Readiness of the Financial Sector for the Impacts of Climate Change
Introduction

Financial institutions (FIs) find themselves under increasing pressure by investors, regulators, consumers and other stakeholders to identify, assess and mitigate the possible risks arising from climate change. In the EBRD region, those risks can stem from policy and market transition towards green economic models as well as from physical risks, such as water stress, elevated flood risk, or changes in precipitation patterns. The financial impact of climate change on financial institutions is not always explicit, with clear challenges in assessing, quantifying and managing those risks.

Recognising the importance of climate risk on financial systems, the Task Force on Climate-related Financial Disclosures (TCFD) introduced recommendations to guide financial institutions to build consistent and forward-looking information on the financial impacts of climate-related risks and opportunities, including those related to the global transition to a lower-carbon economy. Financial regulators also took stock of the potential for adverse impacts to the financial systems and responded with recommendations and guidance on the disclosure of climate related financial risks to help integrate climate impacts into investors’ portfolio management.

The EBRD has undertaken a climate pulse survey of financial institutions across the region in order to understand their progress in incorporating climate risk strategies, to determine what obstacles they face and how to overcome them in the evolving regulatory environment. The results of the survey show that the financial sector is not yet well equipped to identify, manage and disclose climate related information. Additional support is needed in order to guide institutions and countries toward sustainable change.

Factbox: About the Survey

- The online pulse survey was launched in the first quarter of 2021
- Results aim to assess whether the financial sector across the EBRD region is equipped to engage in climate risk management and financial climate-related risk disclosures
- 14 questions were asked on climate awareness, climate risk management and disclosures
- The survey was completed by 134 FIs across 34 economies; this corresponds to a response rate of 62 per cent*
- The composition of respondents was as follows:
  - 23 per cent of respondents are based in EU member states
  - 48 per cent of respondents are regulated by a supervisor who is a member of the Network of Central Banks and Supervisors for Greening the Financial System (NGFS)
  - 44 per cent of respondents have experience with green products through the implementation of EBRD Green Economy Transition (GET) project during the last five years

* 10 of them anonymous. Statements in this report exclude missing values, i.e., questions that were skipped by the respondent.
Highlights of Results

→ Financial institutions have limited awareness of risks associated with climate change. Only 43 per cent of respondents consider impact of their portfolio on climate change as a potential source of risk, for example the greenhouse gas emissions of financed activities.

→ An overwhelming majority (93 per cent) of respondents who consider the climate impact of their portfolio as a potential source of risk manage such risk through exclusions.

→ More than 40 per cent of respondents either do not consider the impact of climate change on their operations (i.e. physical climate risk), or such factors do not affect their investment decisions, even if they consider them.

→ The introduction of climate-related requirements or supervisory expectations by governments, policymakers or regulators is by far the most important external factor motivating FIs to strengthen their climate risk management.

→ Lack of tools, standardisation, data and practical guidance are on the other hand considered as most significant obstacles.

Findings from the survey align with experiences of other institutions.

“More than half [of directly supervised banks] have no approach for assessing the impact of climate risks. This finding is made all the more striking by the fact that, of the 20 per cent of the banks who do have a systematic way of assessing the climate risks, almost all find that climate risks are already having, or are about to have, a material impact on their risk profile.”

– European Central Bank

“It is important for financial institutions to identify and analyse risks associated with exposure to sectors that are vulnerable to climate and environmental risks, as those sectors have a significant presence in Croatia’s economy. The results of the survey of 20 Croatian banks show that the banks are aware of those risks but still underestimate their own exposure to them.”

– Croatian National Bank


Statement from Sandra Švaljek, Deputy Governor, presented at the joint HNB-EBRD online event “The Role of Banks in Greening Our Economies” in April 2021
With the intensification of extreme weather events in the past two decades and the resulting significant loss of human life and revenues every year, impacts related to a changing climate, environmental degradation and loss of biodiversity are now considered the top long-term risks globally, according to the World Economic Forum.

