EBA CONSULTATION ON THE DRAFT GUIDELINES ON THE MANAGEMENT OF ESG RISKS

Comment from CDP

April 2024

Comment from CDP on the draft guidelines for the management of ESG risks

CDP is a global non-profit that runs the world's environmental disclosure system for companies, cities, states and regions. With more than 20 years on the front line of environmental disclosure for thousands of organizations around the world, CDP is familiar with the role that sustainable finance plays in achieving a thriving future—where investments drive economic growth and environmental stewardship together in the real economy—and with the most important challenges financial institutions face in addressing climate change and environmental degradation.

In this public consultation response, CDP proposes amendments to the draft guidelines issued as part of the mandate of the European Banking Authority (EBA) to develop minimum standards and reference methodologies for the identification, measurement, management, and monitoring of Environmental, Social, and Governance (ESG) risks by institutions, per Article 87a (5) of Directive 2013/36/EU, known as the Capital Requirements Directive (CRD). The recommendations elaborated in this response are formulated based on the experience and nature of the work of CDP in environmental and sustainable finance, as well as on data and reports elaborated with information from more than 23,000 organizations globally disclosing environmental information through CDP's disclosure system.

CDP's climate transition plan framework

This section is extracted from CDP Technical Note: Reporting on Climate Transition Plans. The document is the result of research that has identified and mapped out existing frameworks and benchmarks pertinent to transition planning. Given the dynamic nature of this area, especially within the evolving regulatory environment, CDP's framework and methodologies are designed to be flexible, allowing for adjustments in alignment with future disclosure regulations. Currently, within CDP's framework, **'transition'** is understood as the process of undertaking actions that:

- Align a business model with a world in which two key outcomes are pursued:
    - the global average temperature is allowed to rise by no more than 1.5°C above preindustrial levels; and
    - natural ecosystem health is restored.
- Enable a thriving economy that works for people and the planet in the long term.

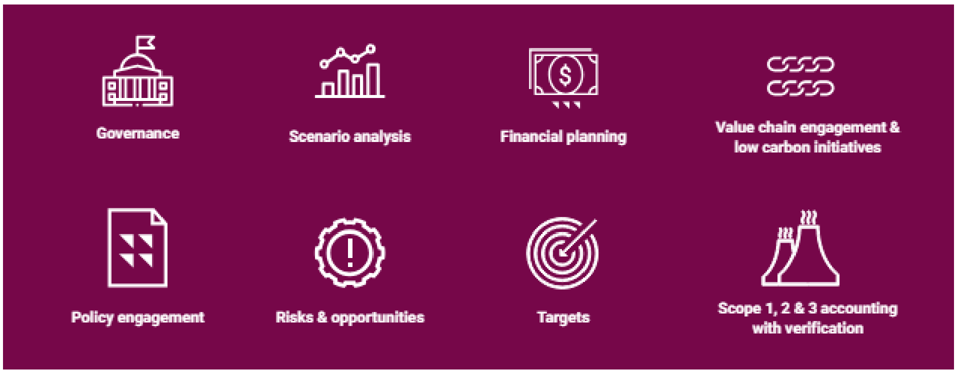
A credible transition plan sets out how an organization will achieve the above.

Credible transition plans: A credible transition plan is a time-bound action plan that outlines how an organization will achieve its strategy to pivot its existing assets, operations, and entire business model toward a trajectory aligned with the latest and most ambitious climate and environmental science recommendations [e.g., halving greenhouse gas (GHG) emissions by 2030 and reaching net-zero by 2050 at the latest, thereby limiting global warming to 1.5°C].

CDP has developed six fundamental principles that can guide organizations in the preparation of a credible transition plan:

1. **Accountability**: It has clearly defined roles and responsibilities, including effective governance mechanisms where the board and C-suite executives are accountable for the implementation.
2. **Internally coherent:** It is integrated into the business strategy and financial planning of the organization.
3. **Forward-looking:** It should reflect considerations of the short- and long-term, trending towards 2050. However, an emphasis on the short-term (the next 5-year timeframe) is critical to achieving long-term climate and environmental ambitions.
4. **Time-bound and quantitative approach:** The Key Performance Indicators (KPIs) of the plan are quantifiable under quantitative methodologies and are outlined for defined timeframes.
5. **Flexible and responsive:** The plan is reviewed and updated regularly, with a defined stakeholder feedback mechanism in place (e.g., shareholders, at AGMs).
6. **Complete**: The plan covers the whole organization and its value chain, any exclusions from the plan must not be material to the organization and/or to its impacts on the natural environment (i.e., ensuring the double materiality principle applies to disclosure of exclusions).

In November 2021, CDP pioneered a discussion paper on climate transition plans, in which we identified the following key elements that constitute a credible climate transition plan:



For further details, see CDP's framework for the key elements of a climate transition plan outlined in the previously mentioned technical note and the insights coming from disclosure data presented in CDP's Climate Transition Report 2022.

Consultation on draft Guidelines on the management of ESG risks

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?

