ABBL Response to the EBA Consultative Document
Guidelines on ESG risks management

18 April 2024

Final response

Key messages

- **A risk-based approach** must be ensured across the Guidelines ('GL')

- **Prefer methodological flexibility** and practical recommendations over (too) prescriptive GL for banks to set their own targets and develop their own metrics ,and risk management tools s based on their own strategies, their own commitments, profile, activities and exposures.

- **Clarify certain concepts** to avoid misinterpretation or confusion especially in the case where there might be overlaps between regulatory expectations.

- **Ensure consistency across regulations and publications** that would prevent banks to navigate different guidelines, reports and recommendations to identify what is effectively expected from them.

- We welcome the **flexible approach regarding the CRD transition plans** which requires consistency with the CSRD but leaves flexibility as to whether this results to single transition plan. The **articulation between the CSRD transition plans and CRD plans should however be further clarified**, in particular how the CRD based transition plans are to be implemented and managed in relation to the overall strategy.

- Given the current level of maturity of tools and methodologies for the management of ESG risks (not only in the financial sector) and the numerous regulatory developments banks will have to comply with in the next few years (notably CSRD), **institutions will need sufficient time for the application of the Guidelines.** Implementation period of at least two years is necessary given the complexity of the topic and its interdisciplinary nature (data, IT, strategy, risk processes). In this regards we would welcome further clarification on the entry into force and the application date of the GL. Concerning the application, we propose a **phased approach on certain elements and perimeters** in line with the EBA Guidelines on Loan Origination and Monitoring, where phased implementation timelines were also established.

Response to the EBA questions

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?

We **welcome the flexible approach of the Guidelines** which build on and ensure consistency between principles, targets, actions and tools put in place in accordance with the various regulatory framework relating to transition plans, and it neither obliges banks to have a single plan, nor requires multiple plans.
That being said, we would appreciate further clarification of the concept of "prudential" (transition) plans, either from a normative Pillar 1 normative or Pillar 2 economic perspective. This would ensure consistency across various EBA publications, in particular the 2023 EBA report on the integration of ESG risks in Pillar 1.

We would also like to stress that the timing of sustainable finance regulations brings the issue of costs and resources necessary to comply with the various requirements and requires as much alignment and harmonisation as possible across CRD, CSRD and CSDDD concepts relating to transition plans.

We understand that strategic decisions and bank's voluntary commitments shall be consistent with the elements of the plans prepared in accordance with the CRD, and articulated in one single transition plan, whereby the CRD-based plan address the financial risk aspects. However, we would appreciate further clarification on how the CRD based transition plans are supposed to be implemented and articulated in relation to the CSRD transition plan of the institution which requires a double materiality assessment and address more strategic actions that could not be risk-driven (focus on financial materiality aspect).

It is also important to clarify to what extent expectations regarding time-horizons in the Guidelines would be aligned with the scenarios defined or recommended by international bodies (ACPR, ECB, NGFS) which would implicitly mean that time-horizon for strategic planning would be extended to at least 10 years.

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

It is important that the consideration of proportionality for other types of risks remain valid for ESG risks in the same manner, using the proportionality principles applied in CRR II as well as in the EBA Guidelines on Internal Governance arrangements. All institutions should be able to manage prudently their ESG risks as another material risks depending on their profiles, the types of activities, clients and exposures that they have.

For that purpose, proportionality for smaller institutions should therefore be applied to the extent that their risk management framework is consistent with the materiality of these risks, given that smaller institutions might not be less exposed to climate-related risks.

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.

Given the level of maturity and the availability of data on social and governance matters compared to climate and to a certain extent environmental topics, banks should be granted sufficient time to cover other topics than climate and a **gradual implementation** should be provided.

Further guidance would be also appreciated – including concrete illustrative examples – to better understand how to handle **interactions between various types of risks.**

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

It should be further clarified whether and to what extent banks should consider both financial and other impacts while conducting ESG risks assessment according to these guidelines.

We suggest clarifying the different materiality perspective in the paragraph 26 by including fictive but concrete examples which would further support the understanding and reconcile the elements related to such concept presented in the various regulatory and supervisory corpus. In the meantime, such guidance should not be too prescriptive and remain flexible based on institutions' individual profile.

Such practical guidance should be consistent with the materiality assessment approach for other types of risks. In addition, all elements within the Guidelines should be subject to such a materiality assessment.

Paragraph 14 Most critical counterparties / average counterparties

The analysis of the "most critical or average of counterparties"(paragraph 14) regarding their deviations from the transition plans of their jurisdictions is **too extensive for a bank-wide materiality analysis at portfolio level**. We would also ask for clarification of what is meant by "most critical".

Different transition pathways and climate scenarios

We would appreciate clarification on how many and which pathways and scenarios are expected to be used and to what extent it diverges from ESG templates required under Pillar III disclosures.

Sectors that highly contribute to climate change

The GL recommend using the list of sectors as specified in Recital 6 of ESG Benchmark Regulation. Further flexibility could be granted to each institution as per Pillar II approach.

Question 5. Do you agree with the specification of a minimum set of exposures to be considered as materiality 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.

As for the previous question, flexibility would be appreciated regarding the minimum set of exposures to be considered as materially exposed to environmental transition risk and avoid too prescriptive approach as there is no one-size-fits-all approach for the identification and the management of ESG risks and this would allow banks to differentiate the approach to be adopted for each client.

