EBF Response to the EBA Consultative Document Guidelines on ESG risks management

16 April 2024

Key messages

- The EBF welcomes the EBA's efforts in developing the draft Guidelines to ESG risk management (hereafter, "the Guidelines"), in accordance with Article 87a (5) of Directive 2013/36/EU (CRD IV). That said, we believe that a **gradual approach** should be envisaged in the Guidelines, starting with environmental considerations (and in particular climate aspects) given their maturity level compared to S&G factors, as well as the fact that risks related to S&G factors are not comparable to environmental factors as a channel of materialization of financial risk. While methodologies already exist for environmental aspects and for climate in particular, methodologies for S&G are often not available. We suggest that at this stage, the EBA Guidelines should be **focusing on the environmental aspect, with emphasis on** climate and envisages a gradual approach for other factors. It would be useful to shape an internationally agreed roadmap for the gradual progression of social and governance factors towards quantitative measures.

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In addition, we suggest that the Guidelines should be **limited to the banking book and focused on credit risk**, while foreseeing a gradual approach when other risk types become more mature and/or material. A phased approach should also be considered for ESG risks concentration processes which imply first the identification and evaluation of ESG factors.

- Considering the current state of methodological developments and the numerous regulatory requirements banks will have to comply with the next few years (notably CSRD), banks will **need sufficient tim**e for the application of the Guidelines. **Implementation period of at least two years is crucial, given the complexity of the topic and its interdisciplinary nature** (data, IT, strategy, risk processes). In this regard, we would appreciate clarification on the entry into force and the application date. We would also like to point out that large institutions within the meaning of the CSRD that qualify as SNCIs and are treated as listed SMEs in the CSRD are only subject to the corresponding reporting obligations for the 2028 reporting year. This should be taken into consideration when finalizing the Guidelines.

- It is important that the Guidelines are i) f**ocusing on the risk perspective and ii) recognizing that ESG related risks are not an independent risk type** but influence the established risk types. However, we believe that some parts of these guidelines are not fully consistent with the first principle of a risk-based approach. Aligning with the EU Climate Law (even if not fully), or with measures prescribed by the European Scientific Advisory Board on Climate Change, or the alignment with the EU Taxonomy is not deemed to be a risk management tool in itself. We suggest that EBA pursues a risk-based principle throughout the entire Guidelines.

- **Proportionality** is a crucial principle for Pillar II and should be considered more holistically and not only with regard to the size of the institution. Proportionality should be better linked to the business model and risk profile of a bank as well as to cost benefits and scope considerations.

- The **materiality assessment** process for ESG risk drivers should be **internally consistent within a bank,** with the objective of integrating ESG risks into existing risk identification and measurement processes. Such approach would also be in line with the ECB's supervisory expectations relating to risk management and disclosure. However, further clarity in terms of the financial materiality aspect in relation to CSRD is needed. In general, we believe that the **entire Guidelines including provisions regarding data collection and engagement policy should be subject to the (financial) materiality assessment**. For example, in our view, exposures towards certain sectors should not be considered materially exposed to environmental transition risk by default. Several other factors should be considered, such as maturity of the loans, diversity of the business, transition possibilities and mitigators.

- We welcome that EBA recognizes that institutions are still developing methodologies that will ultimately be relevant to management. We believe **sufficient room should be left for methodological flexibility** (within the boundaries of CRD VI). It is also very important that this methodological flexibility is **maintained over time** to allow regulatory certainty and avoid disruption by changing methodologies, which could generate greenwashing risk. This flexibility should also apply to the use of proxies as long as these cannot be reasonably replaced by reliable data.

- **Flexibility should also be envisaged regarding metrics and targets**. Banks are responsible of their own risks and should be in the position to set their own metrics and targets based on their own strategies. Our understanding from the mandate in article 87a (5) CRD would be that reference methodologies could be seen as good practice, that might give institutions some kind of orientation for implementing ESG in their ESG risk frameworks. That is why we would like to ask the EBA to better distinguish between mandatory requirements and good practices.

- **Data requirements** in the Guidelines should be formulated in a way that is consistent with data disclosed under the CSRD, including the timing. Data should be collected by the bank for the different portfolios based on portfolio specifics. In addition, we believe that the **use of data from data providers and use of proxies** should be revisited in the Guidelines. The data providers are not only used to obtain estimates but also to optimize/complete the collection of data from corporates even where those data are publicly available (avoiding the need for institutions to examine thousands of sustainability reports of their clients). The **decision on data collection should therefore be left to the institutions** in a consistent manner with the outsourcing framework. Proxies could also be justifiable in particular cases, such as in the retail business or to alleviate the reporting burden of small companies and private customers. We recommend the EBA to further envisage the use of data at sectoral level where single-name information is not available.

- We are also concerned about the potential reputational and legal risks stemming from data quality, as well as how supervisors are going to challenge the quality of the data, and its consequences. It would be useful to introduce a **presumption that the data collected directly or indirectly (through data providers) from sustainability statement under CSRD complies with the data quality requirements**. Availability of public databases regarding emissions, asset localization and insurance coverage would also be helpful. To increase comparability of data and improve understanding of the data that banks will continue collecting, we would like to stress the importance of "institutional proxies" and data made available by regulators and supervisors. We would therefore like to ask the EBA, in collaboration with the ECB, to make the **aggregated information gathered through Fit for 55 (emissions), AnaCredit (statistics of losses), proxies from the ECB economy-wide**

stress test etc. available to the banking sector. In addition, we would like to suggest to EBA to elaborate further (practical) **guidance on when and how proxies may be justified.**

- We welcome the **flexible approach regarding the CRD transition plans** which requires consistency with the CSRD but leaves flexibility as to whether this results to a single transition plan. The link and the consistency between the CSRD transition plans to support the transition to a sustainable economy and CRD plans for managing associated risks should however be further clarified, in particular how the CRD based transition plans are to be implemented and managed in relation to the overall strategy. A clear conceptualization between transition plans to support the transition to a sustainable economy and prudential plans for managing risks associated with the said transition would be welcome. It would also be useful if EBA provides more insight on the elements that need to be worked on by banks in the prudential plan in addition to the CSRD transition plan, with clear articulation and justification of why a certain factor is important from a prudential (risk) perspective.

- The **expectations on the customers' transition plans assessment should be clarified, including the role of third parties assessors and auditors**. While banks should be in the position to understand client's plans, they should be **able to rely on the third party assessment** (e.g. auditors) of the robustness, soundness and credibility of these plans. Remits of the banks should be the same as for the financial statements. Banks can develop methodologies to assess their counterparties transition plans but ca**nnot bear final responsibility for their credibility. We should be able to presume that plans published under CSRD are credible, reliable, robust and sound.**

- We recommend to **omit references to the EU** Taxonomy as EU Taxonomy cannot be considered a risk assessment tool. In addition, as evidenced by the recent reporting, misalignment with the EU Taxonomy may be due to difficulties to evidence the alignment (e.g. difficulties to evidence the DNSH criteria or lack of other documentation). Moreover, it would not provide a whole picture, as many counterparties would not be under the scope of the EU Taxonomy. Making sole reference to the EU Taxonomy as a proxy for non-materiality would also impose significant extraterritorial effects in particular for banks with presence in third countries. Also, banks should not be requested having a certain percentage of exposures towards green investments as a risk mitigation tool but must be allowed to assign investments towards sustainable activities based on their overall commitments and investors' appetite.

- Banks should be given **more leeway in defining their ESG risk appetite**. This depends, among other things, on the business model, size, and portfolio structure. **Banks should be given flexibility to run their business model and strategy, including decarbonisation strategy, as long as they can demonstrate they have put in place a governance and a**

sound risk management framework. The EBA should not be prescriptive in terms of metrics and indicators. Sufficient flexibility should be given to banks also to properly manage their own risks coming from their business model and strategy. It should be up to the institutions to decide which measures they take to measure and mitigate risks. In the latter case, "bearing the risk" may also be a possible option that is not even considered by the EBA. As ESG risk management is becoming part of SREP, **the supervisor will be in a position to assess the robustness of a bank's overall risk management framework.**

- It is not clear **why ESG should play a separate role as a risk driver when determining risk appetite** compared to traditional risks. Ultimately, it materializes in the known risk types for which risk limits and risk capital are set or allocated. A clear differentiation between the Risk Appetite Framework (RAF) and the general limit/threshold framework that an entity can have at a lower management level is missing. It is important to make this differentiation for correct functioning of the risk appetite framework .

- **Alignment commitments serve as important guidance, but they should not be used as risk indicator**. Portfolio alignment is different from risk alignment. It **cannot be concluded that all misalignment results in transition risks**. It should also be left to the institutions to decide which portfolios they include in the alignment assessment from a materiality perspective. There should be also greater flexibility on the scenario choices.

