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# Guidelines on the management of ESG risks

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Consultation Paper  
Public hearing – 28 February 2024

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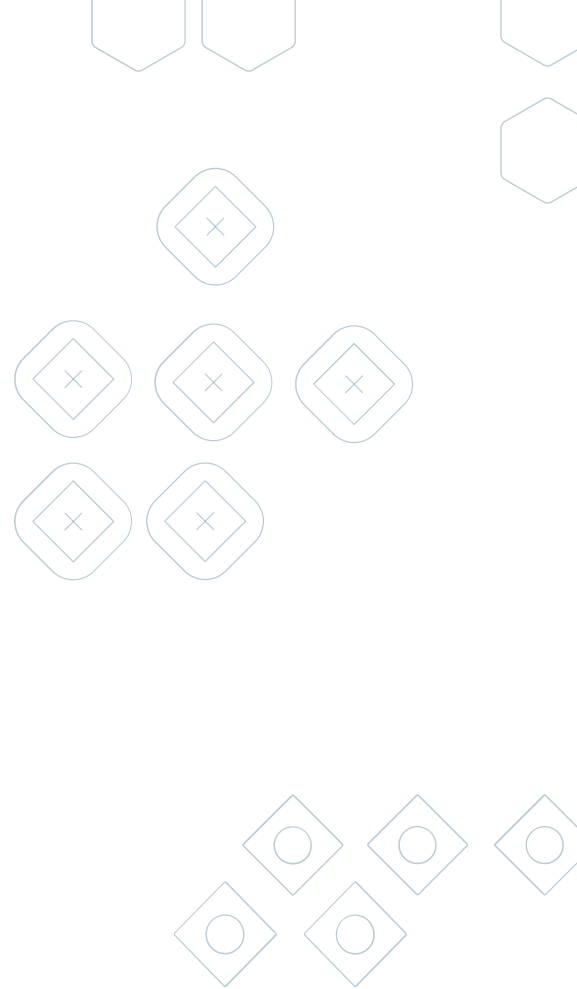
# 01

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## Background

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The ESG risks management Guidelines form part of EBA's roadmap on sustainable finance



# EBA's roadmap on sustainable finance



**Guidelines on ESG risks management** are part of the EBA's comprehensive ESG workplan and regulatory agenda

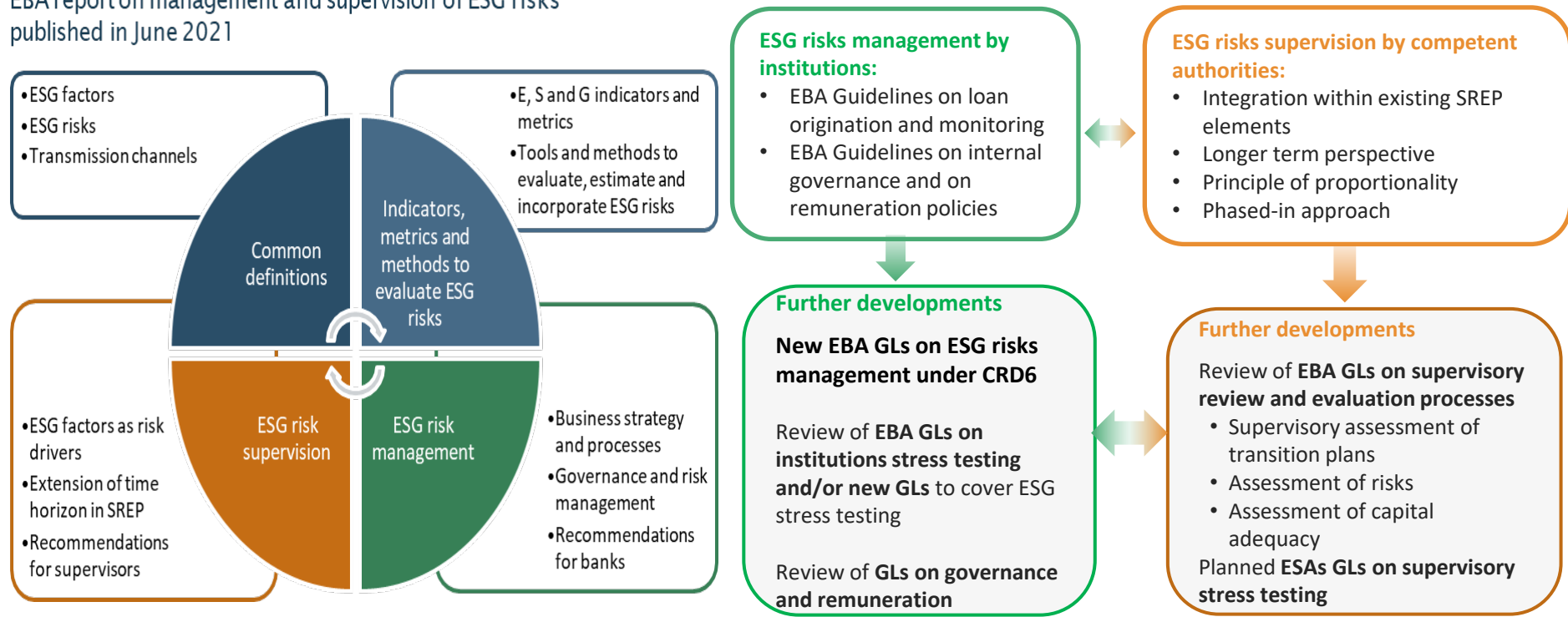
**Overall objective is to build an adequate framework for EU banks and their supervisors to mitigate ESG risks and support an orderly transition to a sustainable economy**

