**Responses to the EBA consultation on ESG risks**

**2. Please provide your views on the proposed definition of ESG factors and ESG risks.**

Mazars acknowledges the importance of creating harmonised definitions of ESG factors and ESG risks. In our view, this is essential for credit institutions to establish adequate risk frameworks and policies to manage ESG risks.

However, we believe the discussion paper does not provide a hierarchy of sources to consider when determining what constitutes an ESG factor. While we welcome the EBA’s efforts to provide a common understanding of ESG risks, in our view the consultation could be more specific in indicating which frameworks are most useful for identifying, assessing, and managing various types of ESG risks.

For example, the paper mentions SFDR as a source of *“a definition of sustainability factors meaning environmental, social and employee matters, respect for human rights, anti‐corruption and anti‐bribery matters”*, before suggesting that other frameworks such as UNPRI, UNEPFI and the Equator Principles can also serve as references for institutions when inferring their ESG risks.

We also believe that more could be done to harmonise the international framework and ensure useful concepts are taken into account in European legislation. Given the aim to create a common global understanding of ESG risks, international discussions should inform any regional or local discussions.

We note that ESG risks are considered to be negative impacts emerging from the ESG factors outlined in Table 1. In our view, the discussion paper could further stress the impact of institutions financing counterparties that are not directly exposed to (or contributors to) ESG factors, but are part of a value chain which may become negative for the environment in the future.

**3. Do you agree that, for the purpose of assessing their inclusion in institutions’ and supervisors’ practices from a prudential perspective, ESG risks should be approached primarily from the angle of the negative impacts of ESG factors on institutions’ counterparties? Please explain why.**

We understand that the EBA is acting within its mandate, provided within CRD V, to reflect ESG risks in the Supervisory Review and Evaluation Process. The EBA is therefore focusing on how ESG factors and risks may impact prudential risks, and by extension solvency.

However, we note that credit institutions may not always have the necessary information to determine all factors to which a counterparty is exposed. In some cases, available information is only collected in the context of loan granting and is limited to financial data. Therefore, to perform a comprehensive analysis of their exposure to ESG risks and factors, institutions would need to develop a stronger relationship with their counterparties.

Furthermore, we agree that direct exposure of institutions to ESG factors *should “be already taken into account in the existing risks management and internal governance framework”*. However, we note that solvency is affected by an institution’s ability to manage its operational risk and analyse its direct exposure to ESG factors across multiple geographies. Therefore, it is our view that direct exposure should be within the scope of this discussion paper. This paper could leverage the ECB guidelines on climate and environmental risks, which consider direct exposure to these risks as an essential part of ESG risk assessment and management.

**4. Please provide your views on the proposed definitions of transition risks and physical risks included in section.**

We support the definitions provided within this discussion paper, and believe it will be important to leverage definitions developed within voluntary frameworks such as NGFS and TEG.

**5. Please provide your views on the proposed definitions of social risks and governance risks**

We support the definitions provided within this discussion paper, and believe it will be important to leverage definitions developed within voluntary frameworks.

**6. Do you agree with the description of liability transmission channels/liability risks, including the consideration that liability risks may also arise from social and governance factors? If not, please explain why.**

We agree with the EBA’s description of liability transmission channels and liability risks, and with the notion that liability risks can arise from social and governance factors. However, we believe this section could better illustrate the channels through which social and governance factors can create liability risk, perhaps through some examples. For instance, lawsuits may arise from a counterparty’s treatment of its employees, or if business practices lead to social damage. Similarly, poor governance practices can engender negative outcomes for external stakeholders and result in demands for compensation.

Additionally, we note that potential lack of affordable access to liability insurance could be applied beyond climate risk to also cover social and governance factors, given that liability insurance premiums often reflect these factors.

**7. Do the specificities of investment firms compared to credit institutions justify the elaboration of different definitions, or are the proposed definitions included in chapter 4 also applicable to them (in particular the perspective of counterparties)? Please elaborate on the potential specificities of investment firms in relation to ESG risks and on how these specificities, if any, could be reflected in this paper.**

In our view, the definitions provided in Chapter 4 are applicable to both credit institutions and investment firms. Both are exposed to counterparties through different channels and transactions. For example, investment firms are exposed to counterparties through financial investment products such as stocks, bonds, derivatives whereas credit institutions can be exposed through loans and financing obligations. This, together with other differences in their business models, affects the way the aforementioned risks are managed rather than the ways in which they are defined.

