BANKING STAKEHOLDER GROUP

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(EBA consultation on Guidelines on the management of ESG risks)

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EBA consultation on Guidelines on the management of ESG risks

General considerations

The BSG welcomes the opportunity to give inputs on the consultation of the suggested minimum standards and reference methodologies for the identification, measurement, management, and monitoring of Environmental, Social and Governance (ESG) risks by institutions.

The BSG supports the EBA's view that Institutions should integrate ESG risks in their regular risk management framework by considering their role as potential drivers of all traditional categories of financial risks, and that institutions should have a robust and sound approach to managing and mitigating ESG risks over the short, medium and long term.

The BSG also supports the view of the EBA that Institutions should embed ESG risks in their regular processes including risk appetite, internal controls and ICAAP.

The EBA is mandated under Article 501c of Regulation (EU) No 575/2013, i.e. the CRR, and Article 34 of Regulation (EU) 2019/2033, i.e. the IFR, to assess whether a dedicated prudential treatment of exposures substantially associated with environmental and/or social objectives and those subject to environmental and/or social impacts would be justified, and to provide reports on this topic. Based on these mandates EBA issued a report in October 2023 'On the Role of Environmental and Social Risks in the Prudential Framework', following a consultation to which the BSG had responded[1]. [The BSG welcomes that the final report is largely in line with BSG response to the consultation.] The BSG further highlights the need to continue work on this topic to account for advancements in methodologies and data[2].

[1] https://www.eba.europa.eu/sites/default/files/2024-04/85eb7671-4996-4ebf-a592-33d7ecdd816b/BSG_Environmental-Risks-in-Prudential-Framework_FINAL.pdf

[2] See e.g. the latest EIOPA paper on the topic https://www.eiopa.europa.eu/consultations/consultation-prudential-treatment-sustainability-risks_en

The EBA is also mandated in accordance with Article 87a(5) of Directive 2013/36/EU (so-called CRD5) to issue Guidelines on minimum standards and reference methodologies for the identification, measurement, management and monitoring of Environmental, Social and Governance (ESG) risks by institutions, which is the subject of the current consultation.

The response of the BSG emphasizes the inherent challenges with availability and quality of ESG related data. BSG would also like to point out that the increased powers given to authorities by updates of article 104 in CRD3 must be carefully applied and that a 2-step approach is needed between implementation of CRD5 and CRD6.

The BSG also notes that, as regards banks under direct SSM supervision, they are already under significant pressure by the ECB to accelerate the implementation of a holistic environmental risk management framework ("Guide on climate-related and environmental risks")[3], with explicit supervisory expectations, remediation plans, and financial penalties. The BSG recommends that the EBA properly articulates its guidelines with the level 1 text on one hand, and the supervisory practice on the other end. It is desirable to have a common regulatory and supervisory attitude towards ESG, therefore different financial authorities in the EU should have harmonised - or at least not contradictory – requirements within the topic of ESG risk management[4]. Whilst the proposed EBA Guidelines appear to broadly align with the ECB Guide, the BSG encourages the EBA to work closely with the ECB to ensure a full alignment and clarity of application of the respective guidelines.

All in all, on ESG as on other topics, institutions should be expected to have the capacity to understand their own risks and opportunities, (although some challenges for banks to assess materiality and measures ESG risks remains, as noted in Q7 response) and need appropriate time to reassess strategies for changes in market conditions and societal expectations. Given specific challenges with the ESG risk identification and management, outlined in the sections below, more specific provisions on certain aspects would be welcome.

Regarding the scope of the ESG risk management guidelines the BSG appreciates the choice *to mainly focus on environmental risks, although introducing some first indications to define the management practices for social and governance objectives.* Indeed, while the ESG risk management framework needs to be designed with a holistic perspective, as prescribed in the CRD and other EU pieces of regulation, there is no doubt that EU and international scientific regulatory developments for environmental and in particular for climate risks, are much more advanced than for social and governance risks. However, BSG notes that environmental aspects other than climate too are not so much mature. The KPIs have just been proposed by EFRAG, but the implementation of ESRS E 2to 6 is phased-in up to 3 years after entry into force (2027, for reporting in 2028). This means that banks will not have access to verified data from their clients before that date, and

[3] https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.202011finalguideonclimate-relatedandenvironmentalrisks~58213f6564.en.pdf.

[4] See other initiatives by ECB ("Good practices for climate-related and environmental risk management", www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.thematicreviewcercompendiumgoodpractices112022~b474fb8ed0.en.pdf) and EIOPA ("DP on the Prudential Treatment of Sustainability Risks", https://www.eiopa.europa.eu/document/download/b7eda8cb-a03c-4f6f-975e-8223373dd611_en?filename=Discussion%20paper%20on%20the%20Prudential%20Treatment%20of%20Sustainability%20Risks.pdf)

consequently their capacity to comply with extensive risk management expectations for the whole environmental aspects, as for climate, will be very limited. For these reasons, the BSG suggests that the EBA may adopt a staggered approach in the fully-fledged implementation of the Guidelines requiring a progressive alignment of banks with the provisions at hand, giving priority, on a temporal level, to the fully-fledged implementation of provisions on management of climate risks (qualitative and quantitative parts) and, implementation of only qualitative provisions on other ESG aspects, whereas quantitative provisions should be introduced only at a later stage.

Furthermore, the BSG notes that the notion of “social goals” is still nascent in the current EU legal framework. However, some legal texts have begun to establish the legal meaning of “social goals” as well as corresponding KPIs. The already in force Delegated regulation (EU) 2023/27772 of 31 July 2023 (CSRD) covers the whole ESG scope, and the Delegated acts published in the OJ on 22 December 2023 on the basis of European Sustainability Reporting Standards developed by EFRAG[5] also cover the whole ESG scope.

