

EBA/CP/2024/02

18 January 2024

Consultation paper

Draft Guidelines on the management of ESG risks

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1. Responding to this consultation

The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in 7.2.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/ rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

Submission of responses

To submit your comments, click on the 'send your comments' button on the consultation page by 18 April 2024. Please note that comments submitted after this deadline, or submitted via other means may not be processed.

Publication of responses

Please clearly indicate in the consultation form if you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA's rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

Data protection

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EU) 1725/2018 of the European Parliament and of the Council of 23 October 2018. Further information on data protection can be found under the Legal notice section of the EBA website.

2. Executive Summary

The EBA is mandated in accordance with Article 87a(5) of Directive 2013/36/EU to issue Guidelines on minimum standards and reference methodologies for the identification, measurement, management and monitoring of Environmental, Social and Governance (ESG) risks by institutions.

ESG risks, in particular environmental risks through transition and physical risk drivers, pose challenges to the safety and soundness of institutions and may affect all traditional categories of financial risks to which they are exposed. To ensure the resilience of the business model and risk profile of institutions in the short, medium and long term, the guidelines set requirements for the internal processes and ESG risks management arrangements that institutions should have in place.

Institutions, based on regular and comprehensive materiality assessments of ESG risks, should ensure that they are able to properly identify and measure ESG risks through sound data processes and a combination of methodologies, including exposure-based, portfolio-based and scenario-based methodologies.

Institutions should integrate ESG risks in their regular risk management framework by considering their role as potential drivers of all traditional categories of financial risks, including credit, market, operational, reputational, liquidity, business model, and concentration risks. Institutions should have a robust and sound approach to managing and mitigating ESG risks over the short, medium and long term, including a time horizon of at least 10 years, and should apply a range of risk management tools including engagement with counterparties. Institutions should embed ESG risks in their regular processes including risk appetite, internal controls and ICAAP. Besides, institutions should monitor ESG risks through effective internal reporting frameworks and a range of backward and forward-looking ESG risks metrics and indicators.

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. To this end, institutions should assess and embed forward-looking ESG risks considerations in their strategies, policies and risk management processes through transition planning considering short-, medium- and long-term time horizons. While transition plans are relevant under several pieces of EU regulation, CRD-based plans take a risk-based view and contribute to the overall resilience of institutions towards ESG risks.

Next steps

The EBA is consulting on the draft guidelines for a period of three months. Feedback from the public consultation will be taken into account when finalising the guidelines. It is planned that the guidelines will be finalised by end-2024 and apply from [tbc – depending on CRD6 application date].

3. Background and rationale

3.1 Impact of ESG risks

1. Climate change, environmental degradation, social issues and other environmental, social and governance (ESG) factors are posing considerable challenges for the economy. The impact of acute and chronic physical events, the needed transition to a low carbon, resource efficient and sustainable economy as well as other ESG challenges are causing and will continue to cause profound economic transformations that impact the financial sector.
2. The Commission's Renewed Sustainable Finance Strategy and the banking package (Directive 2013/36/EU (Capital Requirements Directive, CRD) and Regulation EU/575/2013 (Capital Requirements Regulation, CRR))¹ recognise that the financial sector has an important role to play both in terms of supporting the transition towards a climate neutral and sustainable economy, as enshrined in the Paris Agreement, the United Nations 2030 Agenda for Sustainable Development and the European Green Deal, and for managing financial risks that this transition may entail and/or stemming from other ESG factors.
3. Environmental risks, including climate-related, are expected *inter alia* to become even more prominent going forward through transition and physical risk drivers. This may affect all traditional categories of financial risks to which institutions are exposed. In addition, social factors – such as human rights, health or working conditions – and governance factors – such as executive leadership or bribery and corruption – may also drive financial impacts on the institutions' counterparties or invested assets and represent sources of financial risk that institutions should assess and manage.
4. To maintain adequate resilience to the negative impacts of ESG factors, institutions established in the EU need to be able to systematically identify, measure and manage ESG risks. However, the specificities of ESG risks such as their forward-looking nature and distinctive impacts over various time horizons as well as the lack of relevant historical experience means that understandings, measurements and management practices can differ significantly across institutions. The EBA's observations stemming from the monitoring of colleges as well as supervisory experience from Competent Authorities also show that management of ESG risks is still at early stages and a "work in progress" in most EU institutions. Despite action taken in recent years, several shortcomings have been observed in the inclusion of ESG risks in business strategies and risk management frameworks that may pose challenges to the safety and

¹ On 27 June 2023, a political agreement¹ was reached between the Council of the European Union and the European Parliament on the proposal put forward by the European Commission on 27 October 2021 on the banking package. The banking package includes amendments to the Capital Requirements Regulation (CRR3) and to the Capital Requirements Directive (CRD6). Following the political agreement and the subsequent technical meetings of the trilogue negotiators, the present consultation paper is based on the text of the Provisional agreement published on the Council's website on 6 December 2023: [Banking sector: Provisional agreement reached on the implementation of Basel III reforms](#).

soundness of institutions as the EU transitions towards a more sustainable economy and ESG risks become increasingly substantiated or materialise.

3.2 Legal mandate and objective of these guidelines

5. To enhance the focus on ESG risks faced by institutions in the prudential framework, new provisions have been introduced and adjustments have been made to several Articles in the CRD and in the CRR. In particular and to ensure a uniform understanding of ESG risks, definitions of ESG risks, environmental risk, physical risk, transition risk, social risk and governance risk have been laid down in Article 4 of the CRR. Articles 73 and 74 of the CRD have been amended to require that short, medium and long-term horizons of ESG risks be included in credit institutions' strategies and processes for evaluating internal capital needs as well as adequate internal governance. A reference to the current and forward-looking impacts of ESG risks and a request for the management body to develop concrete plans to address these risks are also introduced in Article 76.
6. In addition, a new Article 87a has been included in the CRD, according to which:
 1. Competent authorities shall ensure that institutions have, as part of their robust governance arrangements including risk management framework required under Article 74(1), robust strategies, policies, processes and systems for the identification, measurement, management and monitoring of ESG risks over the short, medium and long term.
 2. The strategies, policies, processes and systems referred to in paragraph 1 shall be proportionate to the scale, nature and complexity of the ESG risks of the business model and scope of the institution's activities, and consider short, medium and a long-term horizon of at least 10 years.
 3. Competent authorities shall ensure that institutions test their resilience to long-term negative impacts of ESG factors, both under baseline and adverse scenarios within a given timeframe, starting with climate-related factors. For the testing, competent authorities shall ensure that institutions include a number of ESG scenarios reflecting potential impacts of environmental and social changes and associated public policies on the long-term business environment. Competent authorities shall ensure that for the testing institutions use credible scenarios, based on the scenarios elaborated by international organisations.
 4. Competent authorities shall assess and monitor developments of institutions' practices concerning their ESG strategy and risk management, including the plans, quantifiable targets and processes to monitor and address the ESG risks arising in the short, medium and long-term, to be prepared in accordance with Article 76(2). This assessment shall take into account the institutions' sustainability related product offering, their transition finance policies, related loan origination policies,

and ESG related targets and limits. Competent authorities shall assess the robustness of those plans as part of the supervisory review and evaluation process.

Where relevant, for the assessment referred to in the first subparagraph, Competent authorities may cooperate with authorities or public bodies in charge of climate change and environmental supervision.

7. To foster robust risk management practices and ensure convergence across the Union, the EBA has been empowered in Article 87a(5) of the CRD to issue Guidelines to specify:
 - a) minimum standards and reference methodologies for the identification, measurement, management and monitoring of ESG risks;
 - b) the content of plans to be prepared in accordance with Article 76(2) of the CRD, which shall include specific timelines and intermediate quantifiable targets and milestones, in order to monitor and address the financial risks stemming from ESG factors, including those arising from the process of adjustment and transition trends towards the relevant Member States and Union regulatory objectives in relation to ESG factors, in particular the objective to achieve climate neutrality by 2050 as set out in Regulation (EU) 2021/1119, as well as, where relevant for internationally active institutions, third country legal and regulatory objectives;
 - c) qualitative and quantitative criteria for the assessment of the impact of ESG risks on the risk profile and solvency of institutions in the short, medium and long term;
 - d) criteria for setting the scenarios referred to in paragraph 3 of Article 87a of the CRD, including the parameters and assumptions to be used in each of the scenarios, specific risks and time horizons.
8. These guidelines address the aspects included in letters a, b and c of the mandate entrusted to the EBA. Letter d of the mandate will be addressed through a parallel update of the EBA guidelines on institutions' stress testing and/or the development of any other relevant guidelines.
9. These guidelines aim at enhancing the identification, measurement, management and monitoring of ESG risks by institutions and at supporting their safety and soundness as they are confronted with the short, medium and long-term impact of ESG factors. The guidelines contain requirements as to the internal processes and ESG risks management arrangements that institutions should have in place, including specific plans to address the risks arising from the transition and process of adjustment to relevant sustainability legal and regulatory objectives.
10. The guidelines include minimum reference methodologies to be developed and used by institutions to measure ESG risks. Acknowledging the continuous progress in the availability and development of ESG risks data and methodologies, focus is on the main features of key types of

methodologies, whilst flexibility is left to institutions regarding specific details, also to facilitate the development of institutions' own methodologies over time.

3.3 CRD-based (transition) plans

11. The long-term nature and the profoundness of the transition process towards a climate-neutral and sustainable economy may entail significant changes in the business models of institutions and in the types and levels of risks they are confronted with. As a result, according to Article 76(2) of the CRD, institutions shall set out specific plans to monitor and address the financial risks arising from the transition and process of adjustment to the relevant Member States and Union regulatory objectives in relation to ESG factors, as well as, where relevant for international active institutions, third country objectives. Article 87a(5) subparagraph 2 of the CRD also states that, where relevant, the methodologies and assumptions sustaining the targets, the commitments and the strategic decisions disclosed publicly by institutions under Directive 2013/34/EU², or other relevant disclosure and due diligence frameworks, shall be consistent with the criteria, methodologies, assumptions, and targets used in the plans to be prepared in accordance with the CRD.
12. Several EU legislative initiatives such as the Corporate Sustainability Reporting Directive³ (CSRD) and the proposal for a Corporate Sustainability Due Diligence Directive⁴ (CSDDD) also include provisions related to plans, commonly called transition plans, that should be disclosed and/or developed by sets of non-financial and financial corporates to ensure that their business model and strategy are compatible with the transition. In addition, the European Commission's (EC) recommendation of June 2023 on facilitating finance for the transition to a sustainable economy⁵ includes non-binding recommendations to undertakings on the use of transition plans. These guidelines deal with CRD-based plans and provide a common understanding of what a risk-based (transition) plan entails in the prudential space, while ensuring interoperability with other legislative initiatives and EC's recommendations to the largest possible extent.
13. Plans under non-prudential regulations, such as CSRD and CSDDD, focus on the compatibility of business models of undertakings with the 1.5-degree pathway and the objective of the EU to achieve net-zero greenhouse gas emissions by 2050 or on the due diligence policies, processes and activities conducted to identify and address actual or potential adverse impacts from institutions' activities. Plans under CRD on the other hand are focused on (prudential) risks; they constitute a new risk management tool through which institutions should understand, assess

² Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings

³ Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting.

