 19(a) or Article 29(a) of Directive (EU) 2022/2464, where applicable.
b. For social and governance risks:
   i. compliance with and due diligence on social standards, such as ILO fundamental conventions or World Bank's Environmental and Social Standards,
   ii. governance practices,
   iii. adherence to voluntary or mandatory social and governance reporting,
   iv. negative impact on local communities, including due diligence policies to prevent that,
   v. litigation risks including imminent, pending or completed litigation case related to social or governance issues and due diligence policies.

Institutions should consider the list provided in paragraph 23 when determining the data points needed for the identification and measurement of ESG risks for other types of counterparties than large corporates.

Where data from counterparties and public sources is not available or has shortcomings in light of risk management needs, institutions should assess these gaps and their potential impacts. Institutions should take and document remediating actions, including at least the following measures: a) using estimates or proxies as an intermediate step, and seeking to reduce their use over time as ESG data availability and quality improve; b) assessing the need to use services of third-party providers to gain access to ESG data, while ensuring sufficient understanding of the sources, data and methodologies used by data providers and performing regular quality assurance.

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

Considering that the availability and quality of data is a crucial point, especially in the case of micro/small/medium enterprises (MSMEs), which are not included in the perimeter of the CSRD, and also considering the burden of reporting on such ESG matters represents for micro/small enterprises, Nedcommunity concern is below summarized with regard to point 24 (Availability of data)

According to point 24, "*Institutions should consider the list provided in paragraph 23 when determining the data points needed for the identification and measurement of ESG risks for other types of counterparties than large corporates*", boards should consider the list provided in paragraph 23 in the process of evaluating ESG risks related to counterparties different from large corporates. However, the process of identifying and measuring such risks should be consistent with the corporate's size and resources. Hence, we suggest to add the possibility of using sector level data and performing the analysis of ESG risks and factors at the portfolio level instead than at the level of individual borrowers. The path towards granular data points for these counterparties could be gradual and limited to selected data, also considering the related cost and burden on micro/small Enterprises and on banks themselves.

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Measurement and assessment principles

Institutions' internal procedures should include tools, methodologies and capabilities to: a) identify ESG risk drivers and their transmission channels to prudential risk types and financial risk metrics via the institution's exposures; b) map exposures and/or portfolios according to ESG risk drivers, and any concentration within or between them, c) measure and manage material ESG risks including with a forward-looking perspective.

Institutions' internal procedures should provide for a combination of methodologies, including exposure-based, portfolio-based, and scenario-based methodologies, as set out in paragraphs 30 to 39. The combination of the methodologies should be put together in a way that allows institutions to comprehensively assess ESG risks across time horizons. In particular, institutions should use the exposure method to obtain a short-term view of how ESG risks are impacting the credit risk profile and the profitability of counterparties, use the portfolio-based methods and scenario-based methods to support the medium term planning process and the definition of risk limits and risk appetite steering the institution towards its strategic objectives, and assess through scenario-based methods their sensitivities to ESG risks across different including long time horizons. 28.

With regard to environmental risks, institutions' internal procedures should enable to quantify these risks, such as by estimating the probabilities of materialization and magnitude of financial impacts stemming from environmental factors, and should establish Key Risks Indicators (KRIs) covering the short-, medium- and long-term time horizons and exposures and portfolios materially exposed.

With regard to social and governance risks, where quantitative information is lacking, institutions' internal procedures should provide for a method that starts by evaluating qualitatively the potential impacts of these risks on the operations of, and financial risks faced by, the institution, and gradually develop quantitative measures.

7) *Do you have comments on the measurement and assessment principles?*

> While measuring environmental exposure is increasing becoming a standard practice for banks and the related data quality is improving (or is on a path for improvement), the measurement of social and governance risks, at the exposure level, is less codified and more complex. Considering that boards have to consider also such profiles in their assessment, Nedcommunity believes that a clearer reference to applicable relevant international principles and to their concrete application would be helpful.

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Main features of reference methodologies for the identification and measurement of ESG risks

Exposure-based

At an exposure-based level, in line with the provisions in paragraphs 126 and 146 of the EBA Guidelines on loan origination and monitoring, institutions should have internal procedures in place to assess the exposure of their counterparties' activities and key assets to ESG factors, in particular environmental factors and the impact of climate change, and the appropriateness of the mitigating actions. To this end, institutions should ensure that ESG factors, in particular environmental factors, are properly reflected into their internal risk classification procedures, are taken into account in the overall assessment of default risk of a borrower and, where justified by their materiality, embedded in the risk indicators, internal credit scoring or rating models, as well as the valuation of collateral.

To conduct the assessment of environmental risks at exposure level, institutions' internal procedures should include a set of risk factors and criteria that capture both physical and transition risk drivers, including, where applicable, at least the following: a) the degree of vulnerability to acute and chronic physical risks, taking into account the geographical location and exposure to environmental hazards of the key assets of counterparties and guarantors or of the physical collateral backing the exposures, considering both on-balance sheet (loans and tangible assets) and off-balance sheet (guarantees) exposures; b) the degree of vulnerability to transition risks, considering the relevance of technological developments and environmental regulations applicable or foreseeable to the sector of activity of the counterparty, as well as the current and forecasted GHG emissions in absolute and/or intensity of assets, or energy performance in the case of residential or commercial real estate exposures; c) the likelihood of critical disruptions to the business model and/or supply chain of the counterparty due to environmental factors such as the impact of biodiversity loss, water stress or pollution; d) the (planned) maturity or term structure of the exposure or asset; e) mitigation opportunities, such as private or public insurance coverage for example based on available national catastrophe schemes or similar frameworks, adaptive capacity and transition planning of the counterparty.

Where data needed to assess certain criteria is not yet available, such as for smaller corporate counterparties, institutions should first seek to engage with clients to obtain the data or consider using sector-level characteristics as a first step and, when feasible, operate adjustments to account for counterparty-specific aspects.

With regard to the assessment of social and governance risks at exposure level, institutions should implement due diligence processes to verify the adherence of corporate counterparties to social and governance standards, taking into account the size of companies as well as applicable legislation and international principles (e.g. UN Guiding Principles on Business and Human Rights, OECD Guidelines for Multinational Enterprises, UN Convention against corruption), and assess potential future social and governance risks over short-, medium- and long-term time horizons, e.g. from rising standards or more stringent policies.