The EU 2023/2772 Regulation establishes a long list of “sustainability matters to be included in the materiality assessment”. The delegated act contains specific reporting standards for all 5 environmental objectives (ESRS E1 to 5), 3 social objectives (ESRS S1, 2 and 3) and governance objectives (ESRS G1).

The social framework as defined in ESRS S1, 2 and 3, presented in appendix 1, covers a very prescriptive range of disclosure requirements covering:

- Own Workforce
- Workers in the Value Chain
- Affected Communities

Other important legal texts include the proposal for a directive on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937[6], whose current version was endorsed by the Coreper on March 15th[7], and the EC Final report on Social Taxonomy, dated February 2022[8], produced by the Platform on Sustainable Finance. Those legal texts refer to different approaches and scope, such as the goal of “promoting European core values” and others to avoid “human rights negative impacts". The “due diligence” directive proposal provides for by an Annex containing a list

[5] See ESRS Standards at https://www.efrag.org/lab6

[6] Credit institution falls within the scope of the directive according to Article 3(1)(a)(iv), although according to recital 19 of the text approved on March 15th, 2024 “The definition of ‘chain of activities’ should not include the activities of a company's downstream business partners related to the services of the company. For regulated financial undertakings, the definition of the term ‘chain of activities’ should not include downstream business partners that are receiving their services and products. Therefore, as regards regulated financial undertakings, only the upstream but not the downstream part of their chain of activities is covered by this Directive”.

[7] See pdf (europa.eu).

[8] https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/280222-sustainable-finance-platform-finance-report-social-taxonomy.pdf.

of “violations of rights and prohibitions included in international human rights agreements” (part. 1) and a long list of “Human rights and fundamental freedom conventions”.

In this context, the BSG considers preferable to avoid establishing a “prudential” definition of social factors relevant for the draft Guidelines different from what has been established in other legal texts, in particular, the CSRD/ESRS disclosure framework already in force. These requirements are intended to apply to companies of all economic sectors. As such, they would also apply to banks and bank clients, and therefore should be considered by the EBA as a cornerstone of banks’ approach to social risks[9]. Then, any divergence with definitions, methodologies, metrics should be carefully avoided, and, if really needed, should be well substantiated. In addition, a large part of those disclosure requirements addresses risk management issues, also in the scope of the EBA mandate, such as strategy, impacts, policies, processes, risk mitigation, metrics and targets.

Instead, the draft guidelines seem to take a different approach. Section3 (background and rationale) of the Guidelines makes a reference to the “compliance with due diligence on social standards” without explaining the contents of these duties. Furthermore, Section 4.2.1., point 23b of the draft Guidelines enumerate a list of social risks too generic to be operative. Furthermore, this list covers a perimeter of social goals and social risks that is different from that outlined in the normative texts referred to above. Considering that the CSRD/ESR is a well elaborated piece of legislation that apply to banks and its client, although only for disclosure purpose, it would be preferable - in particular in the paragraph regarding collecting data from client and asset-level data - to simply refer to “social risks” referencing the scope defined in CSRD/ESRS. Notwithstanding this, considering that the focus of the draft Guidelines is to investigate to what extent the violation of principles established for social goals could give rise to financial risks in the balance sheets of banks, the Guidelines could add that banks should pay attention to any risk deriving from the violation of legal duties, established to pursue social goals, in force at national level, in the jurisdiction of the client. Indeed, for the time being, differently from what it happens regarding climate goals (where there is political consensus on the goals to pursue, also in quantitative terms, considering the Paris agreements) national rules differ to a large extent in the “social field” due to different political approaches and choices. Including the reference to duty to protect “social objectives” established in the national laws in the draft Guidelines, could allow the latter to automatically cover the perimeter of the social risks envisaged by the "due diligence" directive once it enters into force. Furthermore, the BSG considers that to the extent that the draft Guidelines aims at assessing financial risks, the EBA may draw the attention of credit institutions to the evolution of jurisprudence on sustainable litigation to assess if the client is bearing material risks on this front.

Given the early process of implementation of 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

[9] This approach is different from some other frameworks (social bonds etc…) which target specifically the “social sector” (healthcare, education, social housing etc…).

consistency between targets, actions and tools put in place in accordance with the various regulatory framework 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 but consider them an integrated part of the SREP.

Having said that, we would appreciate further clarity regarding the CRD-based 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 complement each other, 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. The link and the alignment between the CSRD transition plans and CRD plans should therefore be further clarified.

In this context, we welcome the requirements set in point 11 to keep both transition plans consistent in terms of criteria, methodologies, assumptions and targets. We also note that transition plans as per CSRD/CSDDD and CRD transition plans are highly interconnected:. Identification of such misalignment (via CSRD/CSDDD transition plans) would thus be a starting point for the risk analyses and corresponding determination of the required risk-bearing capacity (capital) for the risk that the institution might decide to accept.

We would in particular appreciate further clarification on how the CRD based 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 and where the EBA sees a gap with the CSRD. Also, clarification on financial materiality aspect would be welcome.

The BSG believes that bank's transition plans have the potential to support the transition of the real economy, to the extent that those plans are well articulated with those of their clients (which will be subject to CSRD/ESRS, and ultimately CSDDD). While transition plans can serve a variety of topics, as defined in numerous frameworks such as TCFD, GFANZ, CDP etc…) those frameworks largely overlap. In this context, banks' own transition plans should be largely based on the transition plans of their clients and banks' own risk mitigation actions with respect to client engagement, credit and investment policies, etc.