⁴ Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937.

⁵ Commission Recommendation (EU) 2023/1425 of 27 June 2023 on facilitating finance for the transition to a sustainable economy - <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32023H1425>

and manage the risks stemming from their activities and exposures in view of the process of adjustment towards the regulatory sustainability objectives of the jurisdictions they operate in, or broader transition trends towards a sustainable economy. In the EU, relevant objectives related to ESG factors include the climate targets for 2030 and 2050 included in the European Climate Law⁶, i.e. respectively the reduction of the level of greenhouse gas emissions by 55% compared to 1990 and achieving net-zero emissions.

14. These guidelines do not require CRD-based plans to set out an objective of fully aligning with Member States or Union sustainability objectives or one specific transition trajectory. CRD-based prudential plans aim at ensuring that institutions comprehensively assess and embed forward-looking ESG risks considerations in their strategies, policies and risk management processes, including by taking a long-term perspective and with a view to ensuring their soundness and resilience to the risks faced. Hence, the goal, focus and contents of CRD-based (transition) plans may have some specificities compared to non-prudential transition plans. At the same time, by incentivizing institutions to develop their understanding of, and strategic response to, (prudential) risks arising from the transition process, the elaboration of plans under CRD may also support institutions in addressing other requirements, such as CSDDD requirements and CSRD disclosure requirements on business strategies and transition plans. As recognized by the EC's recommendation on transition finance, sound transition planning can help undertakings minimise the strategic and financial risks associated with the transition and provide clarity on their business strategy.
15. It is also important to bear in mind that the goal of prudential plans is not to force institutions to exit or divest from carbon intensive sectors but rather to stimulate institutions to proactively reflect on technological, business and behavioral changes driven by the sustainable transition, the risks and opportunities they entail, and prepare or adapt accordingly through structured transition planning, including by engaging with and where needed supporting their clients, notwithstanding other mitigation actions consistent with sound risk management.
16. Moreover, CRD-based plans are closely related to the policy proposals included in the EBA report on ESG risks management and supervision⁷, which recommended institutions to integrate ESG risks into their processes, including by extending the time horizon for strategic planning to at least 10 years, at least qualitatively, and by testing their resilience to different scenarios.
17. Against this background, CRD-based (transition) plans, or prudential (transition) plans, can be understood as the overview and articulation of the strategic actions and risk management tools deployed by institutions, based on a forward-looking business environment analysis, to demonstrate how an institution ensures its robustness and preparedness for the transition towards a climate and environmentally resilient and sustainable economy. Prudential (transition) plans aim at ensuring that institutions identify, measure, manage and monitor ESG

⁶ Regulation (EU) 2021/1119 of the European Parliament and of the Council of 30 June 2021 establishing the framework for achieving climate neutrality and amending Regulations (EC) No 401/2009 and (EU) 2018/1999 ('European Climate Law')

⁷ EBA report on management and supervision of ESG risks for credit institutions and investment firms (EBA/REP/2021/18)

risks, in particular environmental transition and physical risks, over long-time horizons, including through setting targets and milestones at regular time intervals. These plans should be embedded in the institutions' strategy and risk management and address the risks arising from the structural changes that may occur within the industries and counterparties institutions are exposed to, according to the transition pathways and adaptation frameworks compatible with the legal and regulatory objectives of the Member States, EU, and where relevant other jurisdictions in which they operate.

18. These guidelines refer to transition planning as the internal strategic and risk management processes undertaken by institutions to prepare for a transition to a more sustainable economy and implement their transition-related strategy.
19. Acknowledging 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, these guidelines focus on processes and principles with an overview of the main features and core expectations of sound risk-based prudential (transition) plans while leaving flexibility and responsibility to institutions as to specific details and individual internal strategies.

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?

3.4 Proportionality

20. The guidelines have been drafted taking into account the proportionality principle set out in Article 87a(2) of the CRD. Since these guidelines cover internal governance and risk management arrangements of institutions, including CRD-based prudential (transition) plans, they will apply in accordance with the general principle of proportionality applicable to internal governance and risk management arrangements, as laid out in Title I of the EBA guidelines on internal governance⁸.
21. The guidelines take into account that smaller institutions may not be immune to ESG risks, for example due to potential concentrations of exposures in ESG-sensitive economic sectors or geographical areas prone to physical risks. All institutions should therefore implement ESG risks management approaches that reflect the materiality of ESG risks associated with their business model and scope of activities.
22. These guidelines establish in Section 4.1 that institutions should rely on their materiality assessments of ESG risks to design and implement proportionate strategies, policies, processes and systems. These guidelines also take into account that small and non-complex institutions (SNCI) may implement less complex or sophisticated arrangements, such as through a higher

⁸ EBA Guidelines on internal governance under Directive 2013/36/EU (EBA/GL/2021/05)

extent of qualitative considerations and/or estimates and proxies as well as less numerous and less granular methodologies, provided that this does not put at risk their ability to manage ESG risks in a sufficiently safe and prudent manner and in line with their materiality assessment.

23. All references to institutions should be understood as encompassing both SNICs and other institutions, unless the guidelines introduce differentiated specific provisions.

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

3.5 Environmental risks and ESG risks

24. As reflected in the CRD provisions and in line with the sequenced approach adopted under other EBA regulatory products on ESG risks such as the Implementing Technical Standards on Pillar 3 disclosures, the guidelines put emphasis on environmental risks while still containing some minimum requirements on the remaining categories of ESG risks.

25. While institutions are more advanced on the measurement and assessment of climate-related risks, it is important that institutions progressively develop tools and practices that aim at 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 factors⁹.

26. In addition, it should be kept in mind that institutions can be impacted by (so-called 'financial materiality') or have an impact on (so-called 'environmental and social materiality') environmental and social risks through their core business activities, i.e. their lending to counterparties and their investments in assets. On the financial materiality side, the economic and financial activities of counterparties or invested assets can be negatively impacted by environmental or social factors, affecting the value of such activities which might translate into a financial impact on the institution. On the environmental and social materiality side, the economic and financial activities of counterparties or invested assets can have a negative impact on environmental and social factors, which could in turn translate into financial impact on the institution. The assessment and management of environmental and social risks should take both of these dimensions into account to the extent that they affect the financial risks institutions are exposed to.

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

⁹ Annex 1 of EBA Report on management and supervision of ESG risks provides a non-exhaustive list of ESG factors (EBA/REP/2021/18)

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.

3.6 Articulation with international developments and other EBA products

27. The guidelines build on existing EU and international requirements and/or principles on the management of ESG risks, such as the BCBS principles for the effective management and supervision of climate-related financial risks. They also take into account the analysis performed and recommendations included in the EBA Report on ESG risks management and supervision, guidance published by supervisors or networks of central banks such as the Network for Greening the Financial System, as well as supervisory experience regarding institutions' practices on the management of climate and environmental risks.
28. The guidelines are consistent with and include cross-references to other EBA guidelines or standards referring to ESG risks, such as EBA guidelines on loan origination and monitoring with respect to integration of ESG risks in credit risk policies, EBA guidelines on internal governance with respect to integration of ESG risks in governance arrangements, and EBA implementing technical standards on Pillar 3 disclosure of ESG risks with respect to ESG risks metrics. In addition, based on the updated version of the CRD, the EBA will introduce and/or strengthen ESG risks considerations when updating its guidelines on institution's stress testing, guidelines on internal governance and guidelines on remuneration policies. These updates will be done in a way that ensures consistency with these (new) guidelines on ESG risks management, complementing them in specific areas such as the responsibilities of the management body or the integration of ESG risks into institutions' remuneration frameworks.
29. These guidelines are part of EBA's mandates and tasks in the area of sustainable finance and ESG risks which cover the three pillars of the banking supervisory framework as well as other areas related to sustainable finance and the assessment and monitoring of ESG risks, as laid out in the EBA's roadmap on sustainable finance¹⁰.

¹⁰ [EBA roadmap on sustainable finance](#)

4. Guidelines

In between the text of the draft Guidelines that follows, specific questions for the consultation process appear in framed text boxes.

EBA/GL/20XX/XX

DD Month YYYY

Draft Guidelines on the management of ESG risks

1. Compliance and reporting obligations

Status of these guidelines

1. This document contains guidelines issued pursuant to Article 16 of Regulation (EU) No 1093/2010¹¹. In accordance with Article 16(3) of Regulation (EU) No 1093/2010, competent authorities and financial institutions must make every effort to comply with the guidelines.
2. Guidelines set the EBA view of appropriate supervisory practices within the European System of Financial Supervision or of how Union law should be applied in a particular area. Competent authorities as defined in Article 4(2) of Regulation (EU) No 1093/2010 to whom guidelines apply should comply by incorporating them into their practices as appropriate (e.g. by amending their legal framework or their supervisory processes), including where guidelines are directed primarily at institutions.

Reporting requirements

3. According to Article 16(3) of Regulation (EU) No 1093/2010, competent authorities must notify the EBA as to whether they comply or intend to comply with these guidelines, or otherwise with reasons for non-compliance, by [dd.mm.yyyy]. In the absence of any notification by this deadline, competent authorities will be considered by the EBA to be non-compliant. Notifications should be sent by submitting the form available on the EBA website with the reference 'EBA/GL/202x/xx'. Notifications should be submitted by persons with appropriate authority to report compliance on behalf of their competent authorities. Any change in the status of compliance must also be reported to EBA.
4. Notifications will be published on the EBA website, in line with Article 16(3).

¹¹ Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC, (OJ L 331, 15.12.2010, p.12).

