

Climate-change risks (and opportunities): at different speeds banks start disclosing them



When it comes to assessing bank risk, climate change (CC) is not a front-burner topic for most investors or analysts. The focus is still primarily on financial, prudential and risk metrics: profitability (currently whiplashed in Europe by negative rates), credit, market and liquidity risk, capital and funding. But CC-related risks and opportunities, and the way banks disclose, monitor and manage them, will become a central topic for investors and market professionals.

They will be forced to, as political, social and cultural concerns about climate and environmental changes underpinning economic growth and well-being continue to rise. This is especially true for the younger generation, which is a growing segment of bank customers everywhere.

Issuance of green bonds has been strong in recent years: USD 168bn in 2018, USD 162bn in 2017, USD 85bn in 2016, according to the OECD. But market cheering and “go with the flow” appetite for green bonds should not dwarf investor and analyst focus on how companies – including banks – handle risks such as CC.

CC is assumed to be too fuzzy an area when it comes to assessing banks, sometimes tainted by flavour-du-jour political correctness, and in any event lacking credible metrics that would enable proper analysis. Many also point out that, compared to other sectors like fossil fuels, power generation, manufacturing, or transportation, the financial services sector is not among the worst offenders in carbon consumption.

For banks, however, what really counts most is not the direct, but rather the indirect carbon footprint contained in their loan and investment portfolios. Bankers booking fewer business flights is less relevant than CC awareness in lending practices. Too many banks are simply not able to provide such disclosures. But the direction of travel is clear. Several important recent initiatives, coming primarily from regulators and policymakers and supported by various stakeholders – with Europe playing a dominant role – have pushed banks to start disclosing more on CC-related topics.

Over the last few months, more transparency and clarity have emerged in this area, which is very positive. The latest CC disclosure scores show that banks are making relevant progress – albeit at different speeds – but that there is still significant ground to make up for many, especially regarding climate-related metrics and targets.

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Guiding the climate-related work of regulators and policymakers

Last April, the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) – established as a “coalition of the willing” at the end of 2017 at the initiative of Banque de France and currently having 36 members and five observers – issued six recommendations for central banks, supervisors and policymakers aiming at the transition to a low-carbon economy². This is a *sine qua non* since in order to address a global risk, supervisors everywhere are expected to sing from the same hymn sheet.

The recommendation that climate-related risks be integrated into the supervisory process is very likely to find its way in financial regulation and supervision. For some supervisors (in the UK, France, Netherlands, etc.) the process is already underway.

Another important recommendation is achieving robust and internationally consistent climate and environment-related disclosure. The NGFS separates CC-related risks from environment-related risks. The former relate to financial firms’ exposure to physical or transition risks caused by or related to CC. The latter are linked to firms’ activities that may influence environmental degradation (pollution, scarcity of fresh water, deforestation, land contamination, etc.). Specifically, at this time the NGFS recommendations refer mostly to CC risks.

Regarding physical risks, the NGFS joins other bodies in warning about the threat of temperatures rising by more than 1.5°C-2°C compared to pre-industrial levels (the targets of the 2015 Paris Agreement) for human health, food security, water resources or heat exposure. CC risks can lead to disruptive events like mass migration, political turmoil and conflict, in addition to reduction in global incomes. Threats to financial stability are self-evident in this context.

As for the risks related to transitioning to a low greenhouse gas (GHG) economy, the NGFS report cautions that the scale of the necessary economic and financial transformation creates both risks and opportunities for financial institutions. There would initially be a higher cost to adopt low-carbon technologies in some sectors, but this would be dwarfed in time by the cost of no climate action (a “hot house world”).

Pushing for better climate-related disclosure by banks

Last June, the Task Force on Climate-related Financial Disclosures (TCFD) – established in 2015 by the Financial Stability Board and chaired by Michael Bloomberg – published its latest status report on the implementation of its CC-related disclosure recommendations³. Specifically, the recommendations (first published in June 2017) were for organisations across sectors and jurisdictions generating more than USD 1bn in annual revenues (both financial and non-financial groups) to provide climate-related disclosures in their annual financial filings. The 11 recommended disclosures should encompass four specific thematic areas:

1. **Governance:** Board oversight; management role
2. **Strategy:** risks and opportunities; impact on organisation; resilience and strategy
3. **Risk management:** risk ID and assessment process; risk management process; integration into overall risk management
4. **Metrics and targets:** climate-related metrics; GHG emissions (including scope 3 for a value-chain approach); climate-related targets.

Assessing the 2018 CC-related disclosures of ca. 1,100 companies (104 of them banks), the TCFD noted that they had improved significantly since 2016 but were still insufficient for investors. Specifically, more clarity is needed on the potential financial impact of climate issues on companies. Also, a majority of them do not disclose information on the resilience of their CC strategies.

² <https://www.mainstreamingclimate.org/publication/ngfs-a-call-for-action-climate-change-as-a-source-of-financial-risk/>

³ <https://www.fsb-tcfd.org/publications/tcfd-2019-status-report/>

In aggregate, the 364 European companies fare better in terms of disclosure than counterparts in the rest of the world. Also, banks fare better than other sectors, including in the metrics and targets section. Regarding the latter, the relatively skimpy disclosure is understandable given the still insufficient data necessary to build suitable metrics and targets. To a certain extent, large banks' better CC disclosure compared to other sectors would have been spurred by a mix of supervisory guidance, heightened post-crisis focus on risk management and reporting, as well as concern about their public image (badly shattered during the crisis).

