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Utrecht, April 18, 2024

## Sustainable Finance Lab input on the EBA draft Guidelines on the management of ESG risks

We welcome the draft EBA Guidelines on the management of Environmental, Social, and Governance (ESG) risks (the Guidelines). We believe it is crucial to have detailed guidance for financial institutions to manage ESG risks and the transition to a green economy.

The [Sustainable Finance Lab \(SFL\)](#) is a Netherlands-based international academic think-tank that aims to ensure a sustainable and stable financial system by bridging academic knowledge and practice.

In general, we believe there is a need for EBA to speed up the management of ESG risks as these risks are not yet sufficiently managed by banks. The ECB thematic review on climate and environmental risks concludes banks are still lacking sophisticated methodologies and granular information on climate and environmental risks (ECB, 2022). Moreover, a recent report from the ECB on misalignment states that “the euro area banking sector shows substantial misalignment and may, therefore, be subject to increased transition risks” (ECB, 2024a). The Dutch Central Bank performed an analysis of transition plans of the Dutch financial sector and also concluded that many of the transition plans lack concrete plans and strategies (DNB, 2024). These insights show the risks are building up and underline the crucial need to accelerate the assessment and management of ESG risks and transition plans by financial institutions.

As a response to the Guidelines, SFL especially stresses the importance of (1) sufficiently ambitious, robust, and reliable transition plans, (2) the need for prompt action given imperfect data, and (3) the need to not only focus on climate but specifically also focus on nature degradation and its link with climate change.

We strongly support EBA to include prudential transition plans in the Guidelines. Transition plans are a powerful tool for institutions to manage transition risks and to steer financed activities towards greener outcomes. However, in the definition of a transition, we believe there is a need for a stronger link between managing the risks and financing the transition (managing the environmental impacts). It is the tool for strategic planning and decision-making on steering

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activities to finance the transition – aiming to achieve climate neutrality in 2050. As stated in a co-legislative proposal for the Capital Requirement Directive (CRD): “The adequate adjustment of the financial sector, and of credit institutions in particular, is necessary to achieve the objective of net-zero greenhouse gas emissions in the Union’s economy by 2050, while maintaining the inherent risks under control”.<sup>1</sup> Following the so-called double materiality approach, we believe prudential transition plans should not only focus on managing environmental risk but also on environmental impacts as a source of financial risks and a threat to financial stability in the long term. Including environmental impacts would also improve consistency with the Corporate Sustainability Reporting Directive (CSRD) and Corporate Sustainability Due Diligence Directive (CSDDD) requirements. Additionally, we believe clear requirements need to be defined for robust transition plans and to allow for comparability.

We welcome the that the Guidelines include guidance on ESG-related data points and data processes. Given the radical uncertainty and significant potential harm associated with ESG-related financial risk, we believe that a more precautionary approach is necessary, both regarding institutions’ general ESG risk management and the treatment of imperfect or missing data. The EU legislature is supportive of this course of action, with the Article 191(2) stating: “It [EU policy on the environment] shall be based on the precautionary principle and on the principles that preventive action should be taken, that environmental damage should as a priority be rectified at source and that the polluter should pay”.<sup>2</sup> We recognise the shortcomings related to data availability and quality and risk assessment methodologies. However, this does not justify limited progress in integrating ESG risks. Financial institutions should work proactively and act with incomplete information, starting with a focus on the most harmful activities. Better to be roughly right than exactly wrong.

We strongly support the broader focus on ESG, including environmental topics beyond climate. Climate goals cannot be achieved in a world where nature continues to degrade at the current accelerating pace. That is why an integrated approach is needed, for example, for transition plans. Moreover exposures to activities harmful to nature should be disclosed and managed. Even though the nature topic is not as mature as climate, and the data from underlying companies might not be fully available yet<sup>3</sup>, there is much that can be analysed and managed, also qualitatively.

Below, we summarise our response per question.

**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?

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We believe that the current focus of prudential transition plans outlined in the Guidelines is too narrow and insufficiently accounts for the link between the ESG impacts of activities financed

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<sup>1</sup> [COM\\_COM\(2021\)0663\\_EN.pdf \(europa.eu\)](#)

<sup>2</sup> [EUR-Lex - 12008E191 - EN \(europa.eu\)](#)

<sup>3</sup> Companies with less than 750 employees are allowed to omit reporting on biodiversity and ecosystems (ESRS E4) for the first two years.

