

## **BVI<sup>1</sup> position on EBA's Discussion Paper on management and supervision of ESG risks for credit institutions and investment firms**

We welcome EBA's initiative to set an important signal for dealing with ESG risks across the banking and investment firms' sector. It is important to review processes to see how ESG risks can be integrated into the existing business and risk organisation of the supervised entities. In view of the challenges of climate change, the entire financial sector must deal with the associated risks and opportunities. EBA's final report will stimulate the discussion and sensitises the supervised entities in dealing with ESG risks. The outcome of EBA's report therefore will also affect other financial sectors such as asset management and insurance. In Germany, BaFin has already advanced the discussion by publishing a guidance notice<sup>2</sup> on dealing with sustainability risks for all supervised entities.

We focus our response on the impact on asset managers and investment firms. Our main remarks could be summarised as follows:

- **Relevance for investment firms:** Germany represents about 700 MiFID investment firms, accounting for nearly one quarter of all European investment firms affected by the new IFD/IFR framework. The vast majority of these firms (about 600) is only authorised to provide MiFID services such as portfolio management, investment advice, reception and transmission of orders in relation to one or more financial instruments or execution of orders on behalf of clients without a licence to hold client money or securities belonging to clients or to deal on own account. According to the EBA's analyses of the population of all concerned firms by category there are a total of about 870 investment firms in Europe (including UK) with such a limited licence. Therefore, Germany is the biggest market in this field (about 70 per cent of such limited licence firms in Europe). The business activities and prudential risks of these limited licence firms are not comparable with the activities and risks of banks. In particular, the specific MiFID services provided by these investment firms should not be covered by the EBA report because they are already covered by other frameworks such as the EU Disclosure Regulation (SFDR) or the outstanding Level 2 requirements to integrate sustainability risks and factors in MiFID II. Therefore, it should be clarified that the EBA report will only apply to ESG risks with impact on company level (such as the impact on the investment firm's balance sheet assets) and thus on the prudential supervision of investment firms. Moreover, it could be helpful to set up specific examples focused on the activities of investment firms. The longer deadline of 26 December 2021 could be used for this purpose, as the EBA has more time to prepare its report under the IFR compared to the deadline of 28 June 2021 under the CRD. The same applies for the new disclosure requirements of certain investment firms in Article 53 IFR starting from 26 December 2022. We stand ready to support EBA in finding practical and efficient solutions.
- **Relevance for asset management companies:** We would like to highlight that asset management companies are not investment firms, as claimed by EBA in paragraph 14 of the consultation

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<sup>1</sup> BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Asset Managers act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's 114 members manage assets more than 3.6 trillion euros for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 27%, Germany represents the largest fund market in the EU. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit [www.bvi.de/en](http://www.bvi.de/en).

<sup>2</sup> Available under the following link: [https://www.bafin.de/SharedDocs/Downloads/EN/Merkblatt/dl\\_mb\\_Nachhaltigkeitsrisiken\\_en.pdf?\\_\\_blob=publicationFile&v=5](https://www.bafin.de/SharedDocs/Downloads/EN/Merkblatt/dl_mb_Nachhaltigkeitsrisiken_en.pdf?__blob=publicationFile&v=5).



paper. Asset management companies (as defined in Article 5[1][19] CRR and Article 4[1][2] IFR) providing activities with a licence under the AIFMD or the UCITS Directive are not directly affected by this report because they are out of scope of the CRD/CRR or the IFD/IFR framework. In the EU, a total of EUR 10.7 trillion is invested in investment funds such as UCITS or AIFs by private and institutional investors. With assets of EUR 3,000 billion, Germany is the largest asset management market (source: ECB as of 30 June 2020) with a market share of 27 percent. However, the outcome of the EBA report could be indirectly relevant for asset management companies if they manage investment funds for credit institutions which invest their own capital in these funds. This affects about 11 percent (EUR 196 billion, source: BVI statistics as of 30 June 2020) of assets under management on behalf of AIFs managed for institutional investors by German asset management companies. The question how to integrate ESG risks in the management of these investment funds is covered by the AIFMD or UCITS framework only. However, asset management companies regularly provide information on the composition and risks of the investment funds so that the credit institution can assess the risk-bearing capacity through its investment as part of the supervisory review and evaluation process (SREP). Therefore, depending on the detail of information provided by the asset management company to the credit institution, these reporting lines could be affected as long as asset management companies also inform credit institutions on a voluntary basis about the ESG risks connected with that investment. The indicators, metrics and methods used by asset managers in assessing ESG risks of these portfolios are expected to be identical or comparable to those used by credit institutions. This applies even more as asset management companies are part of a banking group and use group-wide systems and processes.