CDP sees the definition of the EBA on prudential transition plans, presented in paragraph 17 of the consulted guideline, as a result of the inconsistencies or lack of definitions across various other regulations. An illustrative example of this would be the proposal of the Corporate Sustainability Due Diligence Directive (CSDDD) that excludes the financial sector within its scope. It is important to state that these circumstances —the lack of a holistic regulatory approach among different instruments— **notably position the proposed Guidelines as a crucial instrument for establishing a definitive and ambitious framework to cover all material risks and risk management policies**, as mandated under Article 76 (2) of the Capital Requirements Directive (CRD).

In this matter, CDP does not fully share the approach taken by EBA on leaving out important global objectives (e.g. alignment with the Paris Agreement) from the definition given to prudential transition plans. The recent CDP Europe Report 2023 highlights that in Europe 66% of the financial institutions disclosing data through CDP are already taking active steps to align their portfolios to an emissions pathway that curbs Earth's temperature increase to 1.5°C above pre-industrial level. Upcoming regulations should be aligned with the level of ambition already manifested by organizations in setting credible transition pathways, rather than lagging by the impossibility of setting clear objectives.

CDP strongly advocates for the inclusion of transition plans that are in alignment with the Paris Agreement and that focus on the compatibility of businesses undertaking a 1.5°C pathway and the objective of the EU to achieve net-zero GHG emissions by 2050. This recommendation is interconnected with the EBA's mission to "contribute to the stability and effectiveness of the European financial system through consistent, transparent, simple and fair regulation and supervision to the benefit of all EU citizens"[1] —while adhering to the global climate objectives set forth during the Global Stocktake at COP28. **The absence of such alignment in the proposed guidelines may leave financial institutions vulnerable to systemic risks, potentially leading to disorderly, insufficient and delayed transition plans**.

EU companies within the scope of the Corporate Sustainability Reporting Directive (CSRD) are mandated to disclose their transition plans from the fiscal year starting in 2024, therefore effective reporting from 2025. Given that the proposal for the CSDDD mandates that transition plans ought to be aligned with and reported under the CSRD, this guideline must adopt the same timeline outlined in the CSRD. **This alignment will ensure that institutions formulate their transition plans according to the consistent timeline established by the CSRD, promoting uniformity and clarity in sustainability reporting**.

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[1] European Banking Authority, "Missions statement and values". Available at: https://www.eba.europa.eu/mission-statement-and-values#:~:text=The%20EBA's%20mission%20is%20to,benefit%20of%20all%20EU%20citizens.

Moreover, there is a pressing need for consistency with macroprudential recommendations to protect the financial system. The ESRB highlights the requirement for "harmonized frameworks",[2] by emphasizing not only the alignment of reporting practices but also the "methods and data inputs used".[3] Given that companies subject to the CSDDD will eventually plan to ensure that their business strategy is compatible with limiting global warming to 1.5°C in line with the Paris Agreement, it is imperative to ensure.

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

CDP endorses the stance taken in paragraph 21 of the proposed guidelines, which acknowledges that smaller institutions are not exempt from ESG risks. We further support the subsequent paragraph that provides leeway for small and non-complex institutions (SNCIs) to adopt simplified processes for conducting their materiality assessments, enabling them to manage their ESG risks effectively. For instance, it may be adequate for an SNCI to carry out its materiality assessment biennially, whereas larger financial institutions should undertake this process at least annually.

Embracing a similar perspective on proportionality, CDP has introduced a new questionnaire this year specifically designed for Small and Medium-sized Enterprises (SMEs), acknowledging that they constitute 99% of all businesses within the EU. This questionnaire offers a streamlined format and additional guidance, customized to accommodate the capabilities of SMEs. Drawing from CDP's experience in crafting this SME questionnaire and our understanding of the principle of proportionality as it relates to materiality assessments for SNCIs, **we recommend that efforts are directed towards ensuring high-quality approaches on the elaboration of materiality assessments for smaller institutions**, stated in paragraph 22. This entails, among other measures, incorporating the Do No Significant Harm (DNSH) principle within the scope of materiality assessments.

Following principle 5 'Bring in scope all business and financial institutions' from CDP's High-Quality Mandatory Disclosure Principles (HQMD), we support when regulators consider an incremental approach to reduce the regulatory burden at first for smaller institutions. For further reference that could be of use, CDP and the SME Climate Hub have developed a simplified framework to help SMEs understand and report on the most vital climate-related indicators and encourage immediate climate action.

- **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.

CDP advocates for the proposed guidelines to pave a clear trajectory for financial institutions to move beyond addressing climate change in isolation. Instead, there should be a concerted focus on the interconnection between climate, nature, social, and governance risks from a management

[2] ECB/ESRB Project Team on climate risk, "Towards macroprudential frameworks for managing climate risk", December 2023. Available at: https://www.esrb.europa.eu/pub/pdf/reports/esrb.report202312~d7881028b8.en.pdf
[3] European Central Bank, "System-wide amplification of climate risk". Available at: https://www.ecb.europa.eu/press/financial-stability-publications/macroprudential-bulletin/html/ecb.mpbu202206_2~1bec56088f.en.html

perspective. The guidelines should serve as a cornerstone for promoting systemic change, **advocating for the joint consideration of these risks and opportunities through a holistic regulatory framework.** That way financial institutions acknowledging exposure to environmental and social risk can translate financial impact as forward-looking impact statements along the materiality assessment timelines established under paragraph 13.

