Response to the European Banking Authority's Consultation on Draft Guidelines on the management of ESG risks

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Overview:

Climate Strategy & Partners (CS) welcomes the opportunity to take part in the European Banking Authority's (EBA) consultation for Draft Guidelines on the management of Environmental, Social and Governance (ESG) risks[1]. This document responds to questions 4, 6, 9, and 16, taking as a basis our latest publication calling for financial institutions to be able to effectively estimate the ESG risks relying on a proper use of data sources and proven portfolio-based methodologies, particularly in their mortgage books through the development of the innovative concepts of voluntary **Mortgage Portfolio Standards** (**MPS**). Clearly, mortgage portfolios are tangible sources of climate risks and these can be reduced through the upgrade of buildings.

As reference, on January 15th of this year **MPS**, was included in the recast[2] of the Energy Performance Building Directive (EPBD), whose final version was adopted in the EU Council on April 12th[3]. Introduced as a voluntary measure in the final EPBD[4], 'mortgage portfolio standards' were defined as:

> *"Mechanisms incentivising mortgage lenders to establish a path to increase the median energy performance of the portfolio of buildings covered by their mortgages towards 2030 and 2050, and to encourage potential clients to improve the energy performance of their property in line with the Union's decarbonisation ambition and relevant energy targets in the area of energy consumption in buildings, relying on the criteria for determining environmentally sustainable economic activities set out in Article 3 of Regulation (EU) 2020/852"*

Developed by CS over the last four years, we believe there is momentum for MPS as it will connect an existing body EU regulatory requirements and best practices developed by banks, for banks, to the critical need to align mortgage portfolios and address the potential for climate risk and stranded real estate assets in the energy transition. The recast EPBD tasks the EU Commission with the adoption of a Delegated Act over the course of 12 months to establish voluntary Mortgage Portfolio Standards via: *comprehensive portfolio framework for voluntary use by financial institutions that supports lenders in targeting and increasing lending volumes provided in accordance with the Union's decarbonisation ambition and relevant energy targets, in order to effectively encourage financial institutions to increase lending volumes provided for energy performance renovations*.

Furthermore, our research finds that at present, over a third[5] of the top-30 banks in Europe already have a form of Mortgage Portfolio Standard, or equivalent, in place. We also note that the EBA mentioned MPS in its December 2023 report "IN RESPONSE TO THE CALL FOR ADVICE FROM THE EUROPEAN COMMISSION ON GREEN LOANS AND MORTGAGES[6]":

> *"Mobilising forces at all levels towards these goals will result in 35 million building units renovated by 2030. The increased rate and depth of renovation will have to be maintained also post-2030 in order to reach EU-wide climate neutrality by 2050. Towards this objective, the recast EPBD introduces the concept of 'mortgage portfolio standards', which is a policy tool aiming to ensure that, over time, credit institutions as well as other mortgage lenders, increase the median energy performance of their real estate portfolios and encourage potential clients to make their immovable properties more energy performant."*

Mortgage portfolio standards are the touchstone which connects an already existing body of best practices developed by banks for banks, to the critical need to align mortgage portfolios and address the potential for climate risk and stranded real estate assets in the energy transition.

*CS remains available for any enquiry about our response to this consultation and to engage on developing the items mentioned above and throughout this document.

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[1] European Banking Authority. (2024). *Consultation on draft Guidelines on the management of ESG risks*. [Website]. Retrieved from https://www.eba.europa.eu/publications-and-media/events/consultation-draft-guidelines-management-esg-risks

[2] European Council. (2024). *'Fit for 55': Council and Parliament reach deal on proposal to revise energy performance of buildings directive*. [Website]. Retrieved from https://www.consilium.europa.eu/en/press/press-releases/2023/12/07/fit-for-55-council-and-parliament-reach-deal-on-proposal-to-revise-energy-performance-of-buildings-directive/

[3] Council of the EU. (2024). *Press release: Towards zero-emission buildings by 2050: Council adopts rules to improve energy performance*. [Website]. Retrieved from https://www.consilium.europa.eu/en/press/press-releases/2024/04/12/towards-zero-emission-buildings-by-2050-council-adopts-rules-to-improve-energy-performance/