2. Subject matter, scope and definitions

Subject matter and scope of application

5. These guidelines specify robust governance arrangements institutions need to have in place in accordance with Articles 87a(1) and 74 of Directive 2013/36/EU¹², and cover:
 - (a) minimum standards and reference methodologies for the identification, measurement, management and monitoring of environmental, social and governance risks, in accordance with Article 87a(5)a) of that Directive;
 - (b) qualitative and quantitative criteria for the assessment of the impact of environmental, social and governance risks on the risk profile and solvency of institutions in the short, medium and long term, in accordance with Article 87a(5)c) of that Directive;
 - (c) the content of plans to be prepared in accordance with Article 76(2) of that Directive by the management body, which shall include specific timelines and intermediate quantifiable targets and milestones, in order to monitor and address the financial risks stemming from ESG factors, including those arising from the process of adjustment and transition trends towards the relevant Member States and Union regulatory objectives in relation to ESG factors, in particular the objective to achieve climate neutrality by 2050 as set out in Regulation (EU) 2021/1119, as well as, where relevant for international active institutions, third country legal and regulatory objectives, in accordance with Article 87a(5)b) of that Directive.
6. These guidelines address the environmental, social and governance risks management processes of institutions as part of their broader risk management framework. They apply in relation to the robust strategies, policies, processes and systems for the identification, measurement, management and monitoring of environmental, social and governance risks over the short, medium and long term that institutions subject to Directive 2013/36/EU shall have as part of their robust governance arrangements including risk management framework required under Article 74(1) of Directive 2013/36/EU. These guidelines also complement and further specify EBA guidelines on internal governance¹³ and EBA guidelines on Loan Origination and Monitoring¹⁴ in relation to the management ESG risks.
7. Competent authorities and institutions should apply these guidelines in accordance with the level of application set out in Article 109 of Directive 2013/36/EU.

¹² Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338). The present consultation paper is based on the text of the Provisional agreement on the banking package published on the Council's website on 6 December 2023: [Banking sector: Provisional agreement reached on the implementation of Basel III reforms](#).

¹³ EBA Guidelines on internal governance under Directive 2013/36/EU (EBA/GL/2021/05)

¹⁴ EBA Guidelines on loan origination and monitoring (EBA/GL/2020/06)

Addressees

8. These guidelines are addressed to competent authorities as defined in Article 4(2) point (i) of Regulation (EU) No 1093/2010 and to financial institutions as defined in Article 4(1) of Regulation No 1093/2010.

Definitions

9. Unless otherwise specified, terms used and defined in Directive 2013/36/EU and Regulation 575/2013/EU have the same meaning in these guidelines.

3. Implementation

Date of application

10. These guidelines apply from [*tbc – date to be aligned with the date of application of the amended Directive 2013/36/EU*]

4. Reference methodology for the identification and measurement of ESG risks

4.1 Materiality assessment

11. As part of the reference methodology for institutions' identification and measurement of Environmental, Social and Governance (ESG) risks to be included in their strategies and internal procedures, institutions should provide for regular performance of a materiality assessment of ESG risks. That assessment should be performed at least every year or, for small and non-complex institutions (SNCI), every two years or more frequently in case of a material change to their business environment in relation to ESG factors, such as significant new public policies or shifts in the institution's business model, portfolios and operations.
12. The ESG risks materiality assessment should be performed as an institution-specific assessment which should consider the potential effects of ESG risks on all conventional financial risk categories to which institutions are exposed, including credit, market, liquidity, operational, reputational, business model and concentration risks. ESG risks materiality assessments should provide institutions with a view on the financial materiality of ESG risks for their business model and risk profile. They should be consistent with and integrated into other materiality assessments conducted by institutions, such as those made for the purpose of the Internal Capital Adequacy Assessment Process (ICAAP).
13. Institutions' internal procedures should provide for assessing the materiality of ESG risks across short (i.e. less than 3 years), medium (3 to 5 years) and long-term time horizons, including a time horizon of at least 10 years.
14. With a view to comprehensively capturing potential impacts of ESG risks, inputs and factors considered in the materiality assessment should include at least the following:
 - a) the consideration and use of both qualitative and quantitative elements and data;
 - b) the assessment of the impact of ESG risks on the most significant activities, services and products;
 - c) with regard to environmental risks, the assessment of both transition and physical risk drivers, including through a review of the main economic sectors that assets being financed support or that the institution's counterparty has as its principal activity, and geographical areas in which collaterals are located. The assessment of transition risk drivers should take into account changes in policies, technologies and market preferences, as well as the extent to which institutions' most critical counterparties or, 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.

15. The materiality assessment should use a risk-based approach that takes into account the likelihood and the severity of the materialisation of the risks.
16. Institutions should at least consider their exposures towards sectors that highly contribute to climate change as specified in Recital 6 of Commission Delegated Regulation (EU) 2020/1818 i.e. the sectors listed in Sections A to H and Section L of Annex I to Regulation (EC) No 1893/2006¹⁵ as materially subject to environmental transition risks.
17. By way of derogation from paragraph 16, institutions may consider some of the sectoral exposures referred to in paragraph 16 as not materially subject to environmental risks provided that they are able to justify it, such as when those sectoral exposures show a high level of alignment with Regulation 2020/852 (EU taxonomy)¹⁶.
18. Institutions should document as part of their ICAAP their ESG risks materiality assessments, including methodologies and thresholds used, inputs and factors considered and main results and conclusions reached.

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

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.

4.2 Identification and measurement of ESG risks

19. As part of minimum standards to identify and measure ESG risks to which institutions are exposed, institutions should include in their internal procedures the identification, collection,

¹⁵ Commission delegated regulation (EU) 2020/1818 supplementing regulation (EU) 2016/1011 as regards minimum standards for EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks - Climate Benchmark Standards Regulation - Recital 6: Sectors listed in Sections A to H and Section L of Annex I to Regulation (EC) No 1893/2006

¹⁶ Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088, and, where applicable, information published by institutions as part of Pillar 3 disclosures on ESG risks (in particular, column "of which environmentally sustainable" in template 1, as well as templates 7 and 8 of Commission Implementing Regulation (EU) 2022/2453)

structuring and analysis of the necessary data and information. Institutions should regularly review and seek to improve their practices in this area, leveraging on private and public-led efforts related to ESG risks' data availability and measurement.

4.2.1 Data processes

20. Institutions' internal procedures should provide for the implementation of sound systems to collect and aggregate ESG risks-related data across the institution as part of the overall data governance and IT infrastructure and should have in place arrangements to assess and improve ESG data quality.
21. Institutions' internal procedures should first build on available ESG data, including by regularly reviewing and making use of sustainability information disclosed by their counterparties, in particular in accordance with the Directive 2013/34/EU¹⁷ or made available by public bodies.
22. Institutions' internal procedures should include the implementation of an approach to engage with their clients and counterparties as part of their new and existing business relationships with a view to capturing relevant ESG-related information, such as by designing specific questionnaires to be filled out at the time of credit origination and during periodic reviews, taking into account the size, complexity and ESG profile of their counterparties.
23. 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:
 - a. For environmental risks:
 - i. geographical location of key assets and exposure to environmental hazards (e.g. floods, water stress, soil erosion) at the level of granularity needed for appropriate physical risk analysis,
 - 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,

¹⁷ Directive 2013/34/EU as amended by Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 as regards corporate sustainability reporting (Corporate Sustainability Reporting Directive)

- vi. energy performance certificates and score in kWh/m² for real estate exposures,
- vii. adherence to voluntary or mandatory climate and environmental reporting,
- viii. litigation risk including imminent, pending or completed litigation case related to environmental issues,
- ix. forward-looking adaptive capacity, including transition plans prepared by non-financial corporates in accordance with Article 19(a) or Article 29(a) of Directive (EU) 2022/2464, where applicable.

b. For social and governance risks:

- i. compliance with and due diligence on social standards, such as ILO fundamental conventions or World Bank's Environmental and Social Standards,
- ii. governance practices,
- iii. adherence to voluntary or mandatory social and governance reporting,
- iv. negative impact on local communities, including due diligence policies to prevent that,
- v. litigation risks including imminent, pending or completed litigation case related to social or governance issues and due diligence policies.

24. Institutions should consider the list provided in paragraph 23 when determining the data points needed for the identification and measurement of ESG risks for other types of counterparties than large corporates.

25. Where data from counterparties and public sources is not available or has shortcomings in light of risk management needs, institutions should assess these gaps and their potential impacts. Institutions should take and document remediating actions, including at least the following measures:

- a) using estimates or proxies as an intermediate step, and seeking to reduce their use over time as ESG data availability and quality improve;
- b) assessing the need to use services of third-party providers to gain access to ESG data, while ensuring sufficient understanding of the sources, data and methodologies used by data providers and performing regular quality assurance.

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

4.2.2 Measurement and assessment principles

26. Institutions' internal procedures should include tools, methodologies and capabilities to:
- a) identify ESG risk drivers and their transmission channels to prudential risk types and financial risk metrics via the institution's exposures;
 - b) map exposures and/or portfolios according to ESG risk drivers, and any concentration within or between them,
 - c) measure and manage material ESG risks including with a forward-looking perspective.
27. Institutions' internal procedures should provide for a combination of methodologies, including exposure-based, portfolio-based, and scenario-based methodologies, as set out in paragraphs 30 to 39. The combination of the methodologies should be put together in a way that allows institutions to comprehensively assess ESG risks across time horizons. In particular, institutions should use the exposure method to obtain a short-term view of how ESG risks are impacting the credit risk profile and the profitability of counterparties, use the portfolio-based methods and scenario-based methods to support the medium term planning process and the definition of risk limits and risk appetite steering the institution towards its strategic objectives, and assess through scenario-based methods their sensitivities to ESG risks across different including long time horizons.
28. 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.
29. With regard to social and governance risks, where quantitative information is lacking, institutions' internal procedures should provide for a method that starts by evaluating qualitatively the potential impacts of these risks on the operations of, and financial risks faced by, the institution, and gradually develop quantitative measures.