With one-fifth of ecosystem services on the brink of collapse,[4] the acknowledgment of nature-related risks and opportunities has become critical, with over half of the world's total GDP highly dependent on nature and its services. Given that over half of the global gross domestic product (GDP) is significantly reliant on nature and its services, **the relationship between climate change and nature degradation demands a unified approach to risk management**.

In 2022, 556 financial institutions disclosed environmental data through CDP's climate change questionnaire, a 67% increase since 2020. An analysis of the data disclosed by these financial institutions highlights a pressing need for the integration of nature-related risks and opportunities into financial decision-making processes. As signaled in CDP's Financial Services Disclosure Report 2022, although climate change considerations have been widely incorporated into the strategies of financial institutions, there remains a substantial gap in the disclosure and management of forest, water, and broader nature-related issues.

Preliminary analysis from CDP on Global Systemically Important Banks (G-SIBs) shows inadequate risk management processes to assess exposures to nature-related risks, with no G-SIBs conducting comprehensive scenario analysis for both water and forests. **In 2023, 24 of the 30 G-SIBs disclosed climate change-related information through CDP**. Due to their lending to sectors with critical impacts on forests and water security, all 24 had an opportunity to disclose forests and water related information, but only 16 chose to do so.[5] The initial findings also highlight a disparity in addressing different nature-related issues, with more G-SIBs integrating forest related risks into their strategy than water related risks. This selective attention to nature issues underscores an incomplete approach to environmental risk management within the financial sector.

These observations highlight the pressing need for enhanced disclosure and supervisory requirements to promote transparency and informed decision-making concerning nature related financial implications. The evidence presented calls for a concerted effort to bridge these gaps, with recommendations for enhanced supervisory requirements to improve resilience against nature loss and degradation. Without substantial improvements in how financial institutions assess, disclose, and manage nature-related risks, the financial sector remains vulnerable to the destabilizing impacts of environmental changes, threatening global economic stability.

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

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[4] Swiss Re Group, "A fifth of countries worldwide at risk from ecosystem collapse as biodiversity declines, reveals pioneering Swiss Re index", September 2020. Available at: https://www.swissre.com/media/press-release/nr-20200923-biodiversity-and-ecosystems-services.html

[5] From this sample, CDP analyzed the self-reported information that each institution disclosed, across three different levels of attainment for 14 different categories of indicators. Preliminary results and policy recommendations were shared in an input paper to the G20 Engagement Group for Think Tanks (T20), in co-authorship with World Wildlife Fund (WWF) and will be further developed in a policy brief due to be published in Q3 2024

CDP acknowledges the importance of guidance on materiality assessments that resonates with the advice provided to corporates under the European Sustainability Reporting Standards (ESRS), as stipulated by the CSRD. We advocate for the guidelines to delineate the connections between these distinct sets of guidance, fostering a unified approach to materiality assessment across different regulations.

As indicated in paragraph 16 of the guidelines, there is an initial focus on sectors significantly linked to climate change. We propose this consideration to be expanded in future iterations to encompass sectors implicated in other environmental topics that are not specific to any one sector, as to those that corporations will be mandated to report on under the ESRS.

The upcoming release of the sector specific ESRS is expected to clarify the intricate links between diverse sectors and environmental issues, enriching the scope and depth of materiality assessments. Recognizing the relevance of a unified regulatory approach, the EBA should not hold its actions in anticipation of these developments. Instead, it is imperative that the EBA proactively establishes comprehensive sector-specific guidance on materiality assessments. **The proposed guideline should thoughtfully cover all activities with direct, indirect and cumulative impacts on nature-related themes**;[6] ensuring that institutions can effectively address and integrate these considerations into their risk management practices.

The significance of sector-specific guidance cannot be overlooked. The [CDP Europe Report 2023: "Get the Money Moving"](), illuminates a concerning trend: both financial institutions and industrial companies largely neglect critical environmental issues, such as deforestation and water security, in their investment strategies and transition planning efforts. This report shows that over 50% of financial institutions reporting through CDP lack of strategic plan to safeguard water security or to prevent deforestation. Only 9% have delineated specific goals concerning deforestation within their lending and investment practices, and just 1% have articulated goals for water security. For this to change it is necessary a clear set of reporting European regulations.

- **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.

While leveraging the EU taxonomy's economic activities as a complementary tool for materiality assessments offers a more detailed analysis than simple sector categorizations, revenue draft guidelines present challenges in utilizing alignment as a criterion to determine materiality. **It is crucial to distinguish between materiality assessment and risk measurement**. For instance, a company may be material concerning biodiversity while adopting mitigation strategies that diminish its risk compared to its peers. However, this does not negate its material status in terms of biodiversity; it's

[6] Taskforce on Nature-related Financial Disclosures, "Recommendations of the Taskforce on Nature-related Financial Disclosures", September 2023. Available at: https://tnfd.global/wp-content/uploads/2023/08/Recommendations_of_the_Taskforce_on_Nature-related_Financial_Disclosures_September_2023.pdf

the distinction between potential and realized impact. Alignment levels may help in assessing transition risk magnitude, yet they do not directly indicate non-materiality.