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by institutions and the consequent financial risks. Environmental impacts are a source of future financial risk since the financing of carbon-intensive activities materialises into financial risks in the future. Leaving impacts out of the prudential transition plan would, therefore expose institutions to significant future financial (systemic) risk. Moreover, misalignment with the transition is an indicator of transition risks. This was highlighted by a recent report from the European Central Bank (2024). Risks and impacts are highly connected and EBA should underline the importance of portfolio alignment for risk assessment and mitigation.

Therefore, both **environmental risks and environmental impacts need to be considered in a transition plan**. The function of a transition plan should be (i) to enable the understanding of the alignment of institutions with climate goals and the management of misalignment and (ii) to identify institutions' exposures to harmful activities as well as the risk management measures in place. Separating climate risk management from impact management disregards the potential synergies between these essential objectives.

Adopting a double materiality approach would also improve consistency with the broader EU framework. We recommend aligning **as much as possible with the requirements and methodologies of the CSRD and CSDDD**. On top of these general requirements the prudential transition plan could be extended with specific requirements related to the risk management part.

Moreover, we suggest **extending the long-term time horizon of 10 years to at least 25 years** to align with 2050 climate goals and the corresponding business strategy highlighted in the transition plan.

We strongly support that the supervisor assesses the robustness of the transition plans as part of the Supervisory Review and Evaluation Process (SREP). Our understanding is that this is done on a yearly basis. We stress the importance of a **thorough supervisory review, including penalties or fines such as capital add-ons in case the plans are not up to standard** to compensate for the higher risks. Also, public access to institutions' prudential transition plans is essential to ensure additional scrutiny of institutions' transition plans through civil society, academia, and the press.

Moreover, we believe additional guidance is needed for transition plans, see our response to Question 23.

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

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We support that all institutions should implement ESG risk management approaches reflecting the materiality of ESG risks, given a proper materiality assessment has been conducted (see Question 4 for suggestions for improvements).

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We understand smaller institutions are allowed to use less sophisticated measures. However, we like to stress there is no evidence that smaller institutions are less exposed to ESG risks, and therefore we warn certain ESG risks might be overlooked.

We stress that **lack of data should not be a reason for institutions not to include certain ESG risks in their risk management**. In the case of imperfect or lacking quantitative data, institutions should assess materiality on a qualitative following the principle of precaution.

**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.

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We agree that for the assessment and management of environmental and social risks, both financial materiality and environmental and social materiality should be considered. We, however recommend EBA to **further specify how a double materiality approach should be considered for ESG risk management** and how the latter feeds in Sections 4 and 5 of the Guidelines on the management of ESG risks, as those mostly focus on the financial materiality side.

We support the statement that institutions need to develop tools and practices aiming to address the wider scope of environmental risks, such as nature degradation. We however believe that environmental risks other than climate are insufficiently addressed in the Guidelines. This is concerning given the pressing issue of nature degradation, for both its own economic impact as well as its link with climate change. **EBA should, therefore, provide explicit and specific guidance on how nature-related risks are to be addressed, taking into consideration interaction with other ESG risks, particularly climate**. Doing so, we recommend EBA to build on the work of the ECB, the Network for Greening the Financial System (NGFS) and the Task Force on Nature-related Financial Disclosure (TNFD) (ECB, 2024b; NGFS, 2023a; NGFS-INSPIRE, 2022; TNFD, 2023). In a recent SFL-report, we provide examples of how climate and nature are linked (the so-called climate-nature nexus), and we list example tools and methodologies that can be used to assess nature-related risks (Knijp et al., 2024).

There is also evidence that fossil fuel activities are particularly associated with numerous biodiversity, human, and indigenous rights scandals (Daley & Lawrie, 2022).

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

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The materiality assessment is the starting point for the management of ESG risks. Therefore, it is important to have clear guidance on how such an assessment is conducted. We believe **more guidance is needed to ensure materiality assessments are reliable and comparable**. For example, further clarification on how to assess financial materiality is needed, including qualitative and quantitative thresholds to assess materiality. We also recommend EBA to clarify

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in paragraph 14 b how institutions shall evaluate what activities, services, and products are to be considered most significant.