[4] European Union. (2024).*DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on the energy performance of buildings (recast)*. Retrieved from https://data.consilium.europa.eu/doc/document/PE-102-2023-INIT/en/pdf

[5] Climate Strategy & Partners. (2023). *Engaging Retail Lenders in Home Renovation: Turning Sustainable Finance Commitments into Household Energy Savings and Climate Resilience*. [Website]. Retrieved from https://www.climatestrategy.com/en/informe_27.php

[6] European Banking Authority. (2023). *IN RESPONSE TO THE CALL FOR ADVICE FROM THE EUROPEAN COMMISSION ON GREEN LOANS AND MORTGAGES*. Retrieved from https://www.eba.europa.eu/sites/default/files/2023-12/e7bcc22e-7fc2-4ca9-b50d-b6e922f99513/EBA%20report%20on%20green%20loans%20and%20mortgages_0.pdf

EBA Question 4:

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

EBA consultation[7] (EBA/CP/2024/02) paragraph 14 refers to "*comprehensively capturing potential impacts of ESG risks, inputs and factors considered in the materiality assessment*" including:

"*In the case of significant SME or real estate portfolios, average of counterparties may diverge from transition objectives of the jurisdictions where they operate; the assessment of physical risk drivers should take into account the level of both acute and chronic physical events associated with different transition pathways and climate scenarios*".

As reference, the EBA's Implementing Technical Standards (ITS) on Supervisory Reporting has a template (#210[8]) for disclosures on the energy efficiency of the collateral of loans backed by immovable property. In its October 2023 report "ON THE ROLE OF ENVIRONMENTAL AND SOCIAL RISKS IN THE PRUDENTIAL FRAMEWORK[9]", the EBA indicated that it will reexamine if environmental risks ought to be taken into account while evaluating risk weights for real estate exposures secured by mortgages on residential and commercial immovable property. This revision will be carried out in line with the clarification published by the Basel Committee on Banking Supervision[10] (BCBS), and under the Capital Requirements Regulation (CRR) (Article 124[11]). According to the EBA, only 21%[12] of banks undertaking ITS disclose energy performance information, and a third of these disclosers share information for both commercial and residential real estate**.** Under the EBA's ITS, banks are expected to disclose this information as of 2023, including the percentage of exposures for which, in the absence of an Energy Performance Certificate (EPC) label for the collateral, they are providing estimates.

CS highlights EPCs, as a key data component to carry out materiality assessments within real estate portfolios, as they convey information on the energy consumption and carbon emissions of buildings. The recast Energy Performance Buildings Directive (EPBD), approved by the EU Parliament's ITRE committee on January 15th 2024 calls for the gradual improvement of primary energy use of non-residential building stock through minimum energy performance standards (MEPS), resulting in the renovation of the 16% worst-performing buildings by 2030 and the 26% worst-performing buildings by 2033. Serving as the basis to implement MEPS, the EPBD calls for EPCs to be reorganised into a common criteria wide-EU template to improve financing decisions. Also, the EPBD recast calls for *"national databases for energy performance of buildings should be set up, and the information contained therein should be transferred to the EU Building Stock Observatory*".

Mentioned in the first page of this document, Commission-led Delegated Act process for MPS is expected to engage leading EU lenders, energy technology providers, and consumer associations to compare best practices and give confidence to Member States in the promotion of voluntary Mortgage Portfolio Standards.

CS recommends the EBA to continue its engagement with the EC to share its insights based on ITS. The EC will then be able to reorganise EPCs through a pan-EU template. Coupled with the encouragement of the uptake of voluntary MPS and the gradual growth and improvement of the national databases collected in the EU Building Stock Observatory, EPCs will in due course will be robust to enable both the assessment of materiality risks within financial institutions' real estate portfolios, and the implementation of MEPS.

