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José Manuel Campa
Chairperson
European Banking Authority
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INSTITUTE OF INTERNATIONAL FINANCE

RE: Consultation Paper on Draft Implementing Standards on prudential disclosures on ESG risks in accordance with Article 449a CRR (EBA/CP/2021/06)

Dear Chairman Campa:

The Institute of International Finance (IIF) welcomes the opportunity to comment on the European Banking Authority's (EBA) Consultation Paper on *Draft Implementing Standards on prudential disclosures on ESG risks in accordance with Article 449a CRR*.[1] The IIF is the leading global association of the financial services industry, supporting nearly 450 member institutions in over 70 countries. The comments in this letter have been informed by discussions with experts from across the global IIF membership via the IIF Sustainable Finance Working Group, the IIF Disclosure Working Group, and the IIF Steering Committee on Regulatory Capital.

I. General Comments

Over the past years and months, the European Union (EU) and its agencies have made significant progress in developing frameworks and instruments to support the transition to sustainable finance, including the Non-Financial Reporting Directive (NFRD) and its recent proposed replacement in the form of the Corporate Sustainability Reporting Directive, the Sustainable Finance Disclosure Regulation, and the Taxonomy Regulation. We welcome the ambition of the EBA and other European authorities to advance this important work.

[1] https://www.eba.europa.eu/implementing-technical-standards-its-prudential-disclosures-esg-risks-accordance-article-449a-crr.

In parallel, EU regulators and supervisors have started to advance the framework for including ESG risks in the bank risk management framework, notably with the EBA Discussion Paper on management and supervision of ESG risks for credit institutions and investment firms, the Guide on climate-related and environmental risks produced by the European Central Bank (ECB) and associated gap analysis, several climate risk pilot scenario analyses like the recent French ACPR and EBA pilots as well as the upcoming ECB 2022 exercise.

The IIF commends the contribution that all this work represents to the global regulatory community and strongly welcomes the EU institutions' approach to widely share the concepts and methodologies being developed with the international community, in particular through networks such as the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) and the European Commission's International Platform on Sustainable Finance (IPSF).

However, **IIF members worry that the increase in domestic, regional, and global initiatives is creating a fragmented landscape**. The need for coordination has been acknowledged by the Financial Stability Board (FSB), for example here: "*Looking ahead, the increased sense of urgency has resulted in a proliferation of work by various bodies on climate change. While the greater momentum in climate work is welcome, it also increases the importance of strategic vision, good coordination, and clear communication to the G20 and the public.*"[2] Consequently, **the IIF strongly supports the development of global ESG standards, notably as regards disclosure and classifications**, and is fully committed to engage with the G20 Sustainable Finance Working Group (SFWG) and standard-setting bodies to contribute to the acceleration of the development of such standards, leveraging the considerable work already done by the public and private sectors in Europe and other jurisdictions.

In particular, **we strongly emphasize the need for global alignment of frameworks for ESG disclosure and of the expectations and guidelines of supervisors and regulators in this area**.[3] Certain ESG risks, such as climate change, are global in nature and require globally coordinated supervisory and regulatory responses. Disclosure expectations are a prime example since financial institutions' disclosures are analyzed by a variety of global stakeholders and need to be comparable to fulfil their function of reducing information asymmetries and enhancing market discipline. **We encourage the many authorities that are taking action to strengthen disclosure requirements for different ESG factors (including climate risks) to coordinate their work wherever possible, both within their jurisdictions and at the global level through relevant standard-setting bodies.** Hence,

[2] https://www.fsb.org/wp-content/uploads/P060421-1.pdf

[3] See, for instance, the IIF Position Papers "Building a Global ESG Disclosure Framework: A Path Forward" (June 2020) and "Prudential Pathways: Industry Perspectives on Supervisory and Regulatory Approaches to Climate-related and Environmental Risks" (January 2021).

we strongly support the IFRS Foundation's initiative to create a global sustainability reporting standard which has been endorsed by the International Organization of Securities Commissions (IOSCO)[4] and the FSB[5], as well as the intentions of voluntary leadership coalitions like the NGFS to advance common supervisory approaches to disclosure. We are also supportive of a proper involvement of EU standards setters in the governance of such bodies.