8) *Do you have comments on the exposure-based methodology?*

The definition of "*large institutions*" should be clarified. Additionaly we would suggest to replace IEA scenarios with NGFS.

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Portfolio-based

At a portfolio level and with regard to climate-related risks, institutions' internal procedures should provide for the use of at least one portfolio alignment methodology, which refers to methods that seek to assess the degree of alignment of institution's portfolios with climaterelated sustainability targets.

Institutions should implement one or more climate-related portfolio alignment methodologies which should enable the following steps: a) measure the potential gap between existing portfolios and benchmark scenarios consistent with the climate target applicable to the respective portfolios, based on relevant legal and regulatory objective in the EU, in particular reaching net-zero GHG emissions by 2050 and reducing emissions by 55% compared to 1990 level; b) assess the level of climate-related risks - in particular forward-looking transition risks - faced by their portfolios and related impacts on financial risks.

For the purposes of paragraphs 34 and 35, large institutions with securities traded on a regulated market of any Member State should measure the alignment of at least the following sectoral portfolios: power; fossil fuel combustion; automotive; aviation; maritime transport; cement, clinker and lime production; iron and steel, coke, and metal ore production, chemicals to the International Energy Agency (IEA) net zero emissions by 2050 scenario, or any comparable scenario subsequently issued by the IEA. Other institutions should determine to which sectoral portfolios the alignment methodology should apply, in line with the characteristics of their portfolios and materiality assessment. SNCIs may use representative samples of exposures in their portfolios to undertake portfolio alignment assessments.

With regard to other (not climate-related) ESG factors, institutions should provide for additional methodologies at a portfolio-based level in their internal procedures, in particular heat maps that highlight ESG risks of individual economic (sub-)sectors in a chart or on a scaling system as referred to in paragraphs 127 and 149 of the EBA Guidelines on loan origination and monitoring.

In addition, large institutions should develop: a) methods to identify natural capital dependencies, as part of analyses of nature-related or biodiversity risks; b) approaches to measuring the positive or adverse impacts of their portfolios on the achievement of the UN Sustainable Development Goals and evaluating potential related financial risks.

9) Do you have comments on the portfolio-based methodologies, including the reference to the IEA net zero scenario? Should the guidelines provide further details on the specific scenarios and/or climate portfolio alignment methodologies that institutions should use? If yes, please elaborate and provide suggestions.

We believe there is a concern that in Europe there could be a risk of diverting resources from strategic industrial sectors such as automotive, aviation, and maritime transport, which are also essential in terms of defense from a geopolitical perspective.

As a result our proposal is to eliminate the following point 36 on page 24: "*36. For the purposes of paragraphs 34 and 35, large institutions with securities traded on a regulated market of any Member State should measure the alignment of at least the following sectoral portfolios: power; fossil fuel combustion; automotive; aviation; maritime transport; cement, clinker and lime production; iron and steel, coke, and metal ore production, chemicals to the International Energy Agency (IEA) net zero emissions by 2050 scenario, or any comparable scenario subsequently issued by the IEA. Other institutions should determine to which sectoral portfolios the alignment methodology should apply, in line with the characteristics of their portfolios and materiality assessment. SNCIs may use representative samples of exposures in their portfolios to undertake portfolio alignment assessments*".

Furthermore, we don't believe it is necessary to set mandatory frameworks for banks on detailed scenarios and/or climate portfolio alignment methodologies, in order to avoid the risk of the banking sector being herded towards the use of the standardized models and data providers, with a negative indirect impact on the above mentioned strategic industrial sectors, which has to be considered by the board in its assessment.

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Minimum standards and reference methodology for the management and monitoring of ESG risks

ESG risks management principles

Based on their identification and measurement of ESG risks and the assessment of vulnerabilities and mitigation needs, 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.

Institutions should determine which risk management and mitigation tool(s) would best contribute to this, by considering a range of tools, including at least the following:

a) engagement with counterparties aiming at improving their ESG risk profile, in particular by:
   i. reviewing most important and most critical counterparties', or, in the case of significant SME or real estate portfolios, average of counterparties' activities and positioning in relation to ESG factors and trends;
   ii. asking for and assessing the soundness of at least large corporate counterparties' transition plans;
   iii. assessing large counterparties' processes to avoid and/or mitigate greenwashing risk;
   iv. encouraging counterparties to mitigate and disclose ESG risks;
b) adjusting financial terms (e.g. including contractually agreed safeguards and corrective measures), conditions (e.g. tenor) and/or pricing based on ESG risks considerations and the institution's risk strategy and internal capital policy;
c) embedding ESG risks within global, regional and sectoral risk limits, exposure limits and deleveraging strategies;
d) diversification of lending and investments portfolios based on ESG-relevant criteria e.g. in terms of economic sectors or geographical areas,

other risk management tools deemed appropriate in line with institution's risk appetite, such as possible reallocation of financing between and within sectors towards exposures with a better ESG risk profile.

10) *Do you have comments on the ESG risks management principles?*

In the spirit of the previous answer we suggest that the tools listed in this point, while certainly useful, should not be mandatory, but considered as examples of risk management and mitigation tools whose adoption boards should consider when appropriate. A higher degree of flexibility within the general framework, should be provided for banks, given their wide array of business models and specializations (e.g. sectoral).

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Strategies and business models

Institutions should account for ESG risks when developing, formulating and implementing their overall business and risk strategies, which should include at least:

a) understanding and assessing the business environment in which they operate, and how they are exposed to structural changes in the economy, financial system, and competitive landscape over the short, medium and long term as a result of ESG factors;
b) understanding and assessing how ESG risks, in particular environmental risk drivers including transition and physical risks, can have an adverse impact on the viability of their business model and sustainability of their business strategy, including profitability and revenue sources, over the short, medium and long term;
c) considering how these ESG risks, in particular environmental risk drivers including transition and physical risks, may affect their ability to achieve their strategic objectives and remain within their risk appetite;
d) formulating and monitoring ESG risk-related strategic objectives and related Key Performance Indicators (KPIs) as part of their plans as set out in Section 6, including by considering metrics listed in Section 6.3.