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

4.2.3 Main features of reference methodologies for the identification and measurement of ESG risks

a. Exposure-based

30. At an exposure-based level, in line with the provisions in paragraphs 126 and 146 of the EBA Guidelines on loan origination and monitoring¹⁸, institutions should have internal procedures

¹⁸ EBA Guidelines on loan origination and monitoring (EBA/GL/2020/06)

in place to assess the exposure of their counterparties' activities and key assets to ESG factors, in particular environmental factors and the impact of climate change, and the appropriateness of the mitigating actions. To this end, institutions should ensure that ESG factors, in particular environmental factors, are properly reflected into their internal risk classification procedures, are taken into account in the overall assessment of default risk of a borrower and, where justified by their materiality, embedded in the risk indicators, internal credit scoring or rating models, as well as the valuation of collateral.

31. To conduct the assessment of environmental risks at exposure level, institutions' internal procedures should include a set of risk factors and criteria that capture both physical and transition risk drivers, including, where applicable, at least the following:
 - a) the degree of vulnerability to acute and chronic physical risks, taking into account the geographical location and exposure to environmental hazards of the key assets of counterparties and guarantors or of the physical collateral backing the exposures, considering both on-balance sheet (loans and tangible assets) and off-balance sheet (guarantees) exposures;
 - b) the degree of vulnerability to transition risks, considering the relevance of technological developments and environmental regulations applicable or foreseeable to the sector of activity of the counterparty, as well as the current and forecasted GHG emissions in absolute and/or intensity of assets, or energy performance in the case of residential or commercial real estate exposures;
 - c) the likelihood of critical disruptions to the business model and/or supply chain of the counterparty due to environmental factors such as the impact of biodiversity loss, water stress or pollution;
 - d) the (planned) maturity or term structure of the exposure or asset;
 - e) mitigation opportunities, such as private or public insurance coverage for example based on available national catastrophe schemes or similar frameworks, adaptive capacity and transition planning of the counterparty.
32. Where data needed to assess certain criteria is not yet available, such as for smaller corporate counterparties, institutions should first seek to engage with clients to obtain the data or consider using sector-level characteristics as a first step and, when feasible, operate adjustments to account for counterparty-specific aspects.
33. With regard to the assessment of social and governance risks at exposure level, institutions should implement due diligence processes to verify the adherence of corporate counterparties to social and governance standards, taking into account the size of companies as well as applicable legislation and international principles (e.g. UN Guiding Principles on Business and Human Rights, OECD Guidelines for Multinational Enterprises, UN Convention

against corruption), and assess potential future social and governance risks over short-, medium- and long-term time horizons, e.g. from rising standards or more stringent policies.

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

b. Portfolio-based

34. At a portfolio level and with regard to climate-related risks, institutions' internal procedures should provide for the use of at least one portfolio alignment methodology, which refers to methods that seek to assess the degree of alignment of institution's portfolios with climate-related sustainability targets.
35. Institutions should implement one or more climate-related portfolio alignment methodologies which should enable the following steps:
 - a) measure the potential gap between existing portfolios and benchmark scenarios consistent with the climate target applicable to the respective portfolios, based on relevant legal and regulatory objective in the EU, in particular reaching net-zero GHG emissions by 2050 and reducing emissions by 55% compared to 1990 level;
 - b) assess the level of climate-related risks - in particular forward-looking transition risks - faced by their portfolios and related impacts on financial risks.
36. For the purposes of paragraphs 34 and 35, large institutions with securities traded on a regulated market of any Member State should measure the alignment of at least the following sectoral portfolios: power; fossil fuel combustion; automotive; aviation; maritime transport; cement, clinker and lime production; iron and steel, coke, and metal ore production, chemicals to the International Energy Agency (IEA) net zero emissions by 2050 scenario¹⁹, or any comparable scenario subsequently issued by the IEA. Other institutions should determine to which sectoral portfolios the alignment methodology should apply, in line with the characteristics of their portfolios and materiality assessment. SNCIs may use representative samples of exposures in their portfolios to undertake portfolio alignment assessments.
37. With regard to other (not climate-related) ESG factors, institutions should provide for additional methodologies at a portfolio-based level in their internal procedures, in particular heat maps that highlight ESG risks of individual economic (sub-)sectors in a chart or on a scaling system as referred to in paragraphs 127 and 149 of the EBA Guidelines on loan origination and monitoring.
38. In addition, large institutions should develop:

¹⁹ As per the Commission Implementing Regulation (EU) 2022/2453 of 30 November 2022 amending the implementing technical standards laid down in Implementing Regulation (EU) 2021/637 as regards the disclosure of environmental, social and governance risks, the outcomes of these assessments should be disclosed as part of Pillar 3 disclosures.

- a) methods to identify natural capital dependencies, as part of analyses of nature-related or biodiversity risks;
- b) 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-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.

c. Scenario-based

39. Institutions should perform climate/environmental scenario-based analyses, as set out in [*to insert reference to future EBA Guidelines addressing letter d of the mandate under article 87a(5) of the CRD²⁰*].

²⁰ The EBA will be updating its guidelines on institutions' stress testing and/or developing any other relevant guidelines to fulfill letter d of the mandate under article 87a(5) of the CRD. It is expected that the final guidelines on ESG risks management will make reference to this updated version of the guidelines on institutions' stress testing and/or to any other relevant guidelines to specify how institutions should perform environmental-based scenario analyses.

5. Minimum standards and reference methodology for the management and monitoring of ESG risks

5.1 ESG risks management principles

40. For the purposes of integrating ESG risks in the institution-wide risk management framework in accordance with paragraph 152 of EBA Guidelines on Internal Governance²¹, institutions should consider the role of ESG risks as potential drivers of all traditional categories of financial risks, including credit, market, operational, reputational, liquidity, business model, and concentration risks.
41. Institutions should embed ESG risks within their regular risk management systems and processes ensuring consistency with their overall business and risk strategies, including plans in accordance with Article 76(2) of Directive 2013/36, as further specified in Section 6, and a fully integrated approach where ESG risks are properly captured and considered as part of risk management strategies, policies and limits. Where institutions have in place specific arrangements for ESG risks, they should ensure this is reflected and feeds into the regular risk management framework.
42. Based on their identification and measurement of ESG risks and the assessment of vulnerabilities and mitigation needs, institutions should develop a robust and sound approach to managing and mitigating ESG risks over the short, medium and long term, including a time horizon of at least 10 years. Institutions should determine which risk management and mitigation tool(s) would best contribute to this, by considering a range of tools, including at least the following:
- a) engagement with counterparties aiming at improving their ESG risk profile, in particular by:
 - i. reviewing most important and most critical counterparties', or, in the case of significant SME or real estate portfolios, average of counterparties' activities and positioning in relation to ESG factors and trends;
 - ii. asking for and assessing the soundness of at least large corporate counterparties' transition plans;

²¹ EBA Guidelines on internal governance under Directive 2013/36/EU (EBA/GL/2021/05)

- iii. assessing large counterparties' processes to avoid and/or mitigate green-washing risk;
 - iv. encouraging counterparties to mitigate and disclose ESG risks;
- b) adjusting financial terms (e.g. including contractually agreed safeguards and corrective measures), conditions (e.g. tenor) and/or pricing based on ESG risks considerations and the institution's risk strategy and internal capital policy;
 - c) embedding ESG risks within global, regional and sectoral risk limits, exposure limits and deleveraging strategies;
 - d) diversification of lending and investments portfolios based on ESG-relevant criteria e.g. in terms of economic sectors or geographical areas,
 - e) other risk management tools deemed appropriate in line with institution's risk appetite, such as possible reallocation of financing between and within sectors towards exposures with a better ESG risk profile.

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

5.2 Strategies and business models

43. Institutions should account for ESG risks when developing, formulating and implementing their overall business and risk strategies, which should include at least:
- a) understanding and assessing the business environment in which they operate, and how they are exposed to structural changes in the economy, financial system, and competitive landscape over the short, medium and long term as a result of ESG factors;
 - b) understanding and assessing how ESG risks, in particular environmental risk drivers including transition and physical risks, can have an adverse impact on the viability of their business model and sustainability of their business strategy, including profitability and revenue sources, over the short, medium and long term;
 - c) considering how these ESG risks, in particular environmental risk drivers including transition and physical risks, may affect their ability to achieve their strategic objectives and remain within their risk appetite;
 - d) formulating and monitoring ESG risk-related strategic objectives and related Key Performance Indicators (KPIs) as part of their plans as set out in Section 6, including by considering metrics listed in Section 6.3.

44. For the purposes of paragraph 43 and with a view to ensuring sufficiently informed strategies, institutions should consider insights gained from:
- a) Portfolio alignment methodologies, as described in Section 4.2;
 - b) Environmental scenario analyses, taking into account the (potential) business environment(s) in which they might be operating in the short, medium and long term, including over a time horizon of at least 10 years;
 - c) Climate or environmental stress-tests, in line with paragraphs 30 and 31 of EBA Guidelines on institutions' stress testing²².
45. Institutions should have a comprehensive understanding of their business model, strategic objectives and risk strategy from an ESG perspective and should ensure that their governance and risk management frameworks, including risk appetite, are adequate to implement them.

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

5.3 Risk appetite

46. Institutions should ensure that their risk appetite clearly defines and addresses all material ESG risks to which they are exposed. The risk appetite should specify the type and extent of the ESG risks institutions are willing to assume in their portfolio composition in relation to all relevant business lines, geographies - including jurisdictions and more granular geographical areas, economic sectors, activities and products, including as regards the portfolio's concentration and diversification objectives.
47. The risk appetite should be implemented with the support of appropriate ESG-related key risk indicators (KRIs), including potential limits, thresholds or exclusions. These KRIs should anchor ESG considerations in relation to products or financial instruments issued, originated or held by the institution, client segments, type of collateral and risk mitigation instruments. To this end, institutions should at least consider the metrics listed in Section 6.3. Institutions should use backward-looking and forward-looking indicators tailored to their business model and complexity.
48. Institutions should ensure that the risk appetite and associated KRIs are appropriately cascaded down within the institution, including all relevant group entities and business lines and units bearing risk, and are subject to monitoring and escalation processes as set out in section 5.8.

