

# Sustainability: From Supervisory Expectation to prescribed Responsibility



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Sustainability risks are impacting the global economy and the capacity of regulators across the world to meet their objectives of maintaining price and financial stability and to support broader economic policies as well of course as acting justly and ethically for the wellbeing of all people and planet. As such these risks have increasingly become a global and national supervisory area of focus. Regulators have for some time recognised the crucial role that the financial sector has to play in supporting the transition to a climate neutral economy and in meeting other sustainability goals especially in relation to the active management of associated risks.

In 1987, the United Nations Brundtland Commission defined sustainability as *“meeting the needs of the present without compromising the ability of future generations to meet their own needs.”*<sup>1</sup> It is noteworthy that regulators and standard setters are not just addressing ‘climate’, but also environmental, social and governance goals (ESG), and even broader ‘sustainability’ goals.

In 2023, as part of the new Individual Accountability Framework (IAF), the Central Bank of Ireland (Central Bank) introduced the Senior Executive Accountability Regime (SEAR) which applies to senior individuals (who hold Pre-Approval Controlled Functions - PCFs) within credit institutions, insurance undertakings and certain investment firms<sup>2</sup>. The purpose of SEAR is to improve governance, performance and accountability in firms by placing obligations on firms and senior individuals within them, to set out clearly where responsibility and decision-making lies and by identifying what those responsibilities entail.

In Ireland, regulatory focus began with investments as the Sustainable Finance Disclosure Regulation entered force in 2021, which placed requirements on

financial market participants to give transparency to investors. This has now expanded with the EU Corporate Sustainability Reporting Directive (CSRD) which has broader applicability.

This article charts some of the points in the evolution of supervisory expectations regarding certain sustainability risks from Dear CEO letter to SEAR prescribed responsibilities addressing sustainability and links the former to emerging regulation.

## Evolution: from supervisory expectations to prescribed responsibilities

The evolution of supervisory expectations in relation to the management of sustainability risks by FSPs to prescribed responsibilities has been marked by a series of Central Bank industry communications, regulatory assessments and European and international regulatory developments, and a sample of these are set out below.

### Central Bank Dear CEO letter on Supervisory expectation of regulated firms regarding climate and other ESG issues of 3 November 2021

This Dear CEO Letter<sup>3</sup> identified climate change as a strategic priority sets out 5 main areas for FSPs in relation to climate and broader sustainability issues, and covered the aspects of: governance, risk management, scenario analysis, strategic or business model risk and disclosures. Central Bank expectations in relation to ESG issues were not prescriptive and it was acknowledged that these would continue to evolve.



### Assessments of Firms’ exposure to and management of Climate - Related and Environmental risk of 2022

In 2022 supervisory actions were taken at European and domestic level in the banking sector. The ECB undertook Climate Stress tests for Significant Institutions <sup>4</sup>, and a thematic review of climate and environment related risks <sup>5</sup>. The conclusions in the latter report showed that there was acceptance that physical and transition risks are material within the current business planning horizons and that most institutions are taking steps to address these risks but that far reaching engineering efforts were required to manage them. The report stated some concerns around the capability to execute the necessary change and that further supervisory action may be necessary.

The Central Bank’s own 2022 horizontal assessment of Less Significant Institutions’ found that insufficient progresses were made to ensure that climate risk was adequately addressed and mitigated. In particular, Boards of Directors did not have clear, credible and achievable plans in place supported by the necessary resources and capabilities to meet the supervisory expectation in respect to climate risk. <sup>6</sup> Furthermore, climate risks were not generally considered in the context of firm’s strategy or business model, and risk management frameworks required enhancement, both quantitative and qualitative in nature, in order to meet the challenges associated with climate change. <sup>7</sup>

### Central Bank Regulatory and Supervisory Outlook of February 2024

In February 2024 the Central Bank published for the first time the key trends and risks that shape and jeopardise the financial sector and its consequent regulatory and supervisory priorities <sup>8</sup>. In it the Central Bank officially recognised the Sustainability risk as one of the main risks that threatens the financial sector thereby setting climate change and the Net Zero transition as a supervisory priority, expecting regulated entities to improve their response to climate change, including their risk management practices for physical and transition risk.