- The EBA Guidelines on **Internal Governance** provide sufficient framework for the implementation of an appropriate risk culture and the concept of the three lines of defense. **Separate policies and governance for ESG purposes should not be required.**

- We recommend **aligning the section on ICAAP and ILAAP with the ECB expectatio**ns on this part and what was done on materiality assessment by banks. Banks have already incorporated climate scenarios into their ICAAP and ILAAP analysis when deemed necessary following indications of an ECB's Guide on climate -related and environmental risks published in November 2020 regarding the ICAAP. Supervisory scenario setting does not align with the internal character of ICAAP, and we propose to refrain from it. Also a complete integration of ESG risk drivers into the ICAAP normative perspective will be very difficult, given that the time horizons analyzed within this process are shorter than the expected materialization of ESG (physical and/or transition).

- Concentration risk is already integrated into the institutions' internal risk management, whereas the processes are established and operationalised. Therefore, we believe that the approach to concentration risk should remain flexible in order to allow banks to use their own methodologies. It is extremely difficult to define concentration risk in relation to ESG factors. Using some of the proposed metrics (GHG emission, sectoral vulnerabilities) would produce an incomplete and inaccurate picture, as banks will still have to finance the transition of carbon-intensive firms. **The concentration risk could have some adverse impacts on the financing of the transition as it would not consider the transition strategies and pathways of counterparties**. In addition, some concentration risk elements are already included in the models, such as sectors and geography already addressed in the Pillar 2.

- For **market risk**, in general it **is difficult to identify ex ante which part is due to ESG** factors as it is already embedded in the price of the products. The exception could be the case of ESG-linked derivatives, where the coupons paid by the derivative can depend on future ESG KPI tests of the counterparty. For those cases, a specific ESG adjustment may be required. As for the ESG-related factors' impact on market risk capital metrics, we consider stress tests metrics to be the most suited indicators to account for their effect.

- The ILAAP is a process to assess **liquidity and funding risks** and to avoid duplication ILAAP should be leading for ESG. ESG factors are not identified as material for liquidity risks.

- Evaluation of ESG risks from an **operational perspective** is already tackled internally by banks. Banks also provide information in this regard to supervisors. While the internal taxonomies already have a "natural disaster" label, it is extremely difficult to differentiate between natural disasters that are directly caused by environmental factors and those which are not. Illustrative examples of potential future impacts from ESG-factors that could have an impact on operational risk, litigation and reputational risks as well as guidance on how to identify and label operational losses related to environmental risks would be appreciated.

- Concerning **reputational risk**, while banks are already putting in place processes to mitigate greenwashing, the ESAs high-level principles set out in the EBA Progress report on greenwashing monitoring and supervision do not cater fora legally defined definition and should not be referenced in EBA Guidelines. Such a broad understanding of greenwashing reduces legal certainty and therefore risks hampering financial institutions' transition finance efforts.

- We fully share the EBA view on the **importance of engagement policy** to ensure consistency with banks' climate commitments. However, these Guidelines are not an appropriate place to stipulate engagement policies. The ambition of banks to improve their counterparts' ESG profile should be left as a tool that banks may consider in managing their ESG risks or the implementation of their transition plans, instead of being required in prudential guidelines. In any case, the (financial) materiality assessment should be the cornerstone to identify the scope of the counterparts to consider. That is the prerequisite to ensure efficient allocation of resources and considering that the lever with the counterparts highly depends on the type of services banks provide and the depth of their customer relationship.

Response to the EBA questions

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?

We appreciate that the EBA is seeking to understand how the entities are managing the risks associated with the transition of certain sectoral portfolios, based on a materiality assessment (par. 16 and par 17), in particular how the entities are analyzing the risks and opportunities of the sector, the long-term vision of the role of the sector in the decarbonization of the economy and the strategic responses of the different actors of the entire sector.

Given the early process of implementation of the CSRD and the provisions foreseen in the CRD, banks are still determining the most appropriate and relevant approaches for their organisations. In this regard, **we welcome the flexible approach of the Guidelines** which only require to ensure consistency between targets, actions and tools put in place in accordance with different regulatory frameworks and it neither obliges banks to have a single plan, nor requires multiple plans.

We also welcome that CRD does not foresee that banks have to submit the "prudential plans" to the supervisors or to make them public. It is **expected that banks would submit the prudential plans based on supervisory request in the context of SREP.**

Having said that, we would appreciate **further clarity regarding the CRD plans and its relation to CSRD/ESRS reporting requirements** (which also cover disclosure on risk management) and strategic transition plans (that will be disclosed under the CSRD). While CSRD/CSDDD and CRD-based plans will be complementary, **one refers to how the institution is aligning or adjusting its business models and strategies with the 1.5-degree pathway**; whereas the **later analyses how the institution is managing the risks associated with the transition of the economy** - in the short, medium, and long term. Both approaches could diverge if the economy, or key sectors are not progressing as set in the pathways used and could have different business implications.

We would in particular appreciate further clarification on **how the CRD based transition plans are supposed to be implemented and managed in relation to the overall strategy** of the institution and in particular in relation to the (climate CSRD) transition plan of the institution, including the commitments and targets that institutions have set (in many cases). A clear **conceptualization between transition plans to support the transition to a sustainable economy and prudential plans** for managing risks associated with said transition would be welcome. It would be also useful if EBA clearly explains **which elements need to be worked on by banks in the prudential plan in addition to the CSRD transition plan** with clear articulation and justification of why this is important from prudential (risk) perspective .

From what is requested by the EBA Guidelines, we would think that parts of the requirements like describing processes and measures for the management of ESG risks might already be covered in internal policies. The prudential transition plan could therefore also be seen as a summary document.

Further clarification will be appreciated as to:

- financial materiality aspect
- Links between **transition plans (CRD elements) and risk quantification**
- Both, the CRD and CSRD refer to the transition plan as a whole, while EBA Guidelines reference several transition plans, by sector, based on the materiality assessment done by each entity "while leaving flexibility and responsibility to institutions as to specific details and individual internal strategies''. Clarification will be appreciated.
- Clarification is also needed as to why does EBA seem to request the prudential transition plans to be compliant with the EU Climate Law which is a political objective and not risk based. This requirement could generate unintended consequences on a risk perspective. The common alignment of European banks' risk management with the EU's climate and environmental policies leads to systemic risks due to aligned behaviour. In the event of misalignment, we do not see a compelling need for risk mitigation measures. **Banks must be able to accept known risks and manage them in their ICAAP**, for example.
- Finally, for the sake of greater clarity, we would suggest to EBA to consider referring to CRD plans as "**climate risk management plans**" in the EBA Guidelines.

Concerning the level of consolidation, these plans should be **made at consolidated level** and not requested for EU or not EU subsidiaries. We would also like to mention that other jurisdictions have committed to different deadlines to reach their climate objectives and thus the transition risks for non-EU exposures will need to be assessed on a different timeline.

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

We consider **proportionality as a crucial principle for Pillar II.** During the EBA hearing, it was explained that proportionality is being reflected in the methods, i.e. how detailed and sophisticated they are, as well as in the minimum frequency for the materiality assessment, but it cannot lead to a consideration of whether to implement the Guidelines. While we agree with this message, we noticed that most of the simplifications are linked to the classification as SNCIs. We strongly reject this binary use of the principle of proportionality (see our remarks on question 2).

It is important that all institutions manage prudently their ESG risks – as any other material risk. Proportionality for smaller institutions should therefore be applied to the extent that their risk management framework is consistent with the materiality of these risks. From a broader perspective, in terms of size and complexity of institutions, **it is not evidenced, that smaller institutions will be less exposed to climate-related risks.**

The Guidelines only refer to proportionality in the context of the size and complexity of the institution, with references to the SNCI classification in CRR II. However, the EBA Guidelines on internal governance take a broader approach to proportionality. Article 16 of the Guidelines refers to internal governance arrangement being 'consistent with the individual risk profile and business model of the institution'. Similarly, CRD Article 74 refers to governance arrangements being 'proportionate to the nature, scale, and complexity of the risks inherent in the business model and the institution's activities.

For certain business models or portfolios, the materiality of ESG risks may be more limited, requiring a proportionate approach, particularly the context of 'identification and measurement of ESG risks' and 'monitoring', where many of the data and metrics prescribed may not be relevant. Section 3.4 on **Proportionality should make more explicit that if materiality assessments of ESG risks do not identify material ESG risks transmission channels from counterparties, identification data, engagement with counterparties, and internal reporting metrics should be considered in a proportionate manner, regardless of the size of the institution.**

The proportionality and gradual approach and simplifications should therefore be possible not only for SNCIs, but also for the rest of the LSI sector and also large institutions, **depending on their business model and individual risk profile**.