²² EBA Guidelines on institutions stress testing (EBA/GL/2018/04)

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

5.4 Internal culture, capabilities and controls

49. Institutions should develop on an on-going basis their capabilities to identify, assess, mitigate as appropriate and monitor ESG risks. Institutions should ensure, as part of their training policy, that their management body and staff are adequately trained to understand implications of ESG factors and risks with a view to fulfilling their responsibilities effectively. The procedures on training for managers should take into account that knowledge of ESG factors and risks is relevant for the assessment of the suitability of members of the management body and for Key Function Holders in line with the Joint EBA and ESMA Guidelines on suitability assessments²³.
50. The sound and consistent risk culture that accounts for ESG risks implemented within the institution in accordance with Title IV of the EBA Guidelines on internal governance²⁴ should include clear communication from the management body ('tone from the top') and appropriate measures to promote knowledge of ESG factors and risks across the institution, as well as awareness of the institution's ESG strategic objectives and commitments.
51. For the purposes of Title V of the EBA Guidelines on internal governance²⁵, institutions should incorporate ESG risks into their internal control frameworks across the three lines of defense. The internal control framework should include a clear definition and assignment of ESG risks responsibilities and reporting lines.
52. The first line of defense should be responsible for undertaking ESG risks assessments, taking into account materiality and proportionality considerations, during the client onboarding, credit application and credit review processes, and in ongoing monitoring and engagement with clients as well as in new product or business approval processes. Staff in the first line of defense should have adequate awareness and understanding to identify potential ESG risks.
53. As part of the activities of the second line of defense,
- a) the risk management function should be responsible for undertaking ESG risks assessment and monitoring independently from the first line of defense, including by ensuring adherence to the risk limits, questioning and where necessary challenging the initial assessment conducted by business relationships officers;

²³ Joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders under Directive 2013/36/EU and Directive 2014/65/EU (EBA/GL/2021/06)

²⁴ Title IV – Risk culture and business conduct

²⁵ Title V – Internal control framework and mechanisms

- b) the compliance function should ensure adherence to applicable ESG risks rules and regulations and should, in relation to the sustainability commitments made by the institution and the respective policies set, provide advice on the operational - including legal, reputational and conduct risks associated with the implementation or failure to implement such commitments,
 - c) the compliance function and the risk management function should be consulted for the approval of new products with ESG features or for significant changes to existing products to embed ESG aspects.
54. As third line of defense, the internal audit function (IAF) should provide an independent review and objective assurance of the quality and effectiveness of the overall internal control framework and systems in relation to ESG risks, including the first and second lines of defense and the ESG risks governance framework.

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

5.5 Internal Capital Adequacy Assessment Process and Internal Liquidity Adequacy Assessment Process

55. Based on their evaluation of the short, medium and long-term solvency or liquidity impact of ESG risks, institutions should incorporate material effects of ESG risks into their ICAAP and internal liquidity adequacy assessment processes (ILAAP) under both the economic and regulatory perspectives to assess and maintain on an ongoing basis the amounts, types and distribution of internal capital and liquidity that they consider adequate to cover the nature and level of ESG risks.
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.
57. Institutions should build on their risk assessment methodologies, including those referred to in Section 4.2, to identify and measure internal capital needs for individual exposures or portfolios assessed as more vulnerable to ESG risks.
58. With regard to environmental risks, institutions should include in their ICAAP a forward-looking view of their capital adequacy under an adverse scenario that includes specific environmental risks elements. In addition, institutions should specify any changes to the institution's business plan or other measures derived from climate/environmental risks stress testing and/or reverse stress testing, in line with paragraph 90 of EBA Stress Testing Guidelines²⁶.

²⁶ EBA Guidelines on institutions stress testing (EBA/GL/2018/04)

Institutions should provide sufficient contextual information to understand their analysis of the capital and liquidity implications of environmental risks, including by providing clarity on methodologies used and underlying assumptions.

59. When integrating ESG risks in their ICAAP and ILAAP, the complexity of the processes and the degree of sophistication of the methodologies used by institutions should take into account their size and complexity, their materiality assessment as well as the differing levels of availability and maturity of quantification methodologies for environmental risks compared to social and governance risks.

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

5.6 Credit risk policies and procedures

60. For the purposes of integrating ESG risks in credit risk policies and procedures as set out in paragraph 56 of the EBA Guidelines on loan origination and monitoring²⁷, institutions should ensure prudent and clear processes to identify, measure, manage, mitigate and monitor the impacts of ESG risks.
61. Institutions should develop and implement quantitative credit risk metrics with regard to environmental risks, in accordance with their risk appetite and covering most significant client segments, type of collaterals and risk mitigation instruments.
62. Institutions should ensure their credit sectoral policies, reflecting ESG risks, are cascaded down to clear origination criteria available to business lines and business relationships officers.

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

5.7 Policies and procedures for market, liquidity and funding, operational, reputational and concentration risks

63. Institutions should understand the current and potential future impact of ESG risks on the valuation of their positions subject to market risk, in particular for prudent valuation purposes, on their liquidity risk profile and buffers, and on their operational including liability risks, and reputational risks, including through the use of forward-looking analyses.

²⁷ EBA Guidelines on loan origination and monitoring (EBA/GL/2020/06)

64. With respect to market risk, institutions should assess how ESG risks could affect the value of the financial instruments in their portfolio, evaluate the potential risk of losses on their portfolio and increased volatility in their portfolio's value, and establish effective processes to control or mitigate the associated impacts as part of their market risk management framework including where needed setting of internal limits for positions or client exposures.
65. With respect to liquidity and funding risk, institutions should assess how ESG risks could affect net cash outflows (e.g. increased drawdowns of credit lines) or the value of assets comprising their liquidity buffers and, where appropriate, incorporate these impacts into the calibration of their liquidity buffers or their liquidity risk management framework. In addition, institutions should assess how ESG risks could affect the availability and/or stability of their funding sources and take these risks into account in their management of funding risk, including by considering different time horizons and both normal and adverse conditions, which should reflect among others the potential impacts of ESG-related reputational risks, a situation of hampered or more expensive access to market funding and/or accelerated deposit withdrawals driven by ESG factors.
66. With respect to operational risk, institutions should assess how ESG risks could affect the different regulatory operational risk event types (internal fraud; external fraud; employment practices and workplace safety; clients, products, and business practice; damage to physical assets; business disruption and systems failures; execution, delivery, and process management) and their ability to continue providing critical operations, and should incorporate material ESG risks in their operational risk management framework. With regard to environmental risks, institutions should:
- a) identify and label losses related to environmental risks, as drivers of the loss type categories, in their operational losses registers;
 - b) use scenario analysis to determine how physical risk drivers can impact their business continuity; and
 - c) take material environmental risks into account when developing business continuity plans.
67. Furthermore, institutions should assess and manage the impact of ESG risks on conduct risks, litigation risks, and reputational risks, including by considering potential risks associated with lending to and investing in businesses which may be prone to ESG-related controversies. Institutions should have in place sound processes to identify, prevent and manage conduct, litigation or reputational risks resulting from greenwashing or perceived greenwashing practices taking into account the ESAs high-level principles set out in Section 2.1.2 of the EBA Progress Report on greenwashing monitoring and supervision²⁸. That should be done at both the institution (e.g. in relation to sustainability commitments perceived as misleading) and the

²⁸ EBA Progress report on greenwashing monitoring and supervision (EBA/REP/2023/16)

product or activity level (e.g. in relation to products and activities marketed as sustainable), including by monitoring legal developments, market practices, and controversies around alleged greenwashing practices. Institutions should also consider, where applicable, the reputational risks associated with the failure to deliver on their sustainability commitments or transition plans, or with the (perceived) lack of credibility of such commitments and plans.

68. With respect to concentration risk both in the trading and non-trading books, institutions should assess and manage the risks posed by concentrations of exposures, or where appropriate collaterals, in single counterparties, interdependent counterparties or in some industries, economic sectors, or geographic regions which may present a higher degree of vulnerability to ESG risks. To identify ESG-related concentration risks, institutions should consider the size or shares of their exposures that may be affected by ESG risks relative to total exposures. Institutions should take into account several ESG criteria amongst which GHG emissions, sectoral vulnerabilities, vulnerability of geographical areas to physical risks, and social or governance deficiencies or controversies identified in jurisdictions where exposures are located. Institutions should assess if and how ESG-related concentration risks aggravates prior financial vulnerability of exposures.

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?

5.8 Monitoring

69. Institutions should monitor ESG risks through effective internal reporting frameworks that convey appropriate information and aggregated data to senior management and the management body, such as by integrating ESG risks into the regular risk reports or in the form of dashboards containing metrics that support effective oversight.
70. Institutions should monitor ESG risks on a continuous basis and ensure that they maintain an institution wide as well as, for most significant portfolios, a portfolio view of their vulnerability to ESG risks. Institutions should implement granular and frequent monitoring of counterparties, exposures, and portfolios assessed as materially exposed to ESG risks, including through incorporating considerations on ESG risks into regular credit reviews for medium-sized and large counterparties and/or by increasing the frequency and granularity of these reviews due to ESG risks aspects.
71. Institutions should set early warning indicators and thresholds and should have in place strategies and plans to take mitigation actions in case limits are exceeded, including through adaptations to business strategy and risk management.

72. 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:
- a) Historical losses and forward-looking estimate(s) of exposures-at-risk and (potential) financial losses related to ESG risks, e.g. based on scenario-types methods;
 - b) Amount and share of income (interest, fee and commission) stemming from business relationships with counterparties operating in sectors that highly contribute to climate change in accordance with Recital 6 of Commission Delegated Regulation (EU) 2020/1818 i.e. the sectors listed in Sections A to H and Section L of Annex I to Regulation (EC) No 1893/2006. Large institutions should introduce more granular monitoring metrics, such as by calculating income stemming from relationships with the most carbon-intense counterparties and/or companies excluded from EU Paris-aligned Benchmarks²⁹;
 - c) A measure of the potential gap between existing portfolios and benchmark portfolios consistent with the climate target applicable to the respective portfolios based on relevant legal and regulatory objective, such as reaching net-zero GHG emissions by 2050, based on portfolio alignment methods described in Section 4.2 ;
 - d) Scope 3 emissions, i.e. GHG financed emissions, at least for sectors towards which the institution has material exposures, and based on clear and documented methodologies. Examples of methodologies to compute the carbon emission of companies include the Global GHG Accounting and Reporting Standard for the Financial Industry, developed by the Partnership for Carbon Accounting Financials, or the Carbon Disclosure Project;
 - e) The percentage of counterparties with whom the institution has engaged on ESG risks matters, e.g. in relation to their transition plans, at least for sectors and business lines which present material exposures to ESG risks, supplemented with information on the results and/or outcomes of such engagement;
 - f) 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, 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

²⁹ In accordance with points (d) to (g) of Article 12.1 and in accordance with Article 12.2 of Climate Benchmark Standards Regulation

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;

- g) A breakdown of portfolios secured by real estate according to the level of energy efficiency of the collaterals;
- h) A measure of concentration risk related to physical risk drivers (e.g. measurement of exposures and/or collaterals in high flood risks or wildfire risks areas), such as by using a sufficiently granular geographical split of exposures;
- i) Any ESG-related litigation claims in which the institution has been, is or may become involved based on available information;
- j) Progress against all institution's targets set in relation to ESG risks and ESG objectives, including as part of the institution's plan as referred to in section 6 or as part of other sustainability commitments made by the institution.

