



EUROPEAN CENTRAL BANK
BANKING SUPERVISION

Template for comments

Guide on the management and disclosure of climate-related and environmental risks

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General comments

Template for comments

Guide on the management and disclosure of climate-related and environmental risks

Please enter all your feedback in this list.

When entering feedback, please make sure that:

- each comment deals with a single issue only;
- you indicate the relevant article/chapter/paragraph, where appropriate;
- you indicate whether your comment is a proposed amendment, clarification or deletion.

Deadline: 25 September 2020

| ID | Chapter | Paragraph | Expectation or box number | Page | Type of comment | Detailed comment | Concise statement as to why your comment should be taken on board | Name of commenter | Personal data |
|----|-----------|-----------|---------------------------|------|-----------------|--|--|-------------------|---------------|
| 1 | Chapter 3 | 3.2 | | 10 | Clarification | When referring to "liability risk" here, this section refers to losses "stemming from legal claims on the institution" and there is a footnote which adds that counterparties of institutions "may also be impacted by legal risks arising from environmental or climate-related factors which, in turn, can increase the credit risk for the institution." We recommend bringing into the main text a reference to climate-related and environmental litigation both against the institution directly AND its counterparties, as a key example of liability risk. | The impact of climate-related and environmental litigation against counterparties of institutions is of particular importance due to its growing prevalence, its potential for significant financial consequences, and therefore its potential for significant impacts on credit risk. This should be expressly referred to at the start of the Guide, as this type of risk should be considered by institutions throughout the prudential framework. | Sawyer, Jamie | Publish |
| 2 | Chapter 4 | 4.2 | Expectation 2 | 17 | Amendment | Expectation 2 should go further: when determining their business strategy, and in order to effectively integrate climate-related and environmental risks in their business strategy, institutions should be expected to prepare and disclose credible 'Paris-aligned business strategies' that are aligned with the goals of the Paris Agreement and report annually on progress. These business strategies should include short, medium and long term emission reduction targets (covering Scope 1, 2 and 3 greenhouse gas emissions). "Observed practice" examples of this may be given where institutions are now putting in place Paris-aligned strategies, such as BNP Paribas and Barclays Bank. | For an institution's business strategy to credibly reflect climate-related and environmental risks, it will necessarily need to be aligned with the goals of the Paris Agreement. This is particularly important in light of the recognition of the macroeconomic and systemic nature of climate-related risks, and institutions need to play a part in mitigating that systemic risk. The ECB should expect institutions to prepare and disclose Paris-aligned business strategies. | Sawyer, Jamie | Publish |

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| 3 | Chapter 4 | 4.2 | Expectation 2.1 | 17 | Amendment | Scenario analysis "should" (to replace "can") be used to assess risks in the short to medium term as well as the longer term. | Climate-related and environmental risks will crystallise over a long timeframe so scenario should be used to assess longer term risks as well. | Sawyer, Jamie | Publish |
| 4 | Chapter 4 | 4.2 | Expectation 2.1 | 17 | Clarification | In determining which risks are 'material', it should be made clear that quantitative measurements alone are currently unlikely to be adequate while effective methodologies are still being developed, so institutions should not rely solely on quantitative measurements to determine materiality or as a prerequisite for addressing such risks. | This reflects that current methodologies to measure risks are still at an early stage of development. | Sawyer, Jamie | Publish |
| 5 | Chapter 4 | 4.2 | Expectation 2.1 | 18 | Clarification | The "longer-term assessment" of risk through scenario analysis should be clarified to refer to a longer modelling horizon, such as a 30 year horizon (rather than the ">5 years" indication currently given). | Specifying a longer horizon which better reflects the longer term nature of climate-related and environmental risk will avoid banks running scenario analysis with only a 6 or 10 year modelling horizon, for example. | Sawyer, Jamie | Publish |
| 6 | Chapter 4 | 4.2 | Expectation 2.2 | 18 | Clarification | In implementing their business strategy, institutions should disclose their assumptions and targets, and their performance against those targets. If the institution does not use a methodology published by an independent third party, it should publish the methodology it has used to calculate its targets. Targets should be regularly updated over time to reflect the institution's business strategy, which should be informed by the best available science. | There are currently a wide variety of methodologies and assumptions which can underpin a business strategy that reflects climate-related and environmental risks, so it is imperative that the institution is transparent about its assumptions, targets and methodologies. | Sawyer, Jamie | Publish |
| 7 | Chapter 5 | 5.1 | Expectation 3.2 | 20 | Amendment | In ensuring climate-related and environmental risks are adequately embedded in the business strategy and risk management framework, Expectation 3.2 advises the management body to consider the institution's response to the objectives set out under international agreements, such as the Paris Agreement. We are strongly supportive of this. However, we believe that the ECB should specify that it expects institutions to respond to the objectives set out under the Paris Agreement by preparing and disclosing credible 'Paris-aligned business strategies' that are aligned with the goals of the Paris Agreement and reporting annually on progress (as also set out in our comment on Expectation 2 above). These business strategies should include short, medium and long term emission reduction targets (covering Scope 1, 2 and 3 greenhouse gas emissions). | For an institution's business strategy to credibly reflect climate-related and environmental risks, it will necessarily need to be aligned with the goals of the Paris Agreement. This is particularly important in light of the recognition of the macroeconomic and systemic nature of climate-related risks, and institutions need to play a part in mitigating that systemic risk. The ECB should expect institutions to prepare and disclose Paris-aligned business strategies. | Sawyer, Jamie | Publish |