While ESG disclosures by banks will also be governed by general corporate disclosure standards including listing requirements, banks will also potentially have to disclose ESG risks as part of the Pillar 3 framework. Consistency in substance and timing across those two types of requirements is essential. As regards more specifically Pillar 3, we note that the 2021-2022 work program of the Basel Committee on Banking Supervision (BCBS) identifies among its priorities "[t]he assessment, measurement and mitigation of climate-related financial risks, spanning regulatory, supervisory and disclosure-related elements for the banking system"[6] and that the BCBS is evaluating how fit for purpose the existing regulatory framework, including existing Pillar 3 requirements, is for adequately dealing with climate-related risks. The IIF welcomes this endeavor and is supportive of a proper inclusion of the EBA on this work.

Given our hope that global ESG disclosure standards will emerge soon, in particular considering the momentum created around the G20 SFWG and the upcoming 2021 United Nations Climate Change Conference (COP26), we would recommend a more phased approach by the EBA in developing Pillar 3 standards. We acknowledge and value the thought leadership that the EBA has exerted in developing these proposals and fully understand that the proposed draft implementing technical standards (ITS) are a response to its mandate stemming from Article 434a of the Capital Requirements Regulation (CRR). However, **we believe it would be beneficial for the EBA to adopt a phased approach in the implementation of its legislative mandate in order to maintain the maximum flexibility to align its requirements with global standards as they become available**. By adopting such a **'building block' approach**, the EBA would be able to better balance the need of the EU to move forward on this topic, support the work on international convergence and consider the potential future work of standard-setting bodies—which we see as essential to ensure that risks of fragmentation in disclosure requirements are contained.

Before global Pillar 3 standards emerge, significant challenges for global consistency and a level playing field will arise as some jurisdictions move ahead with specific approaches, particularly if highly prescriptive. Therefore, and considering the legislative mandate that the EBA is required to fulfill, **we believe that a building block approach would be the most appropriate to reconcile the**

[4] https://www.iosco.org/news/pdf/IOSCONEWS594.pdf
[5] https://www.fsb.org/wp-content/uploads/P060421-1.pdf
[6] https://www.bis.org/bcbs/bcbs_work.pdf

EU commitment to accelerating the transition to a net-zero economy, while avoiding to impose on its financial sector the burdensome task of adapting to both an EU-specific Pillar 3 ESG framework now and a global standard as and when one will become available.

We think the information required and proposed by the draft ITS goes far beyond what could constitutes a robust 'first building block,' and that some required information is unlikely to be available by the targeted implementation date. In addition, some of the proposed disclosed information is better suited for regulatory reporting than to the disclosure of prudentially relevant information; **we do not see Pillar 3 disclosure requirements as the right fit for some of this information**. For instance, the probability of default might be more suited at this stage for reporting as long as the conceptual and the regulatory frameworks, as well as the associated methodologies to specify a systematic, robust and quantitative link between ESG risk factors and credit risk, do not exist. Furthermore, disclosing banking book exposures to top carbon-intensive firms raises significant legal and confidentiality concerns (further discussed below), but it could be provided in a secure way to a bank's supervisors.

At a fundamental level, **moving ahead with such granular Pillar 3 disclosure requirements can undermine their objective in terms of being informative to and comparable by market participants**. It can also create considerable inefficiencies for financial institutions if they need to develop approaches and systems to meet local requirements which may differ across jurisdictions or be revised in future to account for global standards. **We would therefore strongly encourage the EBA to avoid implementing highly prescriptive Pillar 3 approaches in the short-term, and to refocus its proposal on a first step which would only include what it sees as 'core' information until the BCBS has considered the topic at the global level.** We strongly encourage such a building block approach, starting with a minimum set of disclosures, while in parallel working toward an international standard within the BCBS. As noted above, we understand that this topic is already under consideration within the BCBS Task Force on Climate-related Financial Risks (TFCR).[7] In this more fundamental regard, members also raised doubts whether semi-annual disclosure would be necessary or even feasible, given counterparties will be only disclosing annually.

