Brussels, 17th April 2024

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EACB comments on
EBA Draft Guidelines on the management of ESG risks
(EBA/CP/2024/02)

General comments

The EACB welcomes the opportunity to comment on the EBA Draft Guidelines on the management of ESG risks. We appreciate the effort to give institutions clarity on the expectations substantiating the CRD requirements before setting out the implications in terms of SREP process and supervisory actions, however we urge the EBA to avoid an overly prescriptive approach that would essentially constrain the institutions' learning curve in the management of ESG risks.

We also appreciate that the choice to keep the focus of the draft GLs especially on environmental aspects, given the early stages of development of approaches for the "S" and "G" dimensions.

Answers to selected questions

Q1: 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?

We support the EBA's view that the CRD-based plans would not entail an obligation to set out an objective of fully aligning with Member States or Union sustainability objectives or one specific transition trajectory. We also see that CRD-based prudential plans should aim at ensuring that institutions comprehensively assess and embed forward-looking ESG risks considerations in their strategies, policies and risk management processes, consistently with the risk taking and risk mitigating nature of the banking business.

In this vein, it would be key to uphold the approach outlined in the draft GLs according to which the goal of prudential plans would not be to force institutions to exit or divest from carbon intensive sectors but rather to stimulate a proactive approach and reflection on the relevant technological, business and behavioural changes driven by the sustainable transition, and identify the related risks and opportunities. Customer engagement will indeed be essential going forward; however, it should be clear that not all clients will adjust at the same pace/have the same responsiveness.

Furthermore, we appreciate the EBA's acknowledgment of the fast-evolving developments related to transition plans and the need to preserve the responsibility of management bodies to set the overall business strategies and policies.

While we understand that this is also the EBA's view, we suggest that the GLs explicitly indicate that there is no formal requirement for the plans to be submitted to supervisors (notwithstanding the power of supervisors to request them from specific institutions for specific needs/situations). A generalized obligation to submit the plans would indeed be entirely disproportionate.

Furthermore, in our opinion it is crucial to establish a precise scope of application for the guidelines under review. In this regard, we believe that two challenges emerge:

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- "Operationalizing" the concept of sustainability risk related to the social dimension. This process aims to delineate the perimeter of social topics as precisely as possible and establish characteristics that allow for accurate analysis and quantification.
- Integrating social sustainability into financial decisions, overcoming the potential paradox between the prudential approach to credit and social sustainability. We believe it is necessary to innovate the prudential approach to consider not only the financial risk associated with social issues but also the "worthiness" of investment choices aimed at addressing social issues.

If these challenges cannot be overcome, it would be necessary to clarify in greater detail that the guidelines in question are primarily intended for environmental sustainability and that further developments will follow at a later stage to fully integrate social sustainability into decision-making and prudential processes.

Q2: Do you have comments on the proportionality approach taken by the EBA for these guidelines?

See also Q4.

We appreciate that GLs allow small and non-complex institutions (SNCIs) to implement less complex or sophisticated provisions, and in some cases, even on a voluntary basis, following the principle of proportionality.

However, there is a risk that the prudential principles related to ESG sustainability factors (together with those of reporting imposed by the CSRD) may de facto come into effect, even if not legally binding, without due consideration for proportionality. The adoption of these principles, even if envisaged on a voluntary basis, could indeed establish a new "operationally mandatory" standard to which both financial stakeholders (such as banks, insurers, capital investors) and major commercial stakeholders (such as customers and suppliers) will refer.

In conclusion, we believe it is necessary to further investigate the impacts of adopting guidelines designed for large enterprises on the operations of small businesses. It is essential to ensure that SMEs receive the necessary support to address challenges and adopt sustainability practices without facing financial penalties.

Q3. 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.

Xxx

Q4. Do you have comments on the materiality assessment to be performed by institutions?

We understand the need for all institutions to perform the materiality assessment. We support the EBA stance to allow SNCIs to perform the materiality assessment with a slightly lower regularity, given the more limited resources available and the burden required by the exercise. We however believe that the assessment should be performed every 3 years, instead of 2, in line with the requirement under the SREP GLs to perform the review of all SREP elements.