[7] EBA. (2024). *Consultation paper: Draft Guidelines on the management of ESG risks*. Retrieved from https://www.eba.europa.eu/sites/default/files/2024-01/c94fd865-6990-4ba8-b74e-6d8ef73d8ea5/Consultation%20papaer%20on%20draft%20Guidelines%20on%20ESG%20risks%20management.pdf
[8] European Banking Authority. (2022). *Template 2: Banking book – climate change transition risk: loans collateralised by immovable property – energy efficiency of the collateral.* [Excel document]. Retrieved from https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Draft%20Technical%20Standards/2022/1026172/Annex%20I%20-%20Templates%20for%20ESG%20prudential%20disclosures.xlsx
[9] EBA. (2023). *REPORT ON THE ROLE OF ENVIRONMENTAL AND SOCIAL RISKS IN THE PRUDENTIAL FRAMEWORK: EBA/REP/2023/34, OCTOBER 2023.* Retrieved from https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Reports/2023/1062711/Report%20on%20the%20role%20of%20environmental%20and%20social%20risks%20in%20the%20prudential%20framework.pdf
[10] Basel Committee on Banking Supervision. (2022). *Frequently asked questions on climate related financial risks: 8 December 2022*. Retrieved from https://www.bis.org/bcbs/publ/d543.pdf
[11] EBA. (2023). *Capital Requirements Regulation (CRR) > PART THREE > TITLE II > CHAPTER 2 > Section 2 > Article 124*. [Website]. Retrieved from https://www.eba.europa.eu/regulation-and-policy/single-rulebook/interactive-single-rulebook/3201
[12] ECB. (2023). *The importance of being transparent: A review of climate-related and environmental risks disclosures practices and trends*. Retrieved from https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.theimportanceofbeingtransparent042023~1f0f816b85.en.pdf

EBA Question 6:

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

EBA consultation[13] (EBA/CP/2024/02) paragraph 23 refers to "*Institutions' internal procedures should provide for gathering information needed to assess the current and forward-looking ESG risk profile of counterparties, by aiming at collecting client and asset-level data. That data should, for large corporate counterparties as defined by Article 3(4) of Directive 2013/34/EU, include at least the following, where applicable*".

For environmental risks, the following are considered:

ii. "current and forecasted greenhouse gas (GHG) scope 1, 2 and 3 emissions in absolute and/or intensity such as per million-euro revenues or per units of production"

iii. material impacts on the environment, including climate change and biodiversity, and related mitigation or adaptation policies,

iv. dependency on fossil fuels, either in terms of economic factor inputs or revenue base,

v. energy and water demand and/or consumption, either in terms of economic factor inputs or revenue base,

vi. energy performance certificates and score in kWh/m² for real estate exposures,

vii. adherence to voluntary or mandatory climate and environmental reporting,

Sustainability leaders within financial institutions have identified their mortgage books as containing material climate risks and opportunities. These European banks with net-zero targets, clear transition plans and science-based emissions reductions trajectories are aware of the emerging evidence that shows mortgage arrears and defaults decrease as property energy performance improves[14]. In fact, many have already begun to implement voluntary Mortgage Portfolio Standards as ways to operationalise their overall climate targets, identify data gaps and provide a framework for action in renovation. Our latest publication "Engaging Retail Lenders in Home Renovation[15]" thoroughly reviews and analyses the public disclosures of Europe's 30 largest banks (by assets), mapping their net-zero and related initiatives these banks form a part of, and their overall alignment status in their mortgage operations (page 23 of the report), suggesting that twelve of these top-30 banks are already actively working on implementing a voluntary Mortgage Portfolio Standard, or equivalent (page 29 of the report).

Mentioned in the EBA consultation[16] (EBA/CP/2024/02), "*Institutions should develop CRD-based prudential (transition) plans to address the risks arising from the transition and process of adjustment towards the regulatory objectives related to ESG factors of the jurisdictions they operate in*." As the European Union has just adopted the Capital Requirements Directive[17] (CRD), where banks will have to draw up prudential transition plans following guidance from the EBA, CS agrees with the analysis of I4CE[18], and recommends the EBA to put forward transition plan standards aligned with the European directives on Corporate Sustainability Reporting[19] (CSRD) and on Due Diligences[20] (CSDDD). Both directives are applicable to European financial institutions. Subject to the CSRD, companies will have to report according to European Sustainability Reporting Standards (ESRS), developed by the EFRAG, previously known as the European Financial Reporting Advisory Group.

