ESG Risk Survey for Banks

Market Survey
Whitepaper

January 2025

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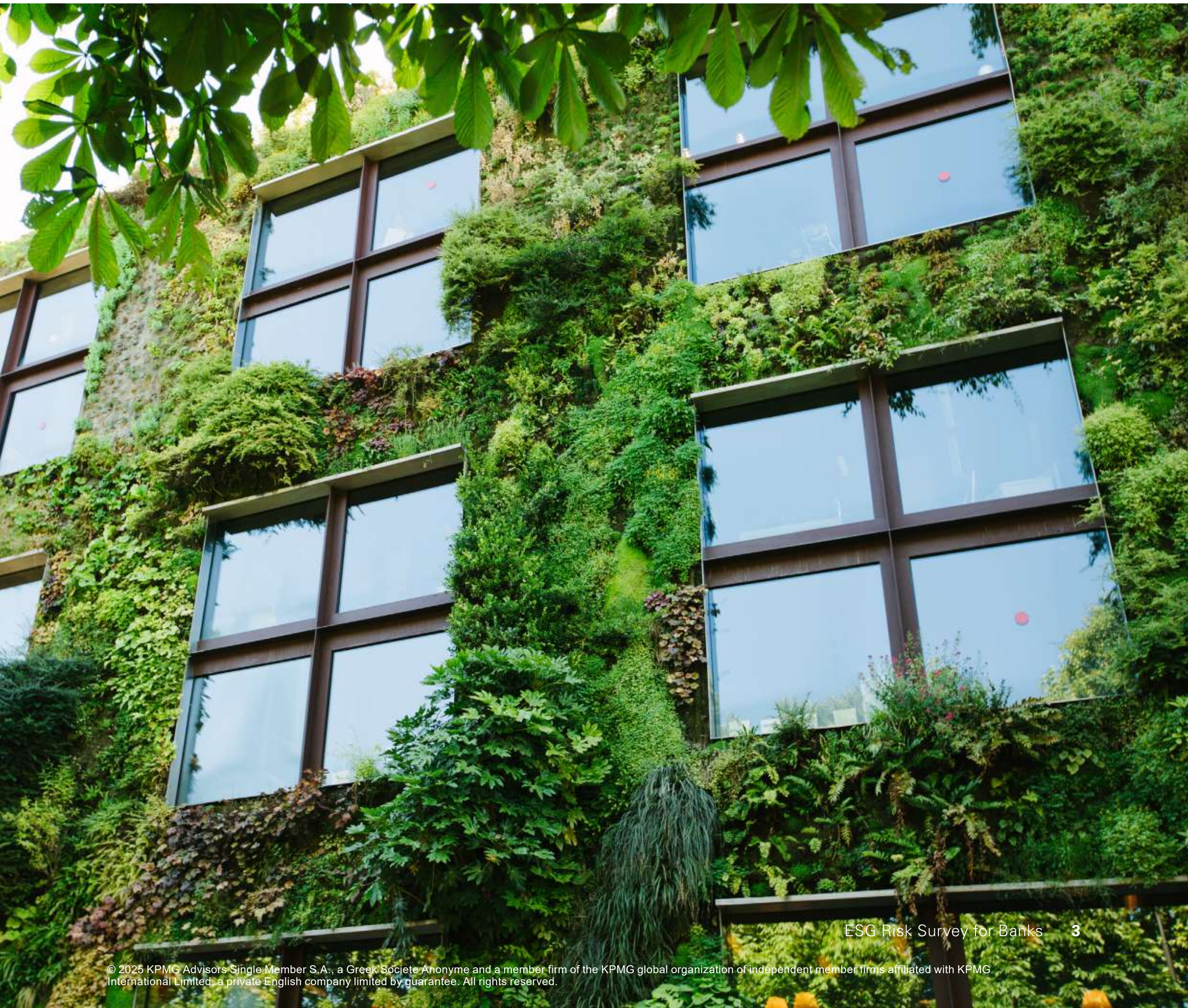
Management Summary

The importance of ESG risks for financial institutions cannot be overstated, as the financial sector is increasingly under scrutiny from regulators, investors and the public to uphold sustainable and ethical standards. The landscape of global finance is rapidly evolving, with a clear pivot towards sustainability that banks need to align with in order to remain competitive and compliant.