Surveying and scoring banks' climate-related disclosure

This summer, CDP (formerly known as Carbon Disclosure Project)⁴ published its scores on the 2018 climate/environmental disclosure of 7,000 companies worldwide, over half of them equally split between Europe and North America⁵. These include ca. 400 financial services firms: banks, insurers, asset managers, and asset owners. The survey captures the latest disclosure (2018).

Specifically, CDP sends detailed questionnaires to companies and cities, with topics following the TFCFD recommendation structure (see above). In addition to CC, disclosure is also requested on environmental risks: water security and deforestation (timber and palm). Not entirely surprising, no financial institution can at this time provide disclosure on water and forest topics, thus for this sector the scores apply solely to climate-related risks and opportunities.

For 2018, the CDP's A list (top scorers) includes the following European banks: AIB, Berner Kantonalbank, DNB, ING, Intesa, Lloyds, and UBS. It also includes three US banks: Bank of America, BNY Mellon, and Goldman Sachs. See *Appendix* for CDP scores for a larger number of European banks.

Analysing the survey's results, with a specific focus on the top 500 companies, CDP found striking differences across countries and regions, with China lagging, the US in-between, and Europe leading in identifying risks and opportunities related to CC. Also, alongside fossil fuel and power industries, the financial sector is more advanced in identifying those.

Overall, based on received replies to the questionnaire, the analysis shows that for financial services (the largest segment within the top 500) the opportunities of transitioning to a low-carbon economy far outweigh the cost of managing the transition: USD 1.25trn (60% of which transition risk and 40% physical risk) vs. USD 645bn. The most commonly identified physical risks are related to extreme weather, change to precipitation and weather patterns, and rising mean temperatures. Transition risks are identified as mainly policy and legal – increased pricing of GHG emissions, regulation of existing products, and enhanced emissions-reporting obligations – but also related to changing customer behaviour, technology, and reputation.

Again, using the top-500 analysis, CDP finds that the financial sector's CC-related risks and opportunities amount to more than 50% of the rest of the sectors combined. This is why the CC risks of banks are far from being a trivial matter.

With respect to regional differences, Europe towers above the rest of the world, especially regarding climate-related opportunities: USD 1.3trn, vs. USD 453bn for the US (all sectors).

⁴ CDP is a large non-profit organisation with affiliates in 50 countries, which for the last decade or so has been providing comprehensive surveys and analyses in this area to help frequent users of this data, including top 525 institutional investors worldwide.

⁵ <https://www.cdp.net/en/scores>

Key takeaways from recent climate-related disclosure of selected banks

The perusal of recent CC public disclosure of 26 large banks (19 of them in Europe)⁶ shows wide differences in the volume and especially the quality of reporting on this topic. A majority of banks can be relatively explicit with respect to the steps they themselves are taking to become good CC citizens, including providing targets on reducing business travel, usage of paper and other supplies, energy-efficient buildings (e.g. 100% renewable electricity for all its buildings worldwide by 2020 for ING). At the same time, implementing a digital strategy can lead to an increase in energy consumption, as highlighted by Nordea.

A few banks (HSBC, BNP Paribas, etc.) helpfully highlight the importance of worldwide staff training to increase CC awareness.

What is fuzzier are the specific strategies and targets the banks have for steering their lending and investments towards climate-friendly segments, regions and companies. Reducing the exposure to fossil-fuel sectors and promoting climate-resistant developments is an expressed goal, but few banks can be specific on timing and on financial targets and metrics.

In terms of the sharpness of the climate-related disclosure, banks like UBS and ING appear to stand out.

Overall, the sentiment is that in aggregate European banks seem to be more advanced in their analysis of climate-related issues and on how they can move ahead in this new world. The road, however, remains steep for all.

Appendix:

CDP scores for European banks (based on 2018 climate-related disclosures)

A	AIB, Berner Kantonalbank, DNB, ING, Intesa, Lloyds, UBS
A-	BNP Paribas, Barclays, RBS, CaixaBank, CGD, KBC, RBI
B	ABN Amro, Rabobank, HSBC, BCP, Commerzbank, Swedbank, BBVA, Unicredit, Bankinter, Bankia
B-	Nordea, Svenska Handelsbanken
C	Credit Agricole, Societe Generale, Credit Suisse, Deutsche Bank, Bank of Ireland, SEB, Danske Bank, Santander, UBI
C-	<i>None</i>
D	J Baer, Sabadell, National Bank of Greece, Natixis, Jyske Bank
D-	<i>None</i>
F	Banque Cantonale de Geneve, Banque Cantonale Vaudoise, Luzerner Kantonalbank, Banco BPI, PKO Bank Polski, Alior Bank, Sparebank1 SR-Bank, Mediobanca, OTP Bank, Erste, Bawag

Source: CDP, June 2019

⁶ Commerzbank, Nordea, DNB, HSBC, Lloyds, Santander, BBVA, Intesa, Unicredit, KBC, ING, Rabobank, UBS, Deutsche, Danske, Societe Generale, BNP Paribas, Credit Agricole, Citigroup, Goldman Sachs, JP Morgan, CBA, Mitsubishi UFJ, ICBC, RBC.



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