[13] EBA. (2024). *Consultation paper: Draft Guidelines on the management of ESG risks*. Retrieved from https://www.eba.europa.eu/sites/default/files/2024-01/c94fd865-6990-4ba8-b74e-6d8ef73d8ea5/Consultation%20papaer%20on%20draft%20Guidelines%20on%20ESG%20risks%20management.pdf

[14] European Commission, Directorate-General for Energy, *The quantitative relationship between energy efficiency improvements and lower probability of default of associated loans and increased value of the underlying assets – Final report on risk assessment*, Publications Office of the European Union, 2022, https://data.europa.eu/doi/10.2833/532126

[15] Climate Strategy. (2023). *Engaging Retail Lenders in Home Renovation: Turning Sustainable Finance Commitments into Household Energy Savings and Climate Resilience*. Retrieved from https://www.climatestrategy.com/en/informe_27.php

[16] EBA. (2024). *Consultation paper: Draft Guidelines on the management of ESG risks*. Retrieved from https://www.eba.europa.eu/sites/default/files/2024-01/c94fd865-6990-4ba8-b74e-6d8ef73d8ea5/Consultation%20papaer%20on%20draft%20Guidelines%20on%20ESG%20risks%20management.pdf

[17] European Commission. (2023). *Latest updates on the banking package*. [Website]. Retrieved from https://finance.ec.europa.eu/news/latest-updates-banking-package-2023-12-14_en

[18] I4CE. (2024). *Prudential transition plans: what's next after the adoption of the Capital Requirements Directive?*. Retrieved from https://www.i4ce.org/wp-content/uploads/2024/01/Prudential-transition-plans-whats-next-after-the-adoption-of-the-Capital-Requirements-Directive.pdf

[19] European Commission. (2024). *Corporate sustainability reporting*. [Website]. Retrieved from https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/company-reporting-and-auditing/company-reporting/corporate-sustainability-reporting_en

[20] European Commission. (2024). *Corporate sustainability due diligence*. [Website]. Retrieved from https://commission.europa.eu/business-economy-euro/doing-business-eu/corporate-sustainability-due-diligence_en#which-companies-will-the-new-eu-rules-apply-to

Nevertheless, ESRS and the CSRD standards offer a broad definition[21] for a transition plan with a 2050 horizon, with relatively low penalties if not implemented.

A transition plan relates to the undertaking's efforts in climate change mitigation. When disclosing its transition plan, the undertaking is expected to provide a high-level explanation of how it will adjust its strategy and business model to ensure compatibility with the transition to a sustainable economy and with the limiting of global warming to 1.5°C in line with the Paris Agreement (or an updated international agreement on climate change) and the objective of achieving climate neutrality by 2050 with no or limited overshoot as established in Regulation (EU) 2021/1119 (European Climate Law), and where applicable, its exposure to coal, and oil and gas-related activities.

Whilst CSDDD makes transition plans mandatory, and makes infringing reporting obligations result in penalties and civil liability, the financial sector will be excluded provisionally[22].

CS recommends the EBA to engage with the European Commission to promote the voluntary uptake of MPS by financial institutions as it would enable them to implement CRD-based prudential plans to identify and act upon ESG risks. In addition, the voluntary uptake of MPS would prepare financial institutions ahead of the eventual CSDDD mandatory transition plans.

[21] EFRAG. (2023). *ESRS E1 CLIMATE CHANGE*. Retrieved from https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FSiteAssets%2FESRS%2520E1%2520Delegated-act-2023-5303-annex-1_en.pdf

[22] Council of the EU. (2023). *Corporate sustainability due diligence: Council and Parliament strike deal to protect environment and human rights*. [Website]. Retrieved from https://www.consilium.europa.eu/en/press/press-releases/2023/12/14/corporate-sustainability-due-diligence-council-and-parliament-strike-deal-to-protect-environment-and-human-rights/

Question 9:

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

As stated in our response to question 6, our report "Engaging Retail Lenders in Home Renovation[23]" (page 23) maps Europe's 30 largest banks (by assets) net-zero and related initiatives these banks form a part of. In our report we analyse three initiatives in depth.