To illustrate this, we can consider an investment firm with exposure to a specific stock. The counterparty in this case is the issuer. An adverse ESG factor could negatively impact the firm’s business, which could impair its ability to pay the promised dividends. The investment firm’s balance sheet would be adversely impacted through the reduced (or unpaid) dividend and/or the resulting price depreciation of the stock in the market. Similarly, a credit institution that has lent capital to a corporate client would be negatively affected if an ESG factor impairs the firm’s ability to pay the interest due. In short, while the mitigant actions may vary, similar definitions can be applied to both types of firms.

**15. Please provide your views on the extent to which smaller institutions can be vulnerable to ESG risks and on the criteria that should be used to design and implement a proportionate ESG risks management approach.**

Smaller institutions are often as vulnerable to ESG risks as larger institutions, and more vulnerable in some cases. However, they may lack the capacity to rapidly and fully study, analyse and embed ESG risks into their risk management frameworks.

In our view, this can be addressed by applying the concept of materiality. As the approach should be proportionate and risk-based, performing a materiality assessment to identify the most significant (and potential) ESG-related risks and issues may be the first step. Institutions would start the assessment from an established list of ESG risk factors (that would come from a regulator’s guide) and narrow it down to the most important, relevant and material ones. When discussing materiality in the context of risk management, we often refer to likelihood of crystallisation and severity of impact.

Those risks ‘singled out’ as most material should be acted upon. Policies should be drafted, their factors / sources should be comprehensively identified, and they should be allocated with an agreed risk appetite (although here, the metrics or nature of the limits will require some work to be defined). Following this, appropriate mitigants should be implemented and exposure to these risks should be regularly measured and monitored.

**16. Through which measures could the adoption of strategic ESG risk-related objectives and/or limits be further supported?**

We believe that beyond publishing an end objective or implementation deadline, an indicative roadmap could be provided for each regulatory development. Notwithstanding differences in business models across institutions, this would support the adoption of strategic ESG risk-related objectives and limits. Such a roadmap would ideally suggest the key steps to be taken by institutions, their sequence, significant milestones and important attention points to be considered when executing the roadmap.

**17. Please provide your views on the proposed ways how to integrate ESG risks into the business strategies and processes of institutions.**

We believe that the conclusions and policy recommendations provided are meaningful and articulated in a way that any type of institution, regardless of its size, complexity or areas of business, can understand, interpret and implement.

Furthermore, we consider incorporating ESG risk-related considerations within currently applicable directives and regulations (such as CRR and CRD for the banking sector) to be a pragmatic approach, as institutions already have a degree of familiarity with such legislative frameworks.

**19. Please provide your views on the proposed ways how to integrate ESG risks into the risk management framework of institutions.**

We note that the proposed methods are not necessarily new to the discipline of risk management, in that they leverage on the existing practices such as:

* having a strategy;
* identifying the risks and exposures that executing this strategy might bring;
* assessing these risks and exposures, and translating them into financial terms to the extent possible;
* implementing mitigation techniques;
* building scenarios; and
* performing stress tests.

However, it will be challenging to treat ESG risks as an ‘upstream’ layer to traditional (and prudential) risks, systematically determine how these risks will relate to or feed into credit, market, operational and liquidity risks, and quantify the impact on capital and liquidity buffers. In our view, processes for assessing traditional (and prudential) risks will need to be reviewed, adjusted and even redesigned. This will need to account for new data, parameters and rules, along with regulatory requirements and developments as these become available.

**24. Please provide your views on the incorporation of ESG risks considerations into the assessment of the credit institution’s internal governance and wide controls.**

In our view, the supervisory review should proportionately incorporate ESG risk-specific considerations into the assessment of credit institutions’ internal governance and wide controls.

In particular, we believe it should consider how ESG risks are embedded within:

* the overall internal governance framework;
* the functioning of the management body;
* corporate and risk culture;
* remuneration policies and practices;
* internal control frameworks;
* risk management frameworks; and
* information systems.