We support that the materiality assessment is risk based and focuses on financial materiality. However, large negative impacts drive financial risks; high levels of emissions are, for example a source of credit risk. Therefore we advise EBA to explicitly state that alignment with the CSRD materiality assessment is needed, i.e. topics considered material from an impact perspective should at least be considered in the risk identification process for transition risks.

EBA states the materiality assessment has a long-term horizon of 10 years. We believe this does not adequately capture the materialisation of long-term environmental risks stemming from the investment in unsustainable activities. We believe a time horizon of 25 years is needed, to align with transition planning.

We welcome that both transition and physical risks need to be assessed in the materiality assessment. However, in paragraph 14 we also expect a reference to nature-related transition and physical risks. The NGFS work and the TNFD work provide examples of these risks (NGFS, 2023b; NGFS-INSPIRE, 2022; TNFD, 2023).

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

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SFL greatly supports the inclusion of a minimum set of prescribed exposures to be considered as materially exposed to environmental transition risks (paragraph 16). **We recommend the list to be further specified and extended to account for nature-related risks** as well. In the identification of such sectors, EBA should build on the extensive body of existing evidence (ENCORE, 2024; Knijp et al., 2024; WWF, 2022). There is also growing evidence that key sectors and companies have been identified as potentially high risk for deforestation (Ministère de la Transition Écologique, 2022; Thomson & Franklin, 2024). In addition to environmentally harmful activities and sectors, the list could be extended to exposures to nature-related risks stemming on geographical reasons, for example biodiverse places like the Amazon. We recommend the list to be regularly reviewed and updated to account for the most recent scientific evidence.

**SFL objects using the EU Taxonomy to support the justification of non-materiality of exposures as stated in the paragraphs 16 and 17.** Since EU Taxonomy alignment does not reflect the level of exposure toward physical climate (or nature) events, the use of EU Taxonomy alignment as a proxy for ESG risk could only be potentially envisioned for transition risk – and even here scientific evidence is lacking. While ‘green’ activities are expectedly associated with less transition risks, this does not mean that they are exempted from transition risk. Therefore, we suggest eliminating the disposition in paragraph 17. The exposures to sectors that highly contribute to climate change listed in paragraph 16 should always be considered materially

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subject to environmental transition risks with no possibility of derogation, even if sectoral exposures show a high level of alignment with the EU Taxonomy Regulation.

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

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We agree institutions should proactively gather ESG related data from their clients and counterparties and should fill gaps when data is not available. According to the EBA's monitoring report on the implementation of IFRS 9, institutions currently follow different approaches to estimating their forward-looking expected losses, highlighting the challenges related to forward-looking data (EBA 2023). Consequently, the EBA should clarify how institutions should use proxies and estimates in the case of data unavailability. The same goes for the use of data provided by external parties: in what context and for what purpose is the use allowed? In general, we recommend EBA to stress that **missing data or difficulties resolving gaps should not discourage banks from integrating these ESG risks and that institutions should take precautionary measures**. The EBA could provide guidance on how such a precautionary approach looks practically, i.e. how institutions can assess and manage ESG risks in the context of data unavailability and what conservative measures can be taken to account for uncertainty.

We recommend including both absolute and relative GHG emissions, in line with transition plan targets (see our response to Question 20). Furthermore, more guidance from EBA is needed when it comes to methodologies for forecasting GHG emissions in paragraph 23a.

SFL recommends further specifying data points on nature-related impacts in paragraph 23 a iii, for example on deforestation, pollution, and water quality. The IPBES impact drivers could be a starting point.

In the section on social and governance risks, more guidance is needed regarding governance practices (23 b ii). For instance, different categories of governance practices could be defined. This would make the assessment of different institutions' exposures to governance risk more understandable and comparable.

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

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We recommend EBA to define specific guidance on what specific KRIs institutions should establish for the measurement of ESG risks, including nature-related risks. Furthermore, KRIs should as well be developed for social and governance risks.

