EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Rischio climatico e regolamentazione bancaria

Sadibaquarantasei

The opinions expressed in this presentation are mine and do not necessarily reflect the views of the ECB

24 March 2023

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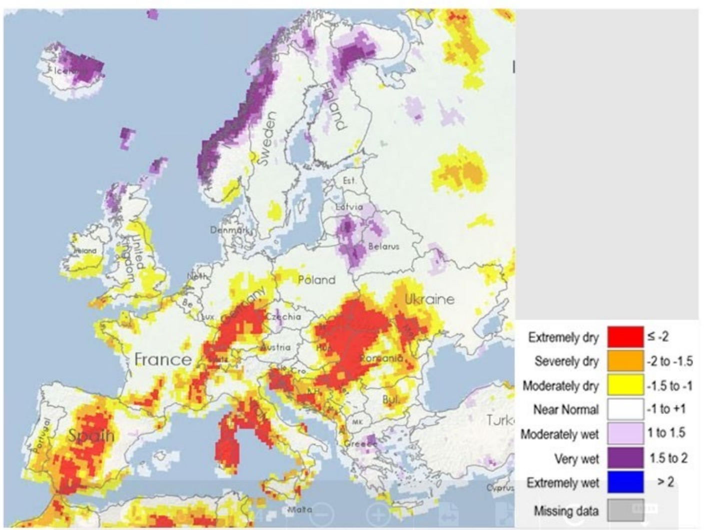
Directorate General Specialised Institutions and LSIs

Climate events have non-linear impacts



JRC - Standardized Precipitation Index SPI, three months ending 10 th of August 2022

Historic Drought Threatens to Cripple European Trade

From the Rhine to the Danube, waterways are failing at the worst possible moment as the climate crisis worsens.

By William Wilkes, Jack Wittels, and Irina Vilcu

August 10, 2022 at 6:01 AM GMT+2 *Updated on August 10, 2022 at 9:28 AM GMT+2*

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Climate-related and environmental risks

Recent actions of the ECB Banking Supervision

The ECB Guide sets out 13 supervisory expectations related to four key elements

Business models and strategy

Chapter 4
Business environment & business strategy

Governance and risk appetite

Chapter 5
Management body, risk appetite, organisational structure & reporting

Risk management

Chapter 6
Risk management framework and processes & scenario analysis and stress testing

Disclosures

Chapter 7
Disclosure policies and procedures, and disclosure content

Source: ECB Guide on climate-related and environmental risks, November 2020

The 2022 supervisory exercises provide complimentary views on the readiness of banks

Risk management

- [ ] 1. Business environment
- [ ] 2. Business strategy
- [ ] 3. Management body
- [ ] 4. Risk appetite framework
- [ ] 5. Organizational structure
- [ ] 6. Internal reporting
- [ ] 7. Risk management framework
- [ ] 8. Credit risk management
- [ ] 9. Operational risk management
- [ ] 10. Market risk management
- [ ] 11. Stress testing
- [ ] 12. Liquidity risk management

Disclosures

- [ ] 13. Disclosures

Horizontal supervisory exercises

Targeted supervisory exercises

1.–10. → Thematic Review on C&E risk

8. Credit risk management → Targeted review on CRE

11. Stress testing → Climate Risk Stress Test

Disclosures → Gap analysis on C&E risk disclosures

Dedicated on-sites

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

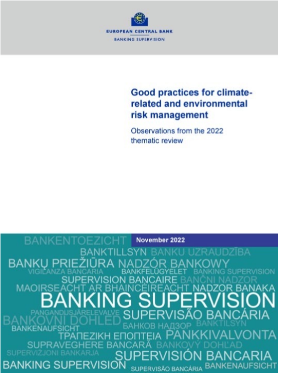
*"We expect all the banks we supervise to be fully aligned with all our expectations by the end of 2024 at the latest. And this is why we will take **enforcement** action if necessary."*

Frank Elderson, Vice Chair of the Supervisory Board of the ECB, 3 February 2023

Good practices demonstrate that swift progress is possible

Business strategy	Transition planning
	Key performance indicators
	Transition products
	Client engagement
	Client transition plans
Governance and risk appetite	Management body
	Remuneration policies
	Second line of defense
	Third line of defense
	Key risk indicators
	Data governance and data collection
	Internal risk reporting

Materiality assessment	Identification of risk drivers
	Identification of exposures
	Determination of materiality
Risk management	Due diligence and data collection
	Controversial client activities
	Credit risk classifications
	Market risk classifications
	Operational risk classifications
	Collateral valuations
	Loan pricing
	Capital adequacy assessments
	Environmental risk exclusions
	Environmental risk due diligence
	Biodiversity foot printing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BANKING SUPERVISION

Good practices for climate-related and environmental risk management

Observations from the 2022 thematic review

November 2022

C&E risks remain a supervisory priority

SSM Priorities 2023-2025

Priority 3 | **Stepping up efforts in addressing climate change**

Strategic objective: Banks to adequately **incorporate climate-related and environmental (C&E) risks within their business strategy, governance and risk management frameworks** in order to mitigate and disclose such risks, aligning their practices with existing regulatory requirements and supervisory expectations