We appreciate the comprehensiveness of the EU sustainable finance approach and how the different pillars interlink and build on each other—e.g. how the draft ITS build on the EU Taxonomy and rely on data from corporates subject to the NFRD. However, these dependencies will make it less likely that other jurisdictions will adapt the same approach. For instance, it is not clear if non-

[7] See April 14, 2021 press release: "*Building on this analytical work, the Committee will investigate the extent to which climate-related financial risks can be addressed within the existing Basel Framework, identify potential gaps in the current framework and consider possible measures to address them. The Committee will undertake further work in three broad strands simultaneously spanning regulatory, supervisory and disclosure-related elements for the banking system.*"

EU investors would have an interest in information on the EU Taxonomy alignment of companies, in case the EU taxonomy approach ends up differing significantly from global taxonomy or classification standards. It is therefore not clear if non-EU companies would have an incentive to disclose such information. **This could give rise to the emergence of parallel frameworks and cause fragmentation, ultimately to the detriment of EU corporates and banks.**

Further, while the ITS permits non-EU exposures to be disclosed in a separate 'non-EU Green Asset Ratio (GAR)' (on a best effort basis and using proxies) by those institutions with subsidiaries outside the EU, it is not clear this would produce very meaningful or comparable outputs. In addition, further to the EU Taxonomy Climate Delegated Act of the European Commission[8], non-EU exposures would be in the denominator of the main GAR but could not be in the numerator. This could raise level playing field issues where EU banks are present in non-EU countries and finance local businesses, especially in emerging economies. Multiplying the number of ratios at this early stage also seems unnecessary and unlikely to be of great value to investors, who are likely to be focusing on banking book/lending activities. Therefore, **we ask the EBA to consider focusing its first building block on this 'core' GAR, and thus allow banks to focus on data collection and processes to produce this essential ratio**, rather than having to disperse their efforts and investments in covering a broad range of KPIs which would reduce the accuracy and reliability of the resulting outputs.

More globally, there is a real issue of data availability that makes the reporting very challenging if not impossible without using estimates and proxies. However, using proxies and estimates in a large scale without a common methodology would undermine comparability and reliability of information and could be a source of legal risks for banks. For these reasons, a phased and proportionate approach should be considered.

The emergence of various frameworks could also put a burden on European banks that might in the future be subject to different requirements in other jurisdictions they are active in. Our members already face enormous data challenges with regard to ESG disclosure within each jurisdiction—addressing these would become even worse if they would have to satisfy different and competing requirements around the world. Ultimately, this would also hinder progress on this very important topic. **We are therefore urging global authorities to seek alignment on definitions and classifications in order to unlock the development of robust data collection platforms.**

[8] https://ec.europa.eu/info/law/sustainable-finance-taxonomy-regulation-eu-2020-852/amending-and-supplementary-acts/implementing-and-delegated-acts_en

II. Specific Comments

As an organization representing a global membership, we have focused our comments on the above points about global alignment and will only raise selected concerns pertaining to the specific proposed templates and tables, and only comment on a few of the detailed questions raised in the consultation paper.

- **Template 1**: We appreciate the complexity around the identification of relevant metrics and methodologies to assess the extent to which transition risk aggravates banks' traditional risks (credit, market, and operational risks). At this stage, none is mature and quantifying this impact in prudential terms is highly challenging for the following reasons:
    - the different time horizons of transition risk materialization and the maturities of banks' exposures;
    - the lack of historical data on companies' defaults due to transition or physical risk factors; and
    - the absence of common metrics and widely recognized climate scenarios to assess borrowers' ability to shift from carbon-intensive sectors towards activities prone to lower transition risks.