- **Common definitions:** We welcome EBA's view that ESG risks should only be considered as a partial aspect of the already known financial risks and not as a separate type of risk. In order to allow for implementation of consistent concepts for ESG risk management across different business lines, the definitions of ESG risk and factors envisaged in the EBA discussion paper should be fully aligned with the relevant SFDR provisions. Moreover, it is of utmost importance to clarify that ESG risks materialise only through their potential significant negative impact on prudential risk categories.
- **Indicators, metrics and methods to assess and manage ESG risks:** The capability of institutions or investment firms to account for ESG risk within their risk management arrangements depends to a great extent upon the availability of public, transparent, relevant and reliable data related to ESG considerations. We understand from the discussion paper that the metrics and methods proposed to assess ESG risks are neither compulsory nor do they have a specific ranking. Such a principle-based approach would be in line with the approach of the SREP under banking and investment firm law. However, it would be helpful to clarify this understanding more prominently.
- **ESG factors and ESG risks in supervision:** The supervision of limited licence investment firms should be focused on operational risks which will be part of the check of the risk-bearing capacity and the SREP.



## Common definitions of ESG factors, ESG risks and their transmission channels

Q1. Please provide details of other relevant frameworks for ESG factors you use.

We do not have any particular additions to the relevant frameworks for identifying ESG factors. As regards the regulatory environment in the EU, however, it is essential to bear in mind that credit institutions and investment firms will operate under the scope of SFDR when providing the MiFID service of portfolio management. The SFDR framework encompasses definitions of ESG risk and ESG factors at Level 1 and will provide detailed specifications to the latter at Level 2 (in relation to the indicators on principal adverse impacts). In order to allow for implementation of consistent concepts for ESG risk management across different business lines, the definitions of ESG risk and factors envisaged in the EBA discussion paper should be fully aligned with the relevant SFDR provisions.

Q2. Please provide your views on the proposed definition of ESG factors and ESG risks.

As described in our answer to Q1, the definitions of ESG risks and factors envisaged in the EBA discussion paper should be fully aligned with the relevant SFDR provisions. Moreover, we miss a clear statement regarding the proportionality principle in assessing ESG risks and the impact on the performance or solvency of the institution or investment firm. We request EBA to clarify that ESG risk means an event or condition that, if it occurs, could cause an actual or a potential **material negative impact** on prudential risk categories (such as the financial performance or solvency of institutions). This would be in line with the risk definitions used in other EU frameworks such as the SFDR.

**We also welcome EBA's view that ESG risks should only be considered as a partial aspect of the already known financial risks and not as a separate type of risk.** This should be highlighted in the final report (such as being part of the definition). We also refer to our answer to Q9.

Q3. Do you agree that, for the purpose of assessing their inclusion in institutions' and supervisors' practices from a prudential perspective, ESG risks should be approached primarily from the angle of the negative impacts of ESG factors on institutions' counterparties? Please explain why.

Q4. Please provide your views on the proposed definitions of transition risks and physical risks included in section 4.3.

Q5. Please provide your views on the proposed definition of social risks and governance risks. As an institution, to which extent is the on-going COVID-19 crisis having an impact on your approach to ESG factors and ESG risks?

Q6. Do you agree with the description of liability transmission channels/liability risks, including the consideration that liability risks may also arise from social and governance factors? If not, please explain why.

In principle, we agree with the proposed approach on considering transmission channels (physical, transition and liability risks).

Q7. Do the specificities of investment firms compared to credit institutions justify the elaboration of different definitions, or are the proposed definitions included in chapter 4 also applicable to them (in particular the perspective of counterparties)? Please elaborate on the potential specificities of investment firms in relation to ESG risks and on how these specificities, if any, could be reflected in this paper.



In our view, the definitions of ESG risks and ESG factors should be used similarly for all supervised entities in order to allow for implementation of consistent concepts for ESG risk management across different business lines. However, the level of impact can be significantly different.

