



EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Climate risks: banks' preparedness to weather the storm

Civil Society
Seminar



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Climate change and banking supervision

Climate change and environmental degradation affect banks through physical risks (e.g. extreme weather events) and transition risks (e.g. rising carbon price).

ECB Banking Supervision works to ensure that banks detect, manage, and disclose risks properly, including those from climate change.

Over time, banks become more resilient to climate and transition shocks, which contributes to the safety and soundness of the banking sector.

ECB supervisory agenda on climate and environmental risks

2020

- ECB sets out supervisory expectations on climate and environmental risks.


2021


- Banks conduct self-assessment of practices and draw up action plans.

2022

- Comprehensive supervisory assessment of banks' abilities to manage climate and environmental risks, including:
 - Published today: Thematic review of banks' capabilities to steer their climate and environmental risk strategies and risk profiles (expectations 1-10).
 - Stress test to assess banks' climate stress testing capabilities (expectation 11).
 - Gap analysis on climate-related and environmental risk disclosures (expectation 13)

Organisation of the thematic review

-  **Objectives**
1. Deep-dive into banks' ability to manage climate and environmental risks
 2. Assess how sound, effective and comprehensive banks' practices are
 3. Foster banks' alignment with supervisory expectations

-  **Set-up**
- **4 core modules:** materiality assessment, strategy, governance, risk management
 - **3 risk-specific modules:** credit risk, market risk, operational risk

 **Sample** **186 banks** (107 significant banks and 79 less significant banks)

Summary of thematic review findings

Overall developments



Banks have overall improved their capabilities since 2021.



However, banks still need more sophisticated methodologies and granular information.



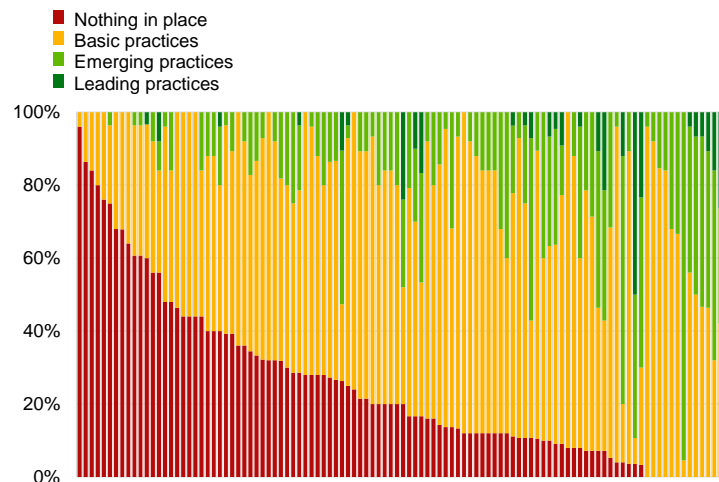
Most banks have devised at least basic practices but half of them have failed to implement them effectively.



Banks continue to significantly underestimate risks. 96% have blind spots in identifying them.

Maturity of practices across areas of supervisory expectations (bank-by-bank)

(percentages of areas of supervisory expectations by institution)



Source: Supervisory assessment of 107 significant institutions' responses to the 2022 thematic review on climate-related and environmental risks.

Selected results per thematic review module



Materiality assessment: 80% of banks reported to be materially exposed to climate risks, up from 50% in 2021.



Strategy: Many banks have taken steps to understand how climate risks impact their business models, but their strategies do not yet address all risks comprehensively.



Governance: Banks have improved their organisational structures. However, they are still in the early stages of tackling climate risks in a granular, bank-wide and comprehensive manner.

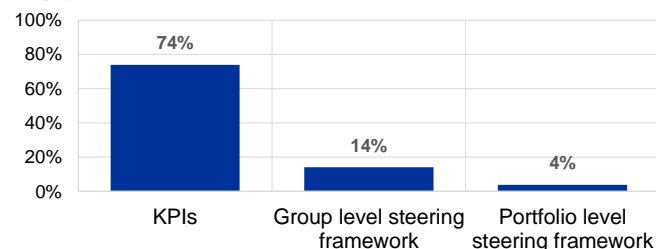


Risk management: Almost all banks use at least basic quantification methods to measure climate risks, but only 25% have advanced methods.

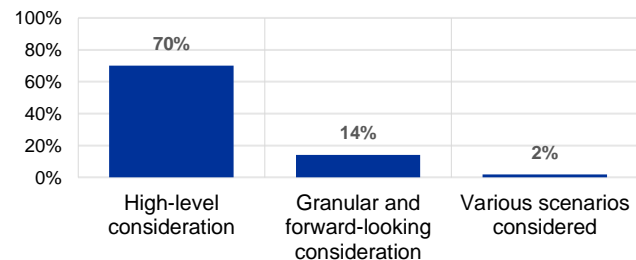
Climate-related risk practices in business strategy

(percentages of banks)