For the purposes of paragraph 43 and with a view to ensuring sufficiently informed strategies, institutions should consider insights gained from:

a) Portfolio alignment methodologies, as described in Section 4.2;
b) Environmental scenario analyses, taking into account the (potential) business environment(s) in which they might be operating in the short, medium and long term, including over a time horizon of at least 10 years;
c) Climate or environmental stress-tests, in line with paragraphs 30 and 31 of EBA Guidelines on institutions' stress testing.

Institutions should have a comprehensive understanding of their business model, strategic objectives and risk strategy from an ESG perspective and should ensure that their governance and risk management frameworks, including risk appetite, are adequate to implement them.

11) Do you have comments on section 5.2 – consideration of ESG risks in strategies and business models?

ESG risk, and in particular, environmental risk, has, in the past few years, not been included in the risks analysis of financial institutions due to the limited understanding of both the transmission mechanism and the direct and indirect impacts stemming from physical hazards (physical risk) and the transition towards a low-carbon economy (transition risk). The scenario is worse for the other two letters of the ESG acronym – Social and Governance – due to the urgency of environmental risk and because regulations (and, in particular, taxonomies), analysis and research are not as developed as the ones referred to for Environmental risk.

It is a matter of fact that every analysis cannot disregard a comprehensive understanding and assessment of the business environment and of how ESG risk can impact - negatively or positively if the financial institution is able to explore and capture opportunities - the financial risk affecting profitability, capital and liquidity of financial institutions.

As ESG risk must be considered as a financial risk - and not just a reputational risk - it must be embedded in the Risk Appetite Framework - approved by the boards on annual basis - and the related KPIs must be subject to quarterly monitoring. Of course, it must be taken in due consideration in the ICCAP, ILAAP and in the strategic planning processes. While all this is the ultimate goal, we have to consider the available resources and skills and must face in order to meet the requirements set by the Guidelines.

In conclusion, the Guidelines should allow banks to take into consideration the maturity of their business environment and to adopt a consistent phase-in approach.

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Risk appetite

Institutions should ensure that their risk appetite clearly defines and addresses all material ESG risks to which they are exposed. The risk appetite should specify the type and extent of the ESG risks institutions are willing to assume in their portfolio composition in relation to all relevant business lines, geographies - including jurisdictions and more granular geographical areas, economic sectors, activities and products, including as regards the portfolio's concentration and diversification objectives. 47. The risk appetite should be implemented with the support of appropriate ESG-related key risk indicators (KRIs), including potential limits, thresholds or exclusions. These KRIs should anchor ESG considerations in relation to products or financial instruments issued, originated or held by the institution, client segments, type of collateral and risk mitigation instruments. To this end, institutions should at least consider the metrics listed in Section 6.3. Institutions should use backward-looking and forward-looking indicators tailored to their business model and complexity. 48. Institutions should ensure that the risk appetite and associated KRIs are appropriately cascaded down within the institution, including all relevant group entities and business lines and units bearing risk, and are subject to monitoring and escalation processes as set out in section 5.8.

12) Do you have comments on section 5.3 – consideration of ESG risks in risk appetite?

We fully agree with the need to include ESG risks in the RAF. However, the lack of quantitative data can compromise the quality of the RAF thresholds and the consistency of ESG-related measure with other RAF indicators. For this reason, we suggest that the Guidelines may allow qualitative risk appetite statements for non-measurable ESG factors.

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Internal culture, capabilities and controls

Institutions should develop on an on-going basis their capabilities to identify, assess, mitigate as appropriate and monitor ESG risks. Institutions should ensure, as part of their training policy, that their management body and staff are adequately trained to understand implications of ESG factors and risks with a view to fulfilling their responsibilities effectively. The procedures on training for managers should take into account that knowledge of ESG factors and risks is relevant for the assessment of the suitability of members of the management body and for Key Function Holders in line with the Joint EBA and ESMA Guidelines on suitability assessments.

The sound and consistent risk culture that accounts for ESG risks implemented within the institution in accordance with Title IV of the EBA Guidelines on internal governance should include clear communication from the management body ('tone from the top') and appropriate measures to promote knowledge of ESG factors and risks across the institution, as well as awareness of the institution's ESG strategic objectives and commitments.

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For the purposes of Title V of the EBA Guidelines on internal governance, institutions should incorporate ESG risks into their internal control frameworks across the three lines of defense. The internal control framework should include a clear definition and assignment of ESG risks responsibilities and reporting lines.

The first line of defense should be responsible for undertaking ESG risks assessments, taking into account materiality and proportionality considerations, during the client onboarding, credit application and credit review processes, and in ongoing monitoring and engagement with clients as well as in new product or business approval processes. Staff in the first line of defense should have adequate awareness and understanding to identify potential ESG risks.

As part of the activities of the second line of defense, a) the risk management function should be responsible for undertaking ESG risks assessment and monitoring independently from the first line of defense, including by ensuring adherence to the risk limits, questioning and where necessary challenging the initial assessment conducted by business relationships officers; b) the compliance function should ensure adherence to applicable ESG risks rules and regulations and should, in relation to the sustainability commitments made by the institution and the respective policies set, provide advice on the operational - including legal, reputational and conduct risks associated with the implementation or failure to implement such commitments, c) the compliance function and the risk management function should be consulted for the approval of new products with ESG features or for significant changes to existing products to embed ESG aspects.

As third line of defense, the internal audit function (IAF) should provide an independent review and objective assurance of the quality and effectiveness of the overall internal control framework and systems in relation to ESG risks, including the first and second lines of defense and the ESG risks governance framework.

13) Do you have comments on section 5.4 – consideration of ESG risks in internal culture, capabilities and controls?

The adoption of an ESG culture is a widely shared objective. Consequently, it is a board responsibility to establish how:

- ESG objectives and risks are incorporated in the business lines and clear to the business managers and risk takers in terms of contribution to the value creation; and
- internal control functions are involved in the spread of this culture.

In particular, the role of internal control functions is crucial, in supporting the board to efficiently identify areas of improvement, together with the appropriateness of the processes, and the possibility to collect high quality and reliable data, which the Guidelines should acknowledge.