We understand the discussion paper in such a way that the main focus lies on the risks to which the institution is exposed to via the impact of ESG factors on its **counterparties** such as the increase of credit risk of the counterparty due to higher probability of default (PD) and loss given default (LGD) **and its impact on the solvency or performance of the institution**. In our view, the solvency risk is closely connected with the level of concentration risks (associated with the default of counterparties and with trading positions of the own balance sheet). According to our understanding, investment firms without a licence for holding clients' assets/securities or dealing on own account such as portfolio managers (limited licence firms) have a very low solvency risk which results more from professional liability and operational risks and not from their supervised activities. **Their focus is more on the impact of ESG risks on the portfolio managed on behalf of clients. However, the concept of counterparty could also work with its impact on portfolio level; it may be understood as a counterparty as an issuer (e.g. sovereign, entity) of assets being part of a portfolio managed on behalf of a client. We would like to highlight that these impacts on specific MiFID services provided by investment firms such as portfolio management are already covered by other EU frameworks such as the SFDR or the outstanding Level 2 requirements to integrate sustainability risks and factors in MiFID II and should be clearly distinguished from the prudential scope of the IFR framework.**

In this regard, we welcome the statement made by EBA at its hearing that the EBA report will only apply to ESG risks of investment firms with impact on company level (such as the impact on the investment firm's balance sheet assets) and thus on the prudential supervision of investment firms. However, in order to eliminate any doubts, it would be helpful to clarify that understanding in the final report.

### Quantitative and qualitative indicators, metrics and methods to assess ESG risks

Q8. Please provide your views on the relevance and use of qualitative and quantitative indicators related to the identification of ESG risks.

We fully support the approach chosen by EBA, i.e. to provide for a non-exhaustive, illustrative list of ESG factors and corresponding indicators. At it stands, we also agree that the best basis for compiling such a list is the reference to international standards on disclosures of sustainability-related information.

Nonetheless, it should be clarified in EBA's final report that ESG indicators are only relevant for the purpose of identifying and managing ESG risks if they flag issues that are material in terms of financial performance. In this regard, due caution should be used when pointing to the indicators for principal adverse impacts (PAIs) to be developed by the ESAs under the SFDR framework. **There is a clear conceptual difference between PAIs and the notion of sustainability or ESG risk.** While sustainability risk is defined under Art. 2 (22) SFDR as a subtype of financial risks, i.e. the risk of actual or potential material negative impact on the value of the investment resulting from an environmental, social or governance event, principal adverse impacts shall capture negative implications of investment decisions on especially environmental, social and employee matters (cf. recital 20, last sentence, of SFDR).

In our view, this means that the future PAI indicators may only be used for identifying ESG risks if they are systematically supplemented by an assessment of financial materiality. ESG risks can indeed



materialise from adverse impacts on e.g. environment or people especially in the long term. For instance, an investment in a company from an GHG-intensive manufacturing sector has an adverse impact in terms of GHG emissions in the first place. This adverse impact could also materialise as a risk for the financial performance in case of introduction of carbon-pricing mechanisms that would penalise highly emitting activities.

**With this caveat, however, we are clearly in favour of aligning the understanding of relevant ESG indicators and related metrics across different EU sustainable finance initiatives.** In addition to the PAI indicators to be determined under the SFDR framework, particular attention should be paid to the upcoming legislative proposal on the revision of NFRD. It is to be expected that the revised NFRD requirements will comprise specific provisions for reporting of sustainability risks and impacts by companies and will be further supplemented by reporting standards including concrete metrics. Given that both frameworks – SFDR and NFRD – pertain also to the activities of credit institutions and investment firms or, in case of NFRD, form the basis for availability of ESG data, coherence between the applicable ESG indicators, metrics and standards is key for a smooth integration of ESG risk management across different business lines and operations.

Moreover, it must be clarified that there is no obligation to use quantitative **and** qualitative indicators related to the identification of ESG risks. At the current stage, approaches in the market for the measurement of ESG risk are not standardised so that the use of qualitative indicators only (such as descriptive considerations of interdependencies between ESG indicators and financial risks) should be possible as a first step to identify ESG risks. Consequently, standard quantitative indicators, such as those used throughout the industry to manage market and counterparty risks, cannot be used at present. We assume that the EBA is aware of these de facto limitations; nevertheless, they should be explicitly emphasised.