### Individual Accountability Framework and Sustainability

In 2023 under SEAR, the Central Bank placed a set of obligations related to various aspects of sustainability within the scope of a senior executive’s ‘Prescribed Responsibilities’ that firms must allocate to PCFs. Such obligations are supported by the new statutory Duty of Responsibility, that enable the Central Bank to take enforcement action not only against the firm, but also against senior individuals if they don’t take reasonable steps to prevent contravention of regulations related to the area of the business for which they are responsible.

As mentioned above, sustainability encompasses broad factors, and this is acknowledged by standard setters such as the European Financial



Reporting Advisory Group (EFRAG). We have seen through EFRAG’s European Sustainability Reporting Standards (ESRS’s), which are designed to implement CSRD, that obligations include not just climate and environment but also supply chain, community impact, consumer protection and business conduct (which includes governance). The

CSRD which obliges in-scope entities to report on sustainability matters entered force on 5 January 2023 and its requirements take effect in a phased manner from 2024 onwards, with the first reports being published currently.

The prescribed responsibilities reflected in existing ESRSs are set out in the table below:

Prescribed Responsibility		ESRS Reference
PR4	Responsibility for leading the development of the firm’s culture, including on matters relating to diversity and inclusion, by the Board.	ESRS 2 General Disclosures ESRS G1 Business Conduct
PR5	Responsibility for overseeing the adoption of the firm’s culture, including on matters relating to diversity and inclusion, in the day-to-day operation of the firm.	ESRS S1 Own workforce
PR7	Responsibility for ensuring that action is taken to prevent further harm or detriment to customers	ESRS G1 Business Conduct
PR12	Responsibility for ensuring the independence, autonomy and effectiveness of the firm’s policies and procedures on whistleblowing.	ESRS G1 Business Conduct
PR16	Responsibility for the board’s development and maintenance of the firm’s business model.	ESRS 2 General Disclosures
PR19	Responsibility for the firm’s outsourcing framework.	ESRS S2 Workers in the Value Chain
PR21	Responsibility for oversight and governance of strategic decisions, key business initiatives, including development of products, to ensure focus on delivering fair outcomes for customers	ESRS 2 General Disclosures ESRS G1 Business Conduct
PR 24	Responsibility for managing financial risks from climate change.	ESRS E1 Climate Change



It is also important to note that sustainability knowledge and competence are both recognised and required under the Minimum Competency Code Part 1<sup>9</sup> from 1 January 2025.

In conclusion, it can be seen from the above that whilst responsibility for Sustainability, including sustainable conduct, may not always be specifically stated in Regulations, it is indeed clearly implied and expected from SEAR in scope firms with Senior Executives bearing the ultimate responsibility.

### Further reading:

1. Accountability and sustainability: key themes in financial regulation - Gerry Cross, Director Financial Regulation Policy and Risk - 16 May 2019.
2. “Much done, much more to do - climate risks and the banking sector” - Remarks by Deputy Governor Sharon Donnery - 12 June 2023.
3. Meeting the climate challenge - Remarks by Deputy Governor Sharon Donnery - 27 November 2024.
4. The impact of recent regulatory developments in Ireland on ESG and governance - A&L Goodbody, October 2023.

5. EBA Guidelines on the management of environmental, social and governance (ESG) risks - EBA/GL/2025/01.

**Update following Omnibus Regulation Announcement 26 February 2025:** As of today 6th March 2025, the mapping of the prescribed responsibilities in the article is correct and in line with the Irish transposition of the Corporate Sustainability Reporting Directive (CSRD). Firms are still required to report - and indeed are reporting under the current CSRD. We do however have the provision in the European Commission’s Omnibus Simplification Package, released on 26 February 2025, which proposes significant amendments to the European Sustainability Reporting Standards (ESRS), including a proposal referencing reducing mandatory data points, with a focus on reduction of qualitative data points. We will monitor the developments on this and update members and readers to keep you informed.

### REFERENCES

1. Sustainability | United Nations
2. Central Bank Guidance on the Individual Accountability Framework - April 2024
3. Central Bank Dear CEO letter Supervisory expectations of regulated firms regarding climate and other ESG issues - November 2021
4. 2022 climate risk stress test
5. Walking the talk - Banks gearing up to manage risks from climate change
6. Horizontal assessment of Less significant institutions’ board approved plans relating to climate and environmental risk (2022).
7. CBI Horizontal Assessment of MiFID Investment Firm Exposure To, and Management Of, Climate-Related and Environmental Risks (2024).
8. Central Bank Regulatory & Supervisory Outlook - February 2024.
9. Minimum Competency Code 2017 Addendum June 2024