Nordic Financial Unions
NFU

EBA Discussion Paper on management and supervision of ESG risks for credit institutions and investment firms

About NFU

NFU – Nordic Financial Unions is an organization that promotes the interests of the Nordic financial trade unions in Europe. Through a high level of competence and dialogue, NFU contributes to shaping a sustainable financial sector, fundamental for job creation. Currently, NFU represents eight trade unions in the bank, finance and insurance sector in Denmark, Finland, Iceland, Norway and Sweden.

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Consultation replies:

Common definitions of ESG factors, ESG risks and their transmission channels (Chapter 4)

Question 1: Please provide details of other relevant frameworks for ESG factors you use.

NFU welcomes the possibility to provide feedback to this consultation, and generally, the discussions surrounding sustainable finance and integration of ESG considerations.

We would like to comment on two segments: the definition of sustainable finance and the understanding of the ESF factors.

On the definition of sustainable finance, currently there is no uniformly accepted definition of sustainable finance on EU level. What we usually note is a tendency to equate sustainable finance with sustainable investing, as depicted in the Action Plan: Financing Sustainable Growth, and the Sustainability-related Disclosures Regulation (Article 2 (17)). We see a

similar effort being made by EBA in the attempt to better define sustainable finance (point 24). We would welcome further work in this direction, where sustainable finance and sustainable investment are addressed separately. In NFU´s view, these terms are different – while sustainable investment focuses on the consideration of ESG factors in investment decision-making, sustainable finance is much broader and relates to an orientation to holistically use the ESG approach in making people and community-centered decisions, and to tailor all societal aspects to meet the present and future needs of citizens in a flexible, inclusive and self-sufficient way. As such, sustainable finance relates to supporting job creation, supporting local growth, fostering innovation, promoting good working environment and more[1].

On the relevant frameworks for ESG factors, we acknowledge the summary provided by the EBA and its intention, and the different examples included in Table 1. On several occasions, we have called for better coherence between the different legislative files addressing same/similar concepts. Particularly, a uniformed way of presenting even examples of the Social (and Governance) factors would be much appreciated. As it was rightfully noted by the EBA, they have been the least developed so far and can therefore be considered the least comprehensible to stakeholders.

In the current listing of Social (and Governance) factors in the European Framework (Table 1), we have noted that the EBA has used the Taxonomy Regulation, the Disclosure Regulation and the consultation on the RTS on the ESG factors as sources, providing examples that represent own interpretation of these documents. For example, stemming from the Taxonomy Regulation comes the mention of the ILO core conventions, but not the other instruments. Additionally, another one of these sources, the RTS on the ESG factors, has in turn been developed as an interpretation of several international instruments addressing labor and human rights, and the TEG Report on Benchmarking – and to much criticism, one year ahead of time and without any consultation of actors with social competence in the process.

It appears that, at every new occasion, the social and governance factors receive a new interpretation by a respective authority, which can make the landscape look even more

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[1] NFU Policy Paper ´Making Headway to Sustainable Finance´ available here

complex. Therefore, there could be benefit from developing a more consistent display of these factors as a minimum, in cooperation with actors with social competence, until there is real progress in the period to come.

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

Regarding the definition of ESG factors, it could be useful to include ´... financial performance or solvency, *or their determinants* ...´ as negative impacts can showcase in a non-financial aspect of the activities of companies and have financial consequences after/later. In addition, when listing the intrinsic features of ESG factors, it would also be useful to state that one of those features is information asymmetry. ESG data is far less consolidated and as it is itself based on interpretation of other data from various sources, there is no ´single truth point´ established yet. At the same time, the focus in the ESG data discussions is often placed on the data that is available, not the data that is important.

Regarding the definition of ESG risks, it could be of merit to expand it further, in concept and time frame (mentioned in the further parts of the consultation), although it is understandable that, in that case, the discussion could go out of the scope of this discussion paper.

Question 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.

Initially, this could be a good step forward. As the sustainable finance discussion evolves, and the outcomes of the sustainable investments are assessed, particularly when it comes to impact investments, the supervisory practices will likely have to change.

Question 5: Please provide you views on the proposed definition of social risks and governance risks. As an institution, to which extent is the on-going COVID-19 crisis having an impact on your approach to ESG factors and ESG risks?

In terms of the whole segment of the social factors and social risks, we firstly acknowledge and agree EBA´s mention that this angle of the discussion has not received the same level of attention, and therefore currently is less developed than the environmental angle. There is still progress made, and even more in sight. We would have appreciated seeing more and better elaborations on the social factors, not only from the aspect of social unrest as the outcome of policy change or in line with the COVID-19 pandemic. We acknowledge both of these dimensions, but we find that the different angles within the social factors/risks, for example, labor rights, human rights, due diligence and more, could have been better elaborated.