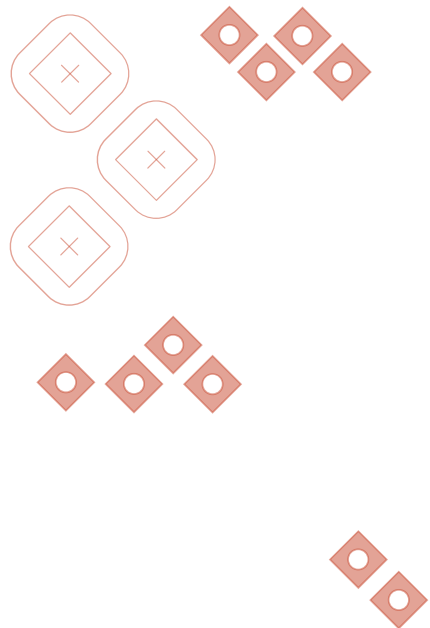
- ensuring a thorough but proportionate application
- fostering resilience of the EU banking sector and broader economy
- facilitating convergence at EU and international levels

**through a holistic and sequenced approach**

# ESG risks management and supervision

EBA report on management and supervision of ESG risks  
published in June 2021

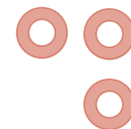
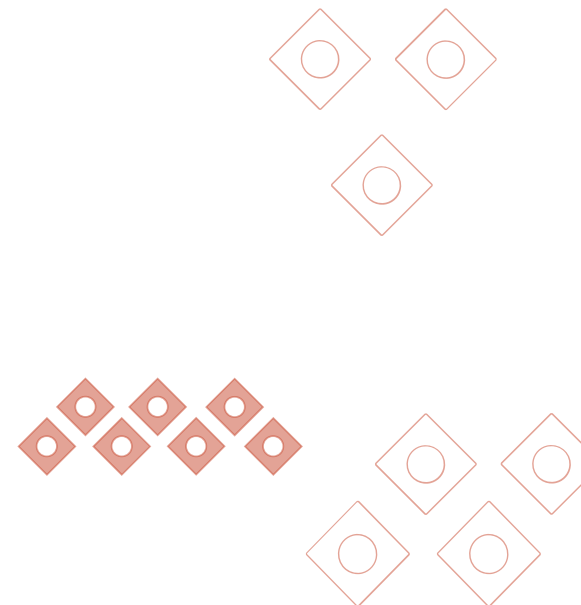