Q9. As an institution, do you use or plan to use some of the ESG indicators (including taxonomies, standards, labels and benchmarks) described in section 5.1 or any other indicators, inter alia for the purpose of risks management? If yes, please explain which ones.

The main challenge in assessing ESG risks for the purpose of risk management is that no standards exist yet, no empirical data is available on a historical basis and with respect to comparability and reliability, and the time horizon differs between the short-term view in assessing the existing financial risks and the long-term view in assessing the ESG risk. Data on long-term risk aspects is still scarce. Identification of a specific exposure of a portfolio to ESG risk will thus be a challenging exercise.

It is important to consider that assessing of ESG risks and ESG indicators should be commensurate to the availability of relevant ESG data. We would like to highlight the Eurosystem reply<sup>3</sup> of the ECB to the European Commission's public consultation on the Renewed Sustainable Finance Strategy and the revision of the Non-Financial Reporting Directive which clearly states a need to improve the quality of sustainability and climate-related information. In particular, the ECB emphasises that available sustainability and climate-related data and scores suffer from a lack of standardisation and comparability. Moreover, in the absence of a consistent set of publicly available corporate-level information, the metrics developed by market data providers seek to consolidate the (limited) quantitative and qualitative environmental information provided by companies. The ECB highlights that situation as an impediment to the consistent use of ESG data by financial institutions and market participants and stresses that

<sup>3</sup> Available under the following link: [https://www.ecb.europa.eu/pub/pdf/other/ecb.eurosystemreplyeuropeancommission-publicconsultations\\_20200608%7Ecf01a984aa.en.pdf](https://www.ecb.europa.eu/pub/pdf/other/ecb.eurosystemreplyeuropeancommission-publicconsultations_20200608%7Ecf01a984aa.en.pdf).





unreliable ESG data and ratings limit users in their capacity to conduct granular financial risk analyses. **Therefore, we expressly request to acknowledge within the final EBA report that the capability of institutions or investment firms to account for ESG risk within their risk management arrangements depends to a great extent upon the availability of public, transparent, relevant and reliable data related to ESG considerations.**

Q10. As an institution, do you use or plan to use a portfolio alignment method in your approach to measuring and managing ESG risks? Please explain why and provide details on the methodology used.  
 Q11. As an institution, do you use or plan to use a risk framework method (including climate stress testing and climate sensitivity analysis) in your approach to measuring and managing ESG risks? Please explain why and provide details on the methodology used.  
 Q12. As an institution, do you use or plan to use an exposure method in your approach to measuring and managing ESG risks? Please explain why and provide details on the methodology used.  
 Q13. As an institution, do you use or plan to use any different approaches in relation to ESG risk management than the ones included in chapter 5? If yes, please provide details.

We understand the discussion paper that the metrics and methods introduced to assess ESG risks are neither compulsory nor do they have a specific ranking. Such an approach would be in line with the principle-based approach of the SREP under banking and investment firm law. However, it would be helpful to clarify this understanding more prominently.

Q14. Specifically for investment firms, do you apply other methodological approaches, or are the approaches described in this chapter applicable also for investment firms?

As described under Q7, the main structural difference between the business models of banks and limited licence investment firms such as portfolio managers is that the impact of ESG risks on activities provided by portfolio managers is focused on portfolio level and not on company level. Therefore, the methods discussed in the asset management sector (including portfolio managers qualifying as investment firms) are all focused on the assessment of ESG risks based on an event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of the investment/portfolio managed on behalf of clients or investors (portfolio level). These methods vary between quantitative and qualitative methods or a combination of both. The spectrum here ranges from very simple approaches to multi-factor methods. Moreover, there is a need to differentiate between methods that are already applied at the strategic level of product design or business activities and methods used for assessing the ESG risk at the portfolio level.

**1) Methods at the strategic level of product design or business activities:** It is important to understand the integration of ESG risks in the investment or risk management processes of portfolio managers on the one hand and the pursuit of investment strategies explicitly labelled as such for certain sustainable products on the other hand. The ESMA proposals on Level 2 measures for the UCITS and AIFM Directives, for example, aim to take sustainability risks into account in the investment and risk management process in all fund portfolios. Products that pursue sustainable objectives and are described in more detail in the SFDR, on the other hand, are to be explicitly separated from these general requirements. This distinction is important when classifying the individual methods used for managing or limiting sustainability risks. In our view, it makes no sense to transfer methods at the strategic level to the investment process of all portfolios as part of the risk management process because these methods are not suitable for managing ESG risks on portfolio level. Insofar as, for example, investments in certain economic sectors are excluded, there are still assets in the portfolio to which ESG risks can be attached. In case these are material, they must be



identified, measured and managed. ESMA also does not propose such methods for the risk management process of investment management companies at EU level but continues its proven principle-based approach with freedom of methods and approaches.

