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Regulation: EBA Report on ESG Risk and Supervision of Investment Firms

October 28, 2022

Regulation

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On October 24, the European Banking Authority (EBA) announced the publication of its **report** on incorporating ESG risks into the supervision of investment firms. The report is intended to establish foundations for the integration of ESG risk considerations into the supervisory process of investment firms and covers elements including: (a) business model analysis; (b) assessment of internal governance and risk management; and (c) assessment of risks. According to the EBA, proportionality is a “key element” of the supervisory approach and competent authorities should consider elements such as an investment firm’s “business model, size, internal organization and the nature, sale and complexity of its services and activities, but also the materiality of its exposure to ESG risks.”

The executive summary to the report states: “The EBA acknowledges the challenges presented by the assessment of ESG risks in light of current data and methodological constraints. It is recommended that the supervisory processes follow a gradual approach, prioritizing the recognition of ESG risks in investment firms’ strategies and governance arrangements, and later incorporating ESG risks in the assessments of risks to capital and liquidity. Supervisory assessment practices are expected to develop over time, alongside the expected improvements in the availability of ESG data as well as the development of methodologies to assess the impact of ESG factors on financial risks.”

Taking the Temperature: This report underlines the importance of regulators adopting an internationally-consistent approach when creating rules for ESG-related matters. It should be reassuring for financial institutions, especially ones operating internationally, to see bodies such as the EBA attempting to establish clear guidance with the intention of creating a coherent and proportionate regulatory landscape. Financial institution regulators in the U.S., EU and other jurisdictions likewise are continuing to develop and refine supervisory procedures for regulated institutions. A key consideration, from a

regulated entity perspective, is consistency among jurisdictions to enable financial firms to assess ESG-related issues globally and according to a largely unified set of criteria.