In particular, the main, and various purposes that a transition plan can address are:

- Providing substance and credibility to the commitments (GFANZ, SBTi) with a view of evolution from high-level targets to concrete implementation plans
- Complementing a disclosure framework based on reported emissions with forward looking information to help investors make better decisions (ISSB, CSRD, European Financial Reporting Advisory Group (EFRAG))
- Contributing to climate risk analysis which also requires forward-looking assessment (EBA, CRD/Capital Requirement Directive (CRR), ECB supervisory expectations)

While these purposes are clearly different, they contain numerous elements of overlap. However, given each framework has been developed and has evolved in silos, with different decision bodies and timelines, similar concepts unfortunately are translated into differing definitions and methodologies. It is essential to minimize such discrepancies, and therefore to root the ESG risk management guidelines in the ESRS risk management disclosure. We recall that the same principles should apply to the overall ESG Pillar 3.

Specific comments and responses to questions on the draft Guidelines on the management of ESG risks

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

Banks should support their customers and counterparties in the adaptation process to climate change and in the transition towards a more sustainable economy. We think this can be achieved by responsible lending in terms of helping clients identify potential vulnerabilities in their operations and supply chains and support them in developing strategies to mitigate these risks. Banks will also help clients improve their operations' resilience to climate-related disruptions and monitor and report on clients' progress in implementing their transition plans. On this basis, banks should then identify transition risks to their own business model and operations, determine their risk appetite and ensure adequate risk bearing capacity. The BSG welcomes that the EBA is seeking to differentiate between the non-prudential transition planning requirements embedded in the CSRD and the proposed CSDDD from CRD-based plans.

The structure of the transition plan to be disclosed under CSRD (as defined by ESRS) already includes not only strategy, but risks, impacts, targets and metrics, as well as governance. The elements relevant for prudential risk management should be fully aligned between the EBA guidelines and the ESRS. The ESRS transition plan, to be disclosed, should be seen as the backbone of the transition plan, with its various building blocks serving different needs, including risk management considerations. Importantly, the CRD-based plans should build upon the CSRD/CSDDD transition plans adding a risk perspective on top of the disclosed elements. It is therefore essential to clarify that CRD-based plans are focused on the management of ESG risks and explain the relationship with climate transition plans under CSRD/ CSDDD, which set out the institution's business strategy and targets for aligning its business with climate change objectives. A coherent regulatory framework that minimises overlapping and conflicting requirements is of importannce.

In addition, a transition plan, like any plan, is fundamentally a series of actions to be taken to achieve a target. There can only be ONE series of targets and ONE series of actions, defined and validated by the appropriate governance.

In order to build such a transition plan (and have it validated by a third-party verifier) will require an extremely granular work within the organisation, to build and consolidate the enterprise-wide transition plan to be disclosed. Such granular work should not be disclosed, as this would provide too much unnecessary details, and may in some cases include confidential competitive information. But the underlying work should be made available to third party verifiers and to supervisors, for them to assess the credibility of the plan. We understand that banks would not have to disclose the "prudential plans" and only submit those based on supervisory request in the context of SREP.

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

It is important that all institutions are able to manage prudently their financial risks arising from ESG factors – as any other material financial 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 environmental 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. The justification of the materiality assessment and corresponding decisions with respect to the treatment of ESG risks should be clearly documented, alongside the clear internal definition of materiality, which is already required in the ICAAP framework for all risks relevant to the institution.

Some stakeholders still raised the risk that a multiple level proportionality approach (depending on the size and the risk profile of the institution) will bring substantial confusion for the application of the guidelines. The guidelines are already principle-based (as well as the existing CRD framework) and should allow an application in a proportionate manner, including for institutions that do not qualify as SNCIs.

Proportionality should therefore apply regarding the following aspects:

- Cost/benefit analysis of the proposed measures - It should be ensured that the requirements add value to the risk-based framework and from a supervisory perspective.
- Scope - 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 insufficient data and methodologies 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.

Some stakeholders, however, are of the view that cost/benefit analysis is not an appropriate approach in the risk-based prudential framework, which primarily concerned with identifying relevant and material risks, i.e. the cost of implementing a measure as such is not a consideration, but rather the materiality of risk for the ability of the institutions to bear such risk. For this, a holistic consideration of ESG risk drivers is needed, i.e. not limiting the analyses to credit risk, but rather taking a broader view to risk identification. This is in line with the principles of the risk-based prudential regulation and, in particular, Pillar 2 framework as banks' internal assessment, which should limit the possible considerations of risk materiality.

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.*

The ESG definitions in CRR3 and the EBA guidelines on loan origination and monitoring are not informative enough to be operational. They are too broad and only refer to 'factors' without defining what these factors are. For example:
- Environmental risk is defined as impact from environmental factors.
- Physical risk is defined as prospective impacts of the physical effects of environmental factors.
- Social risk is defined as impact from social factors.
- Governance risk is defined as impact from governance factors.

The above definitions will not lead to a more harmonized application of internal modelling, unless the EBA refers explicitly to the ESRS definition and aligns its concepts and metrics on those

The EBA should provide additional clarity/guidance with respect to materiality of ESG risk, keeping in mind the appropriate time horizons of ESG risk materialisation. Whilst the objective of prudential transition plans per se is not banks' portfolio alignment with climate objectives, a misalignment, is the starting point for the risk analyses and corresponding determination of the required risk-bearing capacity (capital) for the risk that the institution might decide to accept. Clarifying this and providing guidance to the banks on materiality assessment is paramount to ensure consistent treatment of risks, in particular given the forward-looking character of ESG risks. The conclusions of the EBA monitoring exercise on the IFRS9 implementation (report EBA/Rep/2023/36) serve as an evidence for the need of such guidance, as the EBA has identified largely divergent practices of banks' when handling forward-looking information for risk assessments. The problem is likely to be even more pronounced in case of ESG risks, where challenges with data, time horizons and banks' own expertise persist.

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.

As regards transition planning processes, the EBA should strive to include The BSG understands that the EBA does not wish to include specific examples within the Guidelines to avoid confusing interpretation of expectations. Nevertheless, it may be helpful to develop a complement to the guidelines setting out examples of good practice in these areas, including best practices and examples of climate risk management to facilitate a common understanding of how institutions are expected to support adaptation and transition, and leverage the existing frameworks such as NZBA, ADEME, UK TPT, etc….