# 02

## Objective and general approach of Guidelines on ESG risks management

Legal basis, objective and cross-cutting  
considerations



# Legal basis / EBA mandate

## Article 87(a)5 of Capital Requirements Directive as per December 2023 provisional agreement

EBA shall issue guidelines, in accordance with Article 16 of Regulation (EU) No 1093/2010, 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), 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 [nb: of article 87a of the CRD], including the parameters and assumptions to be used in each of the scenarios, specific risks and time horizons [nb: climate/ESG stress testing].

EBA shall publish those guidelines by [18 months from date of entry into force of this amending Directive]. EBA shall update those guidelines on a regular basis, to reflect the progress made in measuring and managing ESG risks as well as the development of the Union regulatory objectives on sustainability.

# General approach

## ***Key objective***

The GLs aim at enhancing the **identification, measurement, management and monitoring of ESG risks** by institutions and at supporting their **safety and soundness** as the EU transitions towards a more sustainable economy and ESG risks increasingly become substantiated or materialise

## ***Proportionality***

All institutions are subject to the GLs, but proportionality ensured through (i) emphasis on **materiality assessment** and (ii) **SNClIs** may implement **less complex / sophisticated arrangements**

## ***Focus on environmental risks***

Emphasis on E risks while also minimum requirements on S and G. Important for institutions to cover **full spectrum of E risks** beyond climate, e.g. biodiversity-related risks

## ***Consistency with other EU and international initiatives***

The GLs build on and ensure consistency with other **EBA products** referring to ESG risks, **BCBS principles** for the effective management of climate-related financial risks and **EU legislative and non-legislative initiatives relating to transition plans**



## Questions raised in the consultation

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.

# Structure of consultation paper

## Background and rationale

### Reference methodology for the identification and measurement of ESG risks

- Materiality assessment
- Identification and measurement of ESG risks (including approach to data and methodologies)

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

- ESG risks management principles
- Strategies and business models
- Risk appetite
- Internal culture, capabilities and controls
- ICAAP and ILAAP
- Credit risk policies and procedures
- Policies and procedures for market, liquidity and funding, operational, reputational and concentration risks
- Monitoring

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

- Key principles
- Governance
- Metrics and targets
- Climate and environmental scenarios and pathways
- Transition planning



# 03

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## Identification and assessment of ESG risks

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Materiality assessment, data and  
methodologies

## Identification and assessment of ESG risks (1/2)

- ESG risks, in particular E risks through transition and physical risk drivers, may affect institutions' **credit, market, operational, liquidity and funding, concentration risks**
- Institutions should regularly (i.e. yearly, at least every 2 years for SNCIs) perform a **materiality assessment** of ESG risks
  - considering potential effects on all conventional financial risk categories and on significant activities, services and products
  - consistently with, and integrated into, existing materiality assessments e.g. for ICAAP purposes
  - considering short (<3 years), medium (3 to 5 years) and long-term time horizons (≥10 years)
  - with specific requirements set for the assessment of environmental transition and physical risks, including (rebuttable) presumption of materiality for exposures towards sectors recognized by EU regulation as highly contributing to climate change

## Identification and assessment of ESG risks (2/2)

- Institutions should build their internal procedures for the collection, structuring and analysis of **data**, regularly reviewing/improving practices and leveraging public initiatives
  - data items to be collected specified by the GLs (for large corporates)
  - data gaps to be assessed. Estimates and proxies as intermediate steps
- Institutions should combine **exposure-based, portfolio-based and scenario-based methodologies** to assess ESG risks across time horizons
  - allowing for quantification of E risks, qualitative assessment for S and G as first step
  - main features of exposure-based (e.g. set of risk factors and criteria) and portfolio-based (e.g. climate portfolio alignment measure) are specified, leaving a degree of flexibility to institutions to develop methods over time