Also, guidance is needed on how institutions can account for the uncertainty that characterises many ESG risks (Chenet et al., 2021, 2022). In this, it is important to acknowledge non-linear risk developments and tipping points (see e.g. Trust et al., 2023). For instance, integrated assessment models, used for calculating many climate scenarios, are based on dubious and simplifying assumptions, cannot model disorderly climate and environmental change, and do not account for tipping points (Simić, 2023; Trust et al., 2023). Therefore, SFL encourages the

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EBA to **endorse a precautionary approach that goes beyond the limitations of data availability and econometric modelling.**

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

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We welcome the distinction between the exposure-based methodology for risk management purposes and the portfolio-based methodology for alignment purposes. Both are important and there should be consistency between the methods. We support ESG risks to be included in the overall assessment of default risk and internal credit scoring and rating models. It is our understanding ESG risks are therefore included in Pillar I models. We recognise the current Pillar I framework is backward looking and has a short-term horizon. Therefore, given the current setup (until the Pillar I framework is redesigned to allow for more forward-looking information) we suggest integrating ESG risk in a more pragmatic way in for example the margin of conservatism, in the calibration methodology or the downturn component.

The Guidelines are still too vague about how institutions should evaluate the appropriateness of the ESG risk mitigation actions taken by their counterparties. Regarding paragraph 32, the EBA should also specify how exactly institutions should adjust sector-level characteristics to account for counterparty-specific aspects in the case of data unavailability. Before resorting to using different data sources, institutions should engage with their counterparties and only in the case of unsuccessful engagement use external data.

Regarding paragraph 33, more guidance from the EBA is needed on what specific due diligence processes institutions should implement. Do these processes differentiate from due diligence in place for CSDDD, and if so, how exactly should these processes look like?

The EBA should also ensure that the assessment of environmental risks at exposure level includes absolute and relative GHG emissions, **as well as the current and forecasted investments (CAPEX) in activities that are carbon-intensive and harmful to nature.**

SFL greatly supports the inclusion of both off and on balance sheet activities in paragraph 31a and recommends to systematically apply this approach throughout the document. Following a double materiality-perspective, this extension would ensure that ESG risks in off balance sheet activities are properly considered and that the financing of unsustainable activities or companies does not shift off the balance sheet.

Finally, the EBA could provide additional and specific guidance on the granularity needed for appropriate physical risk analysis in paragraph 31 and specify how institutions should assess the likelihood and severity of the materialisation of risks over the long term.

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

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SFL welcomes and further supports the consistent use of the IEA net zero scenario throughout the Guidelines. If other scenarios than the latter are to be used, the EBA should clarify that alignment analysis must be based on a 1.5°C no/low overshoot scenario with limited levels of negative emissions. Scenarios with high overshoot and high levels of negative emissions might underestimate transition risks associated with high carbon activities, since such high levels of negative emissions are unlikely to be achieved. Consequently, SFL urges the EBA to define clear principles on the scenario-based methodology as well as to clarify the difference between portfolio-based and scenario-based methodologies.

Furthermore, the EBA should clarify how institutions should deal with the deficiencies of the IEA net zero emissions scenario. Responding to critiques regarding the lack of sectoral and geographical granularity in the IEA net zero emissions scenario, the EBA should provide guidance on how institutions can account for differences between sectors, countries, and regions. The IEA net zero emission scenario does also not consider land and subsequent nature-based carbon sequestration.

Fossil fuel production should be added to the listed sectors in paragraph 36.

Furthermore, we recommend EBA to ensure that the analysis of portfolio alignment goes beyond mere emissions-based metrics to consider the real alignment of specific sectors. Indeed, evidence suggests that portfolio alignment methodologies are unprecise and insufficient to adequately measure alignment with climate policy (Noels & Janchnik, 2022; OECD, 2023). Hence, institutions should look beyond mere GHG emissions to consider how companies in their portfolios transition their activities. Rather, the EBA could suggest that institutions look at sectoral transition milestones identified in the IEA NZ scenario.

Beyond heat maps, the use of portfolio-based methodologies for other ESG factors is not really specified. Therefore, the EBA could provide further guidance on how portfolio-based methodologies can be applied to ESG risks, including nature, from both a financial and impact-related perspective.

With regards to paragraph 38, it is unclear how ‘large institutions’ are defined as well as what specific the methods and approaches are to be used to identify natural capital dependencies and to measure impact on SDGs. In addition to natural capital dependencies, impact on nature needs to be measured as well.

Furthermore, the EBA should provide further guidance of how to apply the portfolio-based methodology to social and governance risks.

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

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We support the mentioning of engagement as a risk mitigation strategy. The Guidelines could clarify that engagement strategies include clear time-bound objectives, an escalation process, and a divestment strategy for off-track counterparties with no credible prudential transition plan (Masson, 2023).



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Also, we underline the necessity that institutions regularly check whether their counterparties execute risk mitigation actions as planned through long term risk mitigation and adaptation metrics and/or KPIs, as suggested by the NGFS (2024).