Policy and market shifts towards decarbonisation further emphasise the risks in sectors and industries that are impacted by the low-carbon transition, for example through the devaluation of carbon-intensive activities or losses generated by stranded assets. This increases the potential for transition risks in the EBRD region. Furthermore, countries are also exposed to specific physical risks, due to either one-off catastrophic events or to the longer-term and gradual shifts in climate patterns.

Financial institutions in the EBRD region operate in some of the world’s most carbon-intensive economies, where the inevitable shift towards decarbonisation will require deep, structural changes with significant implications for the real economy and the financial system. Furthermore, the region is vulnerable to the adverse effects of climate change, with key physical risks identified to people and infrastructure because of sea level rise, storm surges, droughts, heatwaves, wildfires or flooding.

https://www.weforum.org/reports/the-global-risks-report-2021
The Paris Agreement

Negotiated in 2015 and ratified a year later, it aims to restrict global average temperature increases this century to well below two degrees centigrade relative to pre-industrial levels. Markets are under increased pressure to not only deliver dedicated green financing, but also to ensure that their financing overall does not undermine the objectives of the Paris Agreement. The EBRD has committed to fully align its own financial flows with the objectives of the Paris Agreement.

Why is this relevant to the EBRD and its engagement with the financial sector?

Since 2006, the EBRD has committed €6.6 billion of green finance to 219 partner financial institutions across more than 30 economies, through a variety of financial instruments. The largest contribution to date has been achieved through deployment of EBRD’s Green Economy Financing Facilities (GEFFs), encouraging businesses and homeowners to invest in green technologies. Since the launch of this financing instrument, and with the support of donors, the Bank has distributed almost €5 billion via more than 150 participating financial institutions to support over 200,000 green investments in 27 economies. Together with funding from the Bank’s co-financing partners to date, the GEFFs avoid almost 9 million tonnes of CO₂ emissions per year.

Building from this record, the EBRD is set to become a majority green bank by 2025, aiming to invest 50 per cent of its portfolio in green projects. However, simply scaling up green finance will not be sufficient to address the climate challenge for the financial sector, where systemic changes are needed.

Climate change is not a risk just to individual transactions, but also to the stability of the entire financial sector. Financial institutions will need to identify, assess and manage climate risks, and increase their transparency towards the market.

In this light, the EBRD published its first stand-alone TCFD report in 2020, describing its current procedures, state of preparedness, and future plans to fully comply with the TCFD recommendations.

Furthermore, the Bank is committed to align its activities with the principles of the Paris Agreement. Achieving this will not be possible without engagement with and support to greening financial sector, increasing the ability of FIs to scale up their green financing ambition as well as becoming more resilient to the impacts of climate change.
Awareness of Climate Risk
63 per cent of respondents factor climate change impact in their decision making, but only 43 per cent of respondents consider impacts of climate change as potential source of risk.

An overwhelming majority of respondents who consider the climate impact of their portfolio as a potential source of risk manage such risk through exclusions.

More than 40 per cent of respondents either do not consider the impact of climate change on their operations, or such factors do not affect their investment decisions, even if they consider them.

**Awareness of Climate Risk**

**Highlights of Results**

**Key Takeways**

There is a low level of awareness of climate change risks and its implications for business operations among the surveyed FIs.

On average, nearly 60 per cent of respondents do not have a portfolio-wide approach to assess the impact of their operations on climate change. This means that they do not factor the climate-related impacts of financed activities (e.g. GHG emissions of their financed activities) in their decision-making, or they do so only for dedicated green products. This situation is most common among leasing companies, where 71 per cent do not have such an approach. However, banks are also lagging behind in introducing uniform or standardised approaches that are applicable to their whole portfolio, with 57 per cent of the banks responding that they do not have a portfolio-wide approach.