Given the interplay across the various ESG dimensions, the BSG recommends adopting a holistic approach, such as the framework elaborated by the NGFS on nature related risks, rather than a siloed approach treating each of the 5 environmental, 3 social and 1 governance goals as a separate topic, with a dedicated transition plan.

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?*

The BSG welcomes the materiality assessment. Indeed, if a risk is material, it must be managed, and disclosed.

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.

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 requirements including those regarding data collection and engagement policy should be subject to the (financial) materiality assessment, unless otherwise specified and justified in the guidelines. It would help banks to deepen their analysis and efforts where the risks are material, in a consistent manner with the risk-based approach.
Furthermore, the concept of financial materiality for the purposes of these guidelines need to be further clarified, as referred to in the response to question 3 above.

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.*

We do not agree with the specification of the currently proposed 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 specific 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 of taking a whole list of activity sectors. For this, sector considerations should be complemented by the analysis of clients' transition plans and progress achieved towards implementing them.

Notwithstanding the above, some stakeholders believe that the guidelines would benefit from additional guidance on the economic activities, which clearly represent high transition risk and do not have any feasible transition possibilities in accordance with all available science-based scenarios. A clear set of such activities are exploration of new fossil fuel reserves, which are clearly incompatible with EU objectives and international climate commitments. Such activities should be clearly recognised as relevant for the materiality assessment purposes.

We also do not agree with the reference to the EU Taxonomy. The mere alignment to the EU Taxonomy does not directly imply less ESG risk as the EU Taxonomy regulation classifies the activities as green not from a risk-based perspective. 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 pose significant extraterritorial effects for banks with presence in third countries. EIOPA also rightly noted in point 86 of its consultation paper on the prudential treatment of sustainability risks of 13 December 2023 that “The EU taxonomy on sustainable activities is not considered a feasible approach for the purpose of the analysis as it is not a risk-based taxonomy. In that regard, sustainable activities defined by the EU Taxonomy can also be subject to transition risk”.

We also do not support introducing similar requirements for S&G risk the same manner as environmental risk as they are not comparable as a transmission channel of financial risk to environmental 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.

Therefore, paragraphs 16 and 17 should be deleted and the specific procedure for the materiality assessment should be left to the institutions. Some stakeholders still support the intention of paragraph 16 and suggest EBA to propose a more granular and risk-based list of economic activities to be considered as systematically material.

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

In many banks data does not yet reflect climate and environmental risks to any large extent due to data scarcity, data challenges or other challenges in linking environmental factors to traditional categories of financial risks. It is challenging to collect statistically representative and sufficiently long datasets of reliable quality for various types of ESG risks. Regulatory initiatives under way, such as CSRD and ISSB standards could help, but the disclosure according to these is just starting now.

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 requirement.

We appreciate the flexibility given in para 25 for those instances where data from counterparties and public sources is not available by using estimates/proxies. Indeed, we consider that proxies could be used even in first intention where the data collection directly from the counterparts could be too burdensome for them (especially for SMEs and retail clients)

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 therefore urge the EBA, in collaboration 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 banking sector. In addition, we would like to suggest to EBA to elaborate further (practical) guidance on when and how proxies may be justified.

The draft guidelines are missing to associate and elaborate on the use of external data (CRR article 180.1 f). This area will be of high relevance for risk classification of ESG why the guidelines could benefit from being more explicit and supportive in explaining how use of external data is foreseen to be applied.

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 from the counterparts.

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

Both the EBA, national competent authorities, and the ECB have been strict when it comes to statistical representativeness of IRB data. Banks continuously receive criticism because time series do not have high enough quality or proven representativeness. The question is if it is reasonable to have different views/approaches on the importance of data quality when it comes to ESG related risks.

Introducing requirements to include climate related risk drivers will further increase difficulties in meeting requirements for statistical relevance. Pillar 1 focuses, by construction, on historical data and historical relationships between risk factors. The Pillar 1 framework has not been designed to align with long-term environmental risks, but rather to capture the possible extent of cyclical economic fluctuations. Our view is that climate related risks currently are not reconcilable with the existing Pillar 1 framework and are better reflected in the Pillar 2 framework until there is more robust regulatory quantitative guidance for Pillar 1 treatment.

Climate-related events are uncertain and likely to increase in severity over time, their evolution will involve non-linearities and tipping points. A fundamental challenge is the mismatch between the time horizon of the Pillar 1 framework and the long-term time horizon over which climate and environmental risks are likely to fully materialize.

Considering these contradictions, the suggestion to use Margins of Conservatism to compensate for lack of data is not a sensible measure.

Other stakeholders noted, however, that the Basel Committee on Banking Supervision recommended using margin of conservatism "due to data deficiencies, such as poor data quality or scarce climate-related data, and to other sources of additional uncertainties" in its FAQ on climate-related financial risks from December 2022[10].

Our view is that climate related risks currently are not reconcilable with the existing Pillar 1 framework and are better reflected in the Pillar 2 framework, which would increase the transparency and consistency of how the capital requirements for ESG risks are derived.

Other stakeholders note, however, that macroprudential tools (which can be seen as either part of Pillar 1 or 2) are well suited to deal with forward-looking risks, as these tools have been designed to prevent the build-up of risks in the system. Therefore, considerations of the macroprudential tools to address climate-related systemic risks remain relevant for the EBA work, notably under its other mandates per the revised CRR.

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 purposes (exposure-based for the exposure-level risk assessment, portfolio-based method - for portfolio monitoring and scenario-based method - as an additional risk management tool under the ICAAP and beyond).

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 is 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?*

The requirement to consider social and governance risks at exposure level over short-, medium- and long-term time horizon appears to contradict para 27 which sets out that the exposure-based methodology should be used for the assessment of short-term risks.