* * *

Internal Capital Adequacy Assessment Process and Internal Liquidity Adequacy Assessment Process

Based on their evaluation of the short, medium and long-term solvency or liquidity impact of ESG risks, institutions should incorporate material effects of ESG risks into their ICAAP and internal liquidity adequacy assessment processes (ILAAP) under both the economic and regulatory perspectives to assess and maintain on an ongoing basis the amounts, types and distribution of internal capital and liquidity that they consider adequate to cover the nature and level of ESG risks.

Institutions should include in their ICAAP and ILAAP frameworks a description of the risk appetite, thresholds and limits set for material impacts of ESG risks on their solvency or liquidity, as well as the process applied to keeping these thresholds and limits up to date.

Institutions should build on their risk assessment methodologies, including those referred to in Section 4.2, to identify and measure internal capital needs for individual exposures or portfolios assessed as more vulnerable to ESG risks.

With regard to environmental risks, institutions should include in their ICAAP a forward-looking view of their capital adequacy under an adverse scenario that includes specific environmental risks elements. In addition, institutions should specify any changes to the institution's business plan or other measures derived from climate/environmental risks stress testing and/or reverse stress testing, in line with paragraph 90 of EBA Stress Testing Guidelines.

Institutions should provide sufficient contextual information to understand their analysis of the capital and liquidity implications of environmental risks, including by providing clarity on methodologies used and underlying assumptions.

When integrating ESG risks in their ICAAP and ILAAP, the complexity of the processes and the degree of sophistication of the methodologies used by institutions should take into account their size and complexity, their materiality assessment as well as the differing levels of availability and maturity of quantification methodologies for environmental risks compared to social and governance risks.

14) *Do you have comments on section 5.5 – consideration of ESG risks in ICAAP and ILAAP?*

> Incorporating ESG risks in the internal capital and liquidity assessment processes is of utmost importance. However, Authorities should clarify how they will embed ESG factors and their influence on economic and financial parameters in the SREP. Base on that, banks will be better able to assess the influence of ESG risks on capital and liquidity adequacy. The stronger will be the links between banks ESG profiles and SREP decisions, the higher will be incentives for banks to consider ESG factors in their adequacy assessment processes.

* * *

Credit risk policies and procedures

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.

Institutions should develop and implement quantitative credit risk metrics with regard to environmental risks, in accordance with their risk appetite and covering most significant client segments, type of collaterals and risk mitigation instruments.

Institutions should ensure their credit sectoral policies, reflecting ESG risks, are cascaded down to clear origination criteria available to business lines and business relationships officers.

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

> ESG risks must be integrated in the creditworthiness assessment of every applicant and/or co-obligor. ESG factors can drive credit policies in terms of portfolio segmentation, credit allocation,

target selection. The analysis of ESG risks could improve the ability to perform an efficient and effective creditworthiness assessment with a material impact on at least the probability of default and the loss given default, if (and when) the underlined data is of appropriate quality. The most important barrier that can slower this process is represented by metrics and dataset. While for major companies the lack of data is not relevant, for smaller it is. Until when this lack wouldn't be faced the potential will not be exploited.

* * *

Policies and procedures for market, liquidity and funding, operational, reputational and concentration risks

Institutions should understand the current and potential future impact of ESG risks on the valuation of their positions subject to market risk, in particular for prudent valuation purposes, on their liquidity risk profile and buffers, and on their operational including liability risks, and reputational risks, including through the use of forward-looking analyses.

With respect to market risk, institutions should assess how ESG risks could affect the value of the financial instruments in their portfolio, evaluate the potential risk of losses on their portfolio and increased volatility in their portfolio's value, and establish effective processes to control or mitigate the associated impacts as part of their market risk management framework including where needed setting of internal limits for positions or client exposures.

With respect to liquidity and funding risk, institutions should assess how ESG risks could affect net cash outflows (e.g. increased drawdowns of credit lines) or the value of assets comprising their liquidity buffers and, where appropriate, incorporate these impacts into the calibration of their liquidity buffers or their liquidity risk management framework. In addition, institutions should assess how ESG risks could affect the availability and/or stability of their funding sources and take these risks into account in their management of funding risk, including by considering different time horizons and both normal and adverse conditions, which should reflect among others the potential impacts of ESG-related reputational risks, a situation of hampered or more expensive access to market funding and/or accelerated deposit withdrawals driven by ESG factors.

With respect to operational risk, institutions should assess how ESG risks could affect the different regulatory operational risk event types (internal fraud; external fraud; employment practices and workplace safety; clients, products, and business practice; damage to physical assets; business disruption and systems failures; execution, delivery, and process management) and their ability to continue providing critical operations, and should incorporate material ESG risks in their operational risk management framework.

With regard to environmental risks, institutions should: a) identify and label losses related to environmental risks, as drivers of the loss type categories, in their operational losses registers; b) use scenario analysis to determine how physical risk drivers can impact their business continuity; and c) take material environmental risks into account when developing business continuity plans.

Furthermore, institutions should assess and manage the impact of ESG risks on conduct risks, litigation risks, and reputational risks, including by considering potential risks associated with lending to and investing in businesses which may be prone to ESG-related controversies. Institutions should have in place sound processes to identify, prevent and manage conduct, litigation or reputational risks resulting from greenwashing or perceived greenwashing practices taking into account the ESAs high-level principles set out in Section 2.1.2 of the EBA Progress Report on greenwashing monitoring and supervision. That should be done at both the institution (e.g. in relation to sustainability commitments perceived as misleading) and the product or activity level (e.g. in relation to products and activities marketed as sustainable), including by monitoring legal developments, market practices, and controversies around alleged greenwashing practices. Institutions should also consider, where applicable, the reputational risks associated with the failure to deliver on their sustainability commitments or transition plans, or with the (perceived) lack of credibility of such commitments and plans.

With respect to concentration risk both in the trading and non-trading books, institutions should assess and manage the risks posed by concentrations of exposures, or where appropriate collaterals, in single counterparties, interdependent counterparties or in some industries, economic sectors, or geographic regions which may present a higher degree of vulnerability to ESG risks. To identify ESG-related concentration risks, institutions should consider the size or shares of their exposures that may be affected by ESG risks relative to total exposures. Institutions should take into account several ESG criteria amongst which GHG emissions, sectoral vulnerabilities, vulnerability of geographical areas to physical risks, and social or governance deficiencies or controversies identified in jurisdictions where exposures are located. Institutions should assess if and how ESG-related concentration risks aggravates prior financial vulnerability of exposures.

