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Regulation: ECB Publishes Results of Review on Climate-Related and Environmental Risks

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On November 2, the European Central Bank (ECB) published the **results** of its thematic review into climate-related and environmental risks. As part of its review, the ECB looked at 186 banks with total combined assets of €25 trillion (approximately $25 trillion). The review found “broad acknowledgement” of the materiality of both physical and transition risks within current business plans and that most institutions have devised “institutional architecture to address climate-related risks,” meaning “they have performed an initial mapping of their risk exposures, allocated responsibilities within the organization, set initial key performance and risk indicators, and developed a qualitative mitigation strategy for at least part of their risk exposures.” However, aside from certain “leading institutions,” the ECB observed that a “wait and see” approach remained prevalent in terms of taking concrete action toward long-term goals, such that “strategic commitments are not supported by intermediate targets, limits and thresholds, or these are set such that there is negligible immediate impact on the institution’s exposure profile taking action toward a climate-related strategy.” The ECB also raised concerns that less than 10% of institutions use “sufficiently forward-looking and granular [climate and environmental] risk information in their governance and risk management practices.” The ECB has sent feedback letters to all “significant institutions,” which contained, on average, 25 shortcomings.

The ECB expects institutions to satisfy its articulated expectations by the end of 2024 according to the following milestones:

- By the end of March 2023, have in place “a sound and comprehensive materiality assessment, including robust scanning of the business environment”
- By the end of 2023, manage climate and environmental risks with an “institution-wide approach”
- By the end of 2024, fully align with all “supervisory expectations”

Taking the Temperature: The ECB’s observation that a “wait and see” approach is prevalent is not surprising. Instead of a raft of “trailblazer” banks taking the lead on setting concrete steps, we expect the majority of regulated institutions to continue to be reactive to pressure and guidance from the ECB given the continually evolving nature of the climate and environmental landscape. And, as in other industries, regulatory guidance for financial institutions varies among jurisdictions and, in many cases, remains in formative stages. For

example, in September, the Federal Reserve Board announced that, in 2023, six of the largest U.S. banks will participate in a climate scenario analysis exercise to analyze the impact of various climate scenarios on climate portfolios and business strategies. Following the exercise, the Fed will publish guidance on climate risk management and practices. Nonetheless, even institutions not subject to ECB regulation would be well served to consider its climate-related guidance. Consideration of short- and intermediate-term targets for reaching long-term goals, looking for "blind spots in the identification of C&E risks in key sectors, geographies and risk drivers," and using more granular or scientific information, especially "at the counterparty, facility or asset level in order to develop measurement approaches at higher resolution," are all sensible approaches, even if complex to implement in practice.

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