Furthermore, EU Taxonomy Key Performance Indicators (KPIs) are financial metrics that may not fully capture the materiality impact of a company. A scenario where 70% of revenues are aligned with the taxonomy, while the majority of emissions or impacts come from the remaining activities, exemplifies this disconnect. Consequently, **CDP advises against the use of ambiguous terms** (such as 'high level of alignment') when employing taxonomy KPIs to argue for non-materiality, as this could significantly diminish the comparability of disclosure.

In the scenario where alignment level is employed to assess a company's materiality—a practice previously indicated as not preferred—it is essential to clearly define the Key Performance Indicator (KPI) used to measure this alignment. Such KPIs might include Capital Expenditures (CAPEX), Operational Expenditures (OPEX), revenue, or a combination thereof. Subsequently, a quantitative threshold for alignment could be established, ideally aiming for 100% alignment. Should the specified KPI threshold not be met, institutions must then clarify that the activities falling outside this threshold do not cause any significant harm.

Drawing on the insights from [CDP's EU Taxonomy 2023 Report], three key recommendations aimed at financial institutions emerge, which we advocate for inclusion in this guideline. Firstly, to garner a comprehensive understanding of climate performance, FIs need to interpret Taxonomy alignment data in tandem with corporate emissions, targets, and other elements of corporate transition plans. Secondly, FIs need to avoid using general or sectoral thresholds to benchmark Taxonomy KPIs unless activity-level clustering is applied. Lastly, the evaluation of decarbonization trends alongside alignment trends, through the lens of year-on-year comparisons, is recommended when such analysis is pertinent to the company's transition planning.

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

The processes of identifying, gathering, organizing, and analyzing essential data to assess and manage exposure to ESG risks are crucial steps for any institution. As the non-profit organization that operates the global disclosure system for financial institutions, companies, cities, states, and regions; **CDP welcomes the data management practices proposed in the draft guideline**. However, a few improvements could be made to improve the clarity around the data process institutions will have to perform.

In addressing the data processes, it is important to offer detailed guidance on evaluating the quality of data used in estimations and reporting. This guidance should mirror the specificity found in frameworks such as the Partnership for Carbon Accounting Financials (PCAF)'s guidance on greenhouse gas emissions ensuring institutions can rely on high-quality, relevant data for risk assessments and decision-making. Additionally, for estimated data, the guidelines should stipulate how institutions are expected to work with their portfolios to enhance transparency and the disclosure of ESG data.

Establishing clear expectations for engagement on ESG data transparency between institutions and their portfolios will not only improve the accuracy of risk assessments but also improve the overall integrity of ESG reporting.

Regarding provision 23(a)(vii), CDP suggests an expansion of the requirements for institutions to report on their alignment with specific regulatory and framework disclosures, such as the CSRD and the Taskforce on Nature-related Financial Disclosures (TNFD). This addition would greatly enhance transparency and accountability.

Furthermore, provision 23(a)(ix) should be expanded to detail not only whether transition plans have been prepared but also to include the disclosure of key elements that signify a comprehensive transition plan. **We recommend the inclusion of all the following elements in the draft guidelines**:

- **Governance**: This demonstrates that an organization has board-level oversight of the climate transition plan and that there are defined governance mechanisms in place, to ensure implementation of the plan. To incentivize conscious action and commitment in realizing the plan's goals, it is recommended that executive management incentives are aligned with the organization's climate transition plan goals.

- **Scenario Analysis:** A transition plan should be underpinned by robust scenario analysis to identify potential substantive climate-related risks and opportunities.

- **Financial Planning**: As part of its strategy to achieve net zero, an organization should outline time-bound financial planning details of its transition [e.g., Capital Expenditure (CAPEX), Operating Expenditure (OPEX), Revenue, etc.].

- **Value Chain Engagement & Low-Carbon Initiatives**: A transition plan should include time-bound actions tied to business processes (and those of its value chain), with time-bound KPIs.

- **Policy Engagement**: A transition plan should demonstrate that an organization's public policy engagement aligns with its climate and nature commitments and strategy.

- **Risks and Opportunities**: A transition plan should outline an organization's process for addressing identified climate and nature related risks and maximizing substantive climate-related opportunities.

- **Targets**: A transition plan should contain time-bound, verified science-based targets that are in line with the latest science (e.g. institutions should set near-term SBTs to halve emissions by 2030 and should also set a net zero long-term target – by 2050 at the latest).

- **Scope 1, 2, & 3 Accounting with Verification**: A transition plan should be accompanied by an annual Scope 1, 2 & 3 emissions inventory that is complete, accurate, transparent, consistent, relevant, and verified by a third party.