Moreover, the concept of materiality addressed in the Guidelines appears tailor-made for environmental risks and factors. As anticipated in previous comments, there is a lack of appropriate definitions that allow for the analysis and quantification of the social dimension. This is also due to the fact that a social taxonomy serving as a starting point for the normative definition of social factors and their scope is missing.

Regarding the assessment of financial materiality, we oppose the drafting of Guidelines that may discourage economic and financial activities or investments with a social character due to the negative impact on entities in terms of capital requirements.

Q5. 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.

Xxx

Q6. Do you have comments on the data processes that institutions should have in place with regard to ESG risks?

Xxx

Q7. Do you have comments on the measurement and assessment principles?

Xxx

Q8. Do you have comments on the exposure-based methodology?

Xxx

Q9. 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.

Xxx

Q10. Do you have comments on the ESG risks management principles?

Xxx

Q11. Do you have comments on section 5.2 – consideration of ESG risks in strategies and business models?

The incorporation of ESG risks into business models varies according to each company's sector, size and geographical location. In this vein, we would emphasise that, while it is essential that all financial institutions include ESG factors in their business models, it is equally crucial to recognise the activities of banks that, due to both their legal structure, specific national legal mandates, and the type of business strategy/model, operate as social economy entities in some Member States or as key social actors.

These activities should be reflected in the context of prudential supervision, with the aim of having a holistic view of their capital position that duly factors in this dimension.

It would be highly valuable to ensure that prudential requirements do not impair access to credit for social economy entities as a means of raising corporate standards on social issues (such as low productivity and low growth linked to long-term unemployment, inequality, unequal access to education and human rights violations, fostering investment in disadvantaged areas and promoting their development), allowing funds to flow towards the green and digital transition.

Such an approach would significantly contribute to the promotion of inclusive and sustainable economic growth.

Q12. Do you have comments on section 5.3 – consideration of ESG risks in risk appetite?

We would note that the analysis of the risk appetite, especially in a financial context where investment decisions are guided by expectations of return, risk, and duration, may sometimes conflict with environmental and social interests, or may even prevail over them.

The fact that entities may be more involved in activities related with ESG risks should not implicitly mean that the business is "more" risk-prone, as banks involvement in the transition or in social-related investments may in fact contribute to a safer and more stable financial environment.

Q13. Do you have comments on section 5.4 – consideration of ESG risks in internal culture, capabilities and controls?

Xxx

Q14. Do you have comments on section 5.5 – consideration of ESG risks in ICAAP and ILAAP?

We support the approach to avoid a separate ESG ICAAP but rather include the ESG dimension within the existing ICAAP – this is consistent also with the overall approach that sees ESG risks affecting the traditional risk categories.

We see that ESG risks should inform the ICAAP like other risk drivers (e.g. geopolitical risks). It is unclear however what would be expected in the case where an institution sees that ESG risks do not affect the ICAAP (e.g. would a qualitative description as to why that is not the case be required?)

Q15. Do you have comments on section 5.6 – consideration of ESG risks in credit risk policies and procedures?

Xxx

Q16. 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?

Xxx

Q17. Do you have comments on section 5.8 – monitoring of ESG risks?

Xxx

Q18. Do you have comments on the key principles set by the guidelines for plans in accordance with Article 76(2) of the CRD?

Xxx

Q19. Do you have comments on section 6.2 – governance of plans required by the CRD?

Xxx

Q20. 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?

Xxx

Q21. 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?

Xxx

Q22. Do you have comments on section 6.5 – transition planning?

Xxx

Q23. 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?

Xxx

Q24. 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?

Xxx

Q25. 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.

Xxx

Q26. Do you have other comments on the draft guidelines?

At a general level, the EBA indicates that institutions should progressively develop capacities in assessing and managing "*the impact of a sufficiently comprehensive scope of environmental risks, extending beyond climate-related ones, such as risks stemming from degradation of ecosystems and biodiversity loss, as well as of other ESG factors*".

We understand that ecosystems' degradation and biodiversity loss may be only examples of a broader range of elements, which leaves a certain degree of uncertainty on the ground to be covered by institutions. For example, looking also at the experience with the EU Taxonomy, would institutions be expected to include water and pollution matters in heat maps? Extending the scope of factors increases the complexity of the task, we would appreciate if the EBA could provide some clarity or additional information in this respect.

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