



ECB publishes final guide on climate-related and environmental risks for banks

The European Central Bank (ECB) published its final and amended guide on climate-related and environmental risks following a public consultation. **The guide explains how the ECB expects banks to prudently manage and transparently disclose such risks under current prudential rules.**

The ECB will now follow up with banks in two concrete steps. In early 2021 it will ask banks to conduct a self-assessment in light of the supervisory expectations outlined in the guide and to draw up action plans on that basis. **The ECB will then benchmark the banks' self-assessments and plans, and challenge them in the supervisory dialogue.** In 2022 it will conduct a full supervisory review of banks' practices and take concrete follow-up measures where needed.

The guide will apply immediately.

Scope and application

The guide does not substitute or supersede any applicable law. It should be read in conjunction with other ECB guides and, in particular, the ECB Guide to the internal capital adequacy assessment process (ECB Guide to the ICAAP). **It aims to enhance the industry's awareness of and preparedness for managing climate-related and environmental risks.**

Significant institutions are expected to use the guide, taking into account the materiality of their exposure to climate-related and environmental risks. **Where this is needed, significant institutions are expected to promptly start enhancing their practices.**

As part of the supervisory dialogue, from early 2021, significant institutions will be asked by Joint Supervisory Teams to inform the ECB of any existing divergences in their practices from the supervisory expectations described in this guide and to inform the ECB of arrangements aimed at progressively addressing these expectations.

What are climate-related and environmental risks?

Climate change and environmental degradation are sources of structural change that affect economic activity and, in turn, the financial system. Climate-related and environmental risks are commonly understood to comprise **two main risk drivers: physical risk and transition risk**.

Physical and transition risk drivers impact economic activities, which in turn impact the financial system. This impact can occur directly, through for example lower corporate profitability or the devaluation of assets, or indirectly, through macro-financial changes.

These risks also affect the resilience of an institution's business model over the medium to longer term, and predominantly those institutions with business models that are reliant on sectors and markets which are particularly vulnerable to climate-related and environmental risks.

What are the ECB expectations?

The Guide sets out supervisory expectations relating to the following areas:

1. Business model and strategy, including business environment and strategy;
2. Governance and risk appetite, including Management body roles and responsibilities, risk appetite, organisational structure and reporting;
3. Risk management, including risk management framework, credit/market/operational/liquidity risk management, scenario analysis and stress testing;
4. Disclosures, including policies and procedures

How can Deloitte help?

Our extensive experience can help you to implement this Guide in many ways, including:

I. Governance

- Update risk frameworks and policies for relevant risk types through which climate risks manifest;
- Integrate climate risk within Risk Appetite and management reporting metrics;
- Establish controls embedded into relevant processes covering risk identification, assessment, acceptance or approval, monitoring and reporting;
- Education and awareness;

II. Risk management and risk appetite

- Establish a uniform risk taxonomy and risk categories;
- Support in creating tools to identify and assess physical and transition risks;
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III. Data and tools

- Scenario analysis: using alternative states of the world
- ESG scoring: develop ratings for each type of customer;
- Risk and control assessments: assess and monitor climate risk based on normal bank practices

IV. Risk assessment

- Calibrate PD and LGD considering climate risk;
- Quantify climate-related concentration risk;
- Quantify potential losses due to market risk;
- Integrate climate risk into Operational Risk Assessment Map.

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