We reckon that some of the listed elements are already considered in the proposed guideline. However, we include the list of all these elements and how CDP defines them for a comprehensive overview for EBA to draw the links among the elements as crucial for the credibility and effectiveness of transition plans. For further details on what constitutes credible transition plans, we encourage any interested party to consult CDP's technical note titled 'Reporting on Climate Transition Plans'.

The last concern with the data processes for the detection of ESG risks comes in paragraph 25 a) when the guidelines establish financial institutions to use estimates or proxies as an intermediate step and seek to reduce their use over time to improve data quality. CDP suggests using less vague terminology and clearly defining what would be a suitable timeline to achieve the above.

The recommended disclosures and actions outlined above are achievable to banks overseen by the EBA and would not represent an undue burden. For example, [CDP's Sustainable Finance and Banks Program] facilitates key strategic engagement, environmental disclosure and data insights among banks, financial institutions, large buyers and suppliers, including small and medium-sized enterprises (SMEs). This Program could play an instrumental role in providing vital insights that help understand the current position of several organizations in the data management journey since it outlines clear pathways for transitioning from reliance on estimated data to primarily reported data.

Question 8: Do you have comments on the exposure-based methodology?

CDP supports the development of the exposure-based methodology described in paragraph 31, applauding it as a crucial initiative to provide a comprehensive framework addressing both physical and transition risk drivers, and covering both on- and off-balance sheet exposures. This methodology represents an important effort to guide financial institutions in assessing their vulnerability to both acute and chronic physical risks, as well as transition risks, considering the potential for critical disruptions, the maturity or term structure of asset exposures, and available mitigation opportunities.

Furthermore, the Task Force on Climate-related Financial Disclosures (TCFD) Guidance on Risk Management Integration and Disclosure[7] includes some important insights. The TCFD's 2019 status report, which included a survey to gauge the implementation of its risk management disclosure recommendations and the challenges encountered, highlighted a significant concern. Many companies, having integrated climate-related issues into their existing risk management processes, find the requirement for separate or explicit climate-related financial disclosures challenging. Follow-up discussions revealed a misinterpretation among some companies that the TCFD recommendations needed distinct processes for managing climate-related risks or separate disclosures from their broader risk management activities.

In the TCFD's status report in 2023[8], the challenge of climate-related disclosure frameworks increasing the administrative burden and cost of their disclosure efforts continued to be one of the main concerns among companies. As a response to these concerns, the TCFD developed a singular, accessible framework for climate-related financial disclosure to support existing disclosure regimes coming into alignment over time. Provided a company's disclosures comprehensively detail its risk management processes, including how they address climate-related risks, additional disclosures may not be necessary.

In June 2023, the International Sustainability Standards Board (ISSB) issued its first two IFRS Sustainability Disclosure Standards: **IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information and IFRS S2 Climate-related Disclosures**. Following the release of the TCFD's 2023 annual status report in September, the Financial Stability Board (FSB) requested that the IFRS Foundation assume responsibility for monitoring companies' climate-related disclosures, transferring this role from the TCFD starting in 2024;[9] with the ISSB welcoming the request to take

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[7] Task Force on Climate-related Financial Disclosures, "Guidance on Risk Management Integration and Disclosure", October 2020. Available at: https://assets.bbhub.io/company/sites/60/2020/09/2020-TCFD_Guidance-Risk-Management-Integration-and-Disclosure.pdf
[8] Task Force on Climate-related Financial Disclosures, "2023 Status Report", October 2023. Available at: https://www.fsb.org/wp-content/uploads/P121023-2.pdf
[9] Financial Stability Board (FSB). "FBS Plenary meets in Frankfurt", July 2023. Available at: https://www.fsb.org/2023/07/fsb-plenary-meets-in-frankfurt/

over the TCFD's monitoring duties and the opportunity to build on the TCFD's achievements from 2024.[10]

CDP is convinced about the importance of having truly interoperable standards and frameworks by bringing them together in one place, supporting in that way organizations to navigate a rapidly evolving landscape. [CDP has aligned its questionnaire] with the world's most relevant frameworks and standards, including the TCFD and the IFRS S2 Climate-related Disclosures. This alignment ensures that CDP disclosure serves as a one-stop shop for understanding and disclosing against the relevant market and regulatory demands, supporting organizations on their path to compliance. CDP advocates for the inclusion of clarifications within these guidelines that align with the IFRS S2 recommendations. **This alignment ensures that financial institutions can effectively integrate and disclose climate-related financial risks without duplicating efforts or creating redundant processes**.

Question 9: Do you have comments on the exposure-based methodology?

CDP strongly advocates for the EBA to ensure ambitious coherence with regulations on sustainable finance that the European Union has proposed or already implemented.

A relevant regulation in this context is the proposal for a Regulation of the European Parliament and the Council on the transparency and integrity of ESG rating activities. This proposal provides a crucial definition of ESG ratings that is relevant to portfolio alignment methodologies. Article 3(1) of the [regulatory proposal] defines 'ESG rating' as:

> *"an opinion, a score or a combination of both, regarding a rated item's profile or characteristics with regard to environmental, social and human rights, or governance factors or exposure to risks or the impact on the environmental, social and human rights, or governance factors, that are based on both an established methodology and a defined ranking system of rating categories, irrespective of whether such ESG rating is explicitly labelled as 'ESG rating', 'ESG opinion' or 'ESG score'"*.

