SUSTAINABLE FINANCE LAB

Input consultation EBA Draft Guidelines for the SREP and supervisory stress testing

Sustainable Finance Lab

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The Sustainable Finance Lab (SFL) is an academic think tank whose members are mostly professors from different universities in the Netherlands. The aim of the SFL is to contribute to a financial system that serves people and planet. To this end the SFL develops ideas and provides a platform to discuss them, thus bridging science and practice.

We have mostly focused our feedback on prudential transition planning related topics and broader ESG risk management. As such we have not responded to all questions.

We thank the EBA for the consideration given to these views and look forward to seeing the guidelines finalised.

General

Q1. What are the respondents' views on the overall amendments and clarifications made to the revised guidelines (across Titles 2 – 12)?

SFL welcomes the EBA's revised Guidelines on the Supervisory Review and Evaluation Process (SREP), in particular the more robust integration of environmental, social and governance (ESG) considerations across the different SREP building blocks. We consider this an important step in strengthening the prudential framework's capacity to identify, monitor and address ESG risks for banks and for financial stability. We also welcome the emphasis on simplifying the supervisory framework and improving supervisory effectiveness.

SFL has consistently highlighted the need for a more forward-looking and integrated approach to the treatment of ESG risks within prudential supervision. In an increasingly uncertain world, and given the significant data gaps, uncertainty and methodological constraints related to the assessment of ESG risks, further clarification on the treatment of these and other emerging risks in the SREP Guidelines would be beneficial in several areas. This is particularly the case regarding banks' misalignment with climate objectives and their prudential transition plans.

Q2. What are the respondents' views on the integration of ESG risks and factors across the existing SREP elements in the revised guidelines?

<u>Misalignment</u>

The SREP Guidelines do not use the term 'alignment' with EU objectives in the context of assessing transition risk. The EBA Guidelines on ESG risks do use this language. Consistency of this expectation between the SREP Guidelines and Guidelines on ESG risks guidelines would reinforce the importance of this concept and the central role it has in the assessment of transition risk. We therefore recommend clarifying and embedding this concept more consistently across relevant sections, including for example paragraphs 68a, 140 and 149. Greater clarity in this regard would enable supervisors to address issues of coherence in banks' transition plans more directly and would enhance consistency with the terminology and analytical framework set out in the EBA Guidelines on ESG risks.

The Guidelines could also provide more explicit guidance in the supervisory treatment of financing activities that are inherently misaligned with climate objectives or associated with elevated and difficult-to-mitigate transition risks, while at the same contributing to increased system-wide physical risks. In this context, we suggest that supervisors be explicitly encouraged to consider banks' exposures to activities such as the expansion of fossil fuel production. External resources, such as Urgewald's Global Oil & Gas Exit List (GOGEL), could support such assessments[1].

Transition planning process

We welcome the inclusion of the assessment of the robustness of banks' prudential transition planning processes within the Business Model Analysis (BMA) and the evaluation of internal governance. However, we note that this assessment is not consistently reflected across other SREP building blocks, including the assessment of risks to capital. In our view, robust transition planning processes are vital for monitoring banks' resilience to the transition towards a sustainable economy. To ensure that risk assessment and mitigation measures are explicitly part of the supervisory evaluation, we recommend that such processes should not be confined to the BMA, but rather treated as cross-cutting elements of the entire SREP, in line with the broader treatment of ESG risks.[2] [3], for example in Title 6.2.

Moreover, the SREP Guidelines refer interchangeably to "transition planning process" and to "plans in accordance with Article 76(2) of Directive 2013/36/EU". Readability and clarity would improve with the use of consistent terminology, for example by distinguishing between "prudential transition plans" (i.e. plans developed in accordance with Article 76(2) of Directive 2013/36/EU) and the "transition planning process" (i.e. the broader planning framework through which institutions develop and implement their transition plans, including prudential transition plans).

We also encourage the EBA to maintain structured and continuous engagement with DG CLIMA at the European Commission, which is responsible for developing sectoral transition pathways[4]. Such cooperation would facilitate a more systematic exchange of banking-related data and supervisory insights from the EBA to the Commission, supporting the refinement of transition pathways relevant to the banking sector. In turn, more robust and evidence-based pathways developed by DG CLIMA would enable the EBA to issue clearer and more consistent guidance on transition plans, supporting a more effective and efficient integration of ESG risks concentrations into the SREP.