**Do You Consider the Impact of Your Operations on Climate Change?**

<table>
<thead>
<tr>
<th>Category</th>
<th>Consider Impact to Be a Source of Potential Risk</th>
<th>Consider Impact and Manage through Exclusions</th>
<th>Factor Does Not Impact Investment Decisions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall</td>
<td>36%</td>
<td>21%</td>
<td>40%</td>
</tr>
<tr>
<td>Banks</td>
<td>32%</td>
<td>28%</td>
<td>39%</td>
</tr>
<tr>
<td>Leasing companies</td>
<td>47%</td>
<td>24%</td>
<td>29%</td>
</tr>
<tr>
<td>Microfinance institutions</td>
<td>46%</td>
<td>4%</td>
<td>30%</td>
</tr>
</tbody>
</table>
Financial institutions with recent experience of working with the EBRD Green Economy Transition (GET) products show more climate awareness, indicating that GET finance can be a natural stepping stone for more comprehensive climate risk management engagement.

Respondents without previous experience with EBRD GET products during the last five years are more likely to state that climate change impact of activities financed is not relevant or does not affect their investment decisions.

**Case Study**

In June 2021, the National Bank of Egypt signed a US$100 million Green Economy Financing Facility (GEFF) loan with the EBRD.

By signing its third GEFF, the largest commercial bank in the country does not only commit to providing additional resources for much-needed green investments in small businesses, but also to strengthening its climate corporate governance on an institutional level, including in respect of addressing climate risk management and climate-related risk disclosure.
Despite the potential high exposure to physical climate impacts through water stress, elevated flood risk, as well as changes in precipitation patterns across the EBRD region, many partner financial institutions do not currently consider physical impacts of climate change in their decision making, irrespective of the geography they operate in. More than 40 per cent of respondents either do not consider the impact of climate change on their operations relevant, or such factors do not affect their investment decisions, even if they consider them.
Climate Risk Management: Practical Implementation
Climate Risk Management: Practical Implementation

Highlights of Results

Understanding and appropriately addressing climate risk remains limited by lack of skills, lack of internal capacity, lack of standardisation and lack of tools available to the financial institutions.

Financial institutions in the EBRD region do not sufficiently tap into international best practices. Less than half of the respondents are supporters or signatories of at least one initiative with a strong focus on climate.

Less than half of respondents involve Risk function in leading climate risk management implementation.

Key Messages: Risk Management

The understanding of climate risk management across the EBRD region is in a nascent stage, with few institutions adopting emerging good practice. Responses from the surveyed institutions point to lack of clarity on what skills and resources are required for implementation of risk management and disclosure processes, including in the presence of climate-related regulatory changes. In absence of guidance, FIs are likely to invest in sub-optimal solutions.

Most financial institutions lack capacity and understanding on how to operationalise climate risk management and disclosure. There is a strong perception among respondents - especially in non-EU markets - that the issue of climate risk management is not the responsibility of risk departments.

These results are aligned with earlier findings that financial institutions within the EBRD region are more likely to adopt exclusion lists rather than reflect climate considerations more comprehensively in their risk management system.

Banks lead the way in climate risk implementation in the financial sector. More than half of leasing companies and nearly half of MFIs reported having no department responsible for leading climate risk management efforts, while 12 per cent of leasing companies and 25 per cent of MFIs stated that their risk department is responsible. For
banks, almost 50 per cent said that their risk department is leading climate risk management implementation. Finally, only about 15 per cent of respondents among banks did not assign this responsibility to any department.

The progress on disclosures is even further behind. Only 15 per cent of respondents highlighted that they already publicly disclose some climate risk related information, and nearly one quarter of respondents does not plan to do so in the future.

The above reiterates that the financial sector is at the beginning of the journey for introducing comprehensive climate risk management into its operations. Results indicate that climate risks may still be considered more as environmental rather than financial risks.

“The future is one where climate risk management will be mainstream. Any role that we define in banking will have an element of climate risk. So climate risk will move away from a novel topic on which knowledge is currently centralised, to an all of organisation approach.”