Consequently, **CDP recommends that the EBA explicitly align these guidelines with the requirements and criteria set by the ESG ratings regulation**. Such regulation emphasizes the need for methodologies, including of forward-looking assessments, to be transparent and disclosed to the public and, to a more granular extent, to the users. Key components to be disclosed include the integration of forward-looking information and the scenarios utilized in estimations or models.

Adopting this approach would not only enhance the transparency and integrity of portfolio alignment assessments but also ensure that institutions are better equipped to address and align with the EU's broader sustainable finance objectives, and emissions reduction ambitions.

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

Following CDP'S position on EBA'S definition of prudential transition planning, we suggest that the risk management principles should be aligned with the CSRD reporting requirements. The ESG risks principles should use the Paris Agreement and the goal of 1.5°C as reference points for risk

[10] International Financial Reporting Standards. "IFRS Foundation welcomes culmination of TCFD work and transfer of TCFD monitoring responsibilities to ISSB from 2024". Available at: https://www.ifrs.org/news-and-events/news/2023/07/foundation-welcomes-tcfd-responsibilities-from-2024/

management and monitoring. Furthermore, the EBA should expand on paragraph 42 regarding the engagement of counterparties to make them publicly disclose their ESG risks—as previously understood by the EBA—to provide targets and mitigate these risks. In subsection a) of the same paragraph, **the EBA should guarantee less ambiguity and more consistency in using terms such as 'most important' or 'most critical' when referring to counterparties**. Arguably, even if a counterparty is not one of the 'most important,' but has outsized environmental impacts, it may face significant exposure to climate-related risks. There should be consistency between the results of any materiality assessment, as a means also to understand which activities and companies are the focus of engagements. This must consider the latest science on risks, dependencies, and impacts that certain sectors and activities face. These sectors and activities would then necessarily require a certain amount of scrutiny, including for their transition plans.

- **Question 11:** Do you have comments on section 5.2 – consideration of ESG risks in strategies and business models?

CDP recommends that the EBA require public disclosure against the KPI set in paragraph 43 of the proposed guideline regarding the ESG risk considerations in strategies and business models. In addition, it should be considered for disclosure any revision to initial KPIs set in line with the timelines proposed under materiality assessments. Moreover, suggesting alignment with the CSRD reporting requirements, **the ESG risks in strategies and business models, as well as risk appetite, should use the Paris Agreement and the goal of 1.5°C as reference points for setting and defining these aspects**.

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

One significant aspect of this integration is the formulation of comprehensive transition plans that encompass not only strategy and implementation but also incentive systems for management. These incentive systems serve as a tool to motivate and drive climate action efforts within an organization. **CDP suggests that the EBA includes incentive systems in the requirements of transition plans that can bolster actions on emission reduction initiatives and drive long-term planning for balancing economic growth with environmental and social responsibility**.

CDP data show that many companies already have monetary incentive systems in place as part of corporate governance. About 70% of companies have incentive systems, monetary and/or non-monetary, in place or plan to do so in the next 2 years. Placing incentives for climate-related issues on board and C-suite level is a well-used mechanism by which companies are incentivizing certain behaviors and performances towards their sustainability goals. More than 1,000 companies have incentive systems for C-suite and/or board members. Most companies disclosing choose monetary reward systems as the incentive of choice. 80% of the incentive systems disclosed by companies are monetary. CDP evidence shows that the link between remuneration and long-term plans of companies as part of the governance of transition planning is feasible and already incorporated by many companies. In more than 850 companies, the incentive plans are linked to their long-term planning (based on disclosure from companies headquartered in the EU27 countries through CDP's disclosure system in 2023, only submissions before 21st September 2023 were considered).

This shows that many companies have already made incentives for their employees a part of their governance structure around sustainability within the organization. With a large number of companies planning to implement such incentives, **further indicates that more institutions perceive incentives**

as a good tool to drive change within the organization and to ensure sustainability goals are met, by motivating employees and connecting incentives to the organization's sustainability goals.

- **Question 17:** Do you have comments on section 5.4 – consideration of ESG risks in internal culture, capabilities and controls?

As the world's largest environmental disclosure platform, CDP supports the inclusion of effective monitoring processes within the guidelines that deliver substantial insights, enabling senior management and governing bodies to make informed and precise decisions. This is grounded in the principle that effective management is predicated on effective measurement. The guidance provided in paragraph 72 outlines essential metrics and indicators that financial institutions, including small and non-complex institutions (SNCIs), should utilize to monitor ESG risks effectively. **CDP recommends the inclusion of additional metrics and indicators that reflect stakeholders' expectations regarding financial institutions' disclosures and their connection to real-economy transition plans**.