## Questions raised in the consultation

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

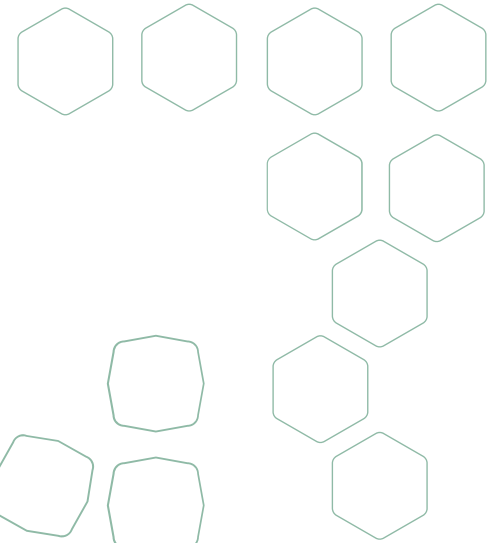
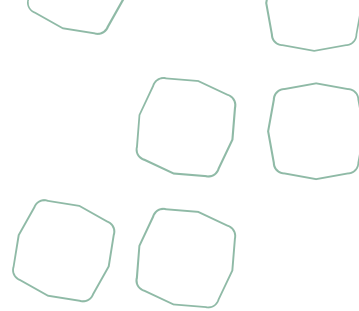
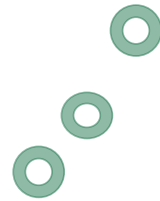
Question 5: Do you agree with the specification of a minimum set of exposures to be considered as materially exposed to environmental transition risk as per paragraphs 16 and 17, and with the reference to the EU taxonomy as a proxy for supporting justification of non-materiality? Do you think the guidelines 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.



# 04

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## Management and monitoring of ESG risks

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Integration into core risk management  
processes and policies



## Management and monitoring of ESG risks (1/2)

- Institutions should embed ESG risks as **risk drivers** within their **regular risk management systems** and processes
- Institutions should consider a **range of risk management tool(s)** including engagement with counterparties, adjustment of financial terms/conditions/pricing, risk limits, diversification and other tools such as reallocation of financing
- Business and risk strategies should be informed by an assessment of ESG risks impacts on the business environment and viability of business model. Institutions should consider insights gained from **forward-looking** assessments e.g. scenario analyses and portfolio alignment methods
- **Risk appetite** should specify the type and extent of ESG risks in portfolio composition in relation to business lines, geographies, economic sectors, activities and products, with the support of KRIs cascaded down within the institution



## Management and monitoring of ESG risks (2/2)

- **Internal culture, capabilities and controls** should be built for & embed ESG risks aspects e.g. roles for the 3 lines of defence
- Institutions should incorporate material effects of ESG risks into their **ICAAP and ILAAP**. Institutions to include a forward-looking view of their capital adequacy under an adverse scenario that includes specific environmental risks elements.
- ESG risks aspects specified for **credit, market, liquidity and funding, operational, reputational and concentration risks** policies
- **Monitoring** to be performed through internal reporting and early warning indicators. Non-exhaustive metrics listed in the GLs.

## Questions raised in the consultation

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?

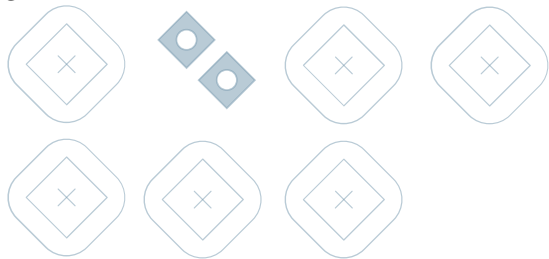
Question 14: Do you have comments on section 5.5 – consideration of ESG risks in ICAAP and ILAAP?

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?