Setting capital today for risks that may materialize after the maturity of the current loan assets (or failing to consider companies' transition plans) is not justifiable from a risk perspective.

[10] https://www.bis.org/bcbs/publ/d543.htm

Some stakeholders emphasise, however, that notwithstanding the above, climate-related financial risks are path-dependent, i.e. the short-term actions of economic agents, including financial institutions, determine the future level of risk (given that transition is a gradual process and delaying the transition increases a risk in the system due to a disorderly and delayed transition). Therefore the objective of transition planning as a risk management tool should be to understand the risks faced by banks and their counterparties due to misalignment with the climate objectives and corresponding pathways.

Bank lending and investment is mostly made to companies rather than to specific assets or projects. General purpose credit facilities, financing customers' day-to-day operations, represent a considerable part of bank lending in the EU. It is challenging to determine precise credit provisions based on ESG risks factors for these types of loans. In addition, it would be premature to modify credit scoring or rating models, as institutions are lacking the evidence and historical, backward-looking statistical data to facilitate this work. Counterparty risk classes may, however, be adjusted (and as already practised by institutions) through expert judgments by way of overrides.

To overcome these challenges, we encourage the EBA to work with other EU (and international) supervisors towards a common baseline approach to transition risk analyses and measurement.

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.*

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 more neutral 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. 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 including sectors, scenarios, metrics and targets. Banks should not be obliged 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.

Some stakeholders noted, however, that misalignment is expected to be correlated with the transition risk (as it indicated the scope of required transformations by the clients) and that exceptions should not be used to guide risk analysis. Supporting the above approach to combine sector- and entity-level considerations, they noted the need for a common understanding of the sectors which are potentially subject to higher transition risks due to the scale of transformations required in these sectors to be aligned with the EU climate objectives.

On the use of scenarios, the BSG notes discrepancies between various sources regarding the target state of the economy, and specifically regarding the use of reference scenarios. Indeed, in their forward-looking exercise, stakeholders would use such scenarios either to build their NZE pathway, or as a benchmark reference for their in-house scenario. Despite efforts on transparency, questions remain on key issues.

First, the lack of granularity of these reference scenarios could largely hinder its transposition for stakeholders. Sectoral granularity is important for (i) corporates which require guidance on their sectoral decarbonisation pathway; and (ii) financial institutions whose portfolios span over multiple sectors. For instance, the IEA NZE 2050 modelling outputs (IEA, 2022b) present the industry as a macro-sector whereas the NGFS NZE scenario (NGFS, 2021) modelling distinguishes specific industrial sub-sectors (e.g., chemicals, cement, steel, non-ferrous metals). Additionally, reference scenarios often lack country-level/local disaggregation of global scenarios.

Then, reference scenarios are based on heterogenous assumptions, which lack transparency, hindering their usability. For instance, little information is provided on considered carbon budgets (at regional, national, or sectoral level). Such core assumptions also encompass the role of negative emissions in the transition to NZE. On that note, we observe the current IEA NZE 2050 model does not consider land and the subsequent nature-based carbon sequestration, and thus attributes a preponderant role to technology-based carbon capture and storage. However, the opposite applies with the IPCC (2014) and NGFS models' outputs, where land is included. Other examples of divergent assumptions can be found in the respective share of GHG emissions reductions attributed to sober behaviours. Contrary to others, the French environmental planification strategy (Secrétariat general à la planification écologique, 2023) clearly outlines the importance of sobriety, and the IEA NZE 2050 scenario describes demand reductions.

Furthermore, it appears interlinkages between reference scenarios and public policies remain unclear. On the one hand, it is important that reference scenarios are transparent about the assumptions made on the state of the legislative environment. We observe this is usually well described (e.g., distinctions between current policies or COP26 pledges scenarios). On the other hand, public policies should clearly state the scenario(s) on which they are backed (e.g., an industrial policy for green hydrogen development may be justified by IEA projections on hydrogen needs by 2030 for the iron sector). Such a link between public policies and scenarios is for instance expressed in the Agence de la transition écologique (ADEME)'s sectoral transition pathways.
One could consider the dense EU Fit-for-55 package (European Council) often fails to explicitly describe interlinkages between policies and the decarbonisation scenario. The plans of companies will be dependent on key assumptions (such as their sectorial decarbonation pathway, regulatory and fiscal policies, carbon price, green infrastructure, etc.), and being able to state and monitor these assumptions will be key for the plan credibility, bearing in mind the plan will evolve over time to adjust for external and internal conditions.

There should be 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.

Other stakeholders called for a greater convergence in terms of the scenarios to be used by banks - recognising the challenges outlined above and also the need for consistent and comparable results of transition planning by institutions. Comparability is a pre-condition for supervisors to review and benchmark transition plans for the SREP purposes. We therefore encourage the EBA to work with other EU supervisory authorities, as well as non-financial authorities, to establish a set of scenarios for common use, as well as encourage further cross-institutional work on the sufficiently granular regional and sectoral pathways. Scenarios, both from IEA and NGFS however still have significant limitations in modelling flows and further work is required to align them with climate science.

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

Cross-border banks' client relationships are mostly international rather than local, why it is imperative that regulators recognize that requirements for ESG risk management must be globally harmonized to the extent possible.

The expectations on the transition plans assessment should 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 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.

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. Banks may choose a risk-acceptance strategy, in which case they should be required to demonstrate sufficient understanding of the risk to be born and be able to allocate risk-bearing capacity (capital) for future losses.

Regulators should avoid imposing overly burdensome control requirements for sectors with a high volume of customers such as mortgage portfolios (point 42 a i) in section 5.1).

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 (which implies demonstrating risk-bearing capacity (capital) allocated for the risks borne). The methods listed in point 42 should be explained as examples and not mandatory.

