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European Banking Authority
Tour Europlaza 20, avenue André Prothin,
92400 Courbevoie, France

Japanese Bankers Association

JBA comments on the EBA Consultation Paper: "*Draft Guidelines on the management of ESG risks*"

Dear Sirs/Madams:

The Japanese Bankers Association[1] (JBA) appreciates the opportunity to provide our comments on the European Banking Authority's (EBA) Consultation Paper: "*Draft Guidelines on the management of ESG risks*"[2] released on 18 January 2024.

We hope that our comments will contribute to further discussions at the EBA.

Responses to the questions

Q1: 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?

- We welcome that the EBA seeks to explain the role of prudential transition plans in the draft guidelines. We believe that it is essential to clarify that prudential transition plans are focused on the management of ESG risks and distinguished from climate transition plans under CSRD/ISSB and CSDDD (corporate disclosure frameworks), which set out the institution's business strategy and targets for aligning its business with climate-related objectives. While we acknowledge that understanding climate risks will help inform broader climate transition plans and support a coherent regulatory framework which minimises overlapping and conflicting requirements, it is essential that prudential transition plans are clearly focused on prudential management of ESG risks. The objectives of the transition plan and other requirements in the corporate disclosure framework (e.g. CSRD/ISSB/CSDDD) will not be same as prudential transition plans and other requirements in the prudential framework. Therefore, duplication should be avoided.
- Transition plans (in general) for banks are a strategic exercise to realise a sustainable future through supporting real-economy clients and not solely developed for risk management purposes. Internationally, many banks have already voluntarily committed to net zero and are developing or have developed transition plans. Transition plans are an initiative for institutions to achieve their own net zero by 2050, including

[1] The Japanese Bankers Association is the leading trade association for banks, bank holding companies and bankers associations in Japan. As of 1 April, 2024, JBA has 114 Full Members (banks), 3 Bank Holding Company Members (bank holding companies), 75 Associate Members (banks & bank holding companies), 49 Special Members (regionally-based bankers associations) and one Sub-Associate Member for a total of 242 members.
[2] https://www.eba.europa.eu/publications-and-media/press-releases/eba-consults-guidelines-management-esg-risks

sector-specific emission reduction targets, and is a tool for stakeholders to understand their net zero strategy and approach, as well as a tool to engage with clients.

- By actively engaging with the clients' transition while also managing risks appropriately based on their transition plan, banks can contribute to the realisation of a sustainable real economy and, as a result, contribute to the reduction of long-term climate-related financial risks.
- We encourage the EBA to avoid the use of the term "transition plan" in this context as it is likely to be confusing to all stakeholders. We suggest referring to CRD based plans as "ESG risk management plans".
- We therefore strongly support the EBA's view that plans under CRD are focused on prudential risks with a view to ensuring their soundness and resilience to the ESG risks faced, forming a risk management tool for institutions to understand, assess and manage the ESG risks and that the guidelines do not require CRD-based plans to set out an objective of aligning with a specific transition trajectory. We strongly agree with the EBA that "the goal of prudential plans is not to force institutions to exit or divest from carbon intensive sectors".
- We also support the EBA's emphasis that it is important to provide sufficient flexibility for institutions to tailor their plans to their specific businesses and internal arrangements.
- Given that institutions currently face multiple requirements in relation to transition planning across a variety of EU legislative frameworks, we believe that that there should be a coherent, clear framework for institutions to work towards.

Q2: Do you have comments on the proportionality approach taken by the EBA for these guidelines?

- We think that the proportionality principle should apply not just in terms of business size, but also in relation to the cost/ feasibility for banks in implementing the proposals versus their regulatory benefits to supervisors.
- This would ensure that both institutions and regulators prioritise those elements which are both relatively efficient to implement and present clear benefits in terms of institutions' management of ESG risks. The considerations may include the scope of ESG risks and financial risk and the degree of appropriate counterparty engagement.
- It is also important to apply proportionality to requirements across the guidelines, enabling institutions to focus on the most material risks to their organisation.

Q4: Do you have comments on the materiality assessment to be performed by institutions?

- We believe that the emphasis here should be to ensure appropriate flexibility for institutions in deciding their specific approach to materiality assessments and to ensure that the assessment uses information and data consistent with the actual sectoral footprint.
- We do not believe that the proposed guideline should provide similar requirements for the materiality assessment across ESG risks, as these may not be relevant for all institutions – again, the emphasis should be on flexibility for each institution.

- It is also important to acknowledge that a sectoral approach may not be appropriate for all environmental and social risks.
- We would like to ask for more detailed guidance or best practice on the methodology of materiality assessment and likelihood regarding ESG risks. These guidance or best practice would be helpful for banks and improve the quality of the disclosure.
- At this point, the data and information for the assessment will limited and the assessment is most likely be based on assumptions and estimation. Therefore, since future results may differ from the materiality assessment, we would like to request a guarantee of safe harbour.

Q5: 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.

- For group institutions based outside the EU, when managing activities outside the EU, we request the EBA to allow flexibility, such as referring to local taxonomy or similar guidelines.