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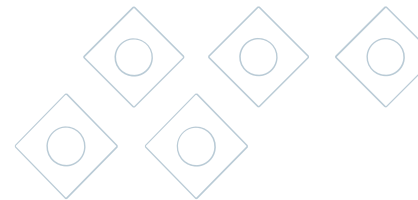
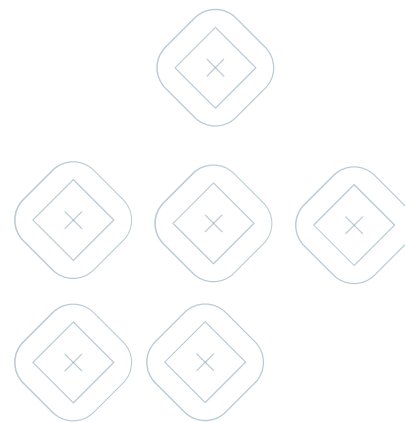
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## Plans to address ESG risks

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Prudential transition plans to monitor and address ESG risks under CRD6



# Plans under article 76(2) of CRD6 (1/3)

## **Background**

The long-term nature and the profoundness of the transition may entail significant changes in the business models of institutions and in the types and levels of risks they are confronted with

- CRD6 requires institutions to set out **plans 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.
- Where relevant, the methodologies and assumptions sustaining the targets, the commitments and the strategic decisions disclosed publicly by institutions under CSRD or other frameworks shall be consistent with the criteria, methodologies, assumptions, and targets used in the plans to be prepared in accordance with the CRD.

## **EBA's approach**

Institutions' plans should **articulate the strategic actions and risk management tools** deployed to ensure robustness & preparedness

- To be considered as part of the **broader EU framework on transition plans** (CSRD, CSDDD, EC recommendation on transition finance)
- **A single transition plan for institutions** whereby the CRD-based plans address the financial risks aspects
- **Goal:** 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

## Plans under article 76(2) of CRD6 (2/3)

- Plans should be based on ESG risks materiality assessments, **reviewed** in accordance with business strategy and **documented**
- Plans should establish different **time horizons**, including a  $\geq 10$  years time horizon, with an intermediate **milestone at 2030** considering the EU objective to cut GHG emissions by 55%. Short-, medium- and long-term objectives to be well articulated (e.g. long-term net zero target should translate into short- and medium-term metrics and strategies).
- Plans should be **integrated into the business strategies**, aligned and consistent with risk and funding strategies, risk appetite, ICAAP, risk management framework and public communication.
- Institutions should clearly identify and allocate **responsibilities** for the development, implementation and monitoring. MB responsible for approval and overseeing implementation

## Plans under article 76(2) of CRD6 (3/3)

- Institutions should set **targets** for risk management and strategic steering purposes, clearly defining activities and business lines covered
- Metrics supporting targets include while are not limited to **financed emissions, climate portfolio alignment, income-based indicators, energy efficiency levels of collateral and counterparties' engagement** (e.g. review of counterparties' own transition plans)
- Institutions should carefully define and select climate and environmental **transition scenarios and pathways** underlying target-setting
- **Transition planning** should rely on several tools including **engagement with counterparties**, integration of ESG criteria in loan origination policies, policies and conditions (e.g. on environmentally harmful sectors or counterparties), approach to adaptation to physical risks, strategic financing choices and development of new products or services – including sustainable & transition finance

## Questions raised in the 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 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?

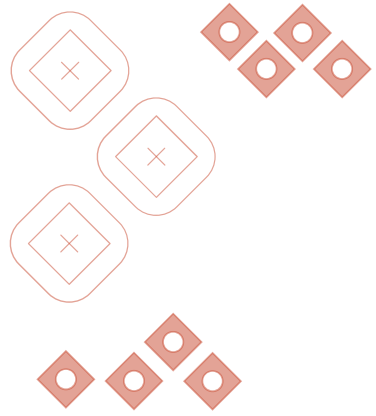
Question 20: Do you have comments on the metrics and targets to be used by institutions as part of the plans required by the CRD? Do you have suggestions for other alternative or additional metrics?

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?