We therefore believe that proportionality should also apply in regards to the following aspects:

- **Cost/benefit analysis of the proposed measures**
  The incorporation of ESG-related risks in the prudential framework will imply a significant workload for entities. It should be ensured that the requirements add value to the risk-based framework and from a supervisory perspective.

- **Scope (See also response to questions 3 &5)**

    - EBA should consider a sequential approach, prioritizing environmental and in particular climate risks to social and governance ones and should not rush into including those for which there are even less sufficient data and methodologies (compared to climate) at the moment. Moreover, it should be acknowledged that **social and governance factors are not comparable to environmental risks as a channel of materialization of financial risk**.

    - The same gradual approach should be applied for risk types. It is recognized by regulators that credit risks are the most material risks category that are or will soon be impacted by ESG factors. EBA guidelines **should start to be implemented on credit risks** and foresee gradual approach when other risk types become more mature and/or material.

    - A **phased approach should also be considered for ESG risks concentration processes** which imply first the identification and evaluation of ESG. In the context of the Pillar 1, we also understand that EBA is keen to develop a specific metric of ESG risk concentration in short term. In that case, it would be critical to ensure a consistent approach in term of timeline in order to avoid disruption by changing methodologies.

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.

Gradual approach and consideration of the corporate data availability (see also our response above)

Banks should be granted sufficient time to cover other topics than climate. A gradual implementation should be provided. Currently, there is a wide knowledge gap between climate and environmental risks and even wider gap in comparison to the management of social and governance risks. Most banks will need more time to improve the social, governance or even biodiversity and nature-related risks, including the improvement of the granularity of information for these types of risk factors. In addition, regarding social and governance risks, the **timing, and requirements from the implementation of other relevant**

regulatory expectations (e.g. CSRD) should also be considered and may impact alignment in the future. The existence of sufficient underlying data should be considered.

The international disclosures standards also only cover climate, so far. Hence definitions, concepts and metrics on other environment-related topics, social and governance topics are not yet fully mature in non-EU jurisdictions, leading to potential inconsistencies across frameworks. Data gap will be even wider, as non-EU companies are not yet required to report on social and governance topics.

An international agreement is key as idiosyncratic issues need to be considered, comparability needs to be ensured and potential reputational and legal risks should be avoided.

Interactions between various types of risks

It could be useful to better understand whether the various types of risks should be assessed independently, or the institution should develop a dependence structure between these types of risks (e.g., transition risks for a corporate counterparty could lead to additional social risk which could negatively affect the households/retail customers of a bank). If the latter is the case, it would be useful to better understand how to properly assess these dependencies.

We are however aware that development of a clear and generally applicable guidance on how to deal with such interactions will be challenging, given the interactions between different types of risk (e.g. E triggers credit risk, S/G triggers reputational risk). Such interdependencies should therefore - where relevant - **be taken into account in the individual risk assessment.**

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

We agree with EBA regarding the fact that both qualitative and quantitative elements and data should be used to run the materiality assessment. Also, we agree to take into account only the most significant activities, services and products. However, we strongly believe that EBA should not be too prescriptive by designing a one size-fits-all process for all institutions.

The materiality assessment process for ESG risk **should be consistent with the objective of integrating ESG drivers into existing risk management processes and remain internally consistent within the bank.** A separate ESG materiality assessment will lead to increased operational complexity. Therefore, we believe that EBA should **emphasize the integration of ESG risks in existing risk identification and measurement processes** (cf. sections 4.2 Identification and measurement, and 5.5 ICAAP and ILAAP). Such approach would also be in line with the ECB's supervisory expectations relating to risk management and disclosure.

The materiality assessment of non-EU exposures should be clearly circumscribed in terms of transition risks as is directly linked with the third-countries climate objectives and their economic dependencies.

Consistent approach to materiality throughout the Guidelines

Some of the provisions in the Guidelines do not seem to be subjected to the materiality assessment (as some of them refer to materiality assessment while others not). Hence, it would be critical that the guidelines state clearly **that all provision including those regarding data collection and engagement policy should be subject to the (financial) materiality assessment.** It would help banks to deepen their analysis and efforts where the risks are material, in a consistent manner with the risk-based approach**.**

Time horizon

Regarding the time horizon, we firmly believe that capturing the time dimension is key to assessing materiality of ESG-enhanced risks and we understand that the considerations of time horizons follow the CRD ("…including a time horizon of at least 10 years"). We suggest however that EBA reflects on what that entails for prudential purposes.

It could also be clarified that long**-term horizon is not expected in relation to every risk management tool** as this would be too excessive and demanding. An approach including several assessments for every risk event depending on the time horizon will also not be efficient nor include all relevant information. We **support an approach including features which enable to qualify the probability and the time horizon of each risk event, notably those that are favoured, triggered, or worsened by ESG risk drivers**.

Paragraph 14- Most critical counterparties

The analysis of the "most critical counterparties"(paragraph 14) regarding their deviations from the transition plans of their jurisdictions is **too extensive for a bank-wide materiality analysis at portfolio level**. We would also ask for clarification of what is meant by "most critical".

Paragraph 15 - Likelihood and severity

We would appreciate clarification on how to assess the likelihood and severity (paragraph 15) of the materialization of risks, particularly if this information is to be embedded in the considered scientific climate scenarios or is to be considered separately from the scenarios.

Please see also our response to Q 17

Question 5. Do you agree with the specification of a minimum set of exposures to be considered as materiality 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.

We do not agree with:

- The specification of a **minimum set of exposures to be considered as materially exposed** to environmental transition risk. It covers nearly all activities and does not take into account the idiosyncratic client's situation. A more selective and granular approach that starts from economic activities but that allows to differentiate between clients should be adopted instead, leveraging on the real progress in their transition plans to net zero.
- The **reference to the EU Taxonomy** to exclude some sectoral activities.
- **Introducing similar requirements for** S&G related risks in the same manner as for environmental risk given they are not comparable as a transmission channel of financial risk (compared to environmental related risks).

Paragraph 16

We do not see the requirement in point 16 to classify certain sectors per se as significant for environmental risks unless proof and documentation to the contrary is provided very critical. **This reversal of the burden of proof effectively reduces the risk inventory to absurdity.** This is because the relevant NACE codes cover the entire economy, which is currently the focus of the transition. This was already a major point of criticism in the ECB's climate stress test, which claimed that 60% of banks' exposures were dependent on fossil fuel industries. Ultimately, it emerged that the majority of exposures are in sectors with comparatively low emissions intensity. There is also insufficient differentiation at the level of NACE code 1. For example, the energy sector is classified as material without differentiating between fossil and renewable energy sources. However**, we do not believe it is appropriate to classify the sectors as material across the board.**

We consider that paragraph 16 is too much sector oriented which is mostly applicable for climate transition risk, and **banks should not be asked to apply different methodologies for every component of ESG aspects** (physical, environmental, social, and governance risks). Moreover, **banks should not treat differently ESG risk drivers compared to other risk drivers.**

As already mentioned above, we believe that a sufficient degree of flexibility should be given to individual institutions to assess the materiality of ESG risks in their specific portfolios using various dimensions (which are necessary to tackle other topical that climate mitigation), including industry sectors. **We do not believe that exposures towards certain sectors should be considered materially exposed to environmental transition risk by default.** In assessing the creditworthiness of a debtors, several other factors should be taken into account such as maturity of the loans, whether the exposures belong to a diversified business group or not, whether the corporate has the willingness/possibility to shift its business model, whether the sector itself has the possibility to decarbonise going forward (existing of new technology or not). **The draft also does not distinguish specific counterparties (best-in-class vs. laggards), neither mitigators, in particular the transition plans of companies or government policies. These factors need to be integrated in the materiality assessment approach.**

Paragraph 17

We also do **not support the reference to the EU Taxonomy as a proxy of justification of non-materiality** as a derogation to default sectoral exposures materiality assessment, par. 17). We support a risk-based approach for the prudential treatment of ESG risk. The EU Taxonomy is not risk-based, as also acknowledged by EBA at previous occasions. There is to date no evidence of a generalized positive risk differential according to "green" vs. "brown" features of counterparty activities. The evidence could actually point to the contrary at this stage (e.g. offshore wind farms vs. Aramco). The assessment of a risk differential should be considered a prerequisite. Moreover, the misalignment with the EU Taxonomy, as evidence by recent reporting, is in many cases **difficulties to evidence and document the alignment etc, so missing clear relationship with the main ESG risk drivers** that the proposed reference to the EU Taxonomy may seek to address. Moreover, it would not provide a whole picture, especially for banks with presence outside the European Union, as many counterparties would not be under the scope of disclosure of this alignment. Making sole reference to the EU Taxonomy as a proxy for non-materially would also pose significant extraterritorial effects for banks with presence in third countries.