One of the specificities of social factors and how they are measured is the gap between efforts/effects, or availability/access. This means that usually the companies are evaluated based on efforts in establishing/availability of an internal procedure to remedy a certain issue, but not on the external element – whether that procedure produces the desired effect or whether access to that solution is possible. This needs to be considered when assessing social risks, as this process is different compared to environmental risks.

As the line between social and governance risks can be blurred when addressing some issues (for example, whistleblowing procedures), similar considerations as above need to be taken into account when assessing governance risks.

Quantitative and qualitative indicators, metrics and methods to assess ESG risks (Chapter 5)

Question 8: Please provide your views on the relevance and use of qualitative and quantitative indicators related to the identification of ESG risks.

The use of qualitative and quantitative indicators is an important step to more granularity in the understanding and assessment of ESG risks. Calculation of climate change -related indicators has already reached good progress and a certain level of standardization. For social and governance risks, such calculations are not always straightforward. They are also

open to (mis)interpretation, and their specific nature requires that both their existence and evolution are monitored over time.

One example is provided under point 100, where the minimum safeguards are mentioned. Firstly, the reference there should be made to the entity, not the economic activity. Secondly, the minimum safeguards are defined (in the Taxonomy) as procedures that should be aligned with the core ILO Conventions, the International Bill of Rights, UNGPS and the OECD Guidelines for Multinational Enterprises. However, no procedural asks are being set on how these instruments should interact with each other, how uniformity will be achieved in assessing the alignment to these minimum safeguards, not how progress will look like.

The management of ESG risks by institutions (Chapter 6)

Question 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 can be vulnerable to ESG risks as that depends on the sector or field they work in, the geographical location of their operations etc. Therefore, in this case the vulnerability is not essentially based on size. The principle of proportionality needs to be maintained and while frameworks can vary, they need to minimize administrative burden while allowing for important and comparable information to be gathered. This is not an easy exercise.

Nowadays, other market participants in the face of Fintech companies are also probing the ´green´ market, and it would be useful to see how they will be incorporated into the legislative framework.

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

EBA´s mention of lack of knowledge and skills is very well observed. This is indeed one of the measures that can advance the uptake of ESG risk-related objectives and limits. As mentioned, sustainability was until recently only a CSR question, but it is now becoming a

mindset shift. However, sustainability in any of its forms has rarely been formally addressed in financial education, and therefore it can be challenging to adjust to a new environment without fully understanding its basis and goals. Internal governance structures therefore need to have the relevant competence in the area of sustainability, sustainable finance, ESG and more, to be able to integrate sustainability into the business models and set objectives/limitations.

It is worthwhile noting that skills on sustainability will also be needed among all actors in the financial system, particularly when it comes to proper treatment of social (and governance) factors.

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

We agree on the need to assess business operations from a longer time perspective and to rely on the use of forward-looking methods, such as scenario analysis.

One of the mentioned aspects of integrating ESG risks into the business processes is the engagement with customers and other relevant stakeholders. Here, we would like to add the need to engage with employees, as well. Finance sector employees are at the forefront of business operations and ´the face´ of the financial sector to customers. Any internal governance decision to embed sustainability will automatically be reflected in management priorities, targets, the extent to which sustainability is part of everyday work for the employee, but also the if and how customers are informed about sustainable choices. Therefore, employees and trade unions should be the first ones that the companies engage with. Trade unions can additionally be central to capacity building but also in the process of evaluation and audit of information, particularly with social and governance characteristics.

Question 18: Please provide your views on the proposed ways how to integrate ESG risks into the internal governance of institutions.

NFU agrees that the ´tone from the top´ is vital in adopting and integrating ESG risks into the internal governance of institutions. Furthermore, we find that all employees should receive education on sustainability, sustainable finance, ESG considerations and more, as

appropriate for their positions. Such education should not be reserved only for employees working in internal control functions.

We also find that the internal governance framework needs to have procedures in place that will allow for safe and anonymous reporting channels in case of breaches connected to ESG risk management.

In the context of point 124, we acknowledge the idea of creating a culture where employees will contribute to the work of the organization, in line with its ESG considerations. However, caution should be paid both to the wording and to the premise of simply aligning variable remuneration with staff ´favoring decisions in line with the institutions´ ESG objectives´. This projects a misleading picture that (mis-)selling is exclusively conditioned by variable remuneration. At the same time it aims to paint a picture where sustainability objectives are to be achieved by employees incentivized to favor them, without considering the needs of customers or their understanding of sustainability. Instead, ownership, better understanding and changed behavior are the factors behind lasting change.

