

Note – EBA's final guidelines on ESG risks

EXECUTIVE SUMMARY

The EBA guidelines on the management of ESG risk requires institutions to integrate ESG risks into their strategy, governance, risk appetite and risk management framework and to ensure alignment with the EU's climate neutrality goals taking into account forward-looking assessments, scenario analyses and transition plans.

Background

- The European Banking Authority (EBA) is required under CRD VI to develop guidance on the Environment, Social and Governance (ESG) risks.
- In this context, the EBA has published in January 2025 its final Guidelines on the management of ESG risks. The Guidelines set out requirement for institutions for the identification, measurement, management and monitoring of ESG risks, including through plans aimed at ensuring their resilience in the short, medium and longterm.

Scope

Guidelines are applicable to :

- EU institutions including SNCI (Small and non-complex institutions), considering the proportionally criteria and covering their material ESG risks.
- Material subsidiaries outside of the EU by having regard to applicable local legislation and ESG regulatory objectives.

Calendar

- **11/01/2026** : General application date
- **11/01/2027** : Application date for SNCIs

Main elements to put in place

Reference methodology for the identification and measurement of ESG risk

1. Materiality assessment

2. Identification & Measurement

2.2. Data process

2.3. Méthodologies

Minimum standards and reference methodology for the management and monitoring of ESG risk

1. ESG risk management principles

2. Strategy & Business models

3. Risk appetite

4. Internal culture, capabilities and controls

5. ICAAP/ILAAP

6. Credit risk policies and processes

7. Policies and processes for Market risk, Liquidity risk, Operational risk and concentration risk

8. Monitoring

Plans in accordance with article 78(2) CRD VI

1. Key principles

2. Governance

3. Transition planning

I- REFERENCE METHODOLOGY FOR THE IDENTIFICATION AND MEASUREMENT OF ESG RISKS

As required by the EBA's prudential framework, institutions should provide for the regular performance of a materiality assessment, the data process and methodologies to have a reference methodology for the identification and measurement of ESG risk.

Materiality, identification and measurement of ESG Risks

Materiality assessment

- Provide for the **regular performance of a materiality assessment of ESG risks** at least every year or for small and non-complex institutions (SNCIs) every two years. Update the assessment more frequently in case of a material change to the business environment related to ESG factors. **The assessment should be included in ICAAP.**
- Use of **risk-based-approach** taking into account both the likelihood of occurrence and the potential magnitude of risks materialisation **across short, medium and long-term time horizon (at least 10 years).**
- Covers **all traditional financial risk categories** including credit, market, liquidity, operational, reputational, business model and concentration risks.
- Use both **qualitative and quantitative information** on the environmental risks (factors including at least climate-related factors, degradation of ecosystems and biodiversity loss). The institutions should assess both **transition and physical risk drivers.**

Identification & measurement risks

Data process

- Implementation of **systems to manage ESG risk data across the institution** as part of the overall data governance and IT infrastructure – including the assessment and improvement of ESG data quality
- Use of both **internal and external available ESG data** (data from clients or providers)
- Collect data to **assess current and forward-looking ESG risk profile of clients** (at least large corporates) including client and asset-level data
 - For environmental risks : emissions, dependency on fossil fuels, energy and water demand, geographical location...
 - For social and governance risks : compliance with social and governance standards...

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Materiality, identification and measurement of ESG Risks

Identification & measurement

Methodologies

Combination of three methodologies to assess ESG risks over all time horizons and within key risk indicators :

