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Nordic Financial Unions

NFU consultation reply to EBAs Guidelines on the management of ESG risks

NFU – Nordic Financial Unions is a lobbying organization that promotes the interests of Nordic financial trade unions in Europe. NFU strives to make the financial sectors prosper in a way that is sustainable for employees, companies, consumers, and societies.

NFU welcomes the opportunity to contribute to the European Banking Authority's consultation on the Draft Guidelines on the management of Environmental, Social, and Governance (ESG) risks. The finance sector is the catalyst for sustainable finance in Europe, and NFU is deeply committed to promoting sustainability in a holistic way by considering environmental, social, and governance aspects. While we appreciate the EBA's efforts to effectively integrate ESG risks into the regulatory framework, we also highlight the importance of the finance sector's employees, whose valuable knowledge and practical experience are vital in managing these risks effectively.

Our subsequent suggestions should therefore be viewed in the context of our overall appreciation for the EBA's efforts to ensure the safety and soundness of institutions and actors within the financial ecosystem in the short, medium, and long term.

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?

NFU appreciates the EBA's comprehensive plans outlined under Article 76(2) of the CRD, particularly the robust materiality assessments of ESG risks and the forward-looking strategy in policy and risk management. We agree that integrating ESG considerations strengthens financial institutions' preparedness for a sustainable economic transition, enhancing both environmental goals and resilience to ESG risks. However, we suggest a more streamlined reporting approach by potentially harmonizing requirements under the CSRD, CSDDD, and CRD, thus reducing administrative burdens while emphasizing effective ESG risk management. Further, we emphasize that to facilitate a successful transition to a climate-neutral and sustainable economy, it is crucial for financial institutions to focus on employee skills development. This ensures they are equipped to effectively manage and monitor ESG risks. Lastly, we note that while the CRD broadly categorizes climate, environmental, social, and governance risks under a unified framework, the EBA's guidelines predominantly address climate and environmental risks. We question this focus, suggesting a more integrated approach that includes social and governance aspects, given their interconnected nature with environmental issues.

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

NFU supports the proportionality approach taken by the EBA for these guidelines, as it recognizes the diversity of institutions within the financial sector. Proportionality ensures that smaller institutions are not overburdened with requirements that may be more suitable for larger, more complex institutions. However, we note that while proportionality is crucial, all institutions, regardless of size, play a role in the transition to a sustainable economy and should be equipped to manage ESG risks effectively. To further support smaller institutions, the EBA should consider providing more tailored guidance or examples on understanding, defining, and implementing proportionate ESG risk management practices. Additionally, facilitating access to ESG data and risk assessment tools could help smaller institutions meet the guidelines without disproportionate effort.

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.

NFU positively views the EBA's comprehensive approach to integrating climate, environmental, social, and governance (ESG) risks into the risk management frameworks of financial institutions. We acknowledge the focus on environmental risks as a starting point, in accordance with CRD Article 87a, which also provides preliminary insights into social and governance risks (page 48, paragraph 12). Going forward, it will be important to expand the guidance to include more detailed management of social and governance risks as well. Recognizing the interconnectedness of ESG risks is vital for understanding their potential impact on financial institutions and the broader economy. It is also crucial to define, interpret, and manage these risks effectively, necessitating high-level training, especially concerning biodiversity and social challenges. Challenges persist with indicators for measuring sustainability—what should be the minimum safeguards? How should we balance trade-offs between ESG risks? Which sustainability goals take precedence when biodiversity loss threatens about half of the global economy and the survival of life on Earth? A valuation of natural resources and biodiversity is necessary. As such, traditional finance employees would require extensive specialized training to integrate these considerations effectively. Finance must integrate with biology for transition plans to be effective and fit for purpose. We suggest that further guidance on integrating these interconnected risks, particularly on how to balance and prioritize actions when ESG goals conflict, would be beneficial. The EBA could develop a framework for managing these trade-offs and provide clearer guidance on prioritizing actions. Additionally, expanding the guidelines to include examples of best practices in managing these trade-offs could support institutions in their ESG risk management efforts.

