

SUPERVISION OF CLIMATE AND ENVIRONMENTAL RISKS

Credit institutions face a number of emerging and evolving risks that may materialise in both the short and long term, such as the risks arising from climate change and environmental degradation. Tackling these risks will undoubtedly be one of the main challenges for institutions and supervisors in the coming years.

Therefore, it is essential that institutions assess this situation and have in place adequate mechanisms and procedures to react to these risks, and that the banking supervisor designs and calibrates its supervisory response appropriately.

To this end, both significant institutions (SIs), under the direct supervision of the European Central Bank (ECB), and less significant institutions (LSIs), under the supervision of the Banco de España, have been asked to carry out a self-assessment exercise regarding the degree to which their banking practices match the supervisory expectations on the management of climate risks and risks deriving from environmental deterioration, published in the last quarter of 2020.¹ In the case of SIs, this exercise was supplemented with the submission of implementation plans aimed at improving this alignment.

The aggregate results of the recent assessment carried out by the ECB in collaboration with some national competent authorities (including the Banco de España) have been published in a report in November 2021, which highlights the following messages:

- institutions have made some progress in adapting their banking practices, but most of them are aware that they are in the early stages of development;
- those institutions that have carried out a comprehensive assessment of climate and environmental risks foresee a material impact on their risk profile in the next three to five years, and they identify credit, operational and business model risks as being the most sensitive;
- although institutions have started to take the first steps, especially in relation to transition risks, they still have a lot of work to do in terms of managing risks deriving from climate change.

In addition, under its mandate to assess the possible inclusion of environmental, social and governance (ESG) risks in the supervisory review and evaluation, the European Banking Authority published in June 2020 a report² on how climate and environmental risks should be incorporated into the regulatory and supervisory framework for credit institutions and investment firms.

Finally, the ECB will pursue two main initiatives next year in the area of climate risk supervision: a climate stress test and a thematic review of the assessment of institutions' progress in coming into line with supervisory expectations.

¹ See the “ECB Guide on climate-related and environmental risks”, published in November 2020, and the “Guide to supervisory expectations relating to the risks posed by climate change and environmental degradation”, published by the Banco de España in October 2020.

² See “EBA report on ESG risks management and supervisión”, published in June 2021.