FÉDÉRATION
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FBF RESPONSE TO EUROPEAN BANKING AUTHORITY CONSULTATION PAPER ON PRUDENTIAL DISCLOSURES ON ESG RISKS IN ACCORDANCE WITH ARTICLE 449a CRR (EBA/CP/2021/06)

The French Banking Federation (FBF) represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorised as banks and doing business in France, i.e. more than 390 commercial, cooperative and mutual banks. FBF member banks have more than 38,000 permanent branches in France. They employ 370,000 people in France and around the world, and service 48 million customers.

FBF strongly supports the progressive development of a Pillar 3 framework for comparable ESG disclosures to inform stakeholders about ESG exposures, risk management and strategies in order to achieve Paris agreement goals.

The third pillar of the Basel regulation was initially intended to foster market discipline through public disclosures about Banks' capital structure, capital adequacy, and risk management. Pillar 3 disclosures were built over time in order to reach an **adequate level of data reliability, consistency and comparability across banks**, and indeed significantly improve the ability of financial markets participants to assess banks' risks management processes, capital structure, risk exposures and capital adequacy.

Therefore, considering this strong focus of Pillar 3 disclosures on risk measures and risk management, and due to the fact that (as stated by the TEG in its Technical report), the Taxonomy and the Green Asset Ratio are not management tools, but are intended to "help plan and report the transition to an economy that is consistent with the EU's environmental objectives", **EU Taxonomy Regulation Article 8 related disclosures should not be included in the Pillar 3 disclosure** (as in any case it will be subject to separate legislation – Delegated Act). Indeed, the Taxonomy-aligned KPIs do not embed risk criteria. In order to avoid any ambiguity for the use of Green Asset Ratio (and the accompanying and additional KPIs) by the market and double disclosures with potential discrepancies, it should only be disclosed in the management report under Article 8 of the Taxonomy Regulation, which rules disclosure requirements.

The inclusion of quantitative information about ESG risk factors and their impacts on common risk categories into Pillar 3 disclosures is clearly premature, for several reasons:

- As of today, the conceptual and the regulatory frameworks, and the associated methodologies to set a systematic, robust and quantitative link between ESG risk factors and credit risk (IFRS 9 stage 2, PDs, impairment, non-performing loans) does not exist. Consequently, **disclosure templates should not mix up ESG non-financial data and risk parameters**. However, this information could be provided by means of supervisory reporting or surveys instead of being publicly disclosed.

- **Specifically, IFRS 9 data requested in the banking book template of the draft ITS goes beyond the current and forthcoming (CRR2) Pillar 3 disclosure requirements** for credit risk at sectoral level and involves a major risk of interpretation by the market. Whereas no risk differentiation could be established at this stage between 'green' and 'brown' assets, we believe IFRS 9 risk data should not be mixed with ESG data in public disclosures. This issue belongs to another EBA mandate and the industry stands ready to provide data to regulators and supervisors to run their analysis via dedicated surveys or supervisory reporting

- **We also believe it is premature to request banks to publicly disclose their exposures to the most exposed sectors** as defined in columns f to k and p to u of the banking book template 1. It pre-empts the decision to develop a taxonomy for harmful activities and uses regulation that has not been developed for that purpose. Information provided by NFRD/CSRD companies would not be sufficient to provide all the required breakdowns. And while the Taxonomy regulation requires the disclosure of a green asset ratio by corporates, this will not provide any information on non-green exposures that would be necessary for banks to fill in the banking book template on this part. In particular, there is no requirement for those firms to disclose their revenues by activity or according to their compliance with Benchmark regulation that would mirror the data requested in this draft template.

- Any ESG reporting currently raises critical data availability, quality and management issues, and the proposed templates would lead to an extended and **heterogeneous use of proxies,** which is in full contradiction with all standards underlying financial risks disclosures under Pillar 3. It is therefore critical to limit the use of proxies to exceptional cases in order to avoid the risk of having **non-comparable Pillar 3 disclosures of low relevance** (due to non-harmonized methodologies, different data shortage) and above all to avoid **putting at risk credit institutions' legal liability.** Indeed, as credit institutions are liable for their disclosures, an over-reliance on proxies could be seen as "misleading information" towards investors and could expose banks to potential legal suits. To mitigate that risk, **it is necessary that proxies** (for instance for physical risk, scope 3 emissions, non-CSRD SMEs, non-EU counterparties, article 12(2) of EU Benchmark regulation, Energy Performance Certificates equivalence across Europe, etc.), where they are possible**, be developed at EU level to be commonly used in the EU**, thereby ensuring a level playing field and comparability across the board.