Question 4: Do you have comments on the materiality assessment to be performed by institutions?

NFU recognizes materiality assessments are vital for understanding the diverse impacts of ESG risks across different time horizons. Incorporating both qualitative and quantitative elements ensures a comprehensive view, acknowledging the forward-looking nature of ESG risks which may not be fully captured through historical data alone. We suggest further guidance on integrating scenario analysis and stress testing within materiality assessments. This could enhance the forward-looking aspect of these assessments, providing a more robust foundation for risk management strategies.

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.

NFU supports the specification of a minimum set of exposures to be considered as materially exposed to environmental transition risk, acknowledging the importance of alignment the EU taxonomy ensures consistency with broader EU sustainability objectives, offering a clear pathway for institutions to justify non-materiality based on credible, standardized criteria. We propose extending similar specifications for the materiality assessment of physical risks, social risks, and governance risks. This could involve developing additional criteria or indicators that reflect the materiality of these risks in a manner consistent with the taxonomy approach for environmental risks.

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

A central problem and challenge is producing comparable, high-quality data. This can only be achieved if the data processes and programs are developed and adopted specifically for producing such data. The systems must be fit for purpose in order for the data to be relevant and comparable. If not, we will compare apples with oranges. It is of utmost importance to define and standardize the ESG data and reporting requirements. NFU values the emphasis on robust data processes for managing ESG risks. Effective data processes enable institutions to capture a detailed and accurate picture of ESG risks. Engaging with clients to capture ESG-related information enriches the data quality and supports a more nuanced risk assessment. We suggest that the EBA could facilitate the development of shared data platforms or services, enhancing data accessibility and quality across the industry. Collaboration with data providers and standard-setting bodies could further standardize ESG data metrics and reporting.

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

NFU agrees that a mix of methodologies is crucial due to the multifaceted nature of ESG risks and their varying impacts over time. This approach allows institutions to capture the immediate effects of ESG risks on credit profiles and profitability and assess longer-term strategic and operational vulnerabilities. The integration of forward-looking scenarios, especially concerning environmental risks, enables institutions to gauge potential future states and adjust their strategies accordingly. While the EBA's approach is comprehensive, an alternative could involve specifying baseline quantitative criteria for ESG risk measurement to ensure consistency across institutions. Furthermore, developing a standardized set of KRIs for industry-wide adoption could enhance comparability and benchmarking of ESG risk profiles.

Question 8: Do you have comments on the exposure-based methodology?

NFU appreciates that the methodology acknowledges the direct impact of ESG factors on credit risk and asset values. By evaluating the vulnerability to physical and transition risks, institutions can better understand the potential financial impacts of ESG factors on counterparties and investments. However, we wish to highlight than an alternative approach could include more detailed guidance on how to implement exposure-based assessments across different industry sectors, taking into account sector-specific ESG risk drivers. Additionally, the EBA could consider establishing thresholds for ESG risk exposure that would trigger enhanced scrutiny or mitigation measures.

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.

NFU appreciates that the guidelines emphasize the need for large institutions with securities traded on a regulated market to measure the alignment of certain sectoral portfolios towards achieving net-zero GHG emissions by 2050, using the International Energy Agency (IEA) net zero scenario or comparable scenarios as a benchmark. While the guidelines recommend using the IEA net zero scenario, they could also suggest or develop a set of alternative scenarios tailored to different sectors or geographic regions, acknowledging the diverse transition pathways across economies. Additionally, providing a framework for incorporating social and governance risks into portfolio alignment methodologies could offer a more holistic view of sustainability.

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

NFU agrees that these principles recognize the pervasive impact of ESG risks on financial institutions' risk profiles. By embedding ESG risks within regular risk management processes, institutions can enhance their resilience to ESG-related adverse outcomes. However, the EBA could consider establishing more granular guidance on the operationalization of these management principles, such as specific criteria for engagement with counterparties on ESG issues or methodologies for adjusting financial terms based on ESG risk assessments.