To answer the question whether the guidelines should provide similar requirements for the materiality assessment of physical risks, social risks, and governance risks, we would like to mention that in the materiality assessment of banking book, banks use the same approach for transition and physical risks, but not for social risks given the state of maturity compared to climate or environmental risks. **We therefore do not believe similar requirements should be provided to assess the materiality of social and governance risks.** Social and governance risks are more related to client-idiosyncrasy. Trying to build a risk-assessment system or metrics for governance or social risks would be extremely burdensome and would not be supported by a cost/benefit analysis. The requirement to analyse ESG materiality over the medium and long term should be limited to climate and environmental risks. The materiality assessment for social, governance, biodiversity risks should be done on a best effort basis at this stage. Please refer to the gradual approach in Q2&3.

Therefore, **paragraphs 16 and 17 should be deleted** and the specific procedure for the materiality assessment should be left to the institutions.

Physical risk

In addition, we would propose that the institutions' materiality assessment should be leading when determining the materiality of physical risks and should take into account mitigations such as insurance and/or public schemes as relevant.

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

Paragraph 21

Institutions must be able to organise their data processes efficiently, with a particular focus on the relevance of business activities in relation to all risk types and the results of the materiality analysis. We request a corresponding addition in paragraph 21.

It would also be useful to introduce a **presumption that the data collected directly or indirectly (through data providers) from official sustainability statement under CSRD complies with the data quality requirement.**

In addition, the use of **external data providers should be explicitly provided for** (not only "public bodies", but also professional data agencies)/data providers.

For the overall data processes, it is important to find a balance between completeness and practicability.

Paragraph 22

We understand the need to collect sufficiently granular data to perform risk assessments foreseen in the CRD. Indeed, capital adequacy considerations should be based on data.

For the most significant large companies, the CSRD will promote the availability of data in a structured form. We therefore support the approach of initially relying on publicly available data and focusing on clients' reporting. **Data requirements in the Guidelines should therefore be formulated in a way that is consistent with data disclosed under the CSRD, including the timing**. Banks should use the published data and should not be obliged to provide additional information that is not included in the CSRD (provided that the companies are subject to the CSRD/ESRS reporting). For corporates outside the EU this information should be provided on a best effort basis.

However, even where counterparties do provide data, comparisons and risk model design is complicated as a result of the current lack of a uniform reporting standard. It also needs to be acknowledged that the CSRD disclosure will not solve all the data information need for all the bank's portfolios, even in a long term. **Bilateral collection of data from counterparties could therefore complement reported data where it is proportionate** (namely considering the ability of the counterparts to bear such a charge), **and to the extent warranted by risk management purposes.** However, we were made aware that some Member States ask financial institutions to limit bilateral outreach to corporates to collect data and rely as much as possible on data reported from CSRD and from data providers. This goes against the requirements from the draft Guidelines to primarily engage with clients to collect data. This contradictory injunction needs to be clarified.

Paragraph 23

We **do not support the necessity to provide all the metrics and units** specified by EBA in paragraph 23. The list of data to be collected from counterparties listed in this paragraph should be primarily i) focused on data being published under CSRD, ii) seen as a recommendation, and iii) concentrated on data on climate related factors (such as greenhouse gas emissions and energy efficiency).

Banks should be allowed to choose the most relevant metrics. For instance, for some sectors, physical intensity per unit of production is more relevant, for others it could be technology mix or both. Therefore, **data should be collected by the bank for their different portfolio based on the portfolio specifics** (e.g. materiality of ESG risks, type of clients / collateral, granularity…) and banks should have the possibility to choose the relevant metrics (e.g. NZBA banks may use the ones used under NZBA portfolio alignments)

Regarding paragraph 23 a ii), we would like to ask EBA to further clarify what the base should be for the forecasted GHG scope 1, 2 and 3 emissions. It should be highlighted that CSRD does not require undertakings to publish their emissions forecasted but only their targets of emission reduction (subject to the materiality principle). Hence, we **suggest replacing the forecasted emission by the target of the counterparties.**

Regarding paragraph 23 a viii) we would like to highlight that an imminent litigation risk of the counterparty is likely to be provisioned by the counterparts. Hence, this consideration may lead to a double counting in the credit risk associated with this counterparty.

Regarding paragraph 23 b) on social factors and data on due diligence, we believe these should be **introduced progressively**, in consistent manner with the Due Diligence Directive (CSDDD) which only covers entities over 1000 employees, and which includes a review clause of 2 years for the application to financial services.

Finally, we would also like to make an additional comment in relation to paragraph 23. The Article 3(4) of Directive 2013/34/EU referred to in paragraph 23 defines 'large institutions', while Article 23 refers to 'large corporate counterparties'. The Article should **use the approach taken in the Pillar ESG disclosures, making the distinction between financial and non-financial corporates**. The information requested in Article 23 is logical to collect for non-financial corporates, but not for financial counterparties.

Paragraph 24

According to the EBA Guidelines on Loan Origination and Monitoring, institutions can **consider analysing ESG factors at portfolio level** instead of at the level of the individual borrower. This regulation makes sense, as it relieves the burden on micro and small enterprises and banks can also obtain good and management-relevant information with sector data. **The possibility of using sectoral information** should be included in point 24.

Paragraph 25

This guideline on data sourcing methodology does not reflect the various reasons for using data providers. The **data providers are not only used to obtain estimates but also to optimize the collection of the data from corporates even where those data are publicly available** (avoiding the need for institutions to examine each of sustainability report of thousands of entities). Instead, this decision should be left to the institutions in a consistent manner with the outsourcing framework. In other words, the use of providers should not be limited to the case where data is not directly available form the counterparts.

Furthermore, we appreciate the flexibility given in paragraph 25 for those instances where data from counterparties and public sources is not available by using estimates/proxies. We **also consider that proxies could be used even as a first option - where the data collection directly from the counterparties could be too burdensome for them (especially for SMEs and retail clients). Also, when the use of proxies is proposed, it must be considered that they may change over time, when real data becomes available. Banks should not be held liable for potential differences between data initially used (estimated or proxies) and real data when available.**

We are concerned how supervisors will consider and challenge the quality of the data, and its consequences. **Availability of public databases regarding emissions, asset localization and insurance coverage would be helpful** in this regard. Banks cannot be solely made responsible for accessing, collecting, and treating this kind of information via questionnaires or any other source of engagement with counterparties. It **can be very burdensome for counterparties**, even for large corporates, left alone SMEs. In this context, we would also like to urge **the EBA, in cooperation with the ECB, to make the aggregated information gathered through Fit for 55 (emissions), AnaCredit (statistics of losses), proxies from ECB economy-wide stress test etc available to the whole banking sector.**

Finally, in paragraph 25, point b), banks would be requested to perform quality assurance on ESG ratings from third-party providers. **We believe that it is not the role of banks to ensure the quality of this data - instead, ESMA will be in charge of the supervision of ESG rating providers.**

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

While the mapping of ESG risk **concentration** seems to be relevant in the development of ESG risks management framework, it should be highlighted that this risk (i) has not been yet defined in the regulation and (ii) implies first identification and evaluation of ESG risks. Hence, **we call for gradual approach in putting in place such a framework.** Also, in the context of the pillar 1, we understand that EBA is keen to develop a specific metric of ESG risk concentration in short term. In that case, it would be critical to ensure a consistent approach in term of timeline in order to avoid disruption by changing methodologies.

Furthermore, while we do not object to the general approach envisaging combination of exposure, portfolio and scenario-based methodology, it could be clarified which particular methodology responds to which particular risk management need, including how the three methodologies complement each other. It should be also clarified that institution can use different methodologies for different portfolios. **The measurement methodology used should be based on the materiality assessment** performed by the institution. In the absence of material risks from counterparties, institutions should be able to rely on the portfolio and forward-looking methodologies.

The ambiguity could be further reduced by defining **clear principles on the scenario-based methodology** and providing further clarity on the difference between portfolio based and scenario-based methodologies.

Paragraph 28 should include more guidance on **expectations relating to the quantification of environmental risk.** We underline the need to strike balance between the need to quantify risks and what is realistic in the short term as depicted in paragraph 29.

Finally, in future guidelines on scenario analysis it would be advisable to **include specific guidance on how to combine top-down and bottom-up scenarios**.

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

It would be useful to understand better if the ESG templates requested for Pillar 3 disclosure are already considered as an example of this exposure-based methodology.

Paragraph 30

In reference to Paragraph 30, we would request clarification why ESG factors should be taken into account in the overall assessment of default risk of a borrower **even in case the risks are not material.** Does it imply a tailored DoD definition related to ESG risk drivers?

In many cases, the integration of ESG aspects into PD modelling **will be challenging** based on the data currently available. We assume that banks do not have to integrate ESG risk drivers into their rating models, provided that an existing ESG score covers all E, S and G components and is used as a decision criterion in the lending process. Clarification will be appreciated.