- In the same vein, **when banks' internal methodologies are not in place yet**, as it is the case for physical risk or scope 3 emissions measurement, the information should not be publicly disclosed. Although **physical risk** analysis will be essential in risk management and banks are actively working on those and on filling the **data gap**, they would have to rely on uncertain information coming from external data providers. Also, comparability across disclosing banks could only be achieved under common climate scenarios, under the same time horizon and with the same methodological assumptions on the assessment of the value chain. For the time being, we believe that the disclosure should remain only qualitative. As for **scope 3 emissions**, we agree that it is a powerful indicator to monitor the "temperature" of banks' portfolio and alignment with commitments they made on reducing their carbon intensity. However, at this stage, **no standard or shared method has been defined and the metrics still lack the robustness required for public disclosures**. Thus, these disclosures may well not adequately capture the commitments of the banking system on climate change and would likely be meaningless. As for any potential future standard, we believe that multiple counting of emissions should be avoided as in the case of bottom-up approaches when a bank finances more than one firm belonging to the same value chain.

<u>We strongly believe that there is a need to sequence the implementation of banks Pillar 3 templates in several building blocks, limiting 2023 disclosure (based on December 2022 position) to a smaller number of core templates and aligning other templates with the timeline, scope and reporting frequency of CSRD</u>:

- **Data** would be critical to allow for Pillar 3 reporting, and **banks mainly rely on their customers** to feed their own templates. These customers do also share the responsibility to progressively reduce their carbon emissions to meet the commitments of the Paris agreement. Some customers would be obliged by regulatory requirements to disclose this information, according to a calendar and ramp up set by legislators. Thus, we would like to outline that the responsibility of disclosure is first on the clients' side, including the quality / reliability & availability of the data. **It is only on the basis of this input that banks would be in a position to produce their own Pillar 3 reports**.

- As a direct consequence of this, there is a need for a **1-year time lag** for banks to start disclosing on their exposures towards their counterparties after the disclosures of the latter. That also means 1 year after the 1st disclosures of other credit institutions. Also, as corporate clients would be disclosing on a yearly basis, there would be hardly any change in 6-month time in banks' disclosure - the information which banks rely upon would either not be up-to-date or not yet available – and as the production process is very resource-intensive, we believe that a **yearly disclosure** frequency would make more sense for banks. This sequencing is a prerequisite to avoid an unreasonable use of proxies potentially leading (as above mentioned) to faithful situations for Banks.

- We understand that the first year ESG Pillar 3 disclosures would be annual and related to the reference date 31 December 2022, hence a publication in the first quarter of 2023. Banks, as users of ESG disclosures, rely on companies' disclosures to produce their own disclosures. Companies which are currently subject to NFRD disclose mainly qualitative ESG information, as well as voluntary KPIs as per EC June 2019 guidelines or TCFD. Such information is largely insufficient for banks to feed the proposed Pillar 3 templates. Consequently, the EC has tabled the legislative proposal enlarging the scope to companies above 250 employees and listed SMEs and announcing future delegated acts to define the content, leveraging the work undertaken by EFRAG. The adoption of the 1st set of standards is expected for 31 October 2022, the adoption of 2nd set of standards by 31 October 2023.
  Even assuming that those delegated acts will include the KPIs necessary to populate Banks Pillar 3 templates, the issue is that the first reporting by non-financial corporates under CSRD is only expected by 2024, one year <u>after</u> the first Pillar 3 report by banks. For listed SMEs, the first reporting under CSRD is even due by 2027. For the type of information to be provided by corporates on a mandatory basis under CSRD (such as the physical risks, sub code NACE, scope 1-2-3, split of revenues by carbon intensive sectors … for instance**), Pillar 3 requirements and calendar should be sequenced with the CSRD calendar, scope and content**, and should be applied one-year after the non-financial corporates, as explained above.