Moreover, it is important to recognise that approaches to attain certain ESG characteristics or sustainable investment objectives can only be applied in a portfolio to the extent to which they have been agreed with investors as part of the investment strategy. This is particularly relevant for dedicated sustainable products. These methods must therefore be systematically shifted to the area of business and risk strategy and may not be transferred to all portfolios in the sense of general regulatory requirements. While these methods are designed to reduce or limit the ESG risk impact on the managed portfolio, the portfolio may nevertheless be exposed to further ESG risks as part of the other relevant financial risks, even if significant risk factors have already been excluded in advance. Such methods include, e.g.:

- **Exclusion criteria/limits.** These may be based on the identification of companies, sectors, regions, countries, etc. that are excluded as investments or subject to investment limits, as a result of the extent of compliance with certain criteria.
- **Positive lists.** These may be based on the identification of the companies, sectors, regions, countries, etc. that are preferred for investment, as a result of compliance with certain sustainability criteria.
- **Best-in-class approach.** Like positive lists, but with the focus on identifying companies that outperform their peer group on the sustainability criteria chosen. As this is a relative approach, the portfolio may include companies that are less sustainable when measured on an absolute basis.
- **Standards-based screening/.** Like positive lists and best-in-class approach, except that the sustainability criteria are not determined in-house, but correspond to internationally recognised standards. E.g.: UN Global Compact.. E.g. “Principles for Responsible Investment”, “Principles for Sustainable Insurance” and “Principles for Responsible Banking”.

**2) Methods used for assessing the ESG risk at the portfolio level:** In this context, it is important to understand that the concept of an assessment of ESG risks as part of the risk management process is not a new stand-alone risk element, but rather a specific sub-set of other relevant financial risks. Otherwise, a distinction from other risk types would be extremely difficult. To put it differently: ESG risk is risk inherent in a portfolio due to ESG factors. Therefore, as it stands, ESG risk in portfolios is in general not identified and measured separately from other risks. Rather, it is included into the exposure to other relevant risks or considered part of the price valuation of portfolio assets.

*Illustrative example:* A portfolio manager invests in shares of an oil company which shows no interest to engage in the development of alternative fuels. This is relevant in terms of ESG risk, but also impacts the market value of the company’s shares, thus potentially resulting in a market risk for sustainability reasons. Therefore, ESG risks may have a material impact on all the existing financial risk types (such as market, liquidity, counterparty and other relevant risks) as a factor that contributes to their materiality. The following methods could be used to identify the ESG risks at the portfolio level, however, they are neither compulsory nor do they have a specific ranking:



- **Scorings:** Comparable with the 'exposure method', this is a qualitative method with focus on the assessment of the performance of an investment with regard to sustainability aspects (e.g. based on ESG scores or CO2 intensities).
  - **Qualitative scenario analysis and stress tests:** This is a descriptive assessment of interdependencies between ESG indicators and financial risks.
  - **Quantitative scenario analysis and stress tests:** This is an assessment based on monetary figures. However, it will be very difficult to integrate such a method in the existing risk measurement methods.
  - **Multi-factor methods:** This is a very complex method where the assessment of ESG risks is based on quantitative and qualitative figures which will be fully integrated into existing risk management processes.
- 3) **Methods used for assessing ESG risks at company level:** The purely company-related processes (e.g. the increase of prudential risks and their impact on the performance and solvency of the investment firm) will be limited to operational risks of portfolio managers which should only play a subordinate role, if at all. This is because the clients' assets/portfolios, which are to be kept strictly separate from own funds of the investment firm, are to be managed according to their specific specifications.
- 4) **We also would like to highlight that the exercise of voting rights is not a procedure or a method of the risk management process.** Rather, they support the achievement of the investment objectives with regard to both financial and, where applicable, sustainable returns. The proper management of portfolios therefore naturally includes examining whether and how the company exercises shareholder and creditor rights with respect to the assets held in the portfolio. However, the relevant decision criteria for or against the exercise of shareholder and creditor rights must be left to the company.