Q6: Do you have comments on the data processes that institutions should have in place with regard to ESG risks?

- While we understand the importance of improving data quality, because it is a moving area, progress in improving data quality is highly uncertain and should be flexible rather than fixed as a procedure.
- Collecting ESG-related data from clients is a prerequisite for risk assessment. However, it should be taken into account that data collection by banks is not yet practically feasible to complete, as in many cases client's data disclosure still requires more progress.
- Furthermore, covering all the types of data listed in the guidance can be a significant burden on both banks and clients. Therefore, a stance such as " should collect the necessary data based on the principles of materiality and proportionality" is preferable.
- The guidelines set out that, in the absence of data, estimate and proxies should be used. However, this increases uncertainty and is less likely to lead to a correct risk assessment, as such a guarantee of safe harbour is required.

Q7: Do you have comments on the measurement and assessment principles?

- We understand that it is not agreed upon whether the exposure or concentration of a portfolio represents ESG risks. A forward-looking ESG risk assessment is difficult at this point.
- It should be clearly stated that the risks to be reflected in internal credit scoring, rating models etc., should take into account only the impact on the financial risks of the financial institution.

- Quantitative exposure assessment through scenario analysis should take into account the time required to establish a methodology for analysing risks accurately.

Q8: Do you have comments on the exposure-based methodology?

- The requirements set out in this section seems plausible. However, currently, there are no established data or methods that definitively address this level of requirements. This should be dealt with while adapting to changes in a moving environment and should be undertaken on best-effort basis.
- Furthermore, at present, there are no instances where climate-related risks have directly led to a default, and it is difficult to reflect in credit rating models without historical data.

Q9: 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.

- It is proposed that Portfolio alignment should use a degree of alignment with a GHG emissions targets as a risk management indicator, but financial institutions may encounter more difficulty in supporting net-zero transition of hard-to-abate sectors (triggering financial institutions' divestment), which could hinder the real economy from achieving decarbonisation. Therefore, careful discussions are required.
- Detailed information should be provided on specific scenarios and methodologies. Specifically, scenarios considering regional characteristics should be provided not only by sector but also by jurisdiction. As for the methodology, we request a proposal that is well acknowledged not only in Europe but globally.
- Alignment with the SDGs is proposed, but careful consideration is required as in some business activities, conflicts between these goals are envisaged.

Q10: Do you have comments on the ESG risks management principles?

- We would like to highlight that there does not appear to be any proportionality around the proposed requirement for institutions to engage counterparties, as specified in para 42(a). We would also emphasise that the scope of counterparty engagement should be linked to institutions' materiality assessment.
- We would appreciate any proposals on the methodology for evaluating clients transition plan, particularly regarding the feasibility of the plans.

Q11: Do you have comments on section 5.2 – consideration of ESG risks in strategies and business models?

- We do not think that the proposals in this section should be used by supervisors to potentially constrain institutions' approach to business models and strategic planning.
- Instead, the focus should be on institutions integrating ESG risks into their strategic planning and linking

this to their internal risk management.

Q12: Do you have comments on section 5.3 – consideration of ESG risks in risk appetite?

- We believe that the significance of identifying the type and degree of ESG risks at the granularity of the proposed guidance is minimal. The type and degree of risk considered necessary in view of the principles of materiality and proportionality should be identified.
- As "forward-looking indicators" may prove to be inaccurate in the future, a safe harbour guarantee is required.

Q14: Do you have comments on section 5.5 – consideration of ESG risks in ICAAP and ILAAP?

- We think the historical data is insufficient and there is no globally unified measurement method, so it is difficult to take into account as ESG risks.

Q15: Do you have comments on section 5.6 – consideration of ESG risks in credit risk policies and procedures?

- We understand that there is still no consensus on how those ESG risks affect the creditworthiness of clients. In such a situation, we think it is difficult for banks to establish a robust risk management framework.
- Since, unlike climate-related risks, there is no specific target set on a global bases for these risks, we think it is difficult to establish a forward-looking framework.
- "Quantitative credit risk metrics with regard to environmental risks" have not yet been established and it is unclear as to what is specifically intended.

Q16: 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?

- Firstly, if concentration risk refers to the concentration of high-emission companies or companies with high physical risk, we believe that they do not necessarily deteriorate in credit all at once by the same factor, and the significance of managing concentration situations is minimal.
- Additionally, since the quantification of climate-related risks has not progressed, it is difficult to reflect it in concentration risk management at this point.
- Banks are already measuring and disclosing FE by sector, and we believe it is important to monitor how it goes going forward.

Q17: Do you have comments on section 5.8 – monitoring of ESG risks?

- While we agree that there is a need for comprehensive monitoring of the transition, with regard to the proposals of the mandatory use of ESG risk indicators in Section 5.8, we believe that monitoring all the

indicators proposed could be an excessive burden for banks and that individual indicators have their various difficulties. We believe that such indicators should not be considered mandatory in the final guidelines, but the indicators to be monitored should be determined by individual institutions based on the principles of materiality and proportionality.