73. When data needed to compute metrics is missing, institutions should follow the steps set out in paragraph 25.

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

6. Plans in accordance with Article 76(2) of Directive 2013/36

6.1 Key principles

(i) Materiality assessment basis

74. The plans referred to in Article 76(2) subparagraph 2 of Directive 2013/36/EU should be based on a robust materiality assessment of ESG risks faced by institutions, conducted in accordance with Section 4.1. Institutions should in particular identify the exposures or portfolios, and the economic activities and production capacities being financed, which may be materially subject to ESG risks arising from the process of adjustment of the economy they operate in towards the applicable legal and regulatory objectives related to ESG factors.
75. For portfolios or exposures assessed as materially exposed to environmental risks, considering both transition and physical risks, institutions should set out dedicated transition planning aimed at addressing and mitigating risks in the short, medium and long term. While institutions should consider as materially subject to environmental risks their exposures towards certain sectors in accordance with paragraphs 16 and 17, they should use more granular information than solely sectoral classification to develop their risk assessment and transition planning.

(ii) Short-, medium- and long-time horizons and milestones

76. Institutions should establish a set of different time horizons as part of their plans which should include a long-term planning horizon of at least 10 years. In addition, institutions should set an intermediate milestone at 2030 to demonstrate how their plans enable them to identify and manage climate-related risks associated with the objective of the EU to reduce GHG emissions by 55% by that date compared to 1990 level.
77. Institutions should ensure that short, medium and long-term objectives and targets interact and are well-articulated. This includes ensuring that long-term objectives, such as commitments to achieve net-zero GHG emissions, translate into medium-term strategies (e.g. medium-term sectoral policies or growth targets for business lines) and that short-term financial metrics or targets (e.g. profitability indicators, cost of risk, KPIs, KRIs, risk limits, pricing frameworks³⁰) are coherent and consistent with the medium-term and long-term objectives.

³⁰ In accordance with section 6 of the EBA Guidelines on loan origination and monitoring (EBA/GL/2020/06)

(iii) Consistency of prudential plans with other processes and communications

78. Institutions should ensure that their plans are well integrated into the business strategies and that they are aligned and consistent with their risk and funding strategies, risk appetite, ICAAP, risk management framework and public communication, and include actions with regard to the business model and strategy of the institution that are consistent with the plans disclosed pursuant to Article 19a or Article 29a of the Directive 2013/34/EU, where applicable.
79. Institutions should describe in their plans their approach to integrating ESG factors in their forward-looking funding strategy, ensuring consistency with institution's broader funding management in the short, medium and long-term.
80. Institutions should ensure that their transition planning, including sectoral or portfolio strategies in the short, medium and long term, are properly reflected in their risk appetite through updates to profitability impact assessments, limits and risk thresholds, taking into account any transition risk stemming from departures from the institution's planned trajectory. The reflection of the transition planning process in risk appetite should be consistent with the institution's business strategy over different time horizons and taken into account in the ICAAP, including by assessing in adverse stress scenarios risks arising from current or future misalignment with the institution's targets and having a clear understanding of internal capital needs consistent with the transition planning process.

(iv) Integration across the institution

81. In view of institutions' obligation to ensure that arrangements, processes and mechanisms related to their plans are consistent and well-integrated, including for their subsidiaries established outside of the EU, and the obligation of those subsidiaries to be able to produce data and information relevant to the purpose of supervising consolidated plans in accordance with Article 109(2) of Directive 2013/36/EU, parent institutions should take into account ESG risks that subsidiaries established outside of the EU are materially exposed to when elaborating and implementing the consolidated plan, by having regard to applicable local legislation and ESG regulatory objectives, and should be able to demonstrate a well-informed consolidated approach.

(v) Review and documentation

82. Institutions should regularly, and at least every time they update their business strategy in accordance with Article 76(1) of Directive 2013/36/EU, review their plans, taking into account updated information such as new materiality assessments of ESG risks, developments in their portfolios and counterparties' activities and new available scenarios, benchmarks or sectoral pathways.
83. Institutions should document their plans, including the criteria, methodologies, assumptions, and targets used, and any relevant update.

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?

6.2 Governance

(i) Roles and responsibilities

84. Institutions should clearly identify and allocate responsibilities for the development, implementation and monitoring of plans. When assigning roles and responsibilities at the appropriate level of seniority, institutions should take into account the interrelation and influence that the transition planning process should have on other processes such as the broader business strategy and risk appetite.
85. The management body should be responsible for the approval of the plans and should oversee their implementation, including by being regularly informed of relevant developments and progress achieved in relation to the institution's targets. The management body should be responsible for taking decisions on remedial actions in case of significant deviations between the institution's performance and its targets.
86. For the purposes of integrating ESG risks across the three lines of defense in line with Section 5.4,
- a) the first line of defense should be responsible for establishing a dialogue with counterparties about their own transition plans and assess consistency with the institution's transition planning. To this end, institutions should ensure that an engagement strategy is clearly defined and that relevant staff possesses sufficient expertise and capabilities to assess the soundness and credibility of their counterparties' transition plans;
 - b) the compliance and risk management functions should ensure that the risk limits set in the risk appetite statement as part of the risk management framework are consistent with all aspects of the institution's plan, including sectoral policies,
 - c) the IAF should review the institution's plan as part of the risk management framework and assess the extent to which it allows proper management of ESG risks. To that end, the IAF should consider if the plan allows the institution to detect and address changes in the risk profile and in products and/or business lines, how the institution addresses deviations from its targets, and whether the underlying assumptions, methodologies and benchmarks are sound.

(ii) Internal processes and capacity

87. Institutions should ensure meaningful and regular interaction and exchanges at all levels of the organization to ensure that insights and feedback from internal stakeholders can be taken

into account in the process of formulating, implementing and reviewing plans. To this end, institutions should at least involve units, departments and functions responsible for strategic planning, risk management, sustainability disclosures, legal services and compliance in the elaboration of plans, and should assess which additional units, departments and functions should be involved.

88. Institutions should ensure they possess sufficient capacity, expertise and resources to develop, implement and monitor their transition planning process as well as to regularly assess the robustness of their plans internally. Institutions should map existing gaps in skills and expertise and take remedial actions where necessary.

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

6.3 Metrics and targets

(i) General provisions

89. Institutions should clearly define and justify which activities and business lines are covered by their targets and should ensure that these sufficiently reflect the nature, size and complexity of their activity and their materiality assessment.
90. The targets set by institutions should serve risk management and strategic steering purposes with a view to mitigating risks stemming from the process of adjustment towards the legal and regulatory sustainability objectives of the jurisdictions where they operate, and broader transition trends towards a sustainable economy.
91. Institutions should set targets at the institution's level and cascade these down to the sectoral/portfolio exposures levels and at the level of economic activities (i.e. individual technologies), at least for the sectors they are materially exposed to and portfolios which they have assessed as being more subject to environmental risks in line with paragraphs 16 and 17.
92. Institutions should set targets over different time horizons, including a short-term 3-years horizon complemented by medium and longer-term targets that convey a forward-looking view on the strategy of the institution.
93. Institutions should review their short and medium-term targets regularly, and at least every time they update their business strategy, and should have processes for the monitoring and review that include a timely escalation procedure in case of significant deviations. Institutions should perform regular projections to assess their ability to achieve their targets.

(ii) Metrics

94. For the purposes of setting targets, SNCIs should consider using while other institutions should use at least the following indicators:
- a) Financed GHG emissions by scope 1, 2 and 3 emissions split by sectors, using a sectoral differentiation as granular as possible and taking into account methodologies referred to in paragraph 72d): the absolute emissions, in tons CO₂equivalent, and intensity of emissions, relative to revenues or units of production, associated with a portfolio. To foster an active risk management approach, institutions should complement sectoral financed emissions targets with criteria supporting the explanation of portfolio emissions reduction or temporary increase and identifying the underlying drivers of emissions, such as technology mix of their counterparties;
 - b) Portfolio alignment metrics showing the extent to which sectoral exposures and production capacities operated by clients are, or are projected to be, (mis-)aligned with a pathway consistent with the applicable climate legal and regulatory objective, based on portfolio alignment methods described in Section 4.2 and related assessment of financial risks impacts;
 - c) Amount and/or share of income related to business with counterparties operating in sectors that highly contribute to climate change, using a sectoral differentiation as granular as possible;
 - d) A breakdown of portfolios secured by real estate according to the level of energy efficiency of the collaterals,
 - e) The percentage of counterparties with whom the institution actively engages regarding adaptability and resilience to the transition to a sustainable economy, e.g. in relation to counterparties' transition plans or net-zero targets, as well as the percentage of positive outcomes e.g. positive assessments of these counterparties' transitioning abilities.
95. When data needed to support the setting of targets is missing, institutions should follow the steps outlined in paragraph 25.
96. Institutions should assess which additional risk-based and forward-looking metrics and targets to include in their plans, including with a view to support risk assessment and strategic steering related to:
- a) Institution's resilience to physical risk, by considering levels of physical risk associated with the transition pathway selected by the institution and adverse scenarios;
 - b) Institution's management of environmental risks other than climate-related, in particular nature and biodiversity-related risks;

- c) ESG-related concentration risk,
- d) ESG-related reputational risk.

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?