For internal risk scoring and rating model, counterparty ratings can be adjusted through expert judgements, by way of overrides. **It is too early and premature to modify rating**

models as banks are lacking evidence, historical data to do so. This may put in danger the whole equilibrium and performance of internally developed rating models.

Paragraph 31

The detailed list of risk factors and the wording "at least" cannot be considered a best practice (for certain portfolios/exposures), as it does not consider the exposure characteristics and materiality. The list is not suitable for all exposures. **The application of the factors should depend on the portfolio specifics.** We recommend that EBA refers to the to the risk factors that institutions "may consider".

Furthermore, with regard to forecasted emission, it should be highlighted that CSRD does not require undertakings to publish their forecasted emissions but only their target of emission reduction (subject to the materiality principle). **Hence, we suggest replacing the forecasted emission by the targets.**

Paragraph 31a

"Look through" from customer to guarantor is not manageable. It should be used with a sense of proportionality (size, importance of the guarantee).

Paragraph 31b

"Look-through" into the supply chain is not manageable (in any case). It should therefore be used with a sense of proportionality (size, importance). The exact scope of the risk types concerned should be defined (e.g. credit risk, market risk).

Paragraph 31 c)

We are concerned with potential wide-reaching impact of the supply chain requirements and would appreciate clarification as regards to EBA expectations about supply chain information.

Paragraph 31 d)

We suggest clarifying that the maturity of the exposure is needed to identify which risks are relevant for the exposure, depending on their time-horizon of materialization.

Paragraph 31 e

It is positive that risk mitigation aspects can be taken into account (point 31(e)), as for physical risks for instance, it is important that banks who are not in the first line, could deduct the insured portion of their loans and only keep the residual one when assessing their materiality.

The willingness and ability of customers to adapt play a major role, particularly in the case of transition risks. The aim must be to involve a broad range of customers in the transformation and support them with financing. If such aspects were not taken into account, there would be a risk of excluding customers willing to transform from financing. We would like to request for further clarification from the EBA on **whether a forward-looking approach on "mitigation opportunities" is required from paragraph 31e**, and how this is expected to be embedded as part of the assessment.

Paragraph 32

We believe additional reflections concerning SME should be included in paragraph 32. It cannot be expected that banks will be engaging with millions of existing clients bilaterally. While it is realistic to expect information gathering during the onboarding process, institutions will to a certain extent need **to rely on external data sources or use of proxies on a portfolio level.** In this context, we refer to the simplifications for micro and small enterprises in the EBA Guidelines on Loan Origination and Monitoring.

Paragraph 33:

Data requirements especially for social and governance aspects need more central boundaries and should be aligned across jurisdictions. It is not reasonable to expect banks reaching out to their clients (esp. for those who are also acting globally) and demand numerous data subsets. Even in cases these have been initially agreed and are collected (which will deviate across firms) it would be burdensome later on to change the processes when regulation is becoming more concrete and regulators are following "best practice ". This is not an issue of internal governance alone as it needs the client interaction.

An essential point where the regulation is falling short is the tendency to categorize businesses via a data driven static approach into "good" and "bad" sectors in risk management space instead of focusing on the transformation needs and progress. This will effectively have as a result that **sectors being deemed greener already will have easier/better access to financing than sectors with e.g. more pollution** while esp. those would need funding to allow for transformation. That may discourage some industries in transforming at all and potentially **penalize financing such activities.** Hence this might widen the spread between industries and **lead to a misallocation of funding.**

Finally, the fact that the medium and long-term horizon should also be relevant for social and governance risk factors in point **33 contradicts point 27**, where the exposure method is intended for the short-term horizon. We are in favour of consistently limiting this for S&G risks as well.

Question 9. Do you have comments on the portfolio alignment 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.

Banks that have aligned their portfolio with the Paris climate goals and have published corresponding commitments and targets use alignment methods such as SBTi or PACTA to pursue and achieve these goals at a strategic level. The achievement of these goals is to large extend dependent on the success and speed of the transformation of the economy. From a strategic perspective, the **alignment commitments provide for an important guidance, but they should not be used as risk indicator. Portfolio alignment is different from risk alignment. It cannot be concluded that all misalignment poses transition risks.**

The guidelines should take a different approach and not define the sectors to which these methodologies apply, nor the scope within each sector. This should depend on the entity risk assessment. The guidelines provide an exhaustive sector list that is not always comparable. For example, for the steel sector, it seems that the guidelines are assuming to apply the methodology of the Sustainable Steel Principles, which is highly data demanding. On the other hand, for the chemicals sector for example, there is not a single agreed methodology. Furthermore, there is no specific roadmap for metal in the IAE scenario unlike the draft guidelines suggest. That is why, we consider that a different approach would be advisable, in which more flexibility is allowed for entities to perform this assessment and align their approach with NZBA framework (when adopted) including sectors, scenarios, metrics and targets. Banks should not be required to adopt a new approach to pilot their portfolios and transition plans as what they are already doing under the NZBA.

Also, this needs to be consistent with the P3 alignment template.

Paragraph 35

In addition, we would like to suggest that the EBA further clarify whether paragraph 35b only relates to transition risk from an impact perspective (i.e. in relation to 35a) and excludes physical risk.

Paragraph 36

It is unclear what is meant by "representative samples of exposures". An explanation would be helpful. For SNCIs to be truly supported, "representative samples of exposures" must be easy to identify in order to keep the effort involved in proving representativeness manageable.

In general, we consider paragraph 36 to be too detailed. It should be at the discretion of the institutions which portfolios they include in the alignment from a materiality perspective.

Paragraph 46

It should be left to the **institutions to decide which portfolios they include in the alignment assessment from a materiality perspective**. **There should be also greater flexibility on the scenario choices.** The IEA 2050 scenarios referenced in paragraph 46 might not be granular enough for bank's exposures (banks should be able to consider the NGFS scenarios instead). The reference scenarios should be selected by the institution, considering its specificities regarding existing climate targets, geography, and business model, rather than being pre-determined in the guidelines. The EBA should also explicitly recognise the high degree of uncertainty associated with climate risk models.

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

We assume that the specification of a longer-term time horizon, in this case at least 10 years, is not intended as a multi-year risk-bearing capacity calculation. As we understand it, institutions would include ESG factors in the normative and economic perspective in the ICAAP with the risk assessment horizons that have applied to date.

The 10-year time horizon implies enormous challenges given the lack of available data, as well as the uncertainties inherent to the transition. **Entities should be granted enough flexibility to set up plans and procedures able to be adjusted to the specific circumstances that will progressively arise.**

Paragraph 42

Paragraph 42 is too restrictive in our view. It should be up to the institutions to decide which measures they take to measure and mitigate risks. In the latter case, "**bearing the risk" may also be a possible option** that is not even considered by the EBA. While less diversified by nature, regionally anchored institutions or institutions with a sectoral specialisation have specialised knowledge. The methods listed in point 42 should therefore be provided as examples and not mandatory.

We fully share the EBA view on the importance of engagement policy to ensure consistency with banks' climate commitments. However, we are wondering whether these guidelines are an appropriate place to stipulate engagement policies. The first objective of the engagement policy is to collect relevant data which is consistent with the need of data quality.

Beyond that, the need for banks to strive towards improving the counterparts' ESG profile (and relative metrics) should be left as a tool that banks may consider managing their ESG risks or the implementation of their transition plans, instead of being required in these guidelines.

In any case, **the (financial) materiality assessment should be the cornerstone to identify the scope of the counterparts to consider**. That is the prerequisite to ensure efficient allocation of resources and considering that the lever with the counterparts highly depends on the type of services banks provide and the depth of their customer relationship. From the counterparties point of view, it may raise concern as they will face several expectation and strategy when they have multiple banks' relationships (which is the case of large corporates).

The requirement to assess the process for greenwashing mitigation in paragraph 42 seems to go far in terms of banks' interference in clients' management.

Also, in paragraph 42 d, the ESG seems to be considered a separate risk instead of a driver of traditional risks.

With respect to the requirements in section 42 a (ii) that institutions should ask for and assess the soundness of at least large corporate counterparties' transition plans, additional guidance on how this assessment should be performed, including guidance on what standards the institution should use, must be provided.

It should be clarified that **banks cannot be made responsible for the assessment of the credibility of clients' transition plans**. Even with a limit to large counterparties, assessing the credibility of transition plans could in practice be a huge challenge for banks, especially without clear benchmarks and further guidance as to the depth of the assessments and a clear link to materiality of risks. **In any case such requirement would go beyond what should be the responsibilities of banks**.