Other stakeholders pointed out that paragraph 42 sets a series of tools to be considered, which already leaves the flexibility for the institutions to adopt the most adequate tools. Moreover, EBA should clarify the expected measures to encourage counterparties to mitigate and disclose ESG risks. Institutions indeed cannot consider having mitigated their ESG risks if engagement does not result in mitigating actions at the level of the counterparty or in the integration of the actual risk. Engagement activities should therefore be linked to clear time-bound objectives, an escalation process and a divestment strategy for off-track counterparties or counterparties with no sound and credible transition plans.

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

We do not dispute that climate and environmental factors can lead to financial losses and must therefore be incorporated both in the overall risk management framework of banks and supervisory framework policies. However, the prudential regulation should ensure that banks have enough capital to withstand unexpected losses rather than being used for climate policy objectives for which other regulation, including direct industry regulation or fiscal measures is better suited. Yet, some stakeholders consider that the guidelines do not contradict this principle.

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.

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

It is not clear why ESG factors 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. 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. It is important to make this differentiation. Flooding the risk appetite framework with ESG-related risks would not make sense, and would hamper its correct functioning. Banks should be able to demonstrate that the ESG risk drivers are appropriately and explicitly reflected in the existing KRIs of their RAF. Where the existing KRIs do not allow for appropriate monitoring of ESG risk drivers, additional targeted KRIs should be defined. Moreover, ESG-related indicators are already part of the banks' Pillar 3 ESG disclosures so that not including any of these indicators at the RAF level could represent a possible regulatory risk for the banks if none of the indicators is monitored by the higher management on an ongoing basis.

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

The existing requirements on internal governance and risk management frameworks should be the basis to identify, assess, mitigate and monitor all material risks, including risks arising from ESG factors and institutions should be granted the flexibility to choose the way they internally consider ESG factors, based on their specific circumstances. The EBA should, therefore, refer to those requirements and avoid defining other types of considerations.
Furthermore, the proposed aspects are already embedded in the ESRS framework and may be referred to accordingly..

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

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.

The BSG 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 following indications of an ECB's document published in November 2020 regarding the ICAAP.

In the BSG's opinion, supervisory scenario setting does not align with the internal character of ICAAP, and we propose to refrain from it.

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/ILAAP, they need to be clearly communicated and well guided. Finally, we would like to stress that a complete integration of ESG risk drivers into the ICAAP will be very difficult, given that the time horizons analysed within this process are shorter than the expected materialization of ESG risks (physical and/or transition risks).

With reference to the responses above, other stakeholders express support for a staggered approach where qualitative requirements for all ESG risks should apply without delays, whereas quantitative requirements would be applicable to climate risk and progressively introduced for other risk types, as data and methodologies become more advanced. Further, the time horizon under consideration for the ESG risks should be longer than for the traditional risk types, given that the future development of ESG risks are path-dependent and are broadly defined depending on the EU sustainability, most notably climate objectives and the corresponding time horizon.

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

Regulators should strive to include best practices and examples of climate risk management in their guidelines to facilitate a common understanding of how institutions are expected to support adaptation and transition.

We advocate for a set of pricing best practices, as opposed to regulatory requirements for pricing strategies and pricing decisions. We point out that ESG-linked features in lending are not intended to compensate institutions for taking on ESG risks. Rather, the ESG adjusted interest rates and fees serve as an 'incentive' for the borrowers to meet specified ESG targets and, by this, mitigate their transition risks.

Further, as stated above, we encourage the EBA to work with other EU (and international) supervisors towards a common baseline approach to transition risk analyses and measurement

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?*

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.

Concentration risk

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 counterparties. Some concentration risk elements are already included in the models such as sectors and geography are already addressed in the Pillar 2. Thus, concentration risk analyses should allow for considerations of the counterparties' alignment with the required transition pathways. Some stakeholders also reiterated the ambition of the guidelines to focus on prudential rules to manage ESG risks. The need to finance the transition of carbon-intensive firms should therefore not exempt firms from adequately considering the concentration risk.

In any case, the ESG concentration 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)

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. The impact of ESG-related factors in derivative pricing is already accounted for by the market in the available market quotes. 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 consideration of liquidity and funding risks is already included in the ILAAP evaluation, so if would be better to avoid any duplication requirements. 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. Therefore, whilst there may be no immediate need to define dedicated metric for ESG risk drivers of liquidity and funding risk, institutions should maintain processes to monitor the materiality of ESG risks to be able to adequately address their build-up in the future.

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. 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 illustrative 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-risks.

Moreover, it is important 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 para 53 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 adjusting 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?*

Many of the indicators provided by the EBA are meaningful for the monitoring of ESG risks.

However, a clear guidance and consistent approach on Scope 3 emissions methodologies is needed to ensure comparability and credibility of risk measurements across the institutions and, based on this, possibility of the EBA to monitor the risks at the systemic level. r.
Furthermore, the BSG notes that risk monitoring should allow not only for sectoral considerations, but also recognition of the counterparties' alignment with the respective sectoral pathways for more accurate reflection of risk.

As an additional general comment, it is suggested to limit 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. 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. Better to make 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 capability and conformity. 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. 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).

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. For the risks, which are accepted, institutions should be required demonstrate sufficient risk-bearing capacity and sound monitoring processes.

The principles do not take into account the extra-European considerations in terms of availability of customer data. It should be also 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. I any case, transition plans have to be made at consolidated level. Banks are and will monitor their portfolio at group level.

Reference to EU Climate law
Regarding the reference to the EU the EU Climate Law the 1990 baseline is not workable for banks institutions with exposures outside EU . 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 take into account 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.

Under the EBA Fit-for-55 scenario analysis banks were requested to take YR 2022 as the baseline. 1990 is not workable.

Time horizons : 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.