16) Do you have comments on section 5.7 – consideration of ESG risks in policies and procedures for market, liquidity and funding, operational, reputational and concentration risks?

On one hand, we fully share the need to adopt adequate "*Policies and procedures for market, liquidity and funding, operational, reputational and concentration risks*"; on the other hand, our concern regards the implementation of the forecasts referred to in point 68 on page 63.

In order to identify, assess, manage and monitor, with a long-term vision, the risks related to these goals, the institutions and their board, respecting principles of proportionality, should rely on (i) uniform metrics and methodologies, comparable at the level of the 27 EU Countries; and (ii) criteria applicable on the basis of datasets intelligible and qualitatively reliable.

For that purpose, we suggest to (i) identify ESG-related concentration risks; (ii) specify risk assessment methods to be applied in a uniform manner (connected to "*sectoral vulnerabilities, vulnerability of geographical areas to physical risks, and social or governance deficiencies or controversies identified in jurisdictions where exposures are located*"); and/or (iii) indicate globally recognized non-self-referential application standards. For the purpose of valuing collateral the IVSC International Valuation Standards could be referred to as they are applied globally.

For example, the Basel 3.1 international agreements introduces in a generic way a concept of «*prudent value*»[1] of collateral connected to a prudent property valuation sustainable for the entire duration of the loan for which, however, in the absence of methodological identification, numerous and very divergent application interpretations are emerging.

* * *

[1] See: CRE20 (Calculation of RWA for credit risk Standardised approach: individual exposures Version effective as of 01 Jan 2023), para 20.71(5) "Prudent value of property: the property must be valued according to the criteria in CRE20.74 to CRE20.76 for determining the value in the loan-to-value ratio (LTV). Moreover, the value of the property must not depend materially on the performance of the borrower. (*https://www.bis.org/basel_framework/chapter/CRE/20.htm*)

Monitoring

Institutions should monitor ESG risks through effective internal reporting frameworks that convey appropriate information and aggregated data to senior management and the management body, such as by integrating ESG risks into the regular risk reports or in the form of dashboards containing metrics that support effective oversight.

Institutions should monitor ESG risks on a continuous basis and ensure that they maintain an institution wide as well as, for most significant portfolios, a portfolio view of their vulnerability to ESG risks. Institutions should implement granular and frequent monitoring of counterparties, exposures, and portfolios assessed as materially exposed to ESG risks, including through incorporating considerations on ESG risks into regular credit reviews for medium-sized and large counterparties and/or by increasing the frequency and granularity of these reviews due to ESG risks aspects.

Institutions should set early warning indicators and thresholds and should have in place strategies and plans to take mitigation actions in case limits are exceeded, including through adaptations to business strategy and risk management.

Institutions should monitor a range of backward and forward-looking ESG risks metrics and indicators. SNCIs should consider using while other institutions should use at least the following indicators: a) Historical losses and forward-looking estimate(s) of exposures-at-risk and (potential) financial losses related to ESG risks, e.g. based on scenario-types methods; b) Amount and share of income (interest, fee and commission) stemming from business relationships with counterparties operating in sectors that highly contribute to climate change in accordance with Recital 6 of Commission Delegated Regulation (EU) 2020/1818 i.e. the sectors listed in Sections A to H and Section L of Annex I to Regulation (EC) No 1893/2006. Large institutions should introduce more granular monitoring metrics, such as by calculating income stemming from relationships with the most carbon-intense counterparties and/or companies excluded from EU Paris-aligned Benchmarks; c) A measure of the potential gap between existing portfolios and benchmark portfolios consistent with the climate target applicable to the respective portfolios based on relevant legal and regulatory objective, such as reaching net-zero GHG emissions by 2050, based on portfolio alignment methods described in Section 4.2 ; d) Scope 3 emissions, i.e. GHG financed emissions, at least for sectors towards which the institution has material exposures, and based on clear and documented methodologies. Examples of methodologies to compute the carbon emission of companies include the Global GHG Accounting and Reporting Standard for the Financial Industry, developed by the Partnership for Carbon Accounting Financials, or the Carbon Disclosure Project; e) The percentage of counterparties with whom the institution has engaged on ESG risks matters, e.g. in relation to their transition plans, at least for sectors and business lines which present material exposures to ESG risks, supplemented with information on the results and/or outcomes of such engagement; f) Ratios representing as part of the institution's total exposures the share of environmentally sustainable exposures financing activities that contribute or enable the environmental objective of climate change mitigation referred to in Article 9 point (a) of Regulation (EU) 2020/852, and the share of carbon-intense exposures, based on clear and documented methodologies. In addition, large institutions should complement this with monitoring metrics in the form of ratios representing, as part of their total exposures, the shares of Taxonomy-aligned exposures for other objectives of the EU Taxonomy as referred to in Article 9 points (b) to (f) of that Regulation, and the shares of exposures detrimental to the achievement of these objectives; for the purposes of determining exposures detrimental to the objective of biodiversity, large institutions should assess material negative impacts of their counterparties' production sites, processes or products on biodiversity; g) A breakdown of portfolios secured by real estate according to the level of energy efficiency of the collaterals; h) A measure of concentration risk related to physical risk drivers (e.g. measurement of exposures and/or collaterals in high flood risks or wildfire risks areas), such as by using a sufficiently granular geographical split of exposures; i) Any ESG-related litigation claims in which the institution has been, is or may become involved based on available information; j) Progress against all institution's targets set in relation to ESG risks and ESG objectives, including as part of the institution's plan as referred to in section 6 or as part of other sustainability commitments made by the institution.

When data needed to compute metrics is missing, institutions should follow the steps set out in paragraph 25.

17) *Do you have comments on section 5.8 – monitoring of ESG risks?*

We do not have any comment on this point.