– Standard Chartered

Statement from Adi Mukherjee, Head, Climate Risk, Standard Chartered Bank, made during the joint ECB-EBRD online event “Emerging Climate-related Risk Supervision and Implications for Financial Institutions” in June 2021.

**Key Messages: Alignment with international standards**

Financial institutions across the EBRD region do not tap sufficiently into the knowledge offered by international best practice initiatives.

Engagement with international initiatives such as TCFD, the Principles for Responsible Banking (UNPRB) and Principles for Responsible Investments (UNPRI), is a valuable tool to access international best practices, yet this participation has been low in the EBRD region, in particular outside of the EU. The majority of respondents reported not being a member or signatory to any of these initiatives. Only 16 per cent of respondents claim to be supporters or signatories of TCFD; EU-based FIs are twice as likely to be TCFD-signatory compared with the rest of the region.

Signatories of those initiatives across the region are frontrunners in adopting climate risk management practices and disclosures for both transition and physical risk management. More than 70 per cent of respondents who claim to be signatories to at least one climate initiative, plan to engage in strengthening climate risk management in the next two years.

Among those respondents who are not signatory to any of the three main initiatives mentioned, around 46 per cent stated that they plan to engage in strengthening climate risk management in the next two years.

Overall, signatories of internationally recognised initiatives show more awareness of the complexity of climate risk management and its implementation. While 9 per cent of non-supporters states that they have sufficiently robust climate risks management approach, none of the supporters considered this to be the case for their organisation.
“Knowledge sharing with other FIs in the context of international initiatives has been very beneficial for our climate risk management implementation. Our Bank has put in place a roadmap for managing climate risks. This has accelerated our planned journey towards climate risk management and we have now presented the first dedicated TCFD report.”

– Turkiye Sinai Kalkinma Bankasi A.S. (TSKB)

Statement from Ms. Meral Murathan, Executive Vice President and Sustainability Committee Member, TSKB. EBRD and the Clean Technology Fund supported the participation of TSKB in the UNEP FI TCFD Banking Pilot – Phase II.

“We are participating in international initiatives to learn from what other more developed markets implemented years before Romania to make sure that we are making progress in the right direction.”

– Banca Transilvania

Statement from Mihaela Nadasan, Deputy CEO, Head of Financial Institutions & Markets and International Relations, Banca Transilvania, during the joint ECB-EBRD online event “Emerging Climate-related Risk Supervision and Implications for Financial Institutions” in June 2021.
The Role of Regulatory Bodies
The introduction of climate-related requirements or supervisory expectations by governments, policymakers or regulators is by far the most important external factor incentivising FIs to strengthen their climate risk management.

Financial institutions supervised by regulators that are members of Network of Central Banks and Supervisors for Greening the Financial System (NGFS) tend to have more ambition to strengthen their climate risk management than respondents whose regulators are not NGFS members.

Lack of specific regulatory guidance, data and standardization are noted by respondents as biggest obstacle to strengthening climate risk management and disclosures.

Key Messages: Regulators play an important role in FI’s approach to climate change

Regulators are likely to play an important role in influencing the approach of financial institutions towards considering the impacts of climate change on their portfolio, and how in turn their portfolio affects climate.

FIs noted that introduction of supervisory expectations on climate risk management and disclosures is the strongest motivator for strengthening their climate risk management, with 63 per cent of respondents ranking this factor first.

FIs regulated by members of the NGFS are more likely to say that the climate impact of their operations is relevant. Out of those respondents who do not consider the impact of their operations on climate change relevant, 71 per cent are regulated by a non-NGFS member.

Map of EBRD Region with NGFS Memberships

- NGFS membership
- No NGFS membership
- Denotes survey response
While respondents recognise the key role of regulators in advancing climate risk management by financial institutions, the practical implementation of risk management and disclosures remains a challenging factor.