Other stakeholders emphasised the importance of aligning banks' prudential rules with other EU policy objectives in order to make banks support transition rather than impede it (given that financial institutions' behaviours themselves impact the transition). Therefore, whilst voluntary initiatives like NZBA are most welcome, these should not serve as a baseline for regulatory action.

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

Introducing separate governance regulation for ESG related risks is a somewhat fragmented approach. Rather, existing regulatory requirements for governance and risk management should be updated to include ESG components.

Notably, given that "prudential transition plans" have been identified as a risk management tools, they should not be treated as an "annex" to the existing requirements, but should rather be integrated (with specifications, where necessary) into the existing requirements on risk management and monitoring, governance and capital adequacy assessment. Specifically here, the requirements of section 6.2 should be integrated with section 5.4.

The BSG notes that remuneration policies can play a role to encourage the management body to implement a strong, sound and credible ESG risk management framework. It therefore calls upon EBA to adapt its guidelines on sound remuneration policies to enhance provisions to prevent excessive ESG risk taking and encourage the adoption and implementation of credible transition plans in line with the regulatory requirements.

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?*

Cross-border banks' client relationships are mostly international rather than local. Strategies are set by institutions at the group level. As such, the production of entity-level metrics and reports in cross-border institutions will be burdensome given the data will not be available per legal entity or accurately attributable to a particular legal entity, and reporting may therefore result in less meaningful and less comparable output. Also, branches do not set their own ESG strategy but are subject to the governance of the parent entity.

Flexibility should be left for banks to set their own metrics. It would be good to clarify 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 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.
The BSG would suggest for EBA to align the target setting horizon with the CSRD (2030 and 2050 instead of a short-term 3-year horizon) and to clarify the definition of "production capacities operated by clients" under 94b.

Other stakeholders are of the view that GHG emissions should be considered both in absolute and intensity values. The intensity approach, whether promoted or de facto accepted by SBTi and many industry alliances, does not reflect the fact that global warming is fed by actual emissions, not intensity, giving a false impression of progress towards a carbon neutral economy and making targets easier to reach. Moreover, different formulae exist for the metric of intensity (e.g. GHG per unit of production, GHG per entreprise value, GHG per million revenue) and EBA should clarify the authorised formulae.

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). The metrics should also be aligned with the metrics specified under #72.

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.

Other stakeholders expressed support for the converging approach to ESG metrics and targets, which will be needed to ensure comparability of the approaches and measurements by institutions and, thus, enable supervisors to perform their review and reach conclusions about the safety and soundness of institutions.

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

It would be interesting 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.

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

The link between the prudential plan and the transition plans required in the CSRD and CSDDD should be clarified. We strongly recommend to align the 2 approaches, which are largely overlapping. See our response to Q1. In commenting this specific point we consider of crucial importance the need f engagement with stakeholders. Indeed, while a company has its Scope 1 GHG emissions under its direct control, their direct influence on Scope 2 and 3 may be largely limited. Hence, engaging with upstream and downstream stakeholders is essential to foster implementation of a consistent transition plan throughout a value chain. Consequently, as part of transition planning, companies must define and implement, an engagement policy that is commensurate with their degree of reliance on Scope 3 emissions. Such engagement practices will obviously vary by sector, and depending on the weight that a company may or may not have on its clients' and suppliers' practices.

As regards financial institutions, as Scope 3 represents most of their total emissions, engagement should be seen as the main driver of a transition plan. Banks should engage with borrowers to ensure they have a credible transition plan. Institutional investors invested in equities should also include ESG transition considerations in their investment and voting policies and practices.
One additional aspect of engagement mentioned in the OECD Corporate Governance principles is the need for consistency between commitment and targets and positions defended in the policy debate: "Boards should ensure that companies' lobbying activities are coherent with their sustainability-related goals and targets. Boards should effectively oversee the lobbying activities management conducts and finances on behalf of the company, in order to ensure that management gives due regard to the long-term strategy for sustainability adopted by the board. For instance, lobbying against any carbon pricing policy may be expected to increase a company's short-term profits but not be in line with the company's goal to make an orderly transition to a low carbon economy."

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?*

Given that ESRS is mostly focus on the content of the plan, the EBA guidelines should . clearly explain 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 and where the EBA sees a gap with the CSRD -

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?*
There shouldn't be a common format. The BSG is of the opinion that 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.*

The overall accumulation of ESG regulations is a challenge in itself, especially given the overall/inconsistencies between various pieces of regulation.

Another challenge is the tendency by the SSM to anticipate and goldplate already ambitious regulations in their supervisory expectations, creating de facto regulations beyond level 1, 2 and 3 texts.

The punitive approach is not conducive to acceleration, but rather to a worrying pushback, especially in the current geopolitical context.

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

In the EBA's 2023 monitoring report for IFRS9 (EBA/Rep/2023/36) the comments on forward looking information (FLI) indicate that there are issues with comparability between the evolution of macroeconomic variables and final ECL figures. This indicates that IFRS9 practices for macro-scenarios vary between EU banks. Incorporating ESG would currently not improve the comparability of FLI between banks, because there are substantial challenges in data representativeness, availability, and data quality for ESG related risks. Therefore, more detailed guidance from the EBA and convergence of approaches is required in certain cases, as outlined in responses above.

Risk-based pricing is the backbone of responsible loan book management and incorporating ESG risk drivers over the lifetime of the financial instrument is meaningful. However, data availability remains a primary challenge, so it is pre-mature to introduce the capture of long-term effects from these risks in IFRS9.

Disclosure requirements should not obligate institutions to disclose proprietary/commercially sensitive information that could give away a competitive advantage. For example, disclosure of forward-looking projections i.e., business model implications, medium- and long-term roadmaps, future financial impacts, sensitivity analysis. Banks have a common law duty of confidentiality to their clients. Disclosure expectations could instead be focused on a portfolio or sector rather than client level.