Question 20: The EBA acknowledges that institutions' approaches to environmental, and particularly climate-related, risks might be more advanced compared to social and governance risks, and gives particular prominence in this report to the former type of risks. To what extent do you support this approach? Please also provide your views on any specificities associated with the management of social and governance risks.

Please kindly refer to our answer to question 8.

ESG factors and ESG risks in supervision (Chapter 7)

Question 22: Please provide your views on the incorporation of ESG factors and ESG risks considerations in the business model analysis of credit institutions.

The incorporation of ESG factors and ESG risks, as rightfully mentioned, is not included in the relevant legislative files. Such inclusion would be needed in the future, as the shift towards re-orienting capital to more sustainable options becomes more and more important

for the financial sector. Forward-looking assessments for institutions should monitor not only the implementation of ESG objectives but also their progression over time. In addition to the points mentioned in point 298, which are very relevant for the climate/environment, competent authorities should also observe political commitments towards the Sustainable Development Goals as they could provide an even wider framework for considering both climate/environmental objectives as well as social and governance-related ones.

Lastly, we agree with the EBA on the assessment of know-how and competence in implementing ESG objectives. As stated earlier, competence on sustainability in wider context, as well as specific finance sector-relevant aspects of it is much needed in the sector and will continue to be relevant as the work with sustainable finance unfolds. In that context, competence in terms of the social and governance aspects in particular, across all sectoral actors, would be essential, as they are a relatively new/less developed category.

Question 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.

While, again, we agree with the assessment of know-how within the internal governance, we would like to highlight, in the context of point 323 that it is not only remuneration policies and variable pay that can create risk incentives for staff, as implied. Corporate culture of non-monetary merit rating systems and aggressive sales targets are active pressure points for employees. These systems are not driven by monetary incentives, instead they affect the overall salary or position of the employee at the company.

An essential part of shifting to sustainable finance is transparency, long-termism and trust-building. Stronger governance practices are key to achieving this. Finance sector employees and trade unions can play a significant role in helping to shape this organizational culture and carry it throughout their relations with customers and other stakeholders.

Question 25: Please provide your views on the incorporation of ESG risks considerations in the assessment of risks to capital, liquidity and funding.

We agree with EBA´s views on point 353 regarding the progress with the methods. Credit institutions and supervisors, in addition to obtaining relevant competence, need to understand the difference in the evaluation of environmental and social risks, both qualitatively and quantitatively.

More advanced information about the standing of institutions on these matters over the short term could be obtained from the non-financial reporting, particularly if the outcomes of the review of the Non-financial Reporting Directive (NFRD) bring improvements, including through potential audit of the non-financial information that is disclosed.

Annex 1

Question 29: If relevant, please elaborate on potential obstacles, including scope of applicability, granularity and data availability, associated with the indicators and metrics included in Annex 1.

The included indicators should indeed be seen as non-exhaustive, as this list touches upon only a fraction of the discussions.

In terms of definitions, it would be beneficial to provide a wider scope of defined terms, just for the sake of clarity. Additionally, the definitions on ´gender pay gap´ and ´human rights policy´ could be aligned with the currently ongoing process of strengthening the principle of equal pay on EU level; and relevant UN developments, respectively.

In terms of the specific indicators, on the environmental side, it is noteworthy to mention that the data on scope 3 emissions is rather hard to obtain, even by frontrunners in the field (as depicted in Nordic Council of Ministers ´A Nordic PreStudy: Assessment and reporting of environment and climate-related risks and impacts on financial markets). On the social side, we acknowledge the consideration to make the split according to the most relevant stakeholders – and we are pleased to see that employees have been included on the list, together with the specific inclusion of training and development opportunities for employees.

However, the ILO Conventions represent a minimum, and other instruments, for example the ones included under Minimum Safeguards in the Taxonomy Regulation, should also be reflected. In addition to ´freedom of association´, we are also missing references to collective bargaining, as well as other elements that speak about ´democracy at work ´ -

such as participation of employees in management bodies, the setup of whistleblowing systems, and diversity principles, including but also going beyond gender equality.

The section on ´Workplace health and safety´ includes a ´ratio of men vs women in total workforce´, which could have better context if placed under the governance section, when looking at diversity and equality. Instead, the quality of the work environment (such as stress and burnout prevention, physical and mental health promotion, right to disconnect) could be included under ´Workplace health and safety´. We are also missing a wider reference to sustainable supply chains and due diligence processes.

Lastly, we would also like to encourage that stakeholders with social competence are involved in the development of indicators, risks, factors or any relevant metrics particularly connected to the Social and partly Governance aspects, as they can truly add value to this process and assist in creating a comprehensive list of factors and indicators.