* * *

Plans in accordance with Article 76(2) of Directive 2013/36 6.1

Key principles

Materiality assessment basis

The plansreferred to in Article 76(2) subparagraph 2 of Directive 2013/36/EU should be based on a robust materiality assessment of ESG risks faced by institutions, conducted in accordance with Section 4.1. Institutions should in particular identify the exposures or portfolios, and the economic activities and production capacities being financed, which may be materially subject to ESG risks arising from the process of adjustment of the economy they operate in towards the applicable legal and regulatory objectives related to ESG factors.

For portfolios or exposures assessed as materially exposed to environmental risks, considering both transition and physical risks, institutions should set out dedicated transition planning aimed at addressing and mitigating risks in the short, medium and long term. While institutions should consider as materially subject to environmental risks their exposures towards certain sectors in accordance with paragraphs 16 and 17, they should use more granular information than solely sectoral classification to develop their risk assessment and transition planning.

Short-, medium- and long-time horizons and milestones

Institutions should establish a set of different time horizons as part of their plans which should include a long-term planning horizon of at least 10 years. In addition, institutions should set an intermediate milestone at 2030 to demonstrate how their plans enable them to identify and manage climate-related risks associated with the objective of the EU to reduce GHG emissions by 55% by that date compared to 1990 level.

Institutions should ensure that short, medium and long-term objectives and targets interact and are well-articulated. This includes ensuring that long-term objectives, such as commitments to achieve net-zero GHG emissions, translate into medium-term strategies (e.g. medium-term sectoral policies or growth targets for business lines) and that short-term financial metrics or targets (e.g. profitability indicators, cost of risk, KPIs, KRIs, risk limits, pricing frameworks30) are coherent and consistent with the medium-term and long-term objectives.

Consistency of prudential plans with other processes and communications

Institutions should ensure that their plans are well integrated into the business strategies and that they are aligned and consistent with their risk and funding strategies, risk appetite, ICAAP, risk management framework and public communication, and include actions with regard to the business model and strategy of the institution that are consistent with the plans disclosed pursuant to Article 19a or Article 29a of the Directive 2013/34/EU, where applicable.

Institutions should describe in their plans their approach to integrating ESG factors in their forward-looking funding strategy, ensuring consistency with institution's broader funding management in the short, medium and long-term.

Institutions should ensure that their transition planning, including sectoral or portfolio strategies in the short, medium and long term, are properly reflected in their risk appetite through updates to profitability impact assessments, limits and risk thresholds, taking into account any transition risk stemming from departures from the institution's planned trajectory. The reflection of the transition planning process in risk appetite should be consistent with the institution's business strategy over different time horizons and taken into account in the ICAAP, including by assessing in adverse stress scenarios risks arising from current or future misalignment with the institution's targets and having a clear understanding of internal capital needs consistent with the transition planning process.

Integration across the institution

In view of institutions' obligation to ensure that arrangements, processes and mechanisms related to their plans are consistent and well-integrated, including for their subsidiaries established outside of the EU, and the obligation of those subsidiaries to be able to produce data and information relevant to the purpose of supervising consolidated plans in accordance with Article 109(2) of Directive 2013/36/EU, parent institutions should take into account ESG risks that subsidiaries established outside of the EU are materially exposed to when elaborating and implementing the consolidated plan, by having regard to applicable local legislation and ESG regulatory objectives, and should be able to demonstrate a well-informed consolidated approach.

Review and documentation

Institutions should regularly, and at least every time they update their business strategy in accordance with Article 76(1) of Directive 2013/36/EU, review their plans, taking into account updated information such as new materiality assessments of ESG risks, developments in their portfolios and counterparties' activities and new available scenarios, benchmarks or sectoral pathways.

Institutions should document their plans, including the criteria, methodologies, assumptions, and targets used, and any relevant update.

18) *Do you have comments on the key principles set by the guidelines for plans in accordance with Article 76(2) of the CRD?*

Relevant points to comment on the key principles set by the EBA Guidelines in accordance with Article 76(2) of the CRD are: (i) the role and responsibilities in the institutions and their boards for the materiality assessment; (ii) the short, medium and long-term horizons; (iii) the integration with other "plans "; (iv) the consistency with the relevant Member State and Union regulatory objectives.

Elements of the key principles which are potentially positive and in full accordance with Article 76(2) of the CRD are the following.

1. The role of the management body, which is entitled and responsible to develop and monitor the implementation of specific plans, quantifiable targets and processes to monitor and also includes the materiality assessment (Guidelines par. 6.1 n. 85: "*The management body should be responsible for the approval of the plans and should oversee their implementation*").
2. The attention to the financial risks arising in the short, medium and long-term (Guidelines par. 6.1 n. 76). The depth of the transition process towards a climate-neutral and sustainable economy has a long-term nature (3.3 CRD-based (transition) plans n.11).
3. It is appropriate to clarify the need for integration of CRD-based plans with the plans disclosed pursuant to Directive 2013/34/EU (Guidelines par. 6.1 n.78) and with the "*transition plans*" under CSRD and CSDD (3.3 CRD-based (transition) plans n. 12). It is also appropriate that prudential plans should be understood as the overview and articulation of strategic actions and risk management tools 3.3 CRD-based (transition) plans n.17). It is not a provision based on art. 76, but it falls under the responsibility of the management body.
4. The definition of Article 76(2) of the CRD "*relevant Member States and Union regulatory objectives and legal acts in relation to ESG factors*" is similar but non equivalent to the different solutions used by EBA (not in the Key principles):

- "*towards the relevant Member States and Union regulatory objectives in relation to ESG factors*" (Guidelines par. 2 n. 5 c; 3.2 Legal mandate and objective of these guidelines n. 7 b; 3.3 CRD-based (transition) plans n. 11);
- "*relevant legal and regulatory objective in the EU*" (Guidelines 4.2 n. 35 a; Guidelines 5.8 n. 72 c);
- "*the legal and regulatory sustainability objectives of the jurisdictions where they operate*" (Guidelines 6.3 n.90.

The definition of Article 76(2) of the CRD including the "*legal acts*" (as well as "*legal and regulatory*") seems to rule out that the plans should be compliant also with programmatic non-binding documents or political positions of UE institutions. The different wordings in the Guidelines (which are not always justified) could be misunderstood. The Guidelines do not require CRD-based plans to set out an objective of fully aligning with Member State or Union sustainability objectives or one specific transition trajectory. But the Guidelines also refer to the (non-binding) European Commission (EC) recommendation of June 2023 on facilitating finance for the transition to a sustainable economy (3.3 CRD-based (transition) plans).