Furthermore, subsection d) of paragraph 72 references CDP as an example of methodologies to compute Scope 3 emissions (i.e., GHG financed emissions), specifically for sectors where institutions have significant exposures. In this aspect, while we appreciate the mention, **it is important to clarify that CDP does not provide methodologies for companies to calculate their GHG emissions**. Rather, CDP enables organizations to disclose their Scope 3 emissions and our scoring methodology incentivizes disclosers to report emissions in line with globally recognized standards and frameworks accompanied by a third-party verification statement.

Moreover, it is crucial to understand that while Scope 3 emissions constitute a major portion of emissions for many sectors, accurately identifying and reporting these emissions across the value chain poses significant challenges. The Science Based Targets Initiative (SBTi)'s Value Chain Report[11] indicates that companies often report emissions from categories that are simpler to calculate, such as business travel, rather than from categories where most emissions occur but are more challenging to quantify.

CDP can share additional resources on Scope 3 emissions that could assist the EBA in refining this guideline section regarding the methodology for calculating and reporting Scope 3 emissions. For example, [CDP's technical note, "Relevance of Scope 3 Categories by Sector",] explores the GHG Protocol's Value Chain (Scope 3) Standard, outlining the 15 categories of Scope 3 emissions and seven qualitative criteria for identifying and reporting relevant Scope 3 activities. This note delves into the pertinent Scope 3 categories by sector, including the Financial Services, where the largest emission sources come from lending, investment, and insurance underwriting activities, categorized under Scope 3 Category 15, "Investments." Portfolio emissions from global financial institutions are significantly larger (700x) than their direct emissions, with category 15 being identified as "Relevant, calculated" by only 37% of the 377 Financial Services companies responding to the 2021 CDP climate change questionnaire on behalf of investors, but comprised over 99% of total Scope 3 emissions and over 99% of total Scope 1+2+3 emissions reported by the sector.

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[11] Science Based Targets Initiative, "Value Change in the Value Chain: Best Practices in Scope 3 Greenhouse Gas Management", November 2018. Available at: https://sciencebasedtargets.org/resources/files/SBT_Value_Chain_Report-1.pdf

CDP collaborates with the Partnership for Carbon Accounting Financials (PCAF) to promote the assessment and aligned reporting of portfolio emissions and other portfolio impact metrics, highlighted in the CDP climate change questionnaire's Financial Services (FS)-specific module, C14 Portfolio Impact. CDP's guidance on calculating portfolio emissions and other impact metrics further supports this initiative. Once more important to reiterate the relevance of [CDP's Sustainable Finance and Banks Program]() to provide the framework to help banks navigate this space and effectively engage clients and their supply chains, leveraging finance to drive resilience.

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

In this or any other framework, **clear principles are crucial for ensuring consistency across various transition plans and disclosure requirements**. Establishing shared principles on transition planning promotes uniformity across different jurisdictions. CDP welcomes the principles related to the consistency of plans with other processes and communications, integration across the institution, and the review of the documentation, as presented in paragraphs 78 to 83. Regarding the principles that cover short-, medium-, and long-term horizons and milestones, we believe these should be aligned with potential modifications to the guideline's understanding of transition planning.

- **Question 19:** Do you have comments on section 6.2 – governance of plans required by the CRD?

CDP recognizes the EBA for incorporating guidelines focused on the governance of transition plans. The significance of establishing robust governance structures for transition planning and oversight of transition plans has been identified by [CDP on its technical note on Climate Transition Plans](). This position is also supported by other organizations that have issued standards and frameworks on the disclosure of transition plans, such as the ISSB (IFRS S2), EFRAG (ESRS), TCFD, UK Transition Plan Taskforce (TPT), Assessment of Low Carbon Transition (ACT), Glasgow Financial Alliance for Net Zero (GFANZ), Climate Action 100+ (CA100+), Climate Bonds Initiative's Climate Bonds Standard (CBI), and Transition Pathway Initiative (TPI).

CDP concurs with the guidelines that mandate institutions to explicitly delineate and assign responsibilities for the formulation, execution, and supervision of transition plans, as specified in paragraph 84. Nevertheless, **CDP seeks additional clarification regarding the term "management body" as used in paragraph 85, advocating for a clear definition of roles between the board of directors and executive management.** CDP's research indicates that to ensure accountability for developing an ambitious plan, as well as the implementation of the ambitious plans, board-level oversight of a climate transition plan is crucial in steering business strategy towards a 1.5C aligned trajectory. Executive management should have responsibility for developing and implementing transition plans, with the support of relevant teams and business units, as mentioned in paragraph 87. Moreover, executive management should also frequently report to the board on the progress toward realizing the plan's ambition, thus feeding into a cycle of accountability and feedback.

Additionally, **CDP encourages the EBA to consider adopting guidelines to incentivize conscious action and commitment from executive management to implement the transition plans**. For instance, the EBA could recommend that executive management incentives be linked to climate performance indicators. Finally, CDP also welcomes the inclusion of paragraphs 86(a) and 88, which acknowledge the need for institutions to ensure the appropriate capabilities and expertise exist within governance structures to develop, implement and monitor an institution's transition planning process.

Question 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?