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| 8 | Chapter 5 | 5.2 | Box 4 | 22, 23 | Clarification | The observed practice notes that "several institutions aim to keep the carbon content of their financed energy mix in line with the target of remaining well below 2C as provided for in the Paris Agreement (2015)." This box should clarify that the goal of the Paris Agreement is to hold the increase in global average temperature to well below 2C above pre-industrial levels and pursue efforts to limit the temperature increase to 1.5C above pre-industrial levels. The ECB should expect institutions to aim to keep their financing in line with a 1.5C target, given the many scientific assessments that show the significantly more devastating impacts if we do not keep below the 1.5C target. | Without this clarification, there is a danger that banks will interpret that it would be acceptable to keep their financing in line with a 2C target, which should not be the ECB's position in light of the scientific evidence. | Sawyer, Jamie | Publish |
| 9 | Chapter 5 | 5.2 | Expectation 4.3 | 23 | Clarification | Expectation 4.3 should be clarified so that institutions' remuneration policies and practices should be linked to the achievement of climate-related and environmental targets and objectives set out in their business strategies and elsewhere. | Due to the potential for the achievement of climate-related and environmental targets to be misaligned with other internal and external incentives, it is imperative that senior decision-makers are appropriately incentivised to achieve targets and are effectively accountable where they fail to do so. | Sawyer, Jamie | Publish |
| 10 | Chapter 5 | 5.3 | Expectation 5.2 | 24 | Amendment | The ECB should "expect institutions to put in place appropriate training on an ongoing basis" for all relevant functions, rather than "encourage appropriate training." | Climate-related and environmental risks may be unfamiliar to many functions and are a rapidly developing area, so training is vital and the ECB should expect rather than encourage it. | Sawyer, Jamie | Publish |
| 11 | Chapter 6 | 6.1 | Expectation 7.2 | 29 | Amendment | We propose an amendment to the text as follows: Where such quantification methodologies are subject to further developments, also taking into account the current work and upcoming publications of international networks and standard setters, institutions are expected to make active efforts to develop or apply appropriate tools and methods "including reasonable proxies and assumptions where necessary so as not to leave known risks unrecognised." | This amendment recognises that the current standards and tools are not sufficiently developed, but the institution should still develop tools and methods even if proxies and assumptions are needed, so the risks are still recognised and quantified to the extent possible at this time, until better tools are developed. | Sawyer, Jamie | Publish |

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| 12 | Chapter 6 | 6.1 | Expectation 7.3 | 29, 30 | Amendment | <p>In relation to entering into constructive dialogue with critical counterparties and agreeing on measures to gradually reduce their climate-related or environmental risks, we propose the following addition:</p> <p>Before providing financing, institutions should require that all counterparties receiving financing have a Paris-aligned business strategy or agree to adopt one by a prescribed deadline. As institutions develop insights on best practices for decarbonisation by sector, they should start to engage with counterparties on their Paris-aligned business strategy before new financing is provided, which may include setting targets or deadlines to achieve their net zero objective. Financing should be subject to conditions and borrower covenants reflecting the above that link to events of default. Counterparty compliance should be monitored, enforced and reported against on an ongoing basis.</p> | <p>The alignment of institutions' business strategies with the Paris Agreement, including the reduction of their Scope 3 greenhouse gas emissions, is heavily dependent on the alignment of their real economy counterparties. For this reason, it is particularly important for institutions that claim a Paris-alignment objective to articulate how they will strategically use their financing decisions to influence their Scope 3 emissions by engaging with their counterparties to change their behaviour.</p> | Sawyer, Jamie | Publish |
| 13 | Chapter 6 | 6.1 | Box 7 | 30 | Amendment | <p>The observed practice set out in Box 7 of adjusting risk weightings for exposures depending on their climate or environmental impact should also be included as an approach for institutions to consider taking as part of the list at Expectation 7.3 (page 30).</p> | <p>The adjustment of risk weightings of assets based on climate or environmental impacts is an effective way to encourage the alignment of financial flows with the goals of the Paris Agreement, so the ECB should set an expectation that institutions should consider this.</p> | Sawyer, Jamie | Publish |
| 14 | Chapter 6 | 6.1 | Expectation 7.4 | 30 | Amendment | <p>As also set out above for Expectation 7.3, we propose the following addition within Expectation 7.4:</p> <p>Before providing financing, institutions should require that all counterparties receiving financing have a Paris-aligned business strategy or agree to adopt one by a prescribed deadline. As institutions develop insights on best practices for decarbonisation by sector, they should start to engage with counterparties on their Paris-aligned business strategy before new financing is provided, which may include setting targets or deadlines to achieve their net zero objective. Financing should be subject to conditions and borrower covenants reflecting the above that link to events of default. Counterparty compliance should be monitored, enforced and reported against on an ongoing basis.</p> | <p>The alignment of institutions' business strategies with the Paris Agreement is heavily dependent on the alignment of their real economy counterparties. For this reason, it is particularly important for institutions that claim a Paris-alignment objective to articulate how they will strategically use their financing decisions to influence their Scope 3 emissions by changing the behaviour of their counterparties.</p> | Sawyer, Jamie | Publish |