- **Exposure-based methods** : assess the exposure of counterparties's activities and key assets to ESG risks and mitigants. Considering environmental factor into overall assessment of default risk of borrower (risk indicators : internal credit scoring or rating models) as well as the valuation of collateral
- **Sector-based, portfolio-based and portfolio alignment methods** :
 - **Sector-based method** : provide for sector-based or portfolio-based methodologies (in particular heat maps) that highlight ESG risks of individual economic (sub) sectors in a chart or on a scaling system.
 - **Portfolio-based method** : use at least one portfolio alignment methodology to assess the degree of alignment of institutions's portfolios with climate related sustainability targets. Measuring the gap between existing portfolios and benchmark scenarios and its financial impacts
 - **Portfolio alignment method** : insights gained from climate portfolio alignment methodologies :
 - Assess and monitor climate-related transition risks stemming from misalignments of counterparties and/or institutions's portfolios with EU, Member State or third country regulatory objectives and pathways consistent with applicable climate goals and potential related financial risks
 - Inform their decision-making process on the formulation and implementation of their risk appetite, business strategy and transition planning
 - **Scenario-based method** : perform climate/environmental scenario-based analyses
- Institutions should use science-based scenarios, including but not limited to those from the international Energy Agency (IEA) or ensuring an alignment with relevant regulatory and policy objectives.

II- MINIMUM STANDARDS AND REFERENCE METHODOLOGY FOR THE ESG RISKS MANAGEMENT

As required by the EBA's prudential framework, institutions should provide embed ESG risks within their regular risk management systems and process ensuring consistency with their overall business, risk strategies, risk appetite and controls.

Minimum standards for the management of ESG risks

ESG risk management principles

- **Consider ESG risks within the regular risk management systems and processes** ensuring consistency with their overall business, risk management strategies, policies and limits.
- **Develop an approach to managing and mitigating ESG risks** over the short term, the medium term and over a long-term horizon of at least 10 years.
- **Consider tools among others**, engagement with counterparties, financial terms, conditions terms or pricing adjustments, ESG risks embedding within global, regional and sectorial risk limits, diversification of portfolios or financing reallocation to better ESG profiles.

Strategies & Business models

- Consider ESG risks when developing and implementing the overall business and risk strategies
- Understand **how ESG risks impact the company** 's business models and its strategic objectives.
- Consider **how the ESG risks may affect the ability to achieve strategic objectives** and remain within the risk appetite
- Implementing and monitoring ESG risk-related strategic objectives and related key **performance indicators based on insights gained from forward-looking approach** (portfolio alignment, environmental stress test and environmental risk scenarios analyses)

Risk appetite

- Define the **level and types of all material ESG** risks to be assumed in the portfolios.
- Ensure that **risk appetite and associated KRIs** (including limits, thresholds and exclusion) are appropriately **cascaded down within institution** and subject to monitoring and escalation processes
- Consider, at least, **metrics listed by EBA** with backward-looking and forward-looking views

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Minimum standards for the management of ESG risks

Internal culture, capabilities and controls

- clear communication from the management body ('tone from the top') and appropriate measures to **promote knowledge of ESG factors and ESG risks across the institution**, as well as awareness of the institution's ESG strategic objectives and commitments.
- **Provide training to ensure staff and management understand ESG implications** and foster a culture of responsibility across all levels
- **Consider ESG risks within internal control frameworks** across the three lines of defense with a clear definition and assignment of responsibilities and reporting lines

ICAAP/ILAAP

- **Taking into account ESG risks in ICAAP and ILAAP** by aligning appetite, thresholds, and limits to identify and measure internal capital needs, ensuring regular updates.
- **Include in the ICAAP a forward-looking view of institution's** capital adequacy under adverse scenario that includes environmental elements specifying any changes to their business plan derived from climate stress testing, **in line with EBA stress testing Guidelines**.
- **Differentiate focus areas** : ICAAP should address broad ESG risks, while ILAAP should target environmental risks with appropriate time horizons.
- **Launch of draft Guidelines on ESG scenario analysis**, which detail the expectation of adopting forward-looking approaches and incorporating the use of scenario analysis as part of their management framework to test institutions' financial and business model resilience to the negative impacts of ESG factors.

Credit risk policies and procedures

- **Embedding in credit risk policies to ensure clear processes** to identify, measure, manage, mitigate and monitor impacts from ESG.
- **Implement quantitative credit risk metrics** covering most significant client segments, types of collaterals and risk mitigation instruments.
- **Ensure that credit sectorial policies, reflecting ESG risks, are cascaded down** to business lines and business relationships officers.

