Friday 28 May, 2021

Response to public consultation on draft technical standards on Pillar 3 disclosures of ESG risks

From the Climate Safe Lending Network

The Climate Safe Lending Network (a project of Green America's Center for Sustainability Solutions) is a transatlantic multistakeholder partnership of banks, NGOs, academics, investors and others aiming to accelerate the decarbonisation of the banking sector to secure a climate-safe world).

We are very impressed and encouraged by the excellent work and leadership by EBA in presenting this consultation paper. Please find the answers to the consultation questions using your numbering:

Question 3: Do the respondents agree that the new draft ITS fits the purpose of the underlying regulation?

The draft ITS do fit the purpose of the underlying regulation. However in respect of the former NFRD (now CFRD) the concept of double-materiality should apply to disclosure on the basis of the contribution to environmental risks as well as the crystallisation of financial risks from environmental risks. This is insufficiently captured in some of the tables relating to physical and transition risks.

A practical suggestion would be to add an additional table asking respondents to repeat their breakdown of exposures by NACE code and identify where there are contributions to environmental risks (impacts) which are not fully covered in financial risks (either transition or physical risk) analyses.

Question 4: Do the respondents agree that the tables with qualitative information proposed capture properly the information that institutions should provide?

Yes - subject to response under Q.3

Question 5: Regarding template 1 – 'Banking book - Climate change transition risk: Quality of exposures by sector', do the respondents agree with the proposals in terms of sector and subsector classification included in the rows of the template and the identification of the most exposed sectors in columns f to k and p to u?

The coverage of sectors and classifications appears to be comprehensive and appropriate with one exception. Under NACE code K: Financial & Insurance Activities, there should be a specific footnote on the requirement for transparent look-through. In other words, financial institutions financing activities via intermediaries must use best efforts in due diligence to look through the financial intermediaries being financed (whether inside or outside the EU) in order to disclose the scope 3 financed emissions held on the financial intermediaries account via their activities. Without such a measure, a loophole is opened which could perversely incentivise banks (many of whom are committing to net zero balance sheets) to evade disclosure via structuring finance via lending to non-banking or non-EU intermediaries. This would be highly counterproductive and would undermine existing EU legislation on emissions reduction.

Question 6: Do the respondents agree with the proposal included in templates 1 and 3 to disclose information on scope 3 emissions and with the transitional period proposed?

With reference to this question and others, the reference to Scope-3 is clear in terms of financed emissions of clients. However it is not explicitly stated which scope of client emissions should be reported. For instance, how is Scope-3 for the mining sector (e.g. coal & lignite) sector accounted for – e.g. the downstream (Scope 3) emissions associated with using coal as a fuel?

Question 7: Do respondents agree that information in terms of maturity buckets by sector proposed in template 2 is relevant to understand the time horizon of when the institution maybe more exposed to climate change transition risk?

Whilst relevant, this is not contextualised with the likely renewal rates. This also (as per response to Q.3) does not take into account the contribution to systemic risk – e.g. whilst shorter tenures may help to mitigate climate-related financial transition risks, they do not materially impact the risk to the environment, especially if renewed.

Question 8: Do respondents agree that information in terms of alignment metrics and relative scope 3 emissions proposed in template 4 is relevant to understand and compare the transition risk phased by institutions? What are the respondents' considerations with regard to the alignment metrics proposed and the sectors that should be covered by this disclosure? Do respondents agree with the transitional period proposed?

(see Q9 response)

Question 9: Regarding the same template 4, what are the respondents' considerations with respect to the choice of the 2 degrees reference scenario, would respondents opt for a different scenario?

The consultation could not have foreseen the publication of IEA scenario NZE2050 however across all templates deviation to this new scenario is clearly the most relevant metric:

https://www.iea.org/reports/world-energy-outlook-2020/achieving-net-zero-emissions-by-2050

2-degrees scenarios fundamentally undermine financial and economic stability (based upon the breakdown of critical natural systems and high risk of climatic feedback loops) and undermine the credibility of many of the modelling exercises.

Question 10: Do respondents agree that information proposed in template 5 is relevant to understand the level of climate change transition risk and that information on exposures towards the most polluting companies is a good complement to the sectorial information included in other templates? Specific feedback is sought on possible alternative formats for the presentation of the information required in template 5. In particular, the EBA seeks feedback on whether aggregate information on exposures towards the top 20 polluting companies in the world, at EU level or at member state level, instead of company-by-company information, would be sufficient to understand how climate-change transition risk may exacerbate the exposition of institutions to credit risk. Feedback is also sought on the specific information that a template on aggregate exposures should include to be meaningful, including possible "buckets" of information on exposures (e.g. exposures towards top 5 polluting firms, next top 5 and so on, or other alternative presentations).

Whilst reference to the highest climate impact polluting firms is useful, it does not include the pace of transition to a net-zero target with a 1.5-degrees scenario. It would be helpful to add the current commitment target for each client and a performance indicator of the degree to which it is on track to meet its stated goal.

Question 12: Do respondents agree that the information included in template 7 is appropriate to understand how and to what extent the institution may be exposed to climate change physical risk and that the differentiation between a simplified and an extended template is necessary in the short/medium term?

The physical risk exposure is not parameterised by timescale (e.g. over what period is being considered). A practical suggestion would be to include both the maturity of the loan period and the anticipated lifespan of the underlying assets).

Question 15: Specific feedback is required from respondents on the way template 10 is defined, and on whether there is additional information that should be added. Feedback is sought on alternative disclosure formats that may contribute to a more standardised and comparable disclosure.

There should be clear distinction between climate change mitigation actions and climate-related financial-risk mitigation actions. There are qualitative elements that should describe, for example, the degree of positive impact through the extent of real-economy decarbonisation being achieved via financing (e.g. the degree to which clients are making properties or production processes more energy efficient or zero emission). Likewise it is important to disclose 'leakage' – passing on the climate emissions to another part of the financial system (especially those in the shadow banking sector who would not be subject to the same level of disclosure regulation).

Question 16: Finally, respondents feedback on whether the draft ITS should include a specific template on forward looking information and scenario analysis, beyond the qualitative information currently captured in the tables and templates under consultation and the information required in template 4.

This would be a very welcome addition. (see response to Q.9) A practical suggestion would be to use IEA NZE2050 as a common reference point. For comparability, taking reference measurements at 2025, 2030 and 2050 would be sufficient to capture the forward scenarios (2035 can be analysed from 2025 onwards to maintain a 10-year view).

We would be delighted to discuss any of the above responses with you further.

With best regards,

James Vaccaro
Executive Director
Climate Safe Lending Network

www.climatesafelending.org