Main points

EBA consultation on Discussion Paper to incorporate ESG risks into the governance, risk management and supervision of credit institutions and investment firms - link

The Dutch Banking Association (NVB welcomes the opportunity to respond to the EBA Discussion Paper on management and supervision of ESG risks for credit institutions and investment firms. It is paramount to evaluate and measure ESG risks in a common and comparable way and have a common understanding of these risks. Hence, we have read the paper with great interest and we are happy to provide feedback.

A. The proposed definitions of ESG factors, ESG risks and their transmission channels are understandable, but ask for further alignment, clarification and guidance.

- The NVB would like to stress the importance of aligning the ESG risk definitions, transmission channels and materiality with other legal initiatives, like SFDR, MiFID, ECB guide on climate and environmental risks and NFRD. When not aligned, this could create an extra complexity for disclosures and internal processes where these concepts are understood differently in different contexts.
- The NVB finds that the EBA should clarify on the scope, interpretation and distinction of the EBA definitions with regard to potential financial impact on the clients and banks (impact on banks/ financial materiality) and actual impact on people and planet (impact by banks). This would also be in line with statements throughout the paper that ESG risk management includes both managing the ESG impact (ESG materiality) and the financial consequences thereof (financial materiality).
- We would like to understand if the EBA poses these definitions as binding, or whether institutions remain to have some room for own definitions. It must be stated that ESG risks are developing rapidly, making flexibility desirable.

B. The NVB finds that the expectations with regard to the incorporation on ESG factors and ESG risks in supervision are clear and understandable. Yet, we remark there are still various practical hurdles.

- From a conceptual point of view, the NVB understands why the time horizon of the supervisory assessment needs to be extended. Benefit lies in looking at a variety of time horizons to manage the impact of climate change as different risks could materialize and inform strategic choices as well as risk appetite setting. From a practical point of view, there are a number of obstacles, including the precise determination of 'long term resilience'.
- The key hurdle on assessing either of these time horizons is around the access to adequate (historic) data and convergence of methodologies that can support the quantification of the impact. This is clearly a topic where banks, regulators and supervisors should team up to collectively determine approaches for this.

C. The NVB understands the proposed ways how to integrate ESG risks into the risk management framework of institutions. However, the NVB is concerned about the increasing role and responsibility for ESG risk management and the resolution that is being placed on them.

- The NVB is concerned about the increasing role and responsibility for ESG risk management and the resolution that is being placed on them. The suggestions advocated in this EBA Discussion Paper effectively push credit institutions further away from their basic function as credit intermediaries, apply more hurdles for investment firms when investing the pooled capital of investors in financial securities, and potentially move Regulators away from their mission of safeguarding the financial system. While this is for a good cause, improving the ESG and sustainability profiles across the market, it is not entirely risk-free even when responsibly implemented. The EBA is invited to give their view on this concern.

D. The NVB strongly endorses the notion that smaller institutions are indeed more vulnerable to ESG risks and advocates for clear notions on proportionality.

- The NVB believes smaller institutions, such as credit institutions and investment firms, can be more vulnerable than larger institutions. The extent to which smaller institutions may be precisely vulnerable to ESG risks varies. It is a function of the institution's business model, relative size, internal organisation and nature and complexity of its activities.
- The principle of proportionality is also important. First, the NVB would like to remark that there is a need to get more substance to the definition and translation of the principle of proportionality. Second, the NVB wants to stress that a proportional approach should be taken which ensures that LSIs further develop, but that the management system and oversight are not disproportionate to the level and materiality of the financial risk. Assurance is a point of attention as this is already costly for LSIs on the normal financial elements.

E. The NVB finds that the mentioned quantitative and qualitative indicators, metrics and methods to assess ESG risks are helpful, but asks for further guidance.

- Currently, the EBA paper focusses mostly on climate and environment. It would be helpful to suggest indicators for other environmental risks, social and governance risks.
- Ideally, banks would be able to assess the ESG risks we are exposed to both qualitatively and quantitatively. At the moment, given the different restraints or challenges (including uncertainty, lack of data, methodological constraints, time horizon mismatch) it is not yet possible to have many quantitative indicators indicating financial implications of ESG risks, certainly not over all sectors of portfolio's over the short, medium and long term. EBA should give flexibility and encourage alternative methods, metrics, and indicators in the short term in order to bring all ideas forward.

F. The adoption of strategic ESG risk-related objectives and/or limits could be further supported through various measures.

- The NVB like to mention one major issue that will need support: the availability of reliable, adequate, recent, and low-cost data. Banks have only access to public information but even so, sources of information may be limited and hard to compare and interpret. This needs to be addressed in coordination with supervisors and institutions. Besides, also methodologies should be developed to translate these data to tangible risk-data. Currently financial institutions are limited because of a lack of data coming from counterparties.
- The variety in determining parameters of materiality or assessing counterparty risk makes it very hard to compare results (also between institutions), and hence, the content of reports.
- Not only the publication of ESG specific papers and guidelines is useful. Extending the currently existing guidance and level 2 regulation on specific risk type to include more practical approaches and solutions to ESG risks would be beneficial.
- Governments and regulators need to prevent arbitrage by institutions and/or counterparties and strive for a level playing field. For instance, there is a difference between developed countries and emerging countries, both in objectives, policies, and priorities as well as in most urgent risks.

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