Reference to EBA Guidelines on ESG risks

[1] About | gogel
[2] https://sustainablefinancelab.nl/paper/closing-the-gap/
[3] https://cetex.org/publications/integrating-bank-transition-planning-into-prudential-supervision/
[4] https://climate.ec.europa.eu/eu-action/eu-funding-climate-action/making-finance-flows-consistent-climate-goals_en#downloads--european-climate-law-aligned-transition-pathways

The inclusion of cross-references to the EBA Guidelines on ESG risks throughout the document is a positive development. For greater clarity and consistency, references could be made even more explicit in certain sections, including for example in paragraphs 60g and 69c.

Time horizon

ESG risks often materialise beyond traditional business planning and capital planning horizons, yet they already warrant supervisory attention today. We welcome the EBA's recognition of the long-term nature of ESG risks, including through the reference to a time horizon of at least 10 years. However, this long-term perspective could be articulated more explicitly and operationalised more consistently across the SREP Guidelines, for example in paragraph 56 and 69c.

Title 2: SREP framework

Q3. What are the respondents' views on the enhanced simplification and proportionality aspects?

We welcome the proposals for simplification and proportionality included in this review of the SREP Guidelines, especially on lowering the frequency and granularity of the SREP process to alleviate the burden on smaller players. However, we strongly invite the EBA to align simplification with the principles specified by the ECB in their recommendations for the Simplification of the European prudential regulatory, supervisory and reporting framework[5], namely without undermining the resilience of the EU banking sector and the effectiveness of the framework's prudential objectives.

Q4. What are the respondents' views on the introduction of a high-level escalation framework?

We welcome the clarification of the high-level escalation framework, promoting consistency in supervisory follow-up. However, the escalation framework should not be dependent on the size of complexity of the institution. This proportionality principle is relevant for the intensity of the supervisory assessment. However, the escalation measures should depend on the materiality of the deficiencies, not the size or complexity. Smaller banks can also be subject to significant financial risks.

Title 4: Business model analysis

Q6. Do you consider the coverage and level of detail of this Title appropriate for its intended purpose?

It is positive that the Business Model Analysis (BMA) now explicitly refers to climate and environmental risks, as well as to institutions' capacity to ensure medium- to long-term resilience to emerging risks, such as ESG and geopolitical risks. We particularly welcome the inclusion of an assessment of the robustness of banks' prudential transition planning processes within the BMA, with its incorporation in the supervisory considerations for assigning a business model score (table 2), and of potential supervisory measures stemming from the BMA, including adjustments to business strategy to address ESG risks, for example by requesting a reinforcement of targets, measures, and actions (table 3).

Our recommendations for further clarification are:

- Paragraph 56: Clarify that ESG risks need to be assessed over a time horizon of at least 10 years, and how this relates to paragraph 56 stating states the business model viability is assessed over a one-year horizon and the sustainability of the strategy over a three-year horizon.

[5]https://www.ecb.europa.eu/press/pubbydate/2025/html/ecb.simplification_supervisory_reporting_framework202512.en.html

- Paragraph 60g: "institution's plan to address ESG risks, to be prepared in accordance with Article 76(2) of Directive 2013/36/EU **and with the EBA Guidelines on the management of ESG risks**;"
- Paragraph 68a: "climate-related and environmental risks, including those arising from ~~process of~~ **the degree of misalignment of portfolios with the** transition towards regulatory objectives applicable in the jurisdiction(s) where the institution operates, (..)";
- Paragraph 69c: "(…) Competent authorities should also consider the capacity of the institution to ensure its medium to long-term resilience on ESG risks by taking into account long time horizons of at least 10 years, **in accordance with the EBA Guidelines on the management of ESG risks and** including by reviewing the environmental business model resilience analyses conducted by the institution in compliance with the EBA Guidelines on environmental scenario analysis."

Title 5: Assessing internal governance

Q7. What are the respondents' views on the updated section 5.7 "ICT systems, risk data aggregation and risk reporting"?