The expectations should therefore be clarified, including on the role of auditors in the assessment of clients' transition plans. While banks should be in the position to understand client's plans, they should be able to rely on third party (e.g. the auditors' assessment) of the robustness, soundness, and credibility of these plans. Remits of the banks should be the same as for the financial statements. Banks can develop methodologies to assess their counterparties transition plans but cannot bear final responsibility for their credibility. **We should be able to presume that plans published under CSRD are credible, reliable, robust, and sound**.

Having said that, we believe that more guidance should be provided by the EU institutions, including on sectoral pathways to which corporate transition pathways could be compared to facilitate the understanding. We believe it should be the responsibility of public institutions to put in place effective measures to assess and monitor the credibility and soundness of the counterparties' transition plans.

On paragraph b) while adjusted pricing policy may result from the credit rating of the counterparts it should not been seen as an automatic tool to use in this case. Indeed, such a tool, if required by regulation, could result in level playing field issue where other banks will offer better prices.

In addition, we do not agree with the request expressed in paragraph 42, point d, for banks to diversify their lending and investment portfolios based on ESG-relevant criteria as the EU Taxonomy is not a risk-based tool. EBA should not request banks to have a certain percentage of exposures towards green investments as a risk mitigation tool but must allow banks to assign investments towards sustainable activities based on their overall commitments and investors' appetite. Banks should focus on the quality of their exposures, and not on the volumes of green exposures.

Finally, to facilitate compliance with the risk management principles the Guidelines should provide guidance on the notion of significant SME and large corporate counterparties (para 42)

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

As already mentioned, the guidelines should consistently recognize that ESG risks are not an independent risk type, but drivers of existing traditional risk types.

The management of ESG elements should be embedded in institutions' internal models and procedures and thus when institutions analyse the risk derived from onboarding, the ESG factors should be taken into account. This implies that **ESG cannot be expected to be entirely segregated within the internal controls.**

Institutions should be given more leeway **in defining their ESG risk appetite.** This depends, among other things, on the business model, size, and portfolio structure. Banks should be given some flexibility to run their business model and strategy as long as they can demonstrate they have put in place a governance and a sound risk management framework.

We would also suggest **clarifying the scope and feasibility of the required stress test** from the EBA, and whether some proportionality principles are required, as from paragraphs 43 and 44, it seems to follow that climate or environmental stress tests are required for the entirety of the business model (i.e. following that business strategy covers the institutions' entire business model).

Concerning paragraph 43 d) we **disagree on the list of mandatory metrics** as specify under 6.3. Please refer to Q 20

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

As already noted in other parts of the consultation, we think that it is of utmost importance to develop a gradual approach into ESG-related risks, starting with environmental risks and following (without rush) social and governance. We must always bear in mind the lack of data that still exists in relation to ESG-related risks.

It is not clear **why ESG should play a separate role as a risk driver when determining risk appetite c**ompared to traditional risks. Ultimately, it materializes in the known risk types for which risk limits and risk capital are set or allocated.

In the proposed guidelines we do not see a clear differentiation between the Risk Appetite Framework (RAF) and the general limit/threshold framework that an entity can have at a lower management level. I**t is important to make this differentiation,** to avoid hampering the correct functioning of the risk appetite framework

The RAF is a formally defined process, with a strict governance model. It is approved by the Board of Directors, and it is based on internal metrics. The risks included in the risk appetite framework must be quantitatively targeted, measurable, and monitored within a specific timeframe (monthly, quarterly). Moreover, they must be carefully selected as the most relevant within their risk category, as we are the top management level. Any other limit/threshold system should be left for lower management levels.

From a proportionality perspective, the **granularity of the requirements should be adjusted.** It is difficult to have too many metrics in the RAS, only the most appropriate ones should be selected.

For large institutions, **metrics and targets must be set at consolidated levels** and it would not be feasible to run different sets of metrics at group level and at more granular levels. This could create adverse effects and would certainly be too difficult to monitor.

Also it seems important to keep in mind that adding too many metrics, targets and limits on ESG considerations may create dangerous unbalanced effects on the full edifice of the Risk appetite framework compared to other risks. As such, we recommend starting with basic ones and to incorporate gradually as ESG factors become material new ones.

In any case, banks should give enough flexibility to **choose relevant metrics with targets and limits.**

Paragraph 47

It is stated that institutions should use backward-looking and forward-looking indicators tailored to their business model and complexity. Considering current challenges on data availability, institutions do not possess backward-looking indicators or information to conduct this requirement currently. Backward looking indicators should only be required when available and useful.

Paragraph 48

Regarding paragraph 48, the consideration of ESG risks in risk appetite should be aligned with the entities' management that already considers the embedding of such risks considering their geographical footprint, business diversification, among other factors. Banks should not be required to change their management processes due to the requirement to conduct a cascade down approach. Risk appetite should be monitored in those risks deemed material according to entities' own models and internal procedures (e. g., at client level, portfolio level…).

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

The EBA Guidelines on Internal Governance provide sufficient framework for the implementation of an appropriate risk culture and the concept of the three lines of defense. **We consider the explanations in section 5.4. to be redundant** with the EBA Guidelines and contrary to considering ESG as driver of existing risk categories.

Banks' internal governance and control guidelines already include specific instructions that affect the whole entity and should suffice. **Separate policies and governance for ESG purposes should not be required**. Banks should be granted the flexibility choosing the way they organize suiting their own circumstances and preferences, taking into consideration ESG factors when appropriate and integrate ESG into their existing processes. Standalone processes and controls to manage ESG risk factors should not be required.

Paragraph 49

While we agree with the proposed guidelines on the importance of the need to train the management on ESG factors and risks, given the novelty of these risks, it should not be a determinant factor in considering a member of the management bodies as unsuitable.

Paragraph 52

Paragraph 52 places the approval process of new products within the first line of defense, which is in contradiction with the traditional role and responsibilities of the 2nd line compliance function. Section 5.4 is too restrictive of the organizational freedom of institutions with regard to ESG topics. **We are in favour of deleting this section**.

Regarding the undertaking of risk assessments which should be carried out by the first line of defense (although ESG risk assessments should be conducted at different stages of the client relationship), ESG risk observance should not be as comprehensive in e.g. credit review process as is at client's onboarding. Exception to this should be clients from sectors under alignment objectives who need a more robust and continuous monitoring.

Paragraph 53

Ensuring adherence or providing advice regarding ESG risk rules or sustainability commitments **does not have to be a sole responsibility of the compliance function**. Assignment of the responsibilities can vary among institutions for different reasons.

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

In line with the ECB Guide to ICAAP (2018), the ICAAP is, above all, an internal process, and it remains the responsibility of individual institutions to implement it in a proportionate and credible manner. For the time being only risks arising from ESG consideration for part of the banking book are taken into consideration by banks in the ICAAP, if they are material. The assessment is based on climate scenarios. The internal methodologies will be capturing counterparties transition plans as they become available.

We would **recommend aligning this section with the ECB expectations** on this part and what was done on materiality assessment by banks. Institutions have already incorporated climate scenarios into their ICAAP and ILAAP analysis when deemed necessary following indications of an ECB's document published in November 2020 regarding the ICAAP.

In our opinion, **supervisory scenario setting does not align with the internal character of ICAAP, and we propose to refrain from it.** While we understand that the ECB requests to include specific elements if relevant in a certain timeframe, e.g. Covid or cyber threats, the required mandatory inclusion of environmental risk elements seems to have a permanent character, which does not correspond to the internal character of ICAAP stress tests under the normative perspective, which should address a financial institution's key vulnerabilities also taking into account the scenario horizon of (at least) three years.

The ICAAP process goes hand in hand with other internal processes. While we agree relevant ESG risk drivers should be incorporated into the process, these risk drivers should be indistinguishable from the rest of the risks, meaning that the ICAAP should take into account all relevant risk drivers in the same manner.

The EBA should take a sequential perspective and start incorporating environmental-related risk factors and not rush into including social and governance until we have enough data to ensure we do it in a sound manner. The novelty of these kinds of risk drivers needs to be considered and if any concrete expectations were to be applied to ESG risk factors in the ICAAP, they need to be clearly communicated and well guided.

We would also like to stress that a **complete integration of ESG risk drivers into the ICAAP normative perspective will be very difficult**, given that the time horizons analyzed within this process are shorter than the expected materialization of ESG risks (physical and/or transition risks).

The longer-term time horizon of 10 years would serve to inform the normative (1-3 years) and economic perspective in relation to possible ESG risk factors. We would however take a **critical view of backing medium and long-term risks with internal capital.** This would be neither appropriate nor sensible. We request appropriate clarification.

Concerning paragraph 55, to the best of our knowledge, EBA, in its previous supervisory publications, did not use the terms “economic” and “regulatory” perspectives. A clear definition of these two terms is therefore necessary and highly appreciated

Finally, the lack of information is a significant obstacle to integrate ESG risks into the ILAAP. Banks are already working to incorporate ESG risk driver into liquidity management, and environmental risks are relatively easier to integrate than social and governance risks.