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| 15 | Chapter 6 | 6.2 | Expectation 8.6 | 34 | Clarification | This section should also state that the impact of climate-related and environmental risks on credit risk should be reflected by institutions in their calculation of risk weightings, so that this will feed into their loan pricing due to the impact on capital requirements. | The adjustment of risk weightings of assets based on climate-related or environmental impacts on credit risk is an effective way to encourage the alignment of financial flows with the goals of the Paris Agreement, so the ECB should set an expectation that institutions should reflect this. | Sawyer, Jamie | Publish |
| 16 | Chapter 6 | 6.3 | Expectation 9.2 | 35 | Clarification | This Expectation largely focuses on reputational risk despite the reference to liability. We suggest clarifying that liability risks may include climate-related or environmental litigation against the institution. | The impact of climate-related and environmental litigation against institutions is of particular importance due to its growing prevalence and its potential for financial and reputational impacts. | Sawyer, Jamie | Publish |
| 17 | Chapter 6 | 6.3 | Expectation 9.2 | 35 | Amendment | When referring to "controversy in connection with their products", we suggest referring to "allegations or perception of greenwashing" as an example. | One concerning example of potential climate-related and environmental litigation is greenwashing by institutions, particularly before the EU Taxonomy is completed, and therefore is worth mentioning specifically. | Sawyer, Jamie | Publish |
| 18 | Chapter 6 | 6.5 | Expectation 11 | 37 | Clarification | In relation to scenario analysis and stress testing, the ECB should provide greater guidance on what climate scenarios should be used to ensure a level of consistency across institutions. In particular, it should be stated that one key scenario institutions should be using should reflect a temperature rise of no more than 1.5C, in line with the goals of the Paris Agreement. | The guidance given around scenario analysis and stress testing is currently insufficient and is likely to lead to highly divergent approaches between institutions. | Sawyer, Jamie | Publish |
| 19 | Chapter 6 | 6.5 | Expectation 11 | 38 | Amendment | The ECB should indicate what longer time horizon it expects institutions to use, such as a 30 year horizon given the longer term nature of climate-related and environmental risks. | Specifying a longer horizon which better reflects the longer term nature of climate-related and environmental risk will avoid banks running scenario analysis with only a 6 or 10 year modelling horizon, for example. | Sawyer, Jamie | Publish |
| 20 | Chapter 6 | 6.5 | Expectation 11 | 37 | Clarification | Institutions should be required to make their scenario analysis models and assumptions public and their methodologies should be subject to third party assurance. | The guidance given around scenario analysis and stress testing is currently insufficient and is likely to lead to highly divergent approaches between institutions, but this risk can be reduced through greater transparency and independent assurance. | Sawyer, Jamie | Publish |

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| 21 | Chapter 7 | | Expectation 13 | 40 | Clarification | The concept of 'double-materiality' that is included in the European Commission's Guidelines on non-financial reporting: Supplement on reporting climate-related information (referred to in Expectation 13), is somewhat confusing and needs to be clarified in this Guide to ensure institutions understand its scope. | Currently there is far too much discretion and leniency afforded for directors and management to decide what does and does not count as material climate-related and environmental risks. Clearly defining the concept of 'double-materiality' is essential to create a more level playing-field to support best practice. | Sawyer, Jamie | Publish |
| 22 | Chapter 7 | | Expectation 13.1 | 40, 41 | Clarification | Institutions should be required to disclose the way in which the materiality of climate-related and environmental risks are assessed, but the ECB should provide more detailed guidance to ensure that there is a level playing field and institutions take consistent approaches to determining materiality. In order to be meaningful, the term 'materiality' must be defined by reference to the reasonable expectations of the users of the relevant information. Where these disclosures are intended to be used solely by investors to inform investment and stewardship decision-making, then investors will be the relevant audience. Where it is envisioned that other stakeholders reasonably have an interest in the information being disclosed (such as creditors, regulators, employees, customers and civil society), then their reasonable expectations will also need to be reflected in the relevant definition and taken into account. See, for example, the materiality process used by PMI: https://www.pmi.com/media-center/news/material-impacts-defining-our-sustainable-priorities | Currently there is far too much discretion and leniency afforded for directors and management to decide what does and does not count as material climate-related and environmental risks. Institutions must be required to regularly obtain and take into account the views of investors and other stakeholders on what information is material to them. Clearly defining and mandating this approach is essential to create a more level playing-field to support best practice. | Sawyer, Jamie | Publish |
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