6.4 Climate and environmental scenarios and pathways

97. For the purposes of elaborating plans and setting targets, institutions should carefully define and select climate and environmental transition scenarios and pathways. To this end, institutions should take all the following steps:
- a) assess the potential implications of EU, Member States and, where relevant, third countries objectives for transition pathways, at least for the sectors towards which they are materially exposed. In this process, institutions should take into account the likely pathways originated from the European Green Deal, the EU Climate Law, and the latest reports and measures prescribed by the European Scientific Advisory Board on Climate Change, in particular in relation to the achievement of the objective of the EU to reduce GHG emissions by 55% by 2030 and achieve net-zero emissions by 2050;
 - b) take into account best available information, including from internal scenario analysis and external up to date scientific evidence;
 - c) consider a range of scenarios publicly available, such as the Joint Research Center Geco scenario or IEA's World Energy Outlook and in particular Net Zero Emission scenario,
 - d) consider any public commitment of the institution with respect to climate mitigation and adaptation.
98. The geographical reference and granularity of the scenarios and pathways used by institutions should be relevant to their business model and exposures.
99. Institutions should ensure that scenarios and pathways used as part of their plans are consistent across the organization and over time, such as when building business strategies and setting targets over different time horizons. Decisions to use different scenarios for different purposes as well as decisions to alternate or modify scenarios should be clearly justified, e.g. based on new scientific evidence or methodologies or better suitability for the specific purpose pursued. Institutions should document the process for scenario selection and the reasons for any change or different usage.

100. Notwithstanding the scenario and pathway selected for setting targets, institutions should understand their sensitivity to transition and physical risks under different scenarios, including the ones leveraging current policies and implying a higher level of physical risk.

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?

6.5 Transition planning

101. Institutions should clearly lay out the internal processes by which they prepare for a transition to a more sustainable economy and implement their objectives and targets i.e. transition planning process, in particular through engagement with counterparties, integration of ESG criteria in loan origination policies, changes in the strategic financing choices, approach to mitigation of and adaptation to physical risks, development of new products or services – including offering of sustainable including transition finance products or services, new policies and conditions (e.g. on carbon-intense or other environmentally harmful sectors or counterparties) and/or setting of specific lending or investment criteria.
102. Institutions should have in place sound data processes to collect, verify and aggregate the data that are needed to inform the formulation of their plans and monitor their implementation. This includes using available public information, including counterparties' transition plan at least for non-financial corporates falling under the scope of Directive (EU) 2013/34, and collecting non-public data from counterparties on their sustainability profile, as set out in paragraph 23. Institutions should determine for which other counterparties they require the submission of their transition plans as part of business relationships.
103. Institutions should have a clear approach to proactively engaging with counterparties in line with paragraph 42a). Engagement tools include reviewing counterparties' ESG risks profile and transition plans, providing relevant information and advice to clients and considering a range of counterparty-specific actions, such as adjustment to product offering, agreement on an action plan and remedial actions to support an enhanced transition trajectory for the counterparty, or as a last resort cessation of the relationship when continuation is considered incompatible with the institution's planning and risk appetite. Institutions should regularly discuss risks arising from the transition and possible options to mitigate such risks with large counterparties from sectors assessed as materially subject to environmental risks, and should regularly assess for which other counterparties engagement is warranted.
104. Institutions should assess the implications of their transition process and planned actions and targets for their business and risk profile in the short, medium and long term, including by estimating the impact on their revenue sources and profitability.

105. Institutions should ensure that their transition planning and any planned shifts in financing activity will be accompanied by updated risk management policies such as procedures related to risk assessment and risk management of new material subsets of portfolios e.g. financing of green and transition technologies.

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?

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.

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

7. Accompanying documents

7.1 Draft cost-benefit analysis / impact assessment

1. On xxxx yyyy, the European Commission published the directive amending the Capital requirements directive (from now on CRD VI). Article 87a of the CRD VI mandates the EBA to issue Guidelines to specify minimum standards and reference methodologies for ESG risks management practices. These guidelines provide the EBA answer to such mandate.
2. As per Article 16(2) of the ESAs regulation (Regulation (EU) No 1093/2010, (EU) No 1094/2010 and (EU) No 1095/2010 of the European Parliament and of the Council), any guidelines developed by the ESAs shall be accompanied by an Impact Assessment (IA) annex which analyses ‘the potential related costs and benefits’ of the guidelines. Such annex shall provide the reader with an overview of the findings as regards the problem identification, the options identified to remove the problem and their potential impacts.
3. The EBA prepared the IA included in this consultation paper analysing the policy options considered when developing the guidelines. Given the nature of the study, the IA is qualitative in nature.

A - Problem identification

4. Environmental, social and governance (ESG) factors are causing and are expected to increasingly lead to significant changes in the real economy that will in turn impact the financial sector through new risks and opportunities.
5. Since the adoption of the Paris Agreement on climate change and the UN 2030 agenda for Sustainable Development in 2015, governments around the world are taking action to encourage the transition to low-carbon and more sustainable economies. In Europe in particular, the European Green Deal targets the ambitious objective of making Europe the first climate-neutral continent by 2050 and it is expected that the financial sector will play a key role in this process.
6. In this regard, the European Commission has launched a set of initiatives to enhance the resilience and contribution of the financial sector. As a result, several efforts have been initiated to incorporate ESG risks into prudential supervision. These guidelines target the inclusion of ESG risks in institutions’ broader risk management frameworks.

B - Policy objectives

7. The main objective of these guidelines is to answer the mandate set up in Article 87a of the CRD VI which requests the EBA to issue ESG risks management guidelines.

8. As a result, the general objective is to provide guidance on how institutions will incorporate ESG risks in their risk management processes including defining how ESG risks should be considered when defining businesses and risk strategies, risk appetites levels and internal controls, risk monitoring, etc.
9. The specific objectives of the guidelines are defined in the CRD VI mandate which indicates that the guidelines should specify:
- the minimum standards and reference methodologies for the identification, measurement, management and monitoring of ESG risks;
 - the content of plans to be prepared in accordance with Article 76(2) of the CRD, which shall include specific timelines and intermediate quantifiable targets and milestones, in order to monitor and address the financial risks stemming from ESG factors, including those arising from the process of adjustment and transition trends towards the relevant Member States and Union regulatory objectives, in particular the objective to achieve climate neutrality by 2050 as set out in Regulation (EU) 2021/1119, as well as, where relevant for internationally active institutions, third country legal and regulatory objectives;
 - the qualitative and quantitative criteria for the assessment of the impact of ESG risks on the financial resilience and risk profile of institutions in the short, medium and long term.

C - Baseline scenario

10. The current framework does not specify any guidelines about how institutions shall incorporate ESG risks in their internal risk management nor it defines how institutions shall define their (transition) plans for prudential purposes. As a result, institutions may follow different criteria to consider ESG risks and incorporate them in their (transition) plans which would create divergencies in how banks account for those risks and pose difficulty for the work of supervisors to monitor and control that banks operate at adequate risks levels.

D - Options considered

11. When drafting the present guidelines, the EBA considered several policy options under nine main areas:

1) Scope of the ESG risks guidelines

Article 87a of the CRD VI mandates the EBA to issue guidelines on ESG risks management practices. The definition of risk management practices for environmental but also for governance and social risks is a very ambitious target considering the slightly preliminary regulatory developments in social and government aspects. Therefore, while developing the current guidelines, the EBA has analysed three possible options:

Option 1: *To focus equally on the three aspects*

Option 2: *To focus on environmental aspects only*

Option 3: *To mainly focus on environmental aspects but give some guidance on social and government aspects.*

2) Frequency of the materiality assessment of ESG risks

Institutions should regularly assess the potential effects of ESG risks on their business models and risks faced by the institution. Such assessment will provide the institution with a view on the financial materiality of ESG risks to which it is or may become exposed. The adequacy of regularity in which such assessment shall be carried out, will ensure that the materiality of ESG risks remains adequately measured. Therefore, while developing the current guidelines, the EBA has analysed three possible options:

Option 1: *Every year for all institutions*

Option 2: *Every two years for all institutions*

Option 3: *Every year for non-SNCIs and at least every two years for SNCIs*

3) Consideration of ESG risks in bank's business and strategies

The needed transition towards a more sustainable economy will lead to new business opportunities but will also expose financial institutions to risks stemming from the transition. Therefore, while developing the current guidelines, the EBA has analysed if banks should consider ESG risks when defining their business models and strategy. In particular, the EBA has analysed two possible options:

Option 1: *ESG risks should be considered in banks' business models and strategies considering different time horizons.*

Option 2: *ESG risks may not be considered in banks' business models and strategies.*

4) Data processes

To ensure an adequate identification and measurement of ESG risks, institutions shall analyse enough information and data. Therefore, while developing the current guidelines, the EBA has analysed how bank's data processes shall be defined to incorporate ESG risks. In particular, the EBA has analysed three possible options:

Option 1: *Institutions shall rely on already available ESG data, aggregate it and exploit it to manage ESG risks.*

Option 2: *Institutions shall aggregate and exploit their already available data but also collect additional ESG data when engaging with their clients and counterparties.*

Option 3: *Institutions shall aggregate and exploit their already available data, collect additional ESG data when engaging with their clients and counterparties and cautiously use as intermediary step proxies, estimation and external data sources when data is not yet available.*

5) Features of reference methodologies for the identification and measurement of ESG risks

When defining their methodologies to identify and measure ESG risks, institutions shall select one or more features of reference. Therefore, while developing the current guidelines, the

EBA has analysed two options regarding which are the most adequate features institutions shall refer to:

Option 1: *Institutions shall develop exposure-based, portfolio-based and scenario-based methodologies.*

Option 2: *Institutions shall develop methodologies based on at least one of the three options included in option 1.*

6) Materiality assessment and (transition) plans

CRD-based plans should be based on a robust materiality assessment of the ESG risks faced by institutions. Therefore, while developing the current guidelines, the EBA has analysed two possible options:

Option 1: *The ESG risks materiality assessment should define as material certain exposures that have substantial climate and environmental risks arising from the process of adjustment towards the legal and regulatory objectives related to ESG factors or transition trends towards a sustainable economy.*

Option 2: *Institutions should have full flexibility when defining the materiality of ESG risks independently from the sector of the exposure.*

7) Data and engagement with counterparties in relation with their transition plans

To formulate an adequate (transition) plan, institutions need to have information about the risks they face in the transition process. This includes information about their counterparties and their own risks during the transition process. Therefore, while developing the current guidelines, the EBA has analysed four possible options regarding the engagement with their counterparties:

Option 1: *Institution should request all counterparties to submit a transition plan as part of the due diligence phase.*

Option 2: *Institution should request all counterparties to submit a transition plan as part of the due diligence phase. Moreover, they should discuss with them their risks arising from the transition and possible options to mitigate such risks.*

Option 3: *Institution should request large counterparties only to submit a transition plan as part of the due diligence phase.*

Option 4: *Institution should request at least large counterparties to submit a transition plan as part of the due diligence phase. Moreover, they should discuss with them their risks arising from the transition and possible options to mitigate such risks.*