### The management of ESG risks by institutions

Q15. Please provide your views on the extent to which smaller institutions can be vulnerable to ESG risks and on the criteria that should be used to design and implement a proportionate ESG risks management approach.

Considering the principle of proportionality is of utmost importance. In this context, we refer to our answer to Q2 where we call for a clarification that ESG risks materialise only through their potential significant negative impact on prudential risk categories. Moreover, we understand the principle of proportionality in such a way that simpler structures, processes and methods may be sufficient for a more limited business scope or lower risk profile. However, more extensive structures, processes and methods are required for supervised entities with more significant ESG risks.

Q16. Through which measures could the adoption of strategic ESG risk-related objectives and/or limits be further supported?

Q17. Please provide your views on the proposed ways how to integrate ESG risks into the business strategies and processes of institutions.

We refer to our answer to Q14.





Q18. Please provide your views on the proposed ways how to integrate ESG risks into the internal governance of institutions.

Q19. Please provide your views on the proposed ways how to integrate ESG risks into the risk management framework of institutions.

Q20. The EBA acknowledges that institutions' approaches to environmental, and particularly climate-related, risks might be more advanced compared to social and governance risks, and gives particular prominence in this report to the former type of risks. To what extent do you support this approach?

Please also provide your views on any specificities associated with the management of social and governance risks.

Not applicable for our members.

Q21. Specifically for investment firms, what are the most relevant characteristics or particularities of business strategies, internal governance and risk management that should be taken into account for the management of the ESG risks? Please provide specific suggestions how could these be reflected.

We refer to our answer to Q14. In addition, we would like to highlight that the outstanding Level 2 requirements under the MiFID II on integrating sustainability risks and factors will also provide organisational requirements for investment firms such as tasks and the role of the risk-management function or procedures for risk assessment; governance and tasks or responsibilities of bodies that undertake the management and supervisory functions in the corporate governance in relation to sustainability risk limits and overseeing their implementation; steps of procedures and processes to ensure the effectiveness and adequacy of sustainability risk integration; skill, expertise and knowledge required for the assessment of sustainability risks; regular reviews of the mechanisms put in place to integrate sustainability risks and regular internal reporting; conflict of interest that might arise in relation to sustainability considerations and the steps to identify, prevent, manage and disclose them. Therefore, it is of utmost importance that internal governance processes envisaged in the final EBA report are fully aligned with the relevant MiFID II (Level 2) provisions and the approaches taken by ESMA.

## ESG factors and ESG risks in supervision

Q22. Please provide your views on the incorporation of ESG factors and ESG risks considerations in the business model analysis of credit institutions.

Q23. Do you agree with the need to extend the time horizon of the supervisory assessment of the business model and introduce as a new area of analysis the assessment of the long-term resilience of credit institutions in accordance with relevant public policies? Please explain why.

Q24. Please provide your views on the incorporation of ESG risks considerations into the assessment of the credit institution's internal governance and wide controls.

Q25. Please provide your views on the incorporation of ESG risks considerations in the assessment of risks to capital, liquidity and funding.

Q26. If not covered in your previous answers, please provide your views on whether the principle of proportionality is appropriately reflected in the discussion paper, and your suggestions in this respect keeping in mind the need to ensure consistency with a risk-based approach.

Q27. Are there other important channels (i.e. other than the ones included in chapter 7) through which ESG risks should be incorporated in the supervisory review of credit institutions?



Not applicable for our members because the questions are addressed to credit institutions and their business models.

However, we would like to highlight that the supervision of investment firms regarding the treatment of risk should consider that the new IFD/IFR framework only applies to non-systemic investment firms. Hence, there is no need for approaches which under the CRD/CRR are required for (systemic) credit institutions. Regarding the potential risks of limited licence investment firms (such as portfolio managers with no dealing on own account), we do not see a need for establishing the same level of high prudential supervision. Therefore, the supervision of limited licence investment firms should be focused on operational risks which will be part of the check of the risk-bearing capacity and the SREP.

## Annex 1

Q28. As an institution, do you use or plan to use some of the indicators and metrics included in Annex 1? If yes, please describe how they are used in relation to your ESG risk management approach.