Lack of regulatory guidance, data and standardisation of reporting frameworks were identified as the most important obstacles to improving climate risk management.

The majority of FIs also do not plan to disclose climate related information in absence of regulatory requirements or supervisory expectations. Conversely, a stronger regulatory environment is driving climate risk disclosures. For instance, 54 per cent of EU-based respondents plan to disclose climate risk information within the next two years. This drops to 37 per cent for respondents supervised by national non-EU regulators.

The Network of Central Banks and Supervisors for Greening the Financial System (NGFS) was established at the Paris “One Planet Summit” in 2017. The Network’s promotes best practices to strengthen the global response required to meet the goals of the Paris agreement as well as to enhance the role of the financial system to manage risks and to mobilise capital for green and low-carbon investments.
Accelerating the Adoption of Climate Risk Management and Disclosures by Financial Institutions
Respondents are aware of some gaps that need to be addressed to build up their capacity for implementing climate risk management and disclosures. Answering the question about the three most important types of support needed from the EBRD to adapt operations to climate change, FIs stated that the most relevant support is upskilling, raising awareness and capacity building across all relevant departments.

As illustrated in the word cloud above, the majority of respondents would welcome technical assistance from the EBRD to adapt their operations to climate change.

In the survey, 38 per cent of respondents state that their Environmental, Social and Governance (ESG) or sustainability departments require significant strengthening through upskilling, capacity-building and/or additional resources. Finance departments and front office are identified as requiring such improvements by 30 per cent of respondents.

Respondents seem to overestimate the capacity of the Board to request climate related information and consider them in decision-making. Board and relevant committees were highlighted as requiring the least strengthening, with 36 per cent of respondents claiming that the Board and relevant committees require minimal or no strengthening. Respondents also do not see lack of engagement from the Board as a major obstacle to improving climate risk management, with 40 per cent stating that this is not an applicable barrier.
Respondents overwhelmingly indicate strong preference to source additional capacity internally from within the organization. This indicates that FIs understand that climate risk management will require a strategic shift in the way they operate and in the way this is managed internally.

Integrating different types of support for FIs is likely to bring a deep-rooted sectoral transformation, which is more likely to remain in place over time, thus guiding the institutions towards better understanding of climate risks and introduction of disclosures.

“Only around 40 per cent of [directly supervised] banks have assigned explicit responsibility for managing climate risks to the management body – and of those, three in four do not report on climate risks to management.”

– European Central Bank

Statement from the keynote of Frank Elderson, Member of the Executive Board, European Central Bank, during the joint ECB-EBRD online event “Emerging Climate-related Risk Supervision and Implications for Financial Institutions” in June 2021.
Key Takeaways

The survey reveals low awareness among respondents of how to implement climate risk management and related organizational arrangements.

While regulators will play a fundamental role, introduction of climate related regulatory/supervisory expectations will need to be underpinned with provision of relevant tools and capacity.

Strong preference of the respondents to internalise relevant expertise indicates that any support provided will contribute to sustainable systemic change in the way financial sector operates.

The survey confirms that support will be needed to strengthen climate corporate governance and climate risk management of financial institutions in the EBRD region, focusing on the following activities:

- Building up capacity of the financial sector with tools and processes to improve its climate risks and opportunities management across their portfolio.
- Improving access of financial sector to the emerging global best practices by strengthening linkages with international initiatives.
- Engaging with regulators on promoting awareness, transparency and disclosure.
- Providing targeted institutional building to formalise sustainable operational models.
- Supporting financial institutions in building internal skills, for example through dedicated technical assistance and training programmes.
Contacts

Dana Kupova, Head of Green Economy Transition, Financial Institutions, EBRD

Yvonne Mitschka, Associate Banker, Green Economy Transition, Financial Institutions, EBRD

Helena Schweiger, Associate Director, Senior Economist, Office of the Chief Economist, EBRD

Victoria Robinson, Associate Economist, Office of the Chief Economist, EBRD