REGULATORY WATCH

EXECUTIVE SUMMARY OF TRANSPARENCY REVIEW

CONTEXT

ECB published its third review of the disclosure of **climate-related and environmental (C&E) risks**. The ECB assessed three dimensions: existence, substantiation and soundness across key areas of expectations.

Scope:
103 SIs under the direct supervision of the ECB in addition to 28 LSIs under the supervision of national authorities from four Member States.

Methodology:
A list of questions was assessed through publicly available disclosures (annual reports, non-financial reports, sustainability reports and Pillar 3 reports) with a reference date of the end of 2021, or a later date where available, resulting in the application of a score (adequate, broadly adequate, somewhat inadequate or inadequate).

KEY FINDINGS

- Banks have shown **clear progress**, in terms of the **existence of disclosures**. But they still need to make an **effort** regarding the **adequacy of disclosures**.

- All of the EU G-SIBs have joined the net-zero banking alliance (NZBA).

- **Key Expectations Assessment:**

  - **Materiality assessment:** More banks are disclosing information on the materiality of their C&E risks but the quality of the disclosed information is often poor.

  - **Business model:** a majority of institutions inadequately assess and consider the impact of C&E risks on their business model or the way their business model affects the climate (double materiality assessment). They are not ready to identify, monitor and set up a long-term strategy to deal with C&E risks.

  - **Governance:** considerable improvements but progress still to be made towards more detailed disclosures about the organisational structure.

  - **Risk management:** a majority of FI disclose minimal information about identifying and managing C&E risks but only a few does so comprehensively. No notable progress on specifying how the elements of C&E risks have been integrated into risk management processes in public reports.

  - **Other environmental risks:** only a small group of banks deploy leading practices disclosing quantitative information about their portfolio exposure. However, most banks have set minimum standards to engage with clients to minimise other environmental impact.

- **Key metrics and targets:**

  - **Financed Emissions:** half of the banks didn't disclose Scope 3 financed emissions. 53% of banks couldn't substantiate their measurement approach. There is rarely a clear reference to reporting date of data. Not enough info on clarity of data. Lack of heterogeneity across banks.

  - **Alignment metrics:** important tool to track progress towards Paris agreement objective. Only 6 institutions provided a breakdown of all exposures by NACE code. 32% of institutions have carried out a PACTA analysis but the outcome of analysis were not in depth.

- **Preparedness for EBA ITS – Pillar 3:**

  - **Social & Governance risks:** most banks do not disclose in a comprehensive manner information on their methodologies and strategy to mitigate those risks. Disclosures focus on bank's own activities and lack details on risks associated with counterparties.

  - **Quantitative metrics:** few banks disclosed a full breakdown of exposures by NACE sector (24% partially disclosed it). 21% of banks disclosed information on the energy efficiency of the collateral of loans collateralised by immovable property. 32% of banks disclosed alignment metrics for indicators of potential climate change transition risk by sector for some of their portfolios. Most banks started disclosing general information related to their EU taxonomy aligned exposures.

Reference: "The importance of being transparent"– Source: ECB

BEST PRACTICES

ECB shared a **list of good practices** observed during the exercise so that SIs can meet the supervisory expectations. Some of those practices are listed below:

- **Materiality assessment:** Heatmaps displaying the risk assessment of different transition scenarios per risk area or heatmaps categorised by client sectors to summarize the assessments' results…
- **Business Model:** heatmap providing an overview of the estimated impacts of both physical and transition risks on the institution's risk profile…
- **Governance:** remuneration scorecard related to performance, a table summarizing the governance structure, a visual describing the three lines of defence, iconographic charts visualizing the competences available at board level, the plans to build up capacity and skills across the management body and staff...
- **Risk Management:** table describing risk drivers and their impact on traditional risk types, list of policies in place to integrate C&E risks within the bank's risk identification, assessment and management processes, table describing the scenarios and scope of stress testing…
- **Metrics & Targets:** chart showing portfolio alignments vis-à-vis various scenarios per sector (by institutions using the PACT analysis), table showing the scope and boundary of GHG emissions and the respective data quality…

CONCLUSION

- Stakeholders are not able to appropriately assess the risks facing the institutions.
- "Substantial efforts" are needed from most of the institutions to disclose ESG risk information as defined in the EBA ITS.
- Banks should inform the ECB about their **plan to address the identified shortcomings** in their forthcoming disclosures and **to comply with the EBA ITS**.

HOW CAPCO CAN HELP

Capco's teams developed an extensive expertise on ESG disclosure.

Capco has a strong and varied track record of supporting clients on ESG disclosure related projects and can assist your organization on the following topics:

- Audit and diagnostic of the actual disclosure and alignment with TCFD, Pillar 3, …,
- Implementation of best practices,
- Process streamlining,
- and others.

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