It would be preferable to clarify that plans must be aligned with binding regulatory acts and may be aligned with ESG recommendations and trends.

Alternatively for non-binding acts the principle comply-or-explain may be applied, principle which was introduced by Article 20 of Directive 2013/34/EU with regard to the corporate governance statement.

* * *

Governance

Roles and responsibilities

Institutions should clearly identify and allocate responsibilities for the development, implementation and monitoring of plans. When assigning roles and responsibilities at the appropriate level of seniority, institutions should take into account the interrelation and influence that the transition planning process should have on other processes such as the broader business strategy and risk appetite. 85.

The management body should be responsible for the approval of the plans and should oversee their implementation, including by being regularly informed of relevant developments and progress achieved in relation to the institution's targets. The management body should be responsible for taking decisions on remedial actions in case of significant deviations between the institution's performance and its targets.

For the purposes of integrating ESG risks across the three lines of defense in line with Section 5.4, a) the first line of defense should be responsible for establishing a dialogue with counterparties about their own transition plans and assess consistency with the institution's transition planning. To this end, institutions should ensure that an engagement strategy is clearly defined and that relevant staff possesses sufficient expertise and capabilities to assess the soundness and credibility of their counterparties' transition plans; b) the compliance and risk management functions should ensure that the risk limits set in the risk appetite statement as part of the risk management framework are consistent with all aspects of the institution's plan, including sectoral policies, c) the IAF should review the institution's plan as part of the risk management framework and assess the extent to which it allows proper management of ESG risks. To that end, the IAF should consider if the plan allows the institution to detect and address changes in the risk profile and in products and/or business lines, how the institution addresses deviations from its targets, and whether the underlying assumptions, methodologies and benchmarks are sound.

Internal processes and capacity

Institutions should ensure meaningful and regular interaction and exchanges at all levels of the organization to ensure that insights and feedback from internal stakeholders can be taken into account in the process of formulating, implementing and reviewing plans. To this end, institutions should at least involve units, departments and functions responsible for strategic planning, risk management, sustainability disclosures, legal services and compliance in the elaboration of plans, and should assess which additional units, departments and functions should be involved.

Institutions should ensure they possess sufficient capacity, expertise and resources to develop, implement and monitor their transition planning process as well as to regularly assess the robustness of their plans internally. Institutions should map existing gaps in skills and expertise and take remedial actions where necessary.

19) Do you have comments on section 6.2 – governance of plans required by the CRD?

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In the current landscape, characterized by a huge increase of complexity and instability, the governance, the evolution of the Internal Control System (ICS) and the "*tone of the top*" set by the boards are the key success factors for the ESG transition.

Since the ESG transition is a radical change aimed at sustainable and resilient financial institutions that can support companies and household in increasing their sustainability, it is a matter of fact that the ICS of financial institutions must evolve to take into consideration the impact of ESG on all their processes, procedures, IT systems and, above all, on the roles and of the responsibilities through all the organization.

* * *

Metrics and targets

General provisions

Institutions should clearly define and justify which activities and business lines are covered by their targets and should ensure that these sufficiently reflect the nature, size and complexity of their activity and their materiality assessment.

The targets set by institutions should serve risk management and strategic steering purposes with a view to mitigating risks stemming from the process of adjustment towards the legal and regulatory sustainability objectives of the jurisdictions where they operate, and broader transition trends towards a sustainable economy.

Institutions should set targets at the institution's level and cascade these down to the sectoral/portfolio exposures levels and at the level of economic activities (i.e. individual technologies), at least for the sectors they are materially exposed to and portfolios which they have assessed as being more subject to environmental risks in line with paragraphs 16 and 17.

Institutions should set targets over different time horizons, including a short-term 3-years horizon complemented by medium and longer-term targets that convey a forward-looking view on the strategy of the institution.

Institutions should review their short and medium-term targets regularly, and at least every time they update their business strategy, and should have processes for the monitoring and review that include a timely escalation procedure in case of significant deviations. Institutions should perform regular projections to assess their ability to achieve their targets.

Metrics

For the purposes of setting targets, SNCIs should consider using while other institutions should use at least the following indicators: a) Financed GHG emissions by scope 1, 2 and 3 emissions split by sectors, using a sectoral differentiation as granular as possible and taking into account methodologies referred to in paragraph 72d): the absolute emissions, in tons CO2equivalent, and intensity of emissions, relative to revenues or units of production, associated with a portfolio. To foster an active risk management approach, institutions should complement sectoral financed emissions targets with criteria supporting

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the explanation of portfolio emissions reduction or temporary increase and identifying the underlying drivers of emissions, such as technology mix of their counterparties; b) Portfolio alignment metrics showing the extent to which sectoral exposures and production capacities operated by clients are, or are projected to be, (mis-)aligned with a pathway consistent with the applicable climate legal and regulatory objective, based on portfolio alignment methods described in Section 4.2 and related assessment of financial risks impacts; c) Amount and/or share of income related to business with counterparties operating in sectors that highly contribute to climate change, using a sectoral differentiation as granular as possible; d) A breakdown of portfolios secured by real estate according to the level of energy efficiency of the collaterals, e) The percentage of counterparties with whom the institution actively engagesregarding adaptability and resilience to the transition to a sustainable economy, e.g. in relation to counterparties' transition plans or net-zero targets, as well as the percentage of positive outcomes e.g. positive assessments of these counterparties' transitioning abilities.

When data needed to support the setting of targets is missing, institutions should follow the steps outlined in paragraph 25.

Institutions should assess which additional risk-based and forward-looking metrics and targets to include in their plans, including with a view to support risk assessment and strategic steering related to: a) Institution's resilience to physical risk, by considering levels of physical risk associated with the transition pathway selected by the institution and adverse scenarios; b) Institution's management of environmental risks other than climate-related, in particular nature and biodiversity-related risks; c)ESG-related concentration risk, d) ESG-related reputational risk.