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Minimum standards for the management of ESG risks

Other risk policies and procedures

Assess current and potential future ESG-related impacts on market, liquidity & funding, operational, reputational and concentration risks :

- **Market** : how ESG risk affect the value of the financial instruments, evaluate the potential risk of losses and increased volatility in their portfolio's value and establish effective processes to control or mitigate the impacts.
- **Liquidity** : how ESG risks affect net cash outflows or the value comprising their liquidity buffers and where appropriate, incorporate these impacts into the calibration of ther buffers or risk management framework. Also assess the availability and stability of funding sources at different time horizons and normal/adverse conditions (including potential impacts on reputational risks)
- **Operations** : how ESG risks affect regulatory risk event types and the potential impacts on conduct risks, litigation and reputational risk related to lending and investing in business which may be prone to ESG-related controversies
- **Concentration** : assess of shares of exposure affected relative to total & if ESG-related concentration aggravates its financial vulnerability

Monitoring

- **Monitor ESG risks on a continuous basis** through internal reporting framework to senior management, implementaing a granular monitoring of counterparties, exposures and portfolio, integrating ESG risks into regular reports. Include ESG factors in regular credit reviews for medium-sized and large counterparties.
- **Implement granular and frequent monitoring** of counterparties, exposures and portfolios assessed as materially exposed to ESG risks, including through incorporating considerations of ESG risks into the credit risk monitoring process of retail counterparties and into regular credit review for medium-sized and large counterparties and/or by increasing the frequency and granularity of these reviews due to ESG risks.
- **Set Early Warning Indicators and backward-looking and forward-looking ESG risk metrics** such as historical losses related to ESG risks and the share of income stemming from business with counterparties contributing to climate change. As part of their management, institutions should have in place sound processes to identify, prevent and manage risks resulting from greenwashing or perceived greenwashing practices.

III- PLANS IN ACCORDANCE WITH 76(2) CRD VI

The plans should provide an overview of the strategic actions and risk management tools deployed by institutions to demonstrate how they ensure their robustness towards ESG risks and preparedness for the transition towards a climate and environmentally resilient and more sustainable economy.

Plans for the management of ESG risks

Key principles

- **The transition plans should be based on a forward-looking** business environment analysis and strategic planning process taking into account an overview of the strategic actions and risk management tools.
- **The plans should address forward-looking ESG risk management aspects while being consistent with other applicable requirements** (due diligence, sustainability reporting and strategic actions) to ensure, in terms of objectives, actions and targets, the consistency of business models with the transition to a sustainable economy.
- **Ensure that arrangements, processes and mechanisms related to their plans are consistent and well integrated**, including in their subsidiaries established outside of the Union and the obligation of those subsidiaries to be able to produce data and information relevant to the purpose of supervising consolidated plans.

Governance

- **Roles and responsibilities** : the management body, the risk management function and the internal audit function play important roles and responsibilities.
- **Internal process and capacity** : regular interaction at all levels of the organization to ensure that insights and feedback from internal stakeholders are taken into account. Ensure sufficient capacity (expertise and resources) and identify existing gaps in skills and expertise and take remedial actions where necessary.
- **Data management** : Institutions should have in place sound governance processes to collect, validate and aggregate the data that are needed to inform their transition planning efforts and monitor their implementation.

Metrics and Climate scenarios

- Ensure that **scenarios and pathways used as part of the plans are consistent across the organisation and time horizons are considered** while building business strategies and setting targets for the short, medium and long term.
- Combine metrics related to climate related risks with management of environmental risks other than climate related, e.g. **risks stemming from the degradation of ecosystems and biodiversity**.
- Set out dedicated actions to **monitor and address material ESG risks** stemming from exposures, portfolios and the economic activities and production capacities being financed.