We support the role of the supervisor in assessing whether there are appropriate and consistent links between the business strategy, risk strategy, digital operational resilience strategy, risk appetite and risk management framework and the prudential transition plans. This is in line with the requirement of EBA guidelines on ESG risks requiring a 'single, comprehensive strategic planning process'. Prudential plans therefore cannot be a stand-alone exercise. They must be embedded in the core steering processes of the bank.

Title 6.2: Assessment of credit and counterparty risk

Q8. Do you consider the coverage and level of detail of this Title appropriate for its intended purpose?

We welcome the recognition in paragraph 149 (under the Assessment of inherent credit risk) that supervisors "should aim at taking into account the specific characteristics of these risks such as their forward-looking nature and distinct impacts over various time horizons". However, this consideration is not reflected in the Assessment of credit risk management and control framework, which could allow for a lower level of supervisory attention to ESG risk management, including risk mitigating actions.

Our recommendations for further clarification are:

- Paragraph 140: To assess the nature of credit risk, competent authorities should consider at least the following subcategories of credit risk by carrying out a more detailed assessment of those subcategories which are considered most relevant for the institution: (…) **j. ESG risks, initially prioritising physical risks and transition risks, including those arising from misalignment with regulatory objective**s"
- Paragraph 149: "(…) giving priority to ~~environmental factors and risks~~ **physical risks and transition risks, including those arising from misalignment with regulatory objectives**."
- Paragraph 150 -160: Specifically mention the specific characteristics of ESG risks, such as their forward-looking nature and distinct impacts over various time horizons, in the context of the Assessment of credit risk management and control framework, including risk mitigating approach. In this, explicitly mention the transition planning process.

- Paragraph 161: Specifically mention in the supervisory considerations (table 6) the assessment of the risk assessment and risk mitigating approach in the context of the transition planning process.

Title 7: SREP capital assessment

Q13. What are the respondents' views on the proposed assessment of the interaction between Pillar 1 and Pillar 2 requirements and on the proposed approach for operationalizing concerning cases where an institution becomes bound by the output floor?

We recognise the Pillar 2 frameworks provides more flexibility compared to Pillar 1, enabling banks to adopt a more forward-looking approach. We stress that the assessment of ESG risks is subject to significant uncertainty, data gaps and methodological limitations. In earlier research and policy work, SFL has argued that these uncertainties justify the application of a precautionary approach in prudential supervision, rather than a wait-and-see approach that could lead to delayed risk recognition. We therefore recommend that the SREP Guidelines more explicitly acknowledge these uncertainties and encourage supervisors to apply an appropriate degree of conservatism when assessing ESG and translating them into supervisory outcomes. This would help ensure that simplifications do not inadvertently weaken prudential safeguards in the presence of imperfect information.

Our recommendations for further clarification are:

- Paragraph 305: When identifying, assessing and quantifying risks to which the institution is exposed, competent authorities should rely on the following sources of information: (…) **d. expert input for emerging risks like ESG and geopolitical risks, for example from the International Energy Agency or European Scientific Advisory Board on Climate Change"**
- Paragraph 309: Clarify that the reliability of the ICAAP calculations also includes whether they are prudent, meaning that banks take into account in their capital measures the limitations and uncertainties around modelling ESG risks.

Title 10: Application of the SREP to cross-border groups

Q16. Do you consider the coverage and level of detail of this Title appropriate for its intended purpose?

We welcome the consolidation on a cross-border basis of all exposures in a financial conglomerate as the foundation for assessing prudential risk, as well as the development of tools to monitor and address these risks on a group-wide basis. Group-wide consolidation would support both the SREP applicable to the banking entities and an assessment of the risks stemming from any other entity in the group, as currently covered in the supplementary supervision of a financial conglomerate in compliance with Directive 2002/87/EC (FICOD). While the present review appropriately addresses capital adequacy and excessive leverage, due consideration should also be dedicated to risk concentration and contagion channels arising from the integration of cross-border entities. A more systematic focus on both the cross-border and the cross-sector dimension would enhance supervisors' ability to identify and manage emerging risks through a prudential lens.

We also support the emphasis on assessment at consolidated level of a financial group as a whole as a starting point for evaluating the overall viability of the group. At the same time, effective and timely communication within the college of supervisors is vital to manage the complexity of cross-border financial groups and to ensure the vulnerabilities arising from individual entities are properly assessed in their group-wide context.