- We also strongly recommend the **alignment of ESG Pillar 3 scope with CSRD scope**. A **separate reporting with non-EU counterparties, until** the development of BCBS standards and the implementation of **equivalent requirements in other jurisdictions, and non-listed SMEs** should be allowed on a **best effort basis.**

- We also believe that **EBA's guidelines on Loan Origination and Monitoring would be inadequate to cover EBA's Pillar 3 proposed templates**, which also justified the alignment of Pillar 3 disclosures with CSRD timeline. First, the Guidelines only cover the loan book of credit institutions; second, the Guidelines only require banks to take into account ESG risks stemming from borrowers, without any specific recommendations as

to how to do so - we believe that this lack of specific guidance cannot be considered as a basis for implementing EBA's Pillar 3 draft ITS, in particular due to the different implementation timelines (cf. different implementing projects) - and third, these guidelines do not require further disclosures from counterparties that can decide not to communicate this information.

We believe that disclosures should focus on the banking book template and avoid putting liability risk on credit institutions by requesting them to disclose exposure data on individual counterparties:

- Information on the **trading book** or **fees and commissions** is not meaningful on ESG risks compared to banking book exposures per sector and geography, and trends in the related metrics could be affected by various other external factors. Fundamentally, the link between ESG long term factors and **the short-term nature of the trading book** is difficult to approach and the framework remains very conceptual at this stage. In our view, the proposed template on the trading book is misrepresenting the risk as it is solely **based on accounting data instead of risk metrics. Therefore, the priority disclosures should be on the exposures of the banking book which represent the vast majority of banks' risks**.

- Finally, as regards template 5 on the disclosure of exposure the **top 20 polluting companies,** we would like to raise our concerns on the banking secrecy, confidentiality, liability risk and business/competition issues in disclosing gross exposures to individual counterparties and therefore we suggest limiting any such disclosures to **exposure data aggregated over a list of counterparties**. With also the objective to ensure consistency and comparability across disclosing banks, we believe **such list of counterparties should be established by an EU Authority** and provided to banks.

In the end, to reach the requirements associated with Pillar 3 disclosures in general, we strongly believe that Pillar 3 ESG disclosures should:

- Be meaningful and adapted to stakeholders' needs,

- Be kept as simple, understandable and comparable possible,

- Be improved over time, based on the progress made (in particular in data management) and lessons learnt (in particular for the trading book),

- Benefit from the same norms and standards as financial disclosures (data availability and quality, standardised and shared methodologies).

We are happy to conclude our key considerations with what banks can disclose under Pillar 3, based on their dependency on CSRD and on the upcoming BCBS consultation on the integration of climate risks in the Basel framework.

We propose to favour an approach by building blocks, starting with a limited number of 'core' templates based on available and a high-quality data and methodologies and adapting progressively the level of granularity of Pillar 3 requirements.

We propose for the 2023 and 2024 reports, which will take place before the implementation of CSRD, the following:

1. **A simplified template 1 Banking book -** Climate Change transition risk: Quality of exposures by sector with the **gross carrying amounts by NACE code**
2. **Template 2 Banking book** - Climate change transition risk: Exposures towards NACE sectors A to H and L - **Maturity buckets**
3. **Template 4: Climate change transition risk - Alignment metrics for the banking book, in the "Mitigating Actions" section**
4. **Template 5 - Exposures in the banking book to top carbon-intensive firms, on an aggregated basis on the basis of a common list to be provided by EBA**
5. **Template 7 -** Exposures in the banking book subject to climate change **physical risk, in a qualitative manner**, at least up until the outcome of 2022 ECB climate stress testing exercise, but with the possibility left for banks to disclose some quantitative physical risk data on a voluntary basis
6. **The Qualitative information templates – to be replaced by an expected compliance with TCFD guidelines.** As TCFD standards are recognized at international level, they ensure comparability among banks and level playing field with non-EU banks

For the reports from 2025, the Pillar 3 framework could be progressively enriched in line with the gradual implementation of the CSRD until the end of the phase-in period and with the development of international standards.