Under the United Nations Environment Programme Finance Initiative (UNEP FI) **Principles for Responsible Banking** (PRB) signatories are expected to align their portfolios with a 1.5°C pathway[24], and in the process, evaluate the transparency of their portfolio exposure to sustainability impacts. **29 out of the 30 largest European banks by assets are signatories**. PRB calls for the integration of impact analysis into portfolio-allocation decisions, and for the development of KPIs for portfolio adjustments with the monitoring and recording of data on new green mortgages and financing emissions targets[25]. PRB signatories have access to a "Portfolio Impact Analysis Tool for Banks"[26] which helps them fulfil PRB's Principle 2 on Impact Analysis and Target-setting. The latest version[27] features a Consumer Banking Identification Module[28] which assists signatories understand ESG impacts associated with their consumer portfolios for home loans and other housing-related credit segmented by client segments (e.g. age groups, professional activities, etc.), and their income-levels. As of June 2023, PRB reports that over 80%[29] of its signatories have conducted an impact analysis on their portfolios.

Convened by UNEP FI, the Net-Zero Banking Alliance (NZBA) is the global banking pillar of the Glasgow Financial Alliance for Net Zero[30], and acts as the climate-focused accelerator for the PRB. As of 2023, **26 out of the 30 largest European banks by assets are members**. In Q4 2022, NZBA signatories indicated that for 65%[31] of the sector focused targets, these covered around 80%[32] of the bank's portfolios, yet **the real estate sub-sector recorded one of the lowest coverages**. First convened in 2022, the NZBA real estate working group has been discussing the use of metrics, benchmarks, and data for bank decarbonisation efforts. Due to the different regional regulatory and reporting requirements, NZBA banks expect to adapt their strategies to respond to the jurisdictions in which they operate. We highlight that NZBA is calling for governments to develop a database at the international level for harmonised energy efficiency measurements in buildings, and emphasises the importance for banks to report on buildings' embedded emissions during the construction phase[33]. Scenarios used for target setting included the **IEA's Net Zero Emissions by 2050 Scenario**[34] (NZE) and NFGS[35] Net Zero 2050[36] (NZ2050).

As of October 2023, 77 European financial institutions have committed to Science Based Targets initiative (SBTi) net-zero targets[37] to be achieved by 2030[38], and 10 of them have approved targets. The SBTi's financial sector project[39] focuses on the target setting within the broader portfolio transition process, providing precise shorter-term components of the high-level commitments, allowing banks to build on their analysis of financed emissions and scenarios. SBTi's steps for FIs to address climate action include:

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[23] Climate Strategy & Partners. (2023). *Engaging Retail Lenders in Home Renovation: Turning Sustainable Finance Commitments into Household Energy Savings and Climate Resilience.* [Website]. Retrieved from https://www.climatestrategy.com/en/informe_27.php
[24] UNEP FI. (2019). *Principles for Responsible Banking: Guidance Document*. Retrieved from https://www.unepfi.org/wordpress/wp-content/uploads/2022/04/PRB-Guidance-Document-Jan-2022-D3.pdf
[25] UNEP FI. (2023). *Responsible Banking: Towards Real-world Impact*. Retrieved from https://www.unepfi.org/wordpress/wp-content/uploads/2023/09/PRB-Second-Progress-Report-2023.pdf
[26] UNEP FI. (2021). *Investment Portfolio Impact Analysis Tool.* [Website]. https://www.unepfi.org/impact/unep-fi-impact-analysis-tools/investment-portfolio-impact-analysis-tool/
[27] UNEP FI. (2022). *NEW: Version 3 of the Portfolio Impact Analysis Tool for Banks is now complete!.* [Website]. Retrieved from https://www.unepfi.org/impact/unep-fi-impact-analysis-tools/portfolio-tool/
[28] UNEP FI. (2022). *User Guide. Portfolio Impact Analysis Tool for Banks (v.3): Consumer Banking/ Identification Module.* Retrieved from https://www.unepfi.org/wordpress/wp-content/uploads/2023/01/Feb2023_User-Guide_Consumer-Banking-Identification.pdf
[29] UNEP FI. (2023). *Principles for Responsible Banking 2nd Biennial Progress Report*. [Infographic]. Retrieved from https://www.unepfi.org/wordpress/wp-content/uploads/2023/09/PRB-Progress-report-graphic.pdf
[30]Glasgow Financial Alliance for Net Zero. (2023). *About us*. [Website] .Retrieved from https://www.gfanzero.com/about/
[31] Net-Zero Banking Alliance. (2022). *Net-Zero Banking Alliance: 2022 Progress Report*. Retrieved from https://www.unepfi.org/wordpress/wp-content/uploads/2022/11/NZBA-Progress-Report_final-1.pdf
[32] Ibid.
[33] Ibid.
[34] IEA. (2023). *Net Zero Emissions by 2050 Scenario (NZE).* [Website]. Retrieved from https://www.iea.org/reports/global-energy-and-climate-model/net-zero-emissions-by-2050-scenario-nze
[35] Network of Central Banks and Supervisors for Greening the Financial System
[36] NFGS. (2023). *Six different scenarios to assess transition and physical risks*. [Website]. Retrieved from https://www.ngfs.net/ngfs-scenarios-portal/explore/
[37] SBTi. (2023). *Companies taking action*. [Website]. Retrieved from https://sciencebasedtargets.org/companies-taking-action#dashboard
[38] SBTI. (2023). *SBTi CRITERIA AND RECOMMENDATIONS FOR NEAR-TERM TARGETS*. Retrieved from https://sciencebasedtargets.org/resources/files/SBTi-criteria.pdf
[39] SBTi. (2022). *FINANCIAL SECTOR SCIENCE-BASED TARGETS GUIDANCE VERSION 1.1: August 2022.* Retrieved from https://sciencebasedtargets.org/resources/files/Financial-Sector-Science-Based-Targets-Guidance.pdf

1. Signing up to an international high-level commitment, such as: Principles for Responsible Banking, or committing to Task Force on Climate-related Financial Disclosures (TCFD) reporting[40].
2. Developing emissions metrics relying on the Partnership for Carbon Accounting Financials[41] (PCAF) to quantify financed emissions.
3. Setting targets through SBTi.

SBTi defines the scope of financial activities of signatories by evaluating the financial assets they hold and by reference to the related initiatives they subscribe to, such as NZBA[42]. This allows them to identify and scope portfolio specific targets[43], which can be later expanded in response to the upgrades to target-setting methods, or carbon accounting standards. **According to SBTi's Sectoral Decarbonization Approach for mortgages, setting up science-based targets requires defining a baseline for emissions for the bank's residential mortgage portfolio**. This calculation should rely on asset-level data as much as possible, and in the event of data gaps, these can be filled with regional proxies. The approach does not yet include a requirement to disclose embodied emissions of the buildings' materials, but SBTi intends to require measurement of buildings' embodied emissions when its members deem that robust data approaches are available, something which many experts think is already the case. **According to SBTi-developed Sectoral Decarbonisation Approaches (SDAs), targets on a mortgage portfolio are set using the in-use operational and upfront embodied emissions decarbonization pathways.** These targets should be disaggregated by building typology and geography using a whole building approach. SBTi offers guidance to FIs to set up science-based targets encompassing the building's whole life cycle[44].

It is clear that mortgage portfolios are material sources of climate risk and that underlying buildings can be upgraded to reduce this. Based on primary research, largely from European banks' own disclosure, our latest report provides a summary and insights (Table 2, page 29), into the most recent actions communicated from the top 30 European banks (by assets) on the climate alignment of their mortgage portfolios. **Twelve top lenders (40%, coloured green) already apply a form of Mortgage Portfolio Standard (although they may not refer to it as such).** Nearly all of the remaining banks are some way through a process that involves components or the entirety of a portfolio alignment.