8) Time horizons considered for banks' (transition) plans

Institutions need to define the time horizons that will be covered by their (transition) plan. Therefore, while developing the current guidelines, the EBA has analysed four possible options:

Option 1: *To set up short term (<2 years) time horizons.*

Option 2: *To set up medium term (>2 years < 5 years) time horizons.*

Option 3: *To set up long term (>5 years) time horizons.*

Option 4: *To consider several time horizons, including a long-term time horizon articulated with short and medium term strategies*

9) Plans' targets

Institutions should define targets as part of the (transition) plans. Therefore, while developing the current guidelines, the EBA has analysed three possible options:

Option 1: *To predefine the full list of metrics that institutions should target.*

Option 2: *Not to predefine the list of metrics that institutions should target and allow institutions to define their own list of transition metrics.*

Option 3: *To include a minimum set of metrics that institutions should target while seeking to complement them.*

E - Assessment of the options and preferred option

12. In respect to the different options considered, the EBA has assessed their potential cost and benefits, and has selected a preferred option in the nine main areas considered:

1) Scope of the ESG risks guidelines

ESG risks include environmental, social and governance factors. Article 87a of the CRD VI, mandates the EBA to issue guidelines on management practices for the full scope of these risks. However, the EU and international regulatory developments for environmental risks are much more advanced than for social and governance risks. Although it is important to continue the development of management practices for the full set of ESG factors, it is also important to allow enough time for institutions to introduce the necessary changes. Therefore, in order to reduce the burden for institutions and the time pressure to adapt to the new regulatory developments, it is considered that the guidelines should focus on environmental risk mainly, although introducing some first indications to define the management practices for social and governance. This is indeed in line with the sequenced approach adopted under other EBA regulatory products (e.g. Pillar 3 ITS). Therefore, the preferred option is **Option 3:** *To mainly focus on environmental aspects but give some guidance on social and government aspects.*

2) Regularity of the materiality assessment of ESG risks

Institutions shall perform their ESG risks materiality assessment with sufficient regularity to ensure that any development in the external environment that could affect their exposure to ESG factors are adequately captured. Focusing on the E factor, environmental changes can develop in a fast manner, for example in terms of new policies or technologies or shifts in market and consumer preferences, potentially affecting the level of banks' exposures to environmental risks. For these reasons, the EBA considers that banks' materiality assessment should be carried out with a short-term periodicity to ensure that the relevant risks are sufficiently and timely captured. However, performing such assessment requires an intensive use of resources creating a burden for institutions. It seems disproportionate to request all types of institutions to perform such assessment with a regularity of up to a year, as small institutions have limited resources available and such request could be very burdensome for them. An adequate balanced approach would allow SNCI institutions to perform the materiality assessment with a slightly lower regularity although keeping an adequate periodicity to capture all potential risks. For these

reasons, the preferred option is **Option 3: Every year for non-SNCIs and at least every two years for SNCIs.**

3) Consideration of ESG risks in bank's business and strategies

The following reasons justify the consideration of ESG risks in bank's business models and strategies:

- the time horizon of ESG risks: the full impact of ESG risks is likely to unfold in a long-term period. Additionally, changes in business models may require some time to be implemented. Therefore, it seems reasonable that institutions follow a forward-looking approach and consider ESG risks when defining their strategies and a business model that will be viable and adequate when the ESG risks materialise.
- potential negative financial impact: when defining their business model, institutions should consider potential financial impacts that may be linked with their strategy. This includes the consideration of ESG risks.
- political actions in favour of transforming the current global economy into a more sustainable one: There are several examples of political actions at international and EU level targeting a transition to a more sustainable economy. These initiatives could push for significant changes in the business environment in the upcoming years. Banks should anticipate the potential negative impact of such transformation and take advantages of the arising new opportunities in the redefinition of their business model.

Moreover, in recent years, some institutions have taken steps to account for ESG factors in their business strategies. However, as concluded in the EBA report on Management and supervision of ESG risks for credit institutions and investment firms³¹, more progress is still needed to adequately incorporate ESG risks in bank's strategies and business models' definition processes. Considering both the reasons that justify the integration of ESG risks in banks' strategies and business models and the current insufficient implementation in bank's processes, the EBA considers that there is a need to incorporate such requirement as part of the ESG risk management guidelines and therefore the preferred option is **Option 1: ESG risks should be considered in banks' business models and strategies considering different time horizons.** Additionally, given the distinctive impacts of ESG risks across different time horizons, banks should consider different, including a long term, time horizons when defining their business models.

4) Data processes

A robust risk management framework heavily relies on data to develop robust metrics and risk indicators. Well defined, strong data processes are key to adequately gather and exploit data to identify and measure ESG risks. However, as explained in the EBA report on Management and supervision of ESG risks for credit institutions and investment firms, the lack of data to identify and measure ESG risks is one of the main challenges faced by institutions. The EBA has balanced these two aspects when defining the way data processes shall be integrated in bank's ESG risk management guidelines. Given the importance of having accurate data to adequately measure ESG risks, it is considered that institutions shall take action to better use and aggregate the data already available and that will be available as a result of EU and international developments on sustainability reporting on one hand, and on the other hand, improve the availability of ESG data

³¹ See report [here](#).

via the collection of relevant ESG information from their clients and counterparties as part of their business relationship. There are other ESG regulatory developments such as the Pillar 3 disclosure requirements as per Article 449(a) of Regulation (EU) 2019/876 that also require the availability of ESG data and push institutions to take action in a similar direction. However, the collection of detailed ESG-related data may create an excessive burden for institutions. In order to reduced such burden, the EBA considers that institutions should be able to use proxies and estimations and rely on external data in those cases where data is not available in house or its collection via engagement with clients and counterparties is considered excessively difficult. Therefore, the preferred option is **Option 3: Institutions shall aggregate and exploit their already available data, collect additional ESG data when engaging with their clients and counterparties and cautiously use as intermediary step proxies, estimation and external data sources when data is not yet available.**

5) Features of reference methodologies for the identification and measurement of ESG risks

When drafting these guidelines, the EBA has analysed which feature should be of reference for institutions when defining their methodologies to identify and measure ESG risks. The options that have been discussed include:

- a) To define exposure-based methodologies, which will provide a granular assessment of the ESG factors at counterparty level.
- b) In addition, institutions could define their methodologies at a portfolio level which will allow them to have a more comprehensive risk assessment and to analyse the degree of alignment of institution's portfolios with climate-related sustainability targets.
- c) Another option would be for institutions to define scenario-based analyses to assess ESG risks allowing a forward-looking perspective.

The definition of methodologies to assess ESG risks at these different levels will answer to different risk management needs. Therefore, the EBA considers that all aforementioned perspectives are needed to adequately measure ESG risks in a comprehensive manner and taking into account the different time horizons in which ESG risks are expected to materialise. Therefore, the preferred option is **Option 1: Institutions shall develop exposure-based, portfolio-based and scenario-based methodologies.**

6) Materiality assessment and (transition) plans

CRD-based plans should be based on a robust materiality assessment of the ESG risks faced by institutions. To guarantee consistency across all the processes in the institutions, the materiality assessment for (transition) plans should be in line with other materiality assessments carried out by the institution. To facilitate such standardisation, institutions should refer to clear definitions of ESG risks and there should be a minimum set of exposures presumed to be materially exposed to environmental risks. Such presumption should be based on the economic sector's – to which the exposure belongs – contribution to climate change; at the same time, institutions should be allowed to demonstrate that some sectoral exposures are not materially exposed to environmental risks if they can provide sufficient evidence. Such evidence may be based on the alignment with the EU taxonomy, as a high degree of alignment would indicate that exposures are already contributing to the EU environmental objectives and may thus be considered as less likely to be negatively affected by transition risks, for example in the form of new public policies supporting the transition. Therefore, the preferred option is **Option 1: The materiality assessment should define as ESG material certain exposures that have substantial**

climate and environmental risks arising from the process of adjustment to the legal and regulatory objectives related to ESG factors or transition trends towards a sustainable economy.

7) Data and engagement with counterparties in relation to their transition plans

In addition to information about their own risks, institutions need information about their counterparties' risks during the transition process to formulate an adequate (transition) plan. However, institutions may encounter some problems while collecting such information as first, not all counterparties may have developed a clear and structured transition plan and second, institutions will need resources to collect transition plans from all counterparties, review and understand them and assess the relevant risks. The direct interaction between the institution and the counterparty to discuss the risks that the latter may face arising from the transition and possible options to mitigate them, is key to have a comprehensive picture of the situation that counterparties are facing. In other words, the collection of all necessary data and information from counterparties is a complex and costly process for institutions. At the same time, a comprehensive set of information is needed to adequately evaluate the risks. In order to reduce the burden for institutions, the EBA considers that such information should be requested at least for the biggest counterparties that represent a higher risk for the institution. However, institutions should have all the relevant data at their disposal to adequately assess the level of transition risk for all counterparties. Therefore, the preferred option is **Option 4: Institution should request at least large counterparties to submit a transition plan as part of the due diligence phase. Moreover, they should discuss with them their risks arising from the transition and possible options to mitigate such risks.**

8) Time horizons considered for banks' (transition) plans

ESG risks have distinctive impacts across time horizons. This is also the case when referring to ESG risks arising from the transition process towards legal and regulatory objectives related to ESG factors. There are intermediate environmental targets that may create a risk in the short or medium term. Therefore, institutions shall consider several time horizons when defining their (transition) plans. They should, however, include a horizon that is long enough to cover for those risks that may materialize in the long term. The preferred option is **Option 4: To consider several time horizons, including a long-term time horizon articulated with short and medium term strategies**

9) Plans' targets

Institutions should define targets as part of the (transition) plans. The EBA is aware that banks are already using some transition metrics either voluntarily or based on current or (expected) future EU legislation. The EBA considers that suggesting/requiring a minimum list of metrics to be included in prudential plans will help achieving more comparable plans easing the work of supervisors in their reviews. At the same time, it is important to allow institutions flexibility in defining the indicators they deem necessary to consider to avoid missing useful metrics adjusted to the specificities of each institution. Therefore, the preferred option is **Option 3: To include a minimum set of metrics that institutions should target while seeking to complement them.**

7.2 Overview of questions for consultation

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?

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

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.

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

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.

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

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

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

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.

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

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?

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?

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

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?

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?

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?

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?

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.

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