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

NFU recognizes the importance of integrating ESG risks into strategic planning. This integration not only prepares institutions' transition plans and business models for a shift towards a sustainable economy but also enables them to effectively navigate the associated social risks and opportunities. Furthermore, it is crucial to emphasize that maximizing financial profit in a sustainable economy necessitates the effective incorporation of ESG risks across the business. This can become a competitive advantage. To facilitate this integration, we recommend that the EBA provide a template or framework. This tool would help institutions operationalize these guidelines more effectively, embedding ESG considerations into their strategic planning processes and avoid potential miscalibration in terms of only focusing on environmental aspects.

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

NFU agrees that the risk appetite should be supported by ESG-related Key Risk Indicators (KRIs), including potential limits, thresholds, or exclusions, that anchor ESG considerations in relation to products, client segments, types of collateral, and risk mitigation instruments. This approach promotes a proactive stance towards ESG risk management, encouraging institutions to make informed decisions that reflect their willingness to engage with ESG-related opportunities and challenges. We suggest a development of standardized ESG risk appetite templates or benchmarks so that institutions could adapt to their specific context. Additionally, the EBA could provide guidance on integrating ESG risks into stress testing frameworks, further informing risk appetite decisions with forward-looking insights.

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

NFU emphasizes the importance of developing internal capabilities to foster a culture that prioritizes ESG considerations can enhance an institution's ability to identify, assess, and manage ESG risks effectively. Training and awareness initiatives equip staff with the necessary tools and knowledge to integrate ESG factors into their day-to-day activities and decision-making processes. However, we insist that the guidelines should specify more detailed requirements for ESG training programs, including core topics to be covered and recommended training frequencies. Additionally, introducing a certification or accreditation system for ESG risk management competence could standardize skills and knowledge across the industry.

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

NFU supports integrating ESG risks into ICAAP and ILAAP to ensure that institutions systematically consider how these risks might affect their capital and liquidity positions over time. This proactive approach would help institutions prepare for potential adverse impacts and aligns their risk management practices with evolving regulatory and market expectations. However, the EBA could provide more granular guidance on modeling and quantifying the impacts of ESG risks within ICAAP and ILAAP frameworks, including examples of adverse scenarios and stress testing methodologies. Additionally, encouraging external validation or peer reviews of ESG risk assessments could enhance the credibility and robustness of institutions' internal processes.

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

NFU supports integrating ESG risks into credit risk policies and procedures, so that institutions can better manage the potential impact of these risks on their credit portfolios. This approach facilitates more informed lending decisions that consider the long-term sustainability of borrowers and projects, thereby reducing potential credit losses related to ESG events or transitions. To further enhance credit risk management in light of ESG risks, the EBA could consider providing detailed methodologies for quantifying the impact of specific ESG factors on credit risk metrics. Additionally, promoting the use of external ESG ratings and assessments, while ensuring proper due diligence, could offer institutions additional insights into borrowers' ESG risk profiles.

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?

NFU agrees that understanding of the multi-faceted impact of ESG risks across various risk categories enables institutions to adopt a holistic risk management approach. This facilitates resilience against potential adverse ESG developments and supports sustainable business growth. However, the EBA could provide specific guidance on integrating ESG considerations into the risk assessment of new products and services, particularly those marketed as sustainable or green. Establishing criteria for ESG-related concentration limits and stress testing scenarios focused on ESG events could further enhance risk management practices.

Question 17: Do you have comments on section 5.8 – monitoring of ESG risks?

NFU supports regular and granular monitoring of ESG risks to enable institutions to quickly identify changes in their risk profiles and take proactive measures to address emerging risks. This supports the dynamic management of ESG risks in alignment with the institution's strategic objectives and regulatory expectations. However, the EBA could encourage the development of industry-wide benchmarks or thresholds for ESG risk indicators, facilitating peer comparisons and enhancing market transparency. Additionally, promoting the integration of advanced analytics and technology solutions into ESG risk monitoring processes could improve the efficiency and effectiveness of risk assessments.

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?