If concrete expectations were to be made regarding the integration of ESG risk drivers into the ILAAP (or even for stress scenarios) they should be well communicated and guided to provide enough time for entities to adapt and comply.

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

We do think that financial institutions should monitor the exposure of their portfolios to physical and transition risks limited to material segments, while monitoring their evolution over time.

On paragraph 61 please refer to the Risk appetite section regarding metrics to be set. Same comments apply.

Question 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?

As commented before, it is very important to take a proportional approach when including ESG-drivers into internal policies and procedures for these risks. Making the required changes into internal policies will imply a very significant workload, when it is not sure that it will produce the desired effects (in many cases we do not have the necessary data to produce risk-driven results). Moreover, for decentralized banking groups it is even more difficult, as the consolidated application of these guidelines will imply that subsidiaries in third countries have to apply any change implemented at the consolidated level. If obtaining data at a European level is difficult, it can be even more challenging in third countries.

Concentration risk

Regarding concentration risks, there are several ways for institutions to assess concentration risk internally. Concentration risk is integrated into the institutions' internal risk management and the processes are established and operationalised so the approach to concentration risk should remain flexible to allow banks to use their own methodologies.

It is extremely **difficult to define concentration risk in relation to ESG factors**. Using some of the proposed metrics (GHG emission, sectoral vulnerabilities) would produce an incomplete and wrong picture, as banks will still have to finance the transition of carbon-intensive firms. The concentration risk could have some **adverse impacts on the financing of the transition** as it would not take into account the transition strategies and pathways of counterparts. Some concentration risk elements are already included in the models such as sectors and geography are already addressed in the Pillar 2.

Furthermore, it should **not be considered for disclosure, or capital treatment nor Systemic Risk Buffer purposes.** Adding ESG in the Systemic risk buffer will have negative impact on financing the transition and the economy at a time where Member States are struggling to put in place incentive measures or support schemes.

In any case, the ESG concentrations risks management should be **introduced gradually** in order to identify the metric that should be monitored. The introduction should be consistent with the development contemplated by the EBA in the SREP guidelines (cf. report on pillar 1 ESG). (see response to question 7)

Reputation risk

Paragraph 67 refers to the ESAs high-level understanding of greenwashing in the EBA's progress report on greenwashing and monitoring and supervision (EBA/REP/2023/16). This is not a legally defined definition and should hence not be referenced in EBA guidelines. Having such a broad understanding of greenwashing reduces the legal certainty and therefore risks hampering financial institutions' transition finance efforts. As already communicated to the EBA in the past, we do consider some examples of greenwashing included in the report of concern. Getting the balance right in terms of how to address greenwashing is important because banks' ability to produce new products and services requires a certain degree of confidence that they will not face greenwashing accusations arising from external factors beyond their control which they have analyzed and considered as best as they can.

Beyond specific products and services, banks need to be able to develop business strategies while communicating on their sustainability commitments and developments. In particular, banks' uptake of voluntary commitments at entity level plays a crucial role in the transition of banks and that of the economy. The EBA needs to consider the role that banks play as financiers of the economy and that the achievement of the commitments is closely related to the **ability and willingness of other players including corporate and government to deliver on the objectives**.

Having said that, banks have **already started to adjust their risk management framework in order to mitigate those risks**: adaptation of their governance and policies (such as credit policies, new product offerings) and will continue to do so.

Market risk

In relation to market risk, in general it is **difficult to identify ex ante which part is due to ESG as it is already embedded in the price of the products.**

For ESG risks in valuation, IFRS13 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, based on that definition the measurement of the fair value is applied using all the market information available under market conditions at the measurement date. **We consider that the impact of ESG-related factors in derivative pricing is already accounted for by the market** in the available market quotes. As an example, in reference [1], it is shown that the market of OTM option price captures worries related to downside tail risks associated with climate policy.

The **exception could be the case of ESG-linked derivatives**, where the coupons paid by the derivative can depend on future ESG KPI tests of the counterparty. For those cases a specific ESG adjustment, either through fair value or prudent valuation AVA, may be required as long as there is no liquid market on ESG-related derivatives on a given counterparty nor information to model the future ESG KPI to apply a mark to model valuation.

As for ESG-related factors impact on market risk capital metrics, **we consider stress tests metrics to be the most suited indicators to account for their effect**. Additionally, we consider that a waiver should be allowed for some of the charges suggested by the report, such as adding a RRAO charge in FRTB-SA or asking for an RNIME in FRTB-IMA for explicitly ESG-linked derivatives, should the bank demonstrate to the satisfaction of competent authorities that the possible losses associated to them are already covered in the prudential framework.

Liquidity and funding risk

The ILAAP is a process to assess liquidity and funding risks and to avoid duplication the ILAAP should be leading for ESG. Regarding para 65 and net cash flows, institutions already assess how ESG risks could affect, but this does not mean specific limits need to be in place if the **impact is assessed immaterial.**

We would like to recall that ESG factors are not material to liquidity risks so far. Even in the report on THE ROLE OF ENVIRONMENTAL AND SOCIAL RISKS IN THE PRUDENTIAL FRAMEWORK published in October last year, EBA recognized that **LCR and NSFR seemed to already have the necessary framework in place** to capture the environmental risks.

It could however be useful if EBA provides some examples of KRI and methodologies for incorporation of the effects of ESG factors into liquidity buffers and funding stability.

Operational risk

Evaluation of ESG risks from the operational perspective is already **tackled internally by banks.** Banks also provide information in this regard to supervisors. However, a common concern within the financial industry is the fact that supervision takes place despite the absent of clear set of rules**.**

While the internal taxonomies already have a "natural disaster" label it is extremely **difficult to differentiate between natural disasters that are directly caused by environmental factors and those which are not** (and are driven by cyclical factors). Paragraph 63 could provide illu**strative examples of potential future impacts from ESG-risks that could have an impact on operational risk** as well as other non-financial risks such as litigation and reputational risks. Paragraph 66 would benefit from further guidance on **how to identify and label operational losses** related to environmental risks given the indirect nature of ESG-drivers.

Moreover, it is of utmost importance to take a proportionate approach. In the cases where it could be differentiated between ESG-driven events and those that are not, it needs to be considered that ESG-driven events would **account for a very small number of the entries into the database.**

In addition, we would like to point out that in paragraphs53 and 63 reputational risk seems to be included within operational risk which is **not consistent with the CRR3 definition** of operational risk (which excludes reputational risk). Therefore, we would suggest deleting these references to reputational risk across the proposed guidelines as they may lead to the conclusion that operational risk includes reputational risk.

Question 17. Do you have comments on section 5.8 – monitoring of ESG risks?

ESG factors are already incorporated in other existing and publicly available reports, so there should **not be any additional requirement to produce a standalone report**, in particular considering that the ESG elements do not constitute a new risk category but are a driver of traditional risks. As a general comment, we suggest limiting the monitoring of metrics at the group level, not at individual entities.

With regard to paragraph 70, a further definition of the term "most significant portfolio" is necessary.

As a general comment on point 72 we would like to reiterate that **EBA should not be prescriptive in terms of metrics and indicators.** Sufficient flexibility should be given to banks in order to properly manage their own risks based on their own business model and strategy. As ESG risk management is now part of SREP, the supervisor will be in a position to check for each bank its own indicators and assess the robustness of its overall risk management framework.

The KPI in point 72(b) does not seem to make sense at the NACE 1 aggregation level. The amount and share of sector-related income seems unsuitable to capture relevant ESG risks as it is unrelated to the risks of counterparties. We are in favour of making the provision more general and deleting the reference to Annex I of Regulation (C) No. 1893/2006.

Institutions subject to reporting requirements are already obliged under Art. 8 of the Taxonomy Regulation as well as under Pilar 3 ITS to provide information on Taxonomy alignment. **The Green Asset Ratio (GAR), which describes the proportion of assets that align with the EU Taxonomy is however not suitable for reflecting the sustainability profile of institutions.** This is due to methodological weaknesses, insufficient coverage of relevant business areas and inability of the Taxonomy to reflect all transition efforts of companies[1] . While the Taxonomy usefulness as sustainable activities classification has its merits and it could also be considered a useful tool for clients' engagement, the GAR has little management implications for institutions, nor does it relate to the risk content of the underlying exposures. Therefore, taxonomy related KPIs should not be the subject of monitoring in accordance with point 72(e). Apart from that, the reference to "the shares of exposures detrimental to the achievement of" taxonomy objectives (paragraph 72(f)) is unclear as to whether monitoring of taxonomy DNSH metrics is expected. We believe that given that the EU Taxonomy is not a risk management tool, the link of the required metrics to what it is indicated in the Taxonomy should be deleted.