Key performance indicators



Strategy-setting process



Summary of recent findings from the stress test



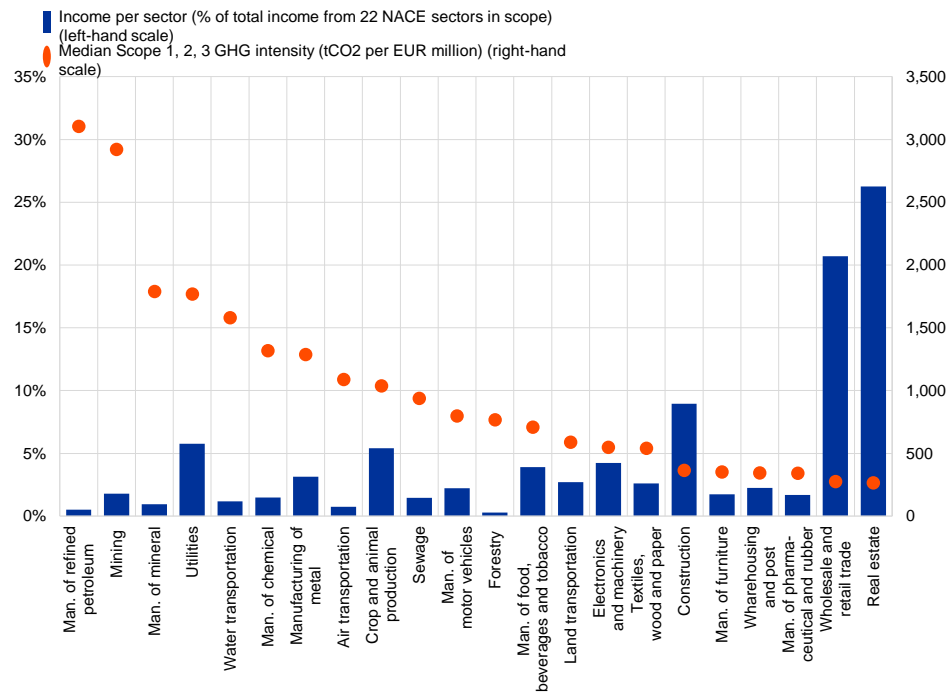
Stock-take on income: Banks generate considerable share of their income from carbon-intensive sectors, amounting to more than 65% of the total from corporations.



Loss projections: While projections significantly understate the actual risk, projecting banks reported €70bn of aggregate losses under the 3 short-term exercises (3-year disorderly transition and the two physical risk scenarios).



Stress testing frameworks: 59% of banks have not integrated climate risk into their stress-testing framework



Summary from the gap analysis on disclosures



Disclosures content: 45% of the banks' disclosures were assessed as insufficient from both the content and substantiation perspectives. Few banks disclose meaningful information on financed emissions, alignment metrics or energy performance certificates



Transparency: 1/3 of institutions do not yet transparently disclose that they are materially exposed to C&E risks in line with their internal materiality assessments

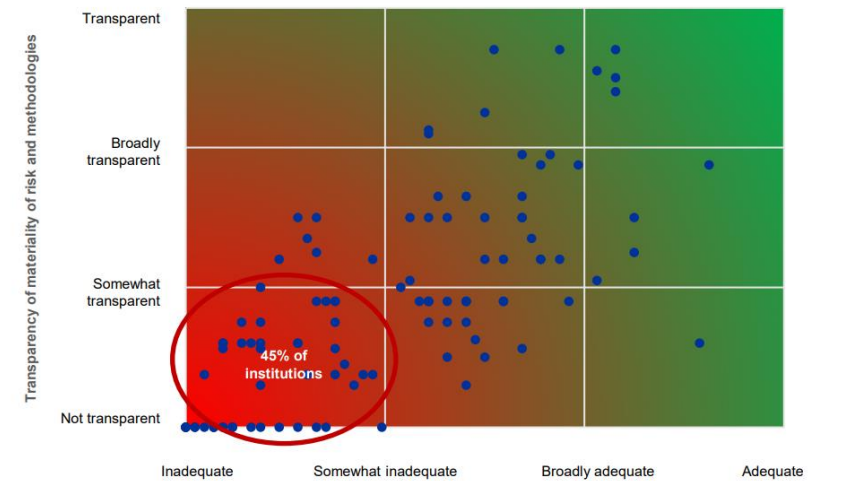


Substantiation: Institutions insufficiently substantiate their C&E risks figures, metrics and targets that they choose to disclose, raising concerns on associated reputation and litigation risk.

Chart 2

The state of climate-related and environmental risk disclosures in the banking sector in terms of content and transparency

(y-axis: the level of alignment of 109 institutions' disclosures with the supervisory expectations set out in the ECB Guide on transparency and substantiation; x-axis: the level of adequacy of 109 institutions' disclosures as regards the expectation set out in the ECB Guide on the content of disclosures)



Good practices show swift progress is possible



Example 1: Data-driven due diligence of clients

- Some banks have embedded climate and environmental risks into their due diligence and lending policies.
- Assessments may include, among other things:
 - Exclusion criteria, e.g. for companies that rely on coal for more than 25% of their energy mix.
 - A client-level risk assessment based on data such as emissions or geographical location data.



Example 2: Using scenarios for target-setting

- Some banks use transition planning tools to enhance the longer-term resilience of their business models.
- They use forward-looking and science-based decarbonisation scenarios to define interim targets showing how their portfolios have to evolve over time, often with the aim to gradually reduce financed emissions.

ECB sets deadlines for banks to deal with climate risks



All significant banks received feedback letters with an average of 25 shortcomings.



The ECB has set institution-specific deadlines for achieving full alignment with its expectations by the end of 2024, including the following milestones:

By March 2023

Adequately categorise climate and environmental risks and conduct a full assessment of their impact on bank's activities

By the end of 2023

Include climate and environmental risks in governance, strategy and risk management

By the end of 2024

Meet all remaining supervisory expectations, including on capital adequacy and stress testing

Findings on climate and environmental risks feed into supervisory review and evaluation process (SREP)

The ECB imposed binding qualitative requirements on more than 30 banks in its ongoing 2022 SREP to address severe weaknesses.

For a small number of banks, the outcome of the 2022 supervisory exercises on climate and environmental risks had an impact on their SREP scores. These, in turn, impact their Pillar 2 capital requirements.



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Q&A