The reference to the EU Taxonomy for the exclusion of some sectorial activities should be removed as we do not support the reference to the EU Taxonomy as a proxi of justification of non-materiality.

To answer the question whether the guidelines should provide similar requirements for the materiality assessment of physical risks, social risks and governance risks we would like to mention that in the materiality assessment of banking book, banks use the same approach for transition and physical risks, but not for social risks given the state of maturity compared to climate or environmental risks. **We therefore do not believe similar requirements should be provided to assess the materiality of social and governance risks.**

Data gathering (par. 23, p20): It should be made clear that the list of data to be collected for large corporate counterparties is indicative and not mandatory. Same remark for social and governance-related information p20-21. (par. 24 and 25, p21): the GL are there too be prescriptive. An explanation including proposed mitigating actions should be sufficient.

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

Data points needed Probabilities of materialization (p22)

"With regard to environmental risks, institutions' internal procedures should enable to quantify these risks, such as by estimating the probabilities of materialization and magnitude of financial impacts stemming from environmental factors, and should establish Key Risks Indicators (KRIs) covering the short-, medium- and long-term time horizons and exposures and portfolios materially exposed." The concept of "estimating the probabilities of materialisation" is broad and could lead to unfair probability distribution which is not an easy task for this type of risks. Further guidance relating to the quantification of environmental risk should be included, including illustrative examples and practices.

Paragraph 23

We **do not support the necessity to provide all the metrics and units** specified by EBA in paragraph 23. The list of data to be collected from counterparties listed in this paragraph should be primarily i) focused on data being published under CSRD, ii) seen as a recommendation, and iii) concentrated on data on climate related factors (such as greenhouse gas emissions and energy efficiency).

Banks should be allowed to choose the most relevant metrics. data should be collected by the bank for their different portfolio based on the materiality of ESG risks identified, the type of clients, collateral and exposures, etc. and banks should have the possibility to choose the relevant metrics (e.g. NZBA banks may use the ones used under NZBA portfolio alignments).

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

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

Climate scenarios (p24): Flexibility should be given regarding the scenarios to be used by banks for measuring portfolio alignment, not only the scenarios of the International Energy Agency (IEA).

It would be useful to understand better if the ESG templates requested for Pillar 3 disclosure are already considered as an example of this exposure-based methodology.

Measurement of positive or adverse impacts (p24-25, par. 38): the provisions are not consistent across the document and seem to be very restrictive, i.e. "…approaches to measuring the positive or adverse impacts of their portfolios on the achievement of the UN Sustainable Development Goals and evaluating potential related financial risks."

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.

Please see comment above on Q9 regarding the use of IEA scenario and the need for consistency with the Pillar III alignment template.

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

Entities should be granted enough flexibility to set up plans and procedures able to be adjusted to the specific circumstances that will progressively arise, i.e. as per the Questions before, the GL should avoid a too prescriptive approach (especially paragraph 42).

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

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

As already noted in other parts of the consultation, we think that it is of utmost importance to develop a gradual approach into ESG-related risks, starting with environmental risks and following (without rush) social and governance. We must always bear in mind the lack of data that still exists in relation to ESG-related risks.

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

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

Liquidity risks (p30): EBA recommendations regarding liquidity risks are difficult to understand given the EBA/REP/2023/34 report on the role of environmental and social risks in the prudential framework, especially as no changes are expected regarding LCR and NSFR, while the EBA nevertheless provides for high-level view in paragraphs 65, p32 The GL should therefore avoid creating any discrepancy between supervisors' expectations and Banks' ability to assess ESG risk drivers impact on liquidity risks.

ICAAP/ILAAP framework (p30: Par. 56): *"…. Institutions should include in their ICAAP and ILAAP frameworks a description of the risk appetite, thresholds and limits set for material impacts of ESG risks on their solvency or liquidity, as well as the process applied to keeping these thresholds and limits up to date."* It seems difficult to have specific limits/triggers regarding ESG impacts on an indicator like the CET1 ratio or the ECAP. Concrete illustrative examples from the EBA would be appreciated.

Reverse stress testing (p30, par. 58): It is difficult to interpret/understand reverse stress testing regarding ESG. Further guidance including practical illustrative examples would be appreciated on such specific aspect of the GL.

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

Regarding credit risk analysis, it should be further clarified that the bank must assess the risk at the counterparty level and not go beyond the value chain of the counterparty in question ("look-through" approach).

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?

Greenwashing / reputation risk (paragraph 67)

Paragraph 67 refers to the ESAs high-level understanding of greenwashing in the EBA's progress report on greenwashing and monitoring and supervision (EBA/REP/2023/16). We would welcome any clarification whether banks should expect the final guidelines to be amended in accordance with the final report on Greenwashing to be released by ESAs by June 2024, including concrete examples of greenwashing across the investment value chain the financial institutions could build on.

ESG risks metrics (p34: Paragraph 72) *"…should at least*" notion should be replaced by a list of not mandatory recommendations like (i) point b which is difficult to understand should a bank finances a transition plan, or (ii) Point f that seems to relate to the GAR . Same remark p39 where the "…should" notion should be replaced by a list of not mandatory recommendations.

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

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?

See comments above in the general comments regarding transition plans.

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

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?

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?

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

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?

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?

Yes, it would be a good idea to propose some non-mandatory templates taking into account the current Pillar III templates (in addition to the CSRD ones) – consistency across guidelines / recommendations is crucial. Different templates should not address the same issues and vice versa.

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.

Key challenges are covered in our previous responses.

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