

CLIMATE RISK SUPERVISION: THEMATIC REVIEW OF THE EUROPEAN CENTRAL BANK

Since the publication in November 2020 of its Guide on climate-related and environmental risks¹, the European Central Bank (ECB) has been analysing institutions' situation with regard to the management of these risks. In the first half of 2021, the ECB requested 112 significant institutions (SIs) to conduct a self-assessment exercise on the alignment of their banking practices with the supervisory expectations set out in the guide, and to submit their implementation plans to improve this alignment.

In 2022, as a follow-up to this exercise and in cooperation with eight national competent authorities, including the Banco de España, the ECB conducted a thematic review. The objective of this review was to check whether institutions adequately identify and manage climate-related and environmental risks, and to analyse their governance strategies and frameworks.

The thematic review was conducted on a total of 186 institutions (107 SIs, including the 10 Spanish SIs, and 79 LSIs, including 4 Spanish LSIs). The main conclusions of this exercise were published in a report in November 2022² and included most notably the following:

- The institutions showed significant progress with respect to the situation in 2021. A high percentage of institutions consider that climate risk has a material impact on their risk profile and business strategy.
- The vast majority of institutions have at least basic practices in place for half of the expectations, and some of them have started to use their transition plans to improve the resilience of their business models over longer time horizons..
- Certain institutions have already started work to address environmental risks in a broader sense (biodiversity loss, increased pollution, etc.).
- On the contrary, institutions generally lack sophisticated methodologies and granular information on climate and environmental risks. Also, the ECB

expresses concern about institutions' implementation capacity, as around half of them have designed practices but have not implemented them effectively.

In short, the thematic review has shown that, despite the progress made, institutions are still far from adequately managing climate and environmental risks. The ECB communicated the results of its assessment to the institutions individually, describing the main shortcomings identified and setting specific deadlines for remedying them, compliance with which will be closely monitored. In general, institutions should achieve, at least, the following milestones:

- As a first step, the ECB expects institutions to adequately classify climate-related and environmental risks and to carry out a complete assessment of the impact of these risks on their activities by March 2023 at the latest.
- In a second step, by the end of 2023 at the latest, the ECB expects institutions to include these risks in their governance, strategy and risk management.
- As a final step, institutions are expected to meet all other supervisory expectations by the end of 2024, including full integration into the internal capital adequacy assessment process and stress tests.

As a result of this thematic review, the ECB imposed qualitative requirements on several institutions in the supervisory review and evaluation process (SREP).

Together with the conclusions report, in November 2022 the ECB published a compendium of observed good practices³, with the aim of guiding institutions to come progressively into line with supervisory expectations.

In addition, in 2022 the ECB undertook the following supervisory actions focused on climate and environmental risks: i) a stress test, intended as a learning exercise to assess institutions' preparedness for tackling climate risks; ii) a specific review of commercial real estate loan portfolios; iii) on-site inspections of a small sample of

1 "ECB Guide on climate-related and environmental risks", published by the ECB in November 2020. <https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.202011finalguideonclimate-relatedandenvironmentalrisks-58213f6564.en.pdf>

2 "Results of the 2022 Thematic Review on climate-related and environmental risks", published by the ECB in November 2022. <https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.thematicreviewcerreport112022-2eb322a79c.en.pdf>

3 "Good practices for climate-related and environmental risk management", published by the ECB in November 2022. <https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.thematicreviewcercompendiumgoodpractices112022-b474fb8ed0.en.pdf>

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significant institutions; and iv) a gap analysis of institutions' disclosures on these risks⁴. In turn, at the end of 2022 the Banco de España started the process of

assessing the degree of progress of less significant institutions in coming into line with the supervisory expectations issued by the Banco de España in 2020⁵.

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- 4 "Supervisory assessment of institutions' climate-related and environmental risks disclosures", published by the ECB in March 2022. https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.ECB_Report_on_climate_and_environmental_disclosures_202203~4ae33f2a70.en.pdf?2e88c1605db8adf0b748ad4aeb8721d7
 - 5 "Banco de España supervisory expectations relating to the risks posed by climate change and environmental degradation", published by the Banco de España in October 2020. https://www.bde.es/f/webbde/INF/MenuVertical/Supervision/Normativa_y_criterios/Recomendaciones_BdE/Expectativas_supervisoras_sobre_riesgo_medioambiental_27102020.pdf

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