We refer to our answer to Q8. In any case, it should be clarified that the indicators and metrics listed in Annex 1 are not mandatory.

Q29. If relevant, please elaborate on potential obstacles, including scope of applicability, granularity and data availability, associated with the indicators and metrics included in Annex 1.

Even though there has been some improvement regarding the overall availability of ESG data in the last years, the persisting lack of comparability and reliability has still fundamental implications for data users, i.e. investors, companies and researchers. Directly reported company data is generally not usable in practice due to the lack of a single access point and the necessity to perform quality checks on the reported information. This gap is being filled by commercial data vendors experiencing rapidly growing business opportunities parallel to the increasing regulatory requirements for the processing of ESG data for the purpose of internal processes (risk management, investment due diligence) and external reporting by financial market participants. Indeed, **market concentration in the ESG data business has significantly increased over the last years**, in particular due to strategic acquisitions. All leading ESG data and research providers, with the exception of ISS for which a majority stake acquisition by Deutsche Börse has been announced, are now either headquartered in the US or owned by US company groups. This situation may become problematic in a twofold respect:

- It may have **implications for the quality and reliability of data**, if EU investors and financial market participants needed to rely on ESG research and qualitative assessments of ESG aspects as basis for ESG ratings that might not fully incorporate and take into account the development of the EU sustainable finance regulations. This is particularly relevant in relation to investments outside the EU, where EU investors will most probably not be able to refer to corporate disclosures, since such disclosures will not meet the EU requirements. This potential outcome cannot be deemed satisfactory from the EU policy perspective.
- It may further strengthen the **pricing power of ESG data providers**. In the last years, data providers have overloaded the market with their products. The pricing frameworks remain opaque, depending largely on the combination of data modules and the size of (ESG) assets under management of the client. A mid-sized to large fund manager will spend between EUR 200,000 and



400,000 per year for a comprehensive set of ESG data. Given that the amount of required data will grow in view of the pending implementation of ESG disclosure duties, we expect this cost to rise in the future. Additional cost for acquisition of Taxonomy-relevant data can be estimated with EUR 50,000 for the current set of indicators (relating to the environmental objectives 1 and 2). These expenses represent a **significant burden especially for SMEs**. More competition in the market would be helpful for raising efficiency as well as product quality and lowering costs.

In order to remedy this situation, EU should urgently take action in order to **introduce a mandatory standard for ESG reporting** by companies. In this regard, we are looking forward to the upcoming Commission's proposal for the revision of the NFRD framework. We trust that it will lay the **foundation for the introduction of uniform metrics and reporting standards that should significantly improve quality and availability of ESG data** and consequently, will help to **overcome the current dependency of data users on commercial data vendors**. A common reporting standard should reflect to the greatest possible extent the prevailing international standards for reporting of non-financial information. It should pertain to all ESG data requested by investors, including data on sustainability risk and opportunities, adverse impact of a company's business activities and the Taxonomy. The scope of mandatory reporting should also be extended to cover all large companies seeking to raise capital via capital markets as well as non-EU issuers that are listed on a regulated market within the EU.

In this context, we refer again to the Eurosystem reply<sup>4</sup> from the ECB (please see our answer to Q9) where the ECB highlights the situation as **an impediment to the consistent use of ESG data by financial institutions and market participants and stresses that unreliable ESG data and ratings limit users in their capacity to conduct granular financial risk analyses**.

Therefore, we fully support the approach proposed by the EBA to compile only an indicative, non-exhaustive list of KPIs on the basis of the commonly recognised international standards. This will ensure sufficient flexibility to focus on the aspects of ESG risks that are particularly relevant to certain sectors while being able to refer to the best available data. The list of relevant indicators could be specified over time when the new standards for ESG reporting by companies become applicable. However, it is clear that the review process in terms of non-financial disclosures by companies has been just initiated and will take several years in order to take full effect. At the current stage, we also cannot assess whether and to what extent it will improve the current situation in terms of corporate data.

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<sup>4</sup> Available under the following link: [https://www.ecb.europa.eu/pub/pdf/other/ecb\\_eurosystemreplyeuropeancommissionpublic\\_consultations\\_20200608~cf01a984aa.en.pdf](https://www.ecb.europa.eu/pub/pdf/other/ecb_eurosystemreplyeuropeancommissionpublic_consultations_20200608~cf01a984aa.en.pdf).