NFU recognizes the EBA's emphasis on robust materiality assessments of ESG risks, underpinned by Section 4.1, as the foundation for CRD-based plans. This approach is crucial for identifying exposures or portfolios significantly impacted by ESG risks during the transition to sustainable economies. However, we suggest the inclusion of dynamic materiality concepts to capture the evolving nature of ESG risks and their impact over time. Additionally, incorporating stakeholder engagement in the materiality assessment process could offer broader insights into emerging ESG risks and opportunities.

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

NFU appreciates the focus on governance within CRD-based plans, emphasizing the responsibility of management bodies to oversee the integration of ESG considerations into strategic planning and risk management. To further strengthen governance frameworks, NFU recommends the establishment of specific ESG committees within the management body. Additionally, it is important to emphasize the involvement of union representatives, particularly pertinent to the social and governance aspects of ESG strategy formulation, implementation, and monitoring.

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?

NFU supports the specification of metrics and targets within CRD plans, as they are fundamental for tracking progress towards ESG objectives and managing transition risks effectively. We propose setting sector-specific targets could provide more tailored pathways for achieving overall ESG objectives.

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?

NFU values the emphasis on climate and environmental scenario analysis within CRD plans. Such scenarios are instrumental in preparing institutions for a range of potential futures and aligning strategies with the transition to a sustainable economy. We suggest that the EBA could provide further guidance on selecting and applying specific scenarios, including the development of specific scenarios that reflect the unique risks and opportunities faced by institutions within different regions. Collaboration with experts within the field could enhance the relevance and accuracy of these scenarios.

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

NFU acknowledges the EBA's focus on transition planning, emphasizing the need for institutions to integrate ESG risks into their business models, strategic planning, and risk management processes. This underscores the crucial role that financial institutions play in aligning with the broader goals of a sustainable economy. We suggest that the EBA enhance its guidelines by providing more specific examples of successful transition planning best practices. Additionally, creating a framework for peer benchmarking could help institutions evaluate the effectiveness of their transition plans relative to industry standards.

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?

NFU believes the current level of granularity in the guidelines provides a good foundation but sees potential for more detailed requirements to ensure comprehensive and effective ESG risk management. We recommend the development of sector-specific guidelines or annexes that address unique risks and opportunities within different segments of the banking and insurance sectors. This could enhance the relevance and applicability of the guidelines for institutions with different business models.

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?

NFU supports the idea of a common format for CRD plans, which could facilitate uniformity and comparability across institutions. We suggest that the EBA consider flexible templates that can be adapted to different institution sizes and business models while maintaining core elements that ensure consistency in reporting.

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.

NFU identifies several primary challenges in implementing these guidelines, which include a lack of training, skills development, and a comprehensive understanding of ESG risks. The complexity and novelty of the sustainability perspective contribute to these challenges. Additionally, there are issues with data availability and methodological uncertainties, as well as the necessity for alignment with other regulatory requirements. Financial institutions frequently struggle to access high-quality ESG data and to utilize emerging methodologies for assessing ESG risks. Moreover, ensuring consistency with other EU and international sustainability standards and requirements is crucial for establishing a unified regulatory framework. To address these issues, we recommend that the EBA collaborates closely with financial institutions, data providers, and other regulatory bodies to enhance data access and clarify methodological approaches. Providing guidance on how to align ESG risk management practices with other regulatory frameworks would also prove advantageous.

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

NFU appreciates the EBA's efforts in developing these guidelines and recommends continuous engagement with industry stakeholders to keep them relevant and practical. Given the dynamic nature of ESG issues and the evolving regulatory landscape, regular updates and revisions are necessary to align the guidelines with best practices and regulatory expectations. We suggest establishing a formal feedback mechanism for financial institutions to regularly share insights, challenges, and suggestions with the EBA, enhancing the guidelines' refinement. Additionally, involving employees and trade unions in the development and implementation process can ensure the guidelines are practical, effective, and reflective of real-world challenges and opportunities. Therefore, we urge the EBA to implement mechanisms for meaningful employee and trade union engagement throughout the guideline development process and beyond.