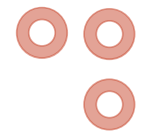
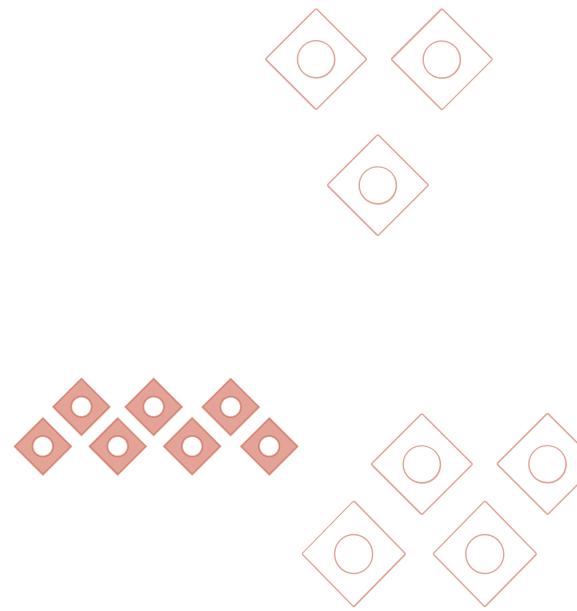


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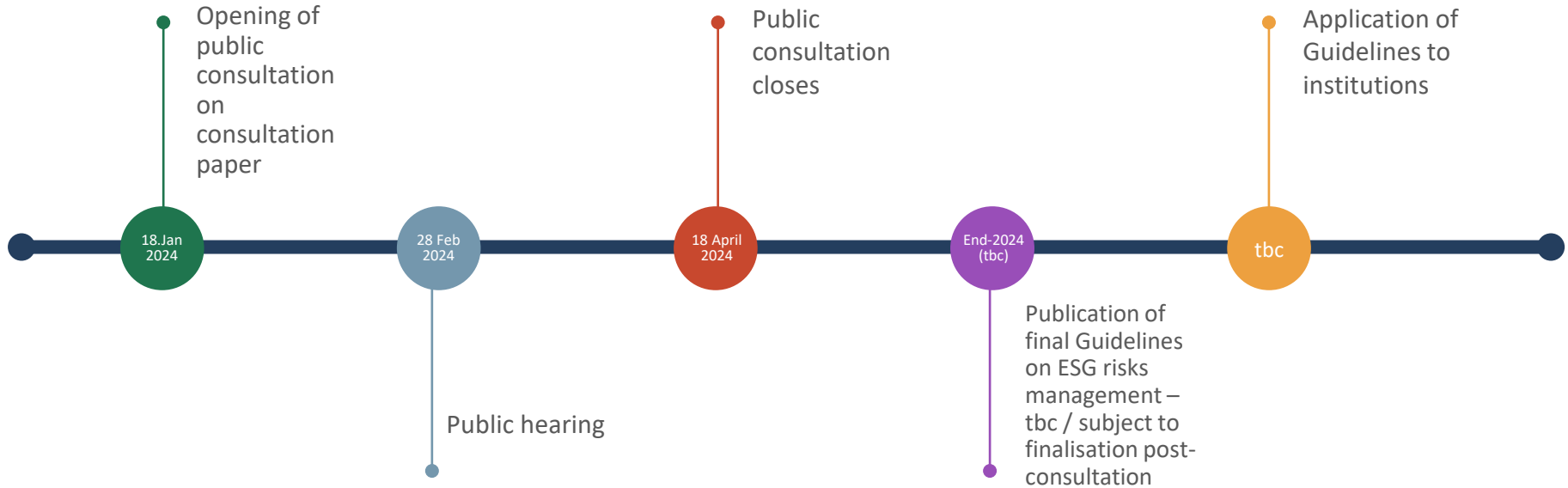
Next steps

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# Timeline



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Thank you

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Floor 24-27, Tour Europlaza  
20 Avenue André Prothin  
92400 Courbevoie, France

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Tel: +33 1 86 52 70 00  
E-mail: [info@eba.europa.eu](mailto:info@eba.europa.eu)

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<https://eba.europa.eu/>