- The EU Taxonomy Regulation was not designed as a risk management tool and we do not consider that taxonomy alignment ratios should be included as a mandatory risk metric. The EBA and European Commission have acknowledged that there are shortcomings in the Green Asset Ratio, and we do not consider that it is a meaningful KPI. The GAR gives rise to several usability challenges and issues with its calculation methodology, which makes it a less reliable or useful metric for investors or other stakeholders to assess the progress of a bank in financing the sustainability transition.
- The lack of symmetry between the numerator and the denominator in the GAR leads to a lack of comparability of its disclosures across banks. This asymmetry is due to the fact that, while the numerator comprises taxonomy aligned activities in the scope of CSRD, the denominator counts instead the total assets independently from the scope of CSRD, including assets that are not eligible for the EU Taxonomy and will not be taxonomy aligned. Different banks have different business models, and the current GAR formula does not enable meaningful comparison across banks as different banks have different proportions of taxonomy eligible activities on their balance sheet. The ratio is significantly impacted by factors such as the proportion of business in sectors covered by the EU Taxonomy, the services that they provide (including the proportion of retail counterparties on their balance sheet) and the proportion of their balance sheet outside the EU (which is unlikely to be eligible for the EU Taxonomy). The asymmetrical treatment of derivatives in the GAR ratio is also an issue that needs refining.
- In addition, the GAR only captures taxonomy-aligned activities. It therefore does not adequately capture financing of activities that contribute to the transition and fall within the European Commission's definition of transition finance, which are not currently aligned with the EU Taxonomy.
- Reporting should be made as necessary in an appropriate manner, but the method should be left to the discretion of the banks.
- There is no historical data on the amount of loss due to ESG risks. Banks are already estimating the amount of credit cost based on scenarios, but there is little significance to manage risks based on the results.

Q18: Do you have comments on the key principles set by the guidelines for plans in accordance with Article 76(2) of the CRD?

- Please see our comments to question 1 above. There remains a lack of clarity over the envisaged role of plans under Article 76(2) CRD. It is important that the guidelines clarify this and maintain focus on risk management and have regard to information that banks will already be reporting at entity level, including under CSRD.
- We query the descriptions in the draft guidelines which appear to envisage the inclusion of "objectives" and "targets" in plans; for example, in paragraphs 77 and 85. It is also unclear why plans would necessarily include "actions with regard to the business model and strategy of the institution that are consistent with the

plans disclosed under the [CSRD]". While we understand the need for banks to consider risk management actions that may be appropriate, this is an example of an area where the draft guidelines appear to envisage the plans to include objectives and targets such as decarbonisation or reducing the institution's impact on ESG factors. Such an extension would go beyond the mandate of understanding and appropriately managing ESG risks to mandating changes in banks' business models through prudential regulation.

- Also important to note that in the proposals, prudential transition plans are not considered for publication as part of Pillar 3. We think that it would not be appropriate to consider a public disclosure approach, given the sensitivity of such plans.
- Again, we note that, in relation to the requirement in para 76 to align with EU climate law objectives, it will be hard for institutions to comply with the 1990 baseline, given the lack of access to portfolio data.
- We would also underline that the proposed approach would be difficult to implement in respect of Third Country or non-EU exposures, given that these may have different transition timelines and less data is likely to be available. Further clarification from the EBA would be needed to ensure a workable approach for global banking groups.
- Climate-related risks have not yet materialised as a credit risk for companies, and formulation of transition plans aimed at reducing exposures with high climate-related risks could effectively result in a reduction in customer transactions.
- Also, it should be implemented in an agile manner while considering developments in regulations and respective jurisdictions, and it is difficult to formulate a long-term plan for 10 years. We recognise that the measurement methodologies of climate-related financial risks, including the measurement method of future projections, have not been established. Therefore, flexibility should be allowed based on the status of each institution. It is desirable to ensure a certain degree of flexibility, as practices for managing climate-related financial risks are still under development, and from the perspective of being able to reflect the diverse responses to climate change due to possible differences in climate change impacts in different jurisdictions and business models of different banks.

Q21: 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?

- The scenarios used for building business strategies are required to be consistent across the organisation in Section 6.4 No. 99, but it should be clarified that a uniform scenario does not necessarily have to be used on a company-wide basis, as different jurisdictions have different transition pathways.

Q22: Do you have comments on section 6.5 – transition planning?

- In the context of preparing for a transition to achieve a more sustainable economy, banks cannot decarbonise ahead of their clients. If finance is not provided to enable clients' transitions, then the transition of the real economy can not happen.
- When banks plan and forecast from a risk management perspective, it can change the behaviour of banks.

That is, if the transition does not proceed as assumed in the planned or forecasted scenario, there is a high possibility that financing will decrease, and the risk of triggering divestment increases.

Q26: Do you have other comments on the draft guidelines?

- In the present situation where many financial institutions and corporations are focusing on climate change measures and TNFD guidance has just been finalised, we believe it is premature to require a uniform risk management for all ESG aspects.

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We thank the EBA for the opportunity to comment on the Consultation paper and hope our comments will contribute to further consideration in the EBA.

Yours faithfully,

Japanese Bankers Association