  We are therefore concerned by the **link between exposures to carbon-related sectors and Probability of Defaults (PD)** in the absence of a demonstrated correlation between both, and in a context where investors plan to fully integrate the climate dimension in their investment decision.

- In addition, we are concerned about the inclusion of **non-EU counterparties**. International banking groups face the issue of not being able to use prior public disclosures as there is no equivalent binding disclosure standards in most other jurisdictions (and this situation will likely remain beyond 2024). As long as there is no similar local standard recognized in the jurisdiction considered, there should be no mandatory public disclosures on non-EU counterparties. Where there is no similar local disclosure requirement for corporates, banks would have to request information from clients that other credit institutions located in the same jurisdictions will not. This will put European banks operating outside of EU jurisdictions at a disadvantage.

- In **Template 5 – Exposures in the banking book to top carbon-intensive firms**, institutions are asked to disclose their exposures towards the top carbon-intensive companies in the world, in the EU, or in the home member state of the institution. This template would require institutions to disclose borrower-specific information for up to 20 counterparties. While we understand the EBA's interest in these specific counterparties, our members raised **legal and confidentially concerns** with this disclosure requirement. We would strongly ask the EBA to reconsider this requirement. Even aggregate exposures to the top 20 counterparties need to be carefully balanced with the legal constraints that accompany disclosures of this nature.

- While we understand that the **Green Asset Ratio (GAR)** could provide useful information on the breakdown of EU Taxonomy-aligned assets, **the GAR will be more reflective of a bank's business model than its exposure to ESG type risks**. We note that the EBA, in its own EU-wide pilot exercise on climate risk, has been focusing only on the EU corporate lending portfolio, and is disclosing only one GAR.[9] Therefore, **we recommend that the first building block of the EU Pillar 3 ESG framework should replicate the scope of the EBA climate pilot exercise by focusing on the EU corporate lending portfolio**, and enlarge the scope of asset classes and KPIs at a later stage. Given the caveats noted by the EBA in its climate pilot exercise report, we believe that, in order to enhance the credibility of the disclosure, the priority could be to allow bank to focus on increasing the robustness of the GAR calculation on this scope, rather than embracing a broader scope where data quality will be even poorer.[10]

- More generally, member firms are concerned that **the GAR will not provide an adequate picture of an institution's actual transitional efforts**. The GAR would not distinguish loans that finance emission reduction projects at carbon-intensive companies from those that specifically finance climate-harming activities. Furthermore, it would not account for assets that have indeed become more energy efficient even if they still do not fulfill the requirements of the EU Taxonomy Regulation. As such, **the GAR will not be useful to assess real progress towards a low-carbon economy**. At the same time, however, it will require a lot of resources from institutions to provide such information. Therefore, we urge the EBA to work closely with the European Commission to complement the current taxonomy with an additional, forward-looking dimension, which would capture the alignment of entities with sectorial transition pathways required to meet the net-zero target.

- While the EBA has tried to incorporate some proportionality elements into the proposals, **it is not fully clear how the proportionality principle will apply to small and non-complex EU entities**. Consideration and clarification on that point would be very helpful.

[9] https://www.eba.europa.eu/eba-publishes-results-eu-wide-pilot-exercise-climate-risk

[10] For example, in the EBA climate pilot exercise banks were required to rely on sector averages to proxy missing data which limits the ability to differentiate between corporates in the same sector.

We provide further points in the Annex.

We hope that you will find our comments useful and constructive. The IIF remains committed to active participation in the development of global sustainability disclosure requirements and looks forward to engaging further with you on this topic. If you have any questions, please feel free to contact the undersigned at sgibbs@iif.com and aportilla@iif.com.