20) *Do you have comments on the metrics and targets to be used by institutions as part of the plans required by the CRD? Do you have suggestions for other alternative or additional metrics?*

With reference to paragraph:

- in point 89 "*Institutions should clearly define and justify which activities and business lines are covered by their targets and should ensure that these sufficiently reflect the nature, size and complexity of their activity and their materiality assessment*", it could be useful to expressly recall the proportionality principle;
- with regard to point 93 "a) "*Financed GHG emissions by scope 1, 2 and 3 emissions split by sectors, using a sectoral differentiation as granular as possible and taking into account methodologies referred to in paragraph 72d): the absolute emissions, in tons CO2 equivalent, and intensity of emissions, relative to revenues or units of production, associated with a portfolio. To foster an active risk management approach, institutions should complement sectoral financed emissions targets with criteria supporting the explanation of portfolio emissions reduction or temporary increase and identifying the underlying drivers of emissions, such as technology mix of their counterparties*"", the indication appears excessively granular, because the bank, in fact, cannot function as a certifying body.

Climate and environmental scenarios and pathways

For the purposes of elaborating plans and setting targets, institutions should carefully define and select climate and environmental transition scenarios and pathways. To this end, institutions should take all the following steps: a) assess the potential implications of EU, Member States and, where relevant, third countries objectives for transition pathways, at least for the sectors towards which they are materially exposed. In this process, institutions should take into account the likely pathways originated from the

European Green Deal, the EU Climate Law, and the latest reports and measures prescribed by the European Scientific Advisory Board on Climate Change, in particular in relation to the achievement of the objective of the EU to reduce GHG emissions by 55% by 2030 and achieve net-zero emissions by 2050; b) take into account best available information, including from internal scenario analysis and external up to date scientific evidence; c) consider a range of scenarios publicly available, such as the Joint Research Center Geco scenario or IEA's World Energy Outlook and in particular Net Zero Emission scenario, d) consider any public commitment of the institution with respect to climate mitigation and adaptation.

The geographical reference and granularity of the scenarios and pathways used by institutions should be relevant to their business model and exposures.

Institutions should ensure that scenarios and pathways used as part of their plans are consistent across the organization and over time, such as when building business strategies and setting targets over different time horizons. Decisions to use different scenarios for different purposes as well as decisions to alternate or modify scenarios should be clearly justified, e.g. based on new scientific evidence or methodologies or better suitability for the specific purpose pursued. Institutions should document the process for scenario selection and the reasons for any change or different usage.

Notwithstanding the scenario and pathway selected for setting targets, institutions should understand their sensitivity to transition and physical risks under different scenarios, including the ones leveraging current policies and implying a higher level of physical risk.

21) *Do you have comments on the climate and environmental scenarios and pathways that institutions should define and select as part of the plans required by the CRD?*

> With reference to paragraph 97(b), the Guidelines request the institutions, and, therefore, their boards, to "*take into account best available information, including from internal scenario analysis and external up to date scientific evidence*". It could be advisable to recall the necessity of the reliability of the used data, providing indication in order to ensure it.
>
> It should be enough to expressly recall paragraph 102, which states that "*Institutions should have in place sound data processes to collect, verify and aggregate the data that are needed to inform the formulation of their plans and monitor their implementation*".

* * *

Transition planning

Institutions should clearly lay out the internal processes by which they prepare for a transition to a more sustainable economy and implement their objectives and targets i.e. transition planning process, in particular through engagement with counterparties, integration of ESG criteria in loan origination policies, changes in the strategic financing choices, approach to mitigation of and adaptation to physical risks, development of new products or services – including offering of sustainable including transition finance products or services, new policies and conditions (e.g. on carbon-intense or other environmentally harmful sectors or counterparties) and/or setting of specific lending or investment criteria.

Institutions should have in place sound data processes to collect, verify and aggregate the data that are needed to inform the formulation of their plans and monitor their implementation. This includes using available public information, including counterparties' transition plan at least for non-financial corporates falling under the scope of Directive (EU) 2013/34, and collecting non-public data from counterparties on their sustainability profile, as set out in paragraph 23. Institutions should determine for which other counterparties they require the submission of their transition plans as part of business relationships.

Institutions should have a clear approach to proactively engaging with counterparties in line with paragraph 42a). Engagement tools include reviewing counterparties' ESG risks profile and transition plans, providing relevant information and advice to clients and considering a range of counterparty-specific actions, such as adjustment to product offering, agreement on an action plan and remedial actions to support an enhanced transition trajectory for the counterparty, or as a last resort cessation of the relationship when continuation is considered incompatible with the institution's planning and risk appetite. Institutions should regularly discuss risks arising from the transition and possible options to mitigate such risks with large counterparties from sectors assessed as materially subject to environmental risks, and should regularly assess for which other counterparties engagement is warranted.

Institutions should assess the implications of their transition process and planned actions and targets for their business and risk profile in the short, medium and long term, including by estimating the impact on their revenue sources and profitability.

Institutions should ensure that their transition planning and any planned shifts in financing activity will be accompanied by updated risk management policies such as procedures related to risk assessment and risk management of new material subsets of portfolios e.g. financing of green and transition technologies.

22) *Do you have comments on section 6.5 – transition planning?*

We do not have any comment on this point.

23) *Do you think the guidelines have the right level of granularity for the plans required by the CRD? In particular, do you think the guidelines should provide more detailed requirements?*

The granularity provided by article 94 seems to be adequate considering the "*draft cost benefit analysis*" (in particular, the items no. 9). Nevertheless, the metrics are substantially only related to "E" factor, rather than "S" and "G".

24) *Do you think the guidelines should provide a common format for the plans required by the CRD? What structure and tool, e.g. template, outline, or other, should be considered for such common format? What key aspects should be considered to ensure interoperability with other (e.g. CSRD) requirements?*

We do not have any comment on this point.

25) *Where applicable and if not covered in your previous answers, please describe the main challenges you identify for the implementation of these guidelines, and what changes or clarifications would help you to implement them.*

As already mentioned, the main challenge is represented by the aim to prepare a 10-years plan under unpredictable circumstances and evolution of several items.

26) *Do you have other comments on the draft guidelines?*

We do not have any comment on this point.

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Nedcommunity is the Italian Association of non-executive and independent directors.

Founded in 2004 it has more than 700 associates, most of which are directors or members of the board of statutory auditors of listed companies or large non listed companies.

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