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Plans for the management of ESG risks

Transition planning

Institutions should document their plan including their methodologies, assumptions, criteria, targets and actions planned to reach targets along with performed and scheduled revisions. It is required to monitor the plan implementation using the reference metrics provided and performing regular projections to assess its ability to achieve their targets.

- **Strategic objectives and roadmap of plan** : (i) high-level overarching strategic objective to address ESG risks in the short, medium and long term in line with overall business strategy and risk appetite ; (ii) Comprehensive set of longterm goals with intermediate mile stones to ensure resilience of the business model towards ESG risks ; (iii) key assumptions, inputs and background information related to these objectives including outcomes of materiality assessments, portfolio alignment assessments and other scenario analyses.
- **Targets and metrics** : (i) quantitative targets set to address ESG risks ; (ii) portfolios, sectors, asset classes, business lines and where applicable, economic activities (i.e. individual technologies) covered by targets and monitoring metrics ; (iii) time horizons over targets and metrics apply.
- **Governance** : (i) roles and responsibilities related to plan validation and implementation including escalation steps in case of deviation from targets ; (ii) capacity and resource related actions to ensure appropriate knowledge, skills and expertise for effective implementation of the plan ; (iii) remuneration policies and practices to promote sound management of ESG risks in line with the institution's objectives and risk appetite; (iv) data and systems used for the transition planning process.
- **Implementation strategy** : overview of short, medium and longterm actions taken or to achieve the plan's targets ; (ii) adaptations to policies and procedures on financial risk categories and to lending and investment policies and conditions on key economic activities, sectors and locations ; (iii) changes introduced to the mix and pricing of services and products to support the implementation of the plan ; (iv) investments and strategic portfolio allocation supporting the institution's business strategy and risk appetite.
- **Engagement strategy** : (i) policies for engaging with counterparties ; (ii) processes, methodologies and metrics used for collecting and assessing information related to counterparties' exposure to ESG risks and alignment with bank's objectives and risk appetite ; (iii) outcomes of engagement practices including an overview of counterparties' adaptability and resilience to the transition towards a more sustainable economy.

HOW CAXENCE PARTNERS CAN HELP ?

CAXENCE PARTNERS is a consulting firm expert in finance delivering change initiatives in **Quantitative Finance, Data Management & IA, Risk Monitoring & Compliance and Transformation Projects** within the financial services industry. CAXENCE PARTNERS meets the needs of banks, asset management companies, insurance companies and companies in other sectors such as the energy sector.

Our service offer regarding ESG risk management covers :

Topic	Description
Business & Risk strategy	<ul style="list-style-type: none">▪ Advice and support to integrate climate-related issues into business planning and risk strategy▪ Advice and support on embedding climate risk management into strategic processes (ICAAP/ILAAP)
Governance	<ul style="list-style-type: none">▪ Design and implement a climate risk management governance framework
Data & Technology	<ul style="list-style-type: none">▪ Requirments and definition of the ESG information model▪ Metrics model definition and KPIs▪ Functional and technological architecture and implementation
Risk identification	<ul style="list-style-type: none">▪ Integrate climate risk components into material risk identification processes (identification and assessment of climate risk drivers, carbon asset risk assessment framework)
Risk management	<ul style="list-style-type: none">▪ Analyse portfolio sensitivity to environmental risks (transition and physical risk including sector/geographic exposures), social risks and governance risks▪ Integrate climate risk components into risk categories (credit risk, market risk, liquidity risk, operational risk and concentration risk...)▪ Design and implement climate risk drivers into exsting risk models▪ Design and implement recommanded methologies (sector-based methods, portfolio-based methods, exposure-based methods, portfolio alignment methods and senario analysis)
Stress testing/ Scenario analysis	<ul style="list-style-type: none">▪ Design and implement a climate risk stress testing framework by interpreting and applying prescribed methodology, scenario generation linked to risks and business drivers, models/projections
Supervisory compliance	<ul style="list-style-type: none">▪ Gap analysis or action plan to design a climate risk management framework in line with supervisory expectations and market practices



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