Art. 430 lit. h (ii) provides for the reporting of "... existing and new exposures to companies in the fossil fuel sector". In order to avoid redundancies, the monitoring requirements in para. 72e should be consistent with the reporting requirements still to be developed in the area of ESG (ESRS) or be postponed until they are developed.

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?

The guideline is too narrow in terms of minimising risk, as a significant level of risk can also be accepted, and a transition plan should not be required in all cases.

Materiality assessment

[1] (see also https://www.ebf.eu/wp-content/uploads/2024/01/Green-Asset-Ratio-January-2024-002-2.pdf.).

The link to financial materiality should be more elaborated upon. We welcome consistency between expectations of the CRD-plans and the content of the guidelines in sections 4 and 5. Our comments to questions 1 and further questions are relevant in this context.

Consistency of prudential plans with other processes and communication

While we appreciate the principle of "consistency of prudential plans with other processes and communications", we do not believe it is reasonable to expect the alignment of every single process to materiality assessment as it may constrain the entities' way of conducting business. Contrary to this, it would be appropriate if this principle focuses more on the lack of consistency between internal procedures and the content of the plan(s).

Data availability

The principles do not take into account the extra-European considerations in terms of availability of customer data. The level of maturity of clients' disclosure is and will continue to be heterogeneous.

Additionally, it should be considered, that at the European level, the CSRD allows the disclosure of ESG information at the consolidated group level. Banks will not have information at the counterparty level.

Reference to EU Climate law

Regarding the reference to the EU Climate Law the 1990 baseline is not workable for banks. Large institutions in particular have exposures outside of the EU and cannot be constraint to those objectives for non-EU exposures. Clarification is therefore requested to understand the link between the EU objective and the monitoring of the whole PFT including non-EU exposures.

In any case, we suggest making clearer **that it is not a requirement to reduce by 55% the emission financed by 2030** but to consider all regulatory and policy taken to address this target. Indeed, it does not make sense to require banks to reduce themselves their emission by 55% as they will need to finance the decarbonisation of emitting counterparts which by construction means that they will increase temporary their financed emission.

Please also note that under the EBA Fit-for-55 scenario analysis banks were requested to take YR 2022 as the baseline. YR 1990 is not workable.

Time horizons

On the time horizons, we understand that those plans have to cover ST, MT and Long-term horizons. However, the definition of ST, MT and LT are not aligned with what banks are currently doing under NZBA. Introducing new interim milestones to match with those time horizon definition will not be workable for banks. Flexibility should be granted to banks to set their own interim milestones.

Paragraph 78 & 79

Some of the requested connections such as liquidity and fundings and P&L and capital ratios are premature. We are therefore asking to have such requirements postponed to a later date.

Paragraph 80

The adverse scenario shall be the same as used under the scenario analysis, internal stress tests run by the banks. We would like to obtain confirmation that the results of those worse case scenario shall not be taken into account in capital ratios (ICAAP).

Paragraph 81

Transition plans have to be made at consolidated level. Banks are and will monitor their portfolio at group level.

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

We are highly concerned about the requirements included in paragraph 86 regarding the first line of defense (business) responsibility for concluding whether counterparties´ transition plans (responding to the CSRD requirements) are credible and sound.

Please see our response to Question 10.

We would also like to suggest removal of the reference to the compliance function from par. 86 bit is not clear why these Guidelines should, only for these limits, go beyond the provision of paragraph 155 of EBA Guidelines on Internal governance that provides that the risk management framework should be subject to independent internal review, e.g. performed by the internal audit function, and reassessed regularly against the institution's risk appetite, taking into account information from the risk management function and, where established, the risk committee"

As commented in response to question 1, we agree that the plans under the CRD should be aligned with the plans that the institution has already prepared and published as part of its sustainability reporting (CSRD). 1.

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?

Please refer to our previous answers whereby we have underlined to necessity to leave flexibility to banks to set their own metrics. We would also appreciate clarification that for those metrics banks will not have to put automatically targets and limits on them but just on selected and most relevant ones.

As a general comment there is need to simplify the exposed approach and to ensure consistency with what many banks are doing for NZBA, transition plan under CSRD and reporting under P3 (portfolio alignment).

Paragraph 90

Concerning the proposed approach on metrics and targets in the guidelines it should be stressed that **strategic targets should not be used as a risk management tool**. Moreover, targets are only effective and efficient if they have a single and not multiple purpose. Paragraph 90 would therefore benefit from being rephrased as follows:

"The targets set by institutions should serve risk management and strategic steering purposes with a view to achieve strategic goals while also considering 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."

Paragraph 91

The target for the technological base is too detailed. It is subject to significant uncertainties regarding data quality and availability. The targets should be adapted to the business model, size and commitment of the institution.

Paragraph 92

Many institutions **set interim targets with a target year around 2030 because institutions use different definitions of time horizons and the scope for a short time horizon is limited.**

Paragraph 94

Paragraph 94a) raises a **critical concern on the methodologies of alignment banks developed under NZBA**. The institutions will have to be in charge of the financing of emissions targets at the sectoral level. However, particularly in the case of interim reduction targets, for other sectors that oil and gas, the **targets are expressed as intensities and not as absolute emissions.** This difference of metric expression (absolute vs intensity), which results from 2 years of methodologies development through NZBA, aims at considering that for some sector it is expected that the new technologies will help them to reduce their emission per unit of production (example electric vehicles instead of thermic) while for other sectors the emission reduction of the banks systematically implies reduction of exposures to these sectors (ex. Oil and gas) . The metric proposed in (e) is also considered inappropriate. In general, institutions should be given more flexibility in the choice of metrics.

We would suggest for EBA to align the target setting horizon with the CSRD (2030 instead of a short-term 3-year horizon) and to clarify the definition of "production capacities operated by clients" under 94b.

For institutions that have already set strategic climate targets (as part of voluntary commitments) it should be sufficient to refer to those targets in their CRD-plan.

The **metrics listed in paragraph 94 (section 6.3) should be viewed as suggestions rather than a list of minimum mandatory metrics**. In particular, the guidelines should not require institutions to set targets for metrics that are based on specific scenarios (e.g. the IEA NZ2050). If minimum requirements are kept those should be concentrated to climate related factors (GHG, energy efficiency

Regarding the percentage of "positive outcomes" in relation to transition plan engagement, the ability to do so depends on the methodology used by individual financial institutions. A binary outcome may not always be possible. **Therefore, progress observed over time against individual institution's transition plan assessment methodologies may be more appropriate.**

Question 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?

The publicly available scenarios quoted do generally not provide regional breakdowns. These are typically global scenarios. Reflecting geographical aspects and granularity will require the consideration of additional or alternative scenarios.

With regard to taking into account EU climate policy objectives in a bank's transition plan definition and target setting, this may not be straightforward for portfolios / sectors containing a material proportion of globally operating companies with significant operations exposed to different climate policy contexts. Flexibility should be considered in these cases.

Also, "risk management" and "strategic steering" as different use cases for climate scenarios and pathways would require financial institutions to also consider "real-world" projections of decarbonisation trajectories in addition to "normative" pathways (such as the IEA NZ Emission scenario)

Finally, we would like to understand whether there is a reason for omitting the NGFS scenarios from paragraph 97c.

In addition, we would like to suggest for EBA to provide more clarity on 97a – i.e. what they can expect of the pathways originated from the mentioned sources.

Regarding paragraph 97, the review of metrics should be aligned with the review of the Strategic Plan of banks.

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

The requirements for transition plans are very extensive. In practice, using and processing the information from borrowers' transition plans is likely to be very resource intensive.

Paragraph 103 requires institutions to advise on counterparties' product offerings and structure and remedial actions to support an enhanced transition trajectory. We believe this is something that this **is in the competition domain of each bank based on their business model and strategy.**

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?

The Guidelines should allow for more flexibility for banks to arrange their own decarbonization strategies. Banks **are responsible of their own risks and are able to set their own metrics and targets based on their own trajectories and strategies**. Please refer to previous answers where we have underlined to necessity to leave flexibility to banks to set their own metrics.

Question 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 believe there should be a common format. We consider a loose framework for a summary of the transition plans sufficient. A list of documents / policies / strategies that are part of and are relevant for the overall transition plan should be included.

Question 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.

Key challenges are covered in our previous response.

Question 26. Do you have other comments on the draft guidelines?

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About EBF

The European Banking Federation is the voice of the European banking sector, uniting 32 national banking associations in Europe that together represent some 4,500 banks - large and small, wholesale and retail, local and international - employing about 2.1 million people. EBF members represent banks that make available loans to the European economy in excess of €20 trillion and that securely handle more than 300 million payment transactions per day. Launched in 1960, the EBF is committed to creating a single market for financial services in the European Union and to supporting policies that foster economic growth.

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