José Manuel Campa
Chairperson
European Banking Authority
Tour Europlaza
20 avenue André Prothin
CS 30154
92927 Paris La Défense CEDEX
France

RE: Discussion paper on the role of environmental risk in the prudential framework (EBA/DP/2022/02)

Dear Chairperson Campa:

The Institute of International Finance (IIF) welcomes the opportunity to comment on the European Banking Authority's (EBA) *Discussion Paper on the role of environmental risks in the prudential framework* (thereafter referred to as "the Discussion Paper"). The IIF is the leading global association of the financial services industry, representing more than 400 member institutions in over 60 countries. The comments in this letter have been informed by discussions with experts from across the global IIF membership via the IIF Sustainable Finance Working Group and other relevant expert groups.

The global financial sector recognizes the critical threats that climate risks pose to global macroeconomic and financial stability, social stability, natural capital, and ecosystem health. Accordingly, financial firms around the world are significantly enhancing risk management capacities, adjusting business strategies, developing new products, and showing leadership on climate issues – including through setting ambitious Net Zero commitments. Regulators and supervisors play a key role in ensuring that climate-related risks are well addressed, thus avoiding the emergence of potentially systemic financial risks. Dialogue regarding the role for regulators and supervisors in responding to climate risks is advancing rapidly in new areas, including the relationship between climate-related risks and the prudential framework. Some jurisdictional and international authorities have begun to specifically examine the intersection of climate-related risks and regulatory capital tools. Against this backdrop, the IIF and its members have recently developed the attached paper entitled "Climate and Capital: Views from the Institute of International Finance (IIF)" to communicate industry's view on using the regulatory capital framework to address climate-related risks.

We are pleased to note that the perspectives set out by the EBA in the Discussion Paper are closely aligned with, and reflect, many of the industry consensus positions that our Climate and

Capital Paper seeks to convey. The IIF commends the EBA for adhering to a risk-based approach to ensure that prudential requirements reflect underlying risks and ultimately support institutions' resilience to such risks. The IIF also considers that the introduction of specific risk-weighted adjustment factors (such as a Green Supporting Factor or a Brown Penalizing Factor) would not be appropriate, and supports the EBA's view of the importance of avoiding the risk of double-counting. Additionally, the IIF appreciates that the EBA recognizes the significant challenges associated with the longer time horizon and forward-looking perspective of climate-related risks. The IIF also supports the EBA's view that other policy instruments outside the prudential framework (e.g., carbon pricing) are likely to have a more important role to play in the transition to a sustainable economy, and that these instruments will have an impact on risks facing the financial sector.

The IIF would like to emphasize four critical issues identified in our paper which are related to the EBA's consideration of prudential policy responses to climate-related risks.

First, neither supervisory climate scenario analyses and stress tests, nor analyses of risk differentials between "green" and "non-green" assets and activities, have to date yielded concrete evidence to support the use of regulatory capital adjustments to address climate-related risks. Precautionary adjustments of the prudential framework without robust evidence would inevitably require a departure from the EBA's risk-based approach to the prudential framework and introduce subjective choices pertaining to broader policy objectives, and could bring unintended consequences.

Second, the IIF believes that the Pillar 1 framework <u>should not</u> be adjusted to address climate-related risks. The IIF supports the view of the EBA set out in the Discussion Paper that the current design of the Pillar 1 framework may already capture climate risks appropriately, and therefore there should be no amendments/modifications to key design pillars, nor should there be efforts undertaken to utilize the existing framework (without modifications) to target climate-related risks in the absence of the necessary risk signals. Additionally, given gaps in the evidence base, necessary data, and methodology, efforts to modify Pillar 1 measures to account for climate-related risks would face major challenges and lead to potential unintended consequences, such as undermining the credibility of the current regulatory capital framework.

Third, the IIF has a number of concerns regarding the potential use of concentration limits, which is addressed as a potential policy option in the Discussion Paper. Looking beyond the issue of a lack of a common exposure classification methodology, the introduction of new concentration limits could lead to unintended consequences for specific regions or sectors, potentially impeding efforts to scale up transition finance where it is most needed. Furthermore, in the instance that such limits constrain financing from the banking and insurance sectors, capital from other sources could be sought by vulnerable firms or sectors, including from unregulated or unsupervised entities. More generally, since the IIF has a number of concerns regarding the use of other Pillar 2 capital adjustments at least at present, the IIF believes that regulators should

focus on dialogue with banks for mutual capacity building rather than pursue the use of capital adjustments in the near term.

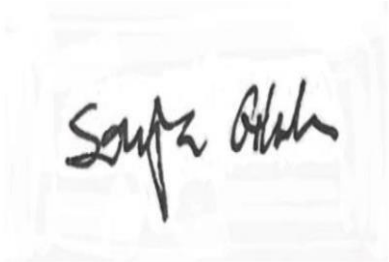
Lastly, the IIF would encourage the EBA to continue and deepen its collaborative efforts with other prudential authorities and global standard setters, such as the Basel Committee on Banking Supervision (BCBS), to develop common approaches regarding the use of prudential tools to respond to dynamic conditions at the international level. Enhanced international collaboration is critical to avoid increasing the risk of regulatory fragmentation, by enabling the development of common approaches that can then be implemented at jurisdictional levels. In particular, any decisions regarding changes to current Pillar 1 approaches should be thoroughly debated and agreed upon by the BCBS, without taking unilateral action on such a relevant matter that can have a significant impact on the global transition of the economy. Similar considerations would apply to Pillar 2, particularly given the already fragmented landscape of its application across jurisdictions.

With regard to the specific questions in the Discussion Paper, we make reference to a number of sections in our paper as specified in the following table:

Question Number in the Discussion Paper	**Relevant sections in IIF paper**
Q2	Section 2.3, Figure 1
Q3	Section 3.1.1
Q4	Section 2.2 ii)
Q5	Section 3.1.1 a), Box 1
Q6	Section 2.1
Q7, Q8	Section 3.2, Section 3.4.1
Q11	Section 4.2 to 4.2.3
Q15	Section 3.1.2, Section 3.4 to 3.4.1, Section 4.2 to 4.2.3
Q17	Section 3.4 to 3.4.1
Q20, Q21	Section 3.1.2, Section 3.4.2
Q30, Q31	Section 3.4.5

We hope that you will find our comments useful and constructive. If you have any questions, please feel free to contact the undersigned at aportilla@iif.com or sgibbs@iif.com.

Yours sincerely,



Andrés Portilla
Managing Director and
Head of Regulatory Affairs
Institute of International Finance (IIF)

Sonja Gibbs
Managing Director and
Head of Sustainable Finance
Institute of International Finance (IIF)