Yours sincerely,

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Annex—Responses to Questions for Consultation

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

- While we understand that the Green Asset Ratio (GAR) could provide useful information on the breakdown of EU Taxonomy-aligned assets, the GAR will be more reflective of a bank's business model than its exposure to ESG type risks. Member firms are concerned that the GAR will not provide an adequate picture of an institution's actual transitional efforts. The GAR would not distinguish loans that finance emission reduction projects at carbon-intensive companies from those that specifically finance climate-harming activities. Furthermore, it would not account for assets that have become more energy efficient as long as they do not fulfill the requirements of the EU Taxonomy Regulation. As such, the GAR will not be useful to assess real progress towards a low-carbon economy. At the same time, however, it will require a lot of resources from institutions to provide such information.
- We propose that the Trading Book Template should be excluded from Pillar 3 at this stage (further discussed in the response to Question 11).
- The inclusion of quantitative information about ESG risk factors and their impacts on common risks categories into the Pillar 3 disclosure is premature. 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, do not exist. Consequently, templates should not mix up ESG non-financial data and risk parameters. The link with risk parameters (PD/Performing/non-performing/Stage 2/ Accumulated impairment, Accumulated negative changes in fair value due to credit risk and provisions) does not seem to be justified and we find it premature to publicly disclose this information. We believe it should be only included under supervisory reporting if needed.
- We understand that the EBA wants to overcome in the Pillar 3 report the fact that no taxonomy for environmentally harmful exposures has been defined in the European regulation so far. However, this requirement goes beyond the purpose of Pillar 3 disclosures and Art. 449a of the CRR mandate. In addition, members struggle to understand the definitions proposed by the EBA; the link with the Climate Benchmark Standards Supplementing Regulation introduces unnecessary complexity and requires information that members are not sure they can obtain from their customers. Finally, not less than three different types of classification of 'harmful activities' or 'harmful companies' are required in the consultation. Members believe this type of reporting is premature and will lead to misinterpretations for preparers and users of the proposed disclosures.

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

- Members propose the three qualitative templates to be replaced by the TCFD report. As TCFD standards are recognized at international level, they ensure comparability and a level playing field among banks.

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).

- In *Template 5 – Exposures in the banking book to top carbon-intensive firms*, institutions are asked to disclose their exposures towards the top carbon-intensive companies in the world, in the EU, or in the home member state of the institution. This template would require institutions to disclose borrower-specific information for up to 20 counterparties. While we understand the EBA's interest in these specific counterparties, our members raised legal and confidentially concerns with this disclosure requirement. We would strongly ask the EBA to reconsider this requirement and allow more aggregated reporting.
- Additionally, as discussed in the EBA's Public Hearing, the EBA should clarify whether the top 20 companies is counted worldwide, EU-wide or locally.

Question 11: What are respondents view on the way template 6 reflects how the trading book of institutions may be impacted by climate change transition risk? Do respondents agree that the threshold proposed to determine which institutions have to disclose this template is the appropriate threshold? Feedback on whether there are alternative ways to present information on the trading book that may allow for a better understanding of how climate change transition risk may impact the trading portfolio.

- We propose to start with the banking book, which represents the major part of the balance sheet of the European banking system. More work needs to be done by regulators and other stakeholders to assess the relevance and usefulness of the inclusion of the trading book in the Pillar 3 disclosure, considering the very burdensome implementation challenges and the perceived absence of clear value added for investors as well as the potential to lead to incorrect interpretations and conclusions. Fundamentally, the conceptual link between long-term ESG factors and the short-term nature of the trading book is difficult to approach and requires greater analysis. The framework remains very conceptual at this stage.

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?

- To provide information on exposures in the banking book subject to climate change physical risk is challenging and the EBA acknowledges that by proposing a simplified and an extended template. However, if the intention of Template 7 is to obtain sector-wide data for supervisors or market participants to infer trends, concentrations or other insights for the industry, IIF members thinks that this will not be achieved as long as there is no standardized way in which physical risk exposures are measured. We propose disclosing the physical risks in a qualitative manner only for the time being.