Institutions should ensure that metrics and targets not only facilitate risk management and strategic direction but also incorporate a methodology for the identification, assessment, and action of climate-related opportunities. To this end, **CDP proposes a revision to paragraph 90 to ensure that its wording encompasses both the mitigation of risks and the recognition of opportunities**.

CDP concurs with the EBA on the need to define explicit guidelines for setting targets. We applaud the insights provided in paragraphs 91 to 93, along with the recommendation for institutions to establish targets across varying time frames and to undertake periodic reviews.

From CDP's analysis, we conclude that a detailed financial plan is essential for demonstrating an institution's alignment with climate goals, as outlined in its climate transition plan, and its viability in a 1.5°C scenario. Therefore, concerning paragraph 94, CDP recommends the inclusion of specific financial projections, including revenue, Capital Expenditures (CAPEX), and Operational Expenditures (OPEX), which are vital for the fulfillment of the plan's objectives.

It is critical to consider a suite of absolute and intensity-based metrics and to transparently disclose the methodology used to calculate these. CDP welcomes that these characteristics are captured across the recommendations for metrics.

Furthermore, as a specific addition to paragraph 94, subsection C, it is recommended that some expectations are introduced around forward-looking metrics regarding the total portfolio exposure to fossil fuels, including details about how this breaks down according to fossil fuel type, value chain exposure (upstream, midstream, and storage), as well as regional breakdowns where possible.

Almost 50% of the 575 financial institutions that disclosed through CDP in 2023 (CDP 2023 disclosure data factsheet), reported holding an estimated US$9 trillion in fossil fuel financing across their portfolios – equivalent to the combined GDP of Japan and Germany. **Identifying these exposures is critical to outlining the extent of stranded asset risks as well as the overall systemic risk posed by future lending**, especially to any activities associated with new fossil fuel capacity.

Question 22: Do you have comments on section 6.5 – transition planning?

The approach to transition planning presented in section 6.5 demands high levels of disclosure and transparency from corporates regarding their transition plans, yet it focuses less on reciprocal requirements. This section requires stronger and more precise language. For instance, paragraph 101 could be enhanced to specify necessary governance requirements for transition plans and establish a clear, explicit link to section 6.2 of the Guideline related to Governance. Furthermore, the current reference in this paragraph to 'transition planning processes' rather than clarifying, adds confusion about the processes and elements of a transition plan. A more effective approach would be to describe these processes accurately as the collection of interoperable metrics from corporates and setting interim targets. Additionally, stronger language is necessary to ensure that institutions determine which counterparties must submit their transition plans as part of business relationships, especially considering that the transition plans of financial institutions are contingent upon those of corporates.

- **Question 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?

CDP considers that the proposed guideline lacks the necessary granularity for transition planning as required by the CRD and should, therefore, include more detailed information. As previously discussed, among other critical elements that need detailed development in the guideline, it is essential to structure the distinct elements that constitute a credible transition plan effectively. **CDP's primary suggestion is to leverage the extensive resources developed by CDP on these elements** (referenced throughout this document); by extrapolating these and other elements from international frameworks, the guidance can not only develop plans but also enhance their credibility.

- **Question 24:** 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?

Finally, CDP recognizes the need for global convergence in the requirements of transition plans within regulatory developments and international frameworks and initiatives. As previously suggested, forthcoming regulatory frameworks, such as those from ISSB (IFRS S2), EFRAG (ESRS), TCFD, UK TPT, ACT, GFANZ, CA100+, CBI, and TPI, should standardize the disclosure of transition plans. These frameworks must align elements such as targets, metrics, and KPIs. Both financial institutions and the real economy must be incorporated into these global frameworks to enable the development of credible transition plans that include comprehensive details like targets, metrics, and KPIs, considering that taxonomies can specify areas such as products. At this moment, when a proliferation of transition plan indicators is occurring,[12] **the EBA should seize the opportunity to develop a format that aligns with other transition plan guidelines.**

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[12] For further reference see Climate Bonds Initiative, "Transition Finance Mapping: Frameworks to assess corporate transition", September 2023. Available at: https://www.climatebonds.net/files/files/Transition%20Mapping%20-%20Climate%20Bonds%20-%206%20Nov%202023.pdf

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About CDP

CDP is a global non-profit that runs the world's environmental disclosure system for companies, cities, states and regions. Founded in 2000 and working with more than 740 financial institutions with over $136 trillion in assets, CDP pioneered using capital markets and corporate procurement to motivate companies to disclose their environmental impacts, and to reduce greenhouse gas emissions, safeguard water resources and protect forests. Over 24,000 organizations around the world disclosed data through CDP in 2023, with more than 23,000 companies – including listed companies worth two thirds global market capitalization - and over 1,100 cities, states and regions. Fully TCFD aligned, CDP holds the largest environmental database in the world, and CDP scores are widely used to drive investment and procurement decisions towards a zero carbon, sustainable and resilient economy. CDP is a founding member of the Science Based Targets initiative, We Mean Business Coalition, The Investor Agenda and the Net Zero Asset Managers initiative. Visit cdp.net or follow us @CDP and on LinkedIn to find out more.

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