Planned supervisory activities

- Follow up on shortcomings identified in the 2022 climate risk stress test and thematic review
- Disclosure gap analysis and review of banks' compliance with new ITS reporting and Pillar 3 disclosure requirements related to climate risk
- Deep dives on reputational and litigation risk associated with C&E risks
- Preparatory work for reviews of banks' transition planning capabilities and ESG mandates expected in CRD6
- Targeted OSIs on climate-related aspects

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Climate-related and environmental risks

Global convergence building up

Bank for International Settlements

The BCBS established the Taskforce on Climate-related Financial Risks (TFCR) to contribute to the Committee's mandate of enhancing global financial stability by undertaking the following initial initiatives on climate-related financial risks in a sequential approach:

Stocktake

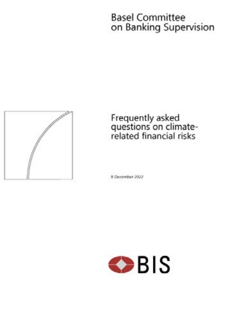
A stocktake of members' existing regulatory and supervisory initiatives on climate-related financial risks. Report published April 2020.

Reports

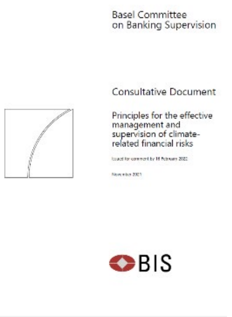
A set of analytical reports on climate-related financial risks, including reports on the transmission channels of such risks to the banking system as well as on measurement methodologies

Framework

Investigate the extent to which climate-related financial risks can be addressed within the existing Basel Framework, identify potential gaps in the current framework and consider possible measures to address them



Pillar 1 FAQs (December 2022).



Pillar 2 Principles (June 2022).

FAQs impact on B3 implementation: example

FAQ 7

Banks should determine whether the current market value incorporates the potential changes in the value of properties emerging from climate-related financial risks (eg potential damage related to weather hazards, the implementation of climate-policy standards or changes in investment and consumption patterns derived from transition policies). National supervisors should consider jurisdiction-specific features that account for climate-related financial risks when setting out prudent valuation criteria.

Paragraph to which FAQ 7 relates: **CRE20.75** *(2023 version)*

This paragraph sets out the prudent valuation of LTV values.

Pending CRR3

EP proposal for CRR3

"In the case of a revaluation beyond the value at the time the loan was granted the value of the property shall not exceed the average value measured for that property or for a comparable property over the last four years in case of commercial immovable property, and over the last eight years in case of residential property. The value of the property can exceed this value in case modifications are made to the property that unequivocally increase its value, such as improvements of the energy performance or improvements to the resilience, protection and adaptation to physical risks of the building or housing unit."

ECB Guide consistent with the BCBS Principles

ECB Guide

Risk management

- 1. Business environment
- 2. Business strategy
- 3. Management body
- 4. Risk appetite framework
- 5. Organizational structure
- 6. Internal reporting
- 7. Risk management framework
- 8. Credit risk management
- 9. Operational risk management
- 10. Market risk management
- 11. Stress testing
- 12. Liquidity risk management

Disclosures

- 13. Disclosures

Risk management

- 1. Business environment and strategy
- 2. Board and senior management
- 3. Implementation of processes, procedures and controls
- 4. Internal control framework
- 5. Capital and liquidity adequacy
- 6. Risk management process
- 7. Internal risk reporting
- 8. Credit risk management
- 9. Market risk management
- 10. Liquidity risk management
- 11. Operational and other risk management
- 12. Scenario analysis

Supervision

- 13-16. Principles on the supervision of climate-related risks

BCBS Principles

International convergence regarding the prudential role of transition planning

Prudential role of transition planning

Tackle credit and market risks arising from portfolio misalignment compared to pathways	Assess vulnerabilities of the business model and identify opportunities	Manage reputational impacts from business strategies disconnected from public statements
Portfolio allocation and risk appetite to factor in transition of sectors at risk and technological pathways	Transition plan to be part of the strategy-setting of banks and be closely linked to the business plan	Public statements that are unsubstantiated in banks' strategies can result in reputational issues

We understand other authorities may have voiced publicly similar messages

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

Climate-related financial risk management and the role of capital requirements

Prudential Regulation Authority
Climate Change Adaptation Report 2021

PRA: *manage risks w.r.t. pathways (Box A)*

HONG KONG MONETARY AUTHORITY
香港金融管理局

Supervisory Policy Manual

GS-1 Climate Risk Management

HKMA: consider shocks from misalignment (3.2.4)

Office of the Comptroller of the Currency

Principles for Climate-Related Financial Risk Management for Large Banks

OCC: *statements consistent with strategies (p.3)*

Outside Prudential scope

Net-zero alignment

Enforcing climate commitments or goals is not in scope of prudential transition planning. Supervisory methodologies nonetheless benefit from the development of net-zero alignment methodologies

The Glasgow Financial Alliance for Net Zero
Our progress and plan towards a net-zero global economy

Task Force on Climate-related Financial Disclosures
Guidance on Metrics, Targets, and Transition Plans

THANK YOU!

Questions?