As transition plans are recognised by the Guidelines as a risk management tools, provisions on transition plans should be integrated into the respective sections on materiality assessment, risk management, monitoring, governance, ILAAP and ICAAP - rather than being singled out in the section 6, which led to certain requirements being duplicative/overlapping.

Appendix : Summary of ESRS Social standards

ESRS S1 : Own Workforce (includes employees and non-employees)

Scope:

(a) working conditions, including:

i. secure employment;
ii. working time;
iii. adequate wages;
v. social dialogue;
vi. freedom of association, the existence of works councils and the information, consultation and participation rights of workers;
vii. collective bargaining, including the rate of the undertaking's workforce covered by collective agreements;
viii. work-life balance; and
viii. health and safety.

(b) equal treatment and opportunities for all, including:

i. gender equality and equal pay for work of equal value;
ii. training and skills development;
iii. employment and inclusion of persons with disabilities;
iv. measures against violence and harassment in the workplace; and
v. diversity.

(c) other work-related rights, including those that relate to:

i. child labour;
ii. forced labour;
iii. adequate housing; and
iv. privacy

"The objective of the Standard is also to enable users to understand the extent to which the undertaking aligns or complies with international and European human rights instruments and conventions, including the International Bill of Human Rights, the UN Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises, the International Labour Organization's Declaration on Fundamental Principles and Rights at Work and ILO fundamental conventions, the UN Convention on Persons with Disabilities, the European Convention of Human Rights, the revised European Social Charter, the Charter of Fundamental Rights of the European Union, the EU policy priorities as set out by the European Pillar of Social Rights, and Union legislation, including the EU labour law acquis."

Disclosure requirements on the subject listed above follow the usual structure of :

1. Strategy
    a. Interests and views of stakeholders
    b. Material impacts, risks and opportunities and interaction with strategy and business model
2. Impacts, risks and opportunity management
    a. Policies related to own workforce
    b. Processes for engaging with own workforce and workers' representatives about impacts

c. Processes to remediate negative impacts and channels for own workforce to raise concerns
d. Taking action on material impacts on own workforce, and approaches to managing material risks and pursuing material opportunities related to own workforce, and effectiveness of those actions

3. Metrics and targets
   a. Targets related to managing material negative impacts, advancing positive impacts, and managing material risks and opportunities, including process for setting the targets, including whether and how the undertaking engaged directly with its own workforce or workers' representatives
   b. Characteristics of the undertaking's employees
   c. Characteristics of non-employees in the undertaking's own workforce
   d. Collective bargaining coverage and social dialogue
   e. Diversity metrics
   f. Adequate wages
   g. Social protection
   h. Persons with disabilities
   i. Training and skills development metrics
   j. Health and safety metrics
   k. – Work-life balance metrics
   l. Remuneration metrics (pay gap and total remuneration)
   m. Incidents, complaints and severe human rights impacts

ESRS S2 : Workers in the Value Chain

"This Standard covers all workers in the undertaking's upstream and downstream value chain who are or can be materially impacted by the undertaking, including impacts that are connected with the undertaking's own operations and value chain, including through its products or services, as well as through its business relationships. This includes all workers who are not included in the scope of "own workforce" ("own workforce" includes employees, individual contractors, i.e., self-employed workers, and workers provided by third party undertakings primarily engaged in 'employment activities'). Own workforce is covered in ESRS S1 Own workforce. See AR 3 for examples of what is included in the scope of this Standard."

Disclosures

1. Strategy
   a. Interests and views of stakeholders
   b. Material impacts, risks and opportunities and their interaction with strategy and business model
2. Impact, Risks and Opportunity management
   a. Policies related to value chain workers
   b. Processes for engaging with value chain workers about impacts
   c. Processes to remediate negative impacts and channels for value chain workers to raise concerns

   d. Taking action on material impacts on value chain workers, and approaches to managing material risks and pursuing material opportunities related to value chain workers, and effectiveness of those actions
3. Metrics and targets
   a. Targets related to managing material negative impacts, advancing positive impacts, and managing material risks and opportunities

ESRS S3 : Affected Communities

The objective of this Standard is to specify disclosure requirements which will enable users of the sustainability statement to understand material impacts on affected communities connected with the undertaking's own operations and value chain, including through its products or services, as well as through its business relationships, and its related material risks and opportunities, including:

(a) how the undertaking affects communities, in areas where impacts are most likely to be present and severe, in terms of material positive and negative actual or potential impacts;

(b) any actions taken, and the result of such actions, to prevent, mitigate or remediate actual or potential negative impacts, and to address risks and opportunities;

(c) the nature, type and extent of the undertaking's material risks and opportunities related to its impacts and dependencies on affected communities, and how the undertaking manages them; and

(d) the financial effects on the undertaking over the short-, medium- and long-term of material risks and opportunities arising from the undertaking's impacts and dependencies on affected communities.

In order to meet the objective, this Standard requires an explanation of the general approach the undertaking takes to identify and manage any material actual and potential impacts on affected communities in relation to:

(a) communities' economic, social and cultural rights (for example, adequate housing, adequate food, water and sanitation, land-related and security-related impacts);

(b) communities' civil and political rights (for example, freedom of expression, freedom of assembly, impacts on human rights defenders); and

(c) particular rights of indigenous peoples (for example, free, prior and informed consent, self-determination, cultural rights).

Disclosures :

1. Strategy
   a. Interests and views of stakeholders
   b. Material impacts, risks and opportunities and their interaction with strategy and business model

2. Impact, Risks and Opportunity management
    a. Policies related to affected communities
    b. Processes for engaging with affected communities about impacts
    c. Processes to remediate negative impacts and channels for affected communities to raise concerns
    d. Taking action on material impacts on affected communities, and approaches to managing material risks and pursuing material opportunities related to affected communities, and effectiveness of those actions
3. Metrics and Targets
    a. Targets related to managing material negative impacts, advancing positive impacts, and managing material risks and opportunities