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

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It would be helpful to have concrete examples and guidance on how different business environments might affect institutions' ESG risk situation.

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

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Given the unprecedented urgency of the state of climate change and nature loss (Lenton, 2023; Stockholm Environment Institute et al., 2023; UNEP, 2023), we recommend EBA to express more prescriptive recommendations on what level of ESG risk appetite might be considered excessive or dangerous. In this, we suggest referring to the planetary boundaries.

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

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We recommend EBA to align section 5.4 on internal culture, capabilities and control with the European Sustainability Reporting Standards (ESRS) and particularly the ESRS G1-1 on Corporate culture and business conduct policy.

Furthermore, the EBA should define clear minimum requirements for the evaluation of counterparties' ESG risk mitigation actions and particularly the qualifications of responsible staff to ensure that the latter follow a high standard.

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

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No additional remarks.

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

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We support the view that ESG risks need to be integrated in loan origination and monitoring processes. We also recommended EBA to specifically state ESG risks to be integrated in internal rating-based models for capital requirement purposes (see our response to Question 8) and in loan loss provisioning calculations. According to the EBA's monitoring report on the implementation of IFRS 9, very few institutions have integrated ESG in their loan loss provisioning (EBA, 2023).

**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?

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Relating to concentration risk, we recommend EBA to specify a minimum set of harmful industries, sectors, or regions that institutions are required to assess. The EBA should clarify that the need to finance the transition should not exempt banks from considering concentration risk in a proper and exhaustive way.

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

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We recommend defining clear guidance and a consistent approach on scope 3 emissions to ensure the credibility and comparability of risk measurement across institutions. With respect to paragraph 72f, the EBA should provide a specific definition of ‘the share of carbon-intense exposures, based on clear and documented methodologies.

Given that institutions increasingly finance the economy through off balance sheet activities (Buchak et al., 2024), the EBA should ensure that financed emissions for off balance sheet activities are fully monitored. Extending the assessment and management of ESG risk to off balance sheet activities is necessary to prevent unsustainable investments to migrate from the balance sheet to off balance sheet activities. At the same time, evidence shows that even off the balance sheet, these activities remain a significant risk for institutions (ECB, 2021).

**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?

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As discussed in our respond to Question 1, the Guidelines should explicitly state that the transition plan follows the double materiality approach including both financial risks and impacts. Moreover, the interconnectedness of climate change and biodiversity requires **biodiversity to be integrated in transition plans**. This can be done on a qualitative bases until nature scenarios and methodologies are more advanced.

To ensure the quality of ESG risk assessment and management, institutions’ plans should be updated yearly (and supervised yearly as part of the SREP) and not only when the business strategy is updated.

SFL welcomes and further supports that institutions environmental objectives should align with the EU environmental commitments.

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

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The Guidelines should specify the responsibility of the board and senior management for taking **decisions on remedial actions in case of significant deviations between the institution’s performance and its targets**. Following the NGFS (2024), transition plans should be reviewed and approved by the board, and senior management should be held responsible for their execution. Here, it is particularly relevant that institutions systematically keep track of their engagement practices and subsequent divestment decision on an aggregate level.

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Also, EBA should define a specific minimum set of qualification ensuring that relevant staff, including the board and senior management, possesses sufficient expertise and capabilities to assess the soundness and credibility of their counterparties transition plans in paragraph 86. These minimum qualifications ought to reflect a good understanding of transition planning per se, as well as sufficient knowledge of the natural science background of climate and environmental change. Furthermore, at least one board member should possess specific knowledge of nature-related risks (Knijp et al., 2024). These educational requirements translate into the need for training and education measures being undertaken on a regular basis (NGFS, 2024).

In addition, more granular engagement metrics should be defined based on the types of engagement already defined in paragraph 42 a.

To ensure an effective governance of ESG risks and encourage the management body to implement a strong, sound, and credible ESG risk management framework, we **recommend EBA to adapt the Guidelines on sound remuneration policies** (NGFS, 2024).

**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?

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While relative- or intensity-based metrics allow for the assessment of mitigation actions on the company- or sector-level, **absolute targets are necessary to effectively assess and manage the transition on a more aggregate level**. In the end, an absolute emission reduction is needed. Reductions in relative GHG emissions do not necessarily coincide with absolute reductions, which could lead to false impressions. Furthermore, the variety of formulas for calculating relative emissions, e.g. GHG per enterprise value, unit of production, or revenue in million, render the use of relative metrics even more difficult. Therefore, the Guidelines should always require both relative and absolute metrics.

In paragraph 94e we recommend adding a metric for the engagement stage the companies are in, to better keep track of institutions engagement strategies. In addition, institutions should disclose the cases where engagement was unsuccessful and led to divestment.

Furthermore, SFL urges the EBA to add metrics and targets for nature-related risks, since current metrics are very much focused on the climate-dimension of environmental risks. Regarding paragraph 94c, we recommend adding the total share of income related to business with counterparties operating in sectors that highly contribute to nature degradation.

Furthermore, SFL urges the EBA to rework paragraph 89 to ensure **that all activities and business lines are covered by targets and metrics**.

In general, the Guidelines could be more prescriptive **on the evaluation of counterparties' transition abilities, including counterparties investment (CAPEX) plans**.

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**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?

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As mentioned earlier, EBA should use the IEA net zero emissions scenario in a consistent way to ensure coherence and comparability between different institutions' ESG risk assessment and management approaches. Beyond the IEA net zero emissions scenario, targets must be based on a 1.5°C no/low overshoot scenario, with limited reliance on negative emissions. Given the lack of sectoral and geographical granularity of the IEA net zero emissions scenario, the EBA should provide guidance on how to improve the granularity of this scenario.

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

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No additional remarks.

**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?

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SFL strongly believes that **more detailed, granular, and specific requirements would be useful to ensure that institutions adopt coherent and comparable transition plans** that are to be effectively supervised and monitored.

First of all, institutions are now free to decide whether to use absolute or relative targets. We consider it crucial that targets are set on an absolute basis. Where relevant, relative targets can be used in addition. See our response to Question 20.

Banks should not only monitor the amount and share of income stemming from business relationships with counterparties operating in sectors that highly contribute to climate change, but also the investments (CAPEX) in fossil fuels and other high-impact activities. Banks also need to report on their escalation policies and policies on carbon credits and offsets.

**A clear implementation plan with short term milestones to achieve the targets is needed.** There is growing evidence of the high degree of risk associated with banks' continuous support of fossil fuel extraction building on recent scenario analysis (California Department of Insurance, 2024) and climate stress tests (ACPR, 2021; Emambakhsh et al., 2023; ESRB, 2023). With the IEA stating that in a 1,5 world there should be no new investments in fossil fuels, financial institutions should make clear in their plans how they terminate fossil fuel related projects. The same should apply to exposures particularly harmful to nature.

Following the recent NGFS report on credible transition plans, we believe that prudential transition plans should mandate institutions to explain the extent to which broader just transition aspects are considered that could impact the community and social level fragility, and consequently, lead to additional financial risk for the institution (NGFS, 2024).

Furthermore, the EBA should further underline the need for institutions to periodically review their prudential transition plans to reflect the latest state of climate science (NGFS, 2024).

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All in all, the Guidelines could be more prescriptive on the content of prudential transition plans, for instance taking orientation on the red flag indicators for the assessment of the ambition, credibility, and feasibility of transition plans identified by Bingler et al. (2023). Additionally, the EBA could build on the work of the Transition Plan Taskforce (TPT), in particular the Disclosure Framework (TPT, 2023) and Banks Sector Guidance (TPT, 2024), and the recommendations from the United Nations' High-Level Expert Group on the Net Zero Emissions Commitments of Non-State Entities (UN HLEG) (UN HLEG, 2022).

**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?

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SFL believes that the interoperability of the prudential transition plans with the transition plan requirements stemming from the CSRD and the CSDDD is key. Therefore, the EBA should clarify that there is one transition plan with a common format. The guidance should develop a common template responding to the requirements mentioned hereabove.

**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.

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The main challenges that SFL identified regarding the Guidelines concern the narrow focus on financial risks instead of impacts. Not considering impact in a transition plan can lead to a build-up of financial risks in the financial system. This also gives rise to another challenge which is the inconsistency with CRD and CSRD based transition plans. We also believe more detailed requirements are needed on what needs to be included in a transition plan. Otherwise the transition plans will not be ambitious enough (relative versus absolute goals) and will not be robust and reliable. Moreover we believe nature needs to be considered in transition planning as well.



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