A mortgage portfolio standard is, in effect, an impact analysis tool for banks to comply with, and that can help them to meet their UNEP FI Principles for Responsible Banking commitment and can assist members in offering climate risk mitigation to their building owning clients. **CS recommends the EBA** to encourage European banks to voluntarily uptake MPS as part of their strategies to decarbonise their assets and to manage and act upon their ESG risks, and in doing so, to first rely on the portfolio-level tools offered by the climate initiatives such as -NZBA- that they are members of. European banks would then develop emissions metrics using on the Partnership for Carbon Accounting Financials[45] (PCAF) to quantify financed emissions, and finally set targets through SBTi. **SBTi and the EU Taxonomy resemble each** other, as they use concrete benchmarks for the evaluation of organisations and economic activities that are aligned with sustainable targets based on the Paris Agreement[46].

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[40] TCFD. (2023). *Task Force on Climate-related Financial Disclosures*. [Website]. Retrieved from https://www.fsb-tcfd.org/
[41] PCAF. (2023). *Enabling financial institutions to assess and disclose greenhouse gas emissions associated with financial activities*. [Website]. Retrieved from https://carbonaccountingfinancials.com/
[42] Others include Net Zero Asset Owners Alliance, Net Zero Asset Managers initiative, and the Net Zero Insurance Alliance among others.
[43] SBTi. (2023). *THE SBTi FINANCIAL INSTITUTIONS NETZERO STANDARD CONCEPTUAL FRAMEWORK AND INITIAL CRITERIA: Consultation Draft, June 2023.* Retrieved from https://sciencebasedtargets.org/resources/files/The-SBTi-Financial-Institutions-Net-Zero-Standard-Consultation-Draft.pdf
[44] Includes: conceptualization of a building's design to financing, development, construction, management, and occupation of the building throughout its lifetime
[45] PCAF. (2023). *Enabling financial institutions to assess and disclose greenhouse gas emissions associated with financial activities*. [Website]. Retrieved from https://carbonaccountingfinancials.com/
[46] Wallhed, N. (2021). *The EU Taxonomy on Sustainable Finance A Major Stride Forward or a Nightmare in Practice?*. Retrieved from http://kth.diva-portal.org/smash/get/diva2:1576581/FULLTEXT01.pdf?fbclid=IwAR1t7olZrPTVM-lPL_qv9G1uG4uAiWFXszQNOpBenVE69nNvPZQff0iMZYw

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?

EBA consultation[47] (EBA/CP/2024/02) paragraph 72 refers to "***Institutions should monitor a range of backward and forward-looking ESG risks metrics and indicators. SNCIs should consider using while other institutions should use at least the following indicators:***

Section "F" states:

Ratios representing as part of the institution's total exposures the share of environmentally sustainable exposures financing activities that contribute or enable the environmental objective of climate change mitigation referred to in Article 9 point (a) of Regulation (EU) 2020/852[48], and the share of carbon-intense exposures, based on clear and documented methodologies. In addition, large institutions should complement this with monitoring metrics in the form of ratios representing, as part of their total exposures, the shares of Taxonomy-aligned exposures for other objectives of the EU Taxonomy as referred to in Article 9 points (b) to (f) of that Regulation, and the shares of exposures detrimental to the achievement of these objectives; for the purposes of determining exposures detrimental to the objective of biodiversity, large institutions should assess material negative impacts of their counterparties' production sites, processes or products on biodiversity;

The EU Taxonomy Regulation provides a set of sectoral criteria for Substantial Contribution (e.g. towards the Climate mitigation objective) and criteria for Do No Significant Harm (in relation to the other environmental objectives). These allow companies and banks to report their balance sheets' Taxonomy alignment and increase their material support for economic activities that contribute substantially to achieving the EU's climate and energy targets. Our latest publication builds on a questionnaire to better understand from retail banks how their sustainable finance pledges impacted their approach to financing energy savings in buildings. **The questionnaire received 19 responses mainly from leading financial institutions**, who indicated that around half of their balance sheet was "covered by the EU Taxonomy" (eligible in the *lingua franca*). This means that around half can have a significant financed emissions impact (such as a loan to a steel foundry) and the other half does not have a material financed impact (such as a loan to a law firm). From 2024, mandatory disclosure obligations of EU Taxonomy will require banks to disclose their Green Asset Ratios (GAR), by segments and therefore for the first time there should be separate disclosures for mortgages, house renovation loans and car loans[49], *inter alia*.

Publication of a green asset ratio (GAR) for financial institutions will show the alignment of lenders' activities with the EU Taxonomy, and – assuming EU Taxonomy criteria are science backed - the Paris Agreement. A GAR is envisaged by the European Banking Authority ("EBA") to cover all lending including to SMEs, households (residential real estate, house renovation loans and motor vehicle loans), local governments, municipalities (house financing) and cover loans, advances, debt securities, equity instruments and repossessed real estate collateral. In 2020, in its communication to the EU Commission[50], the EBA suggested that financial institutions can determine the level of alignment of each lending exposure using the EU Taxonomy thresholds on a case-by-case basis. For residential real estate loans, commercial real estate exposure, housing loans to municipalities, and repossessed real estate collateral, EBA underlying collateral/asset, based on the energy performance certificate label (EPC), in line with the screening criteria proposed in the EU Taxonomy. According to EBA's 2023 report on greenwashing monitoring and supervision[51], the forthcoming EU Taxonomy disclosures for credit institutions and investment firms on the sustainability of their activities will enhance transparency and entity-level sustainability disclosure requirements, particularly for Green Asset Ratio and Green Investment Ratio. EBA's 2021 research[52] shows that under 8% of bank balance sheets are aligned with the EU Taxonomy criteria, increasing to 23% when just considering those covered by the current EU Taxonomy thresholds.

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[47] EBA. (2024). *Consultation paper: Draft Guidelines on the management of ESG risks.* Retrieved from https://www.eba.europa.eu/sites/default/files/2024-01/c94fd865-6990-4ba8-b74e-6d8ef73d8ea5/Consultation%20papaer%20on%20draft%20Guidelines%20on%20ESG%20risks%20management.pdf

[48] Environmental objectives include: (a) climate change mitigation; (b) climate change adaptation; (c) the sustainable use and protection of water and marine resources; (d) the transition to a circular economy; (e) pollution prevention and control; (f) the protection and restoration of biodiversity and ecosystems.

[49] EBF & UNEP FI. (2022). *Practical Approaches to Applying the EU Taxonomy to Bank Lending*. Retrieved from https://www.ebf.eu/wp-content/uploads/2022/02/Practical-Approaches-to-Applying-the-EU-Taxonomy-to-Bank-Lending.pdf

[50] EBA. (2021). *Advice to the Commission on KPIS and Methodology for Disclosure by Credit Institutions and Investment Firms under the NFRD on How and to What Extent their Activities Qualify as Environmentally Sustainable According to the EU Taxonomy Regulation*. Retrieved from https://www.eba.europa.eu/sites/default/documents/files/document_library/About%20Us/Missions%20and%20tasks/Call%20for%20Advice/2021/CfA%20on%20KPIs%20and%20 methodology%20for%20disclosures%20under%20Article%208%20of%20the%

[51] EBA. (2023). *EBA PROGRESS REPORT ON GREENWASHING MONITORING AND SUPERVISION*. Retrieved from https://www.eba.europa.eu/sites/default/files/document_library/Publications/Reports/2023/1055934/EBA%20progress%20report%20on%20greenwashing.pdf

[52] EBA.(2021). *Mapping climate risk: Main findings from the EU-wide pilot exercise*. Retrieved from https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Reports/2021/1001589/Mapping%20Climate%20Risk%20 - %20Main%20findings%20from%20the%20EU-wide%20pilot%20exercise%20on%20climate%20risk.pdf

Given that more than three-quarters of EU bank Taxonomy-relevant lending is not yet aligned with the Paris Agreement. **CS recommends the EBA** to encourage FIs to voluntarily adopt MPS as it is the ideal tool to address this GAR transition to full alignment of buildings-backed lending. Moreover, together with increased information transparency, reporting requirements and capital incentives, MPS would encourage mortgage lenders to work with homeowners and building-owner clients to renovate, improve homes and save energy[53].

[53] Climate Strategy & Partners. (2021). *Underwriting the Renovation Wave with Mortgage Portfolio Standards for Energy Efficiency*. Retrieved from https://www.climatestrategy.es/press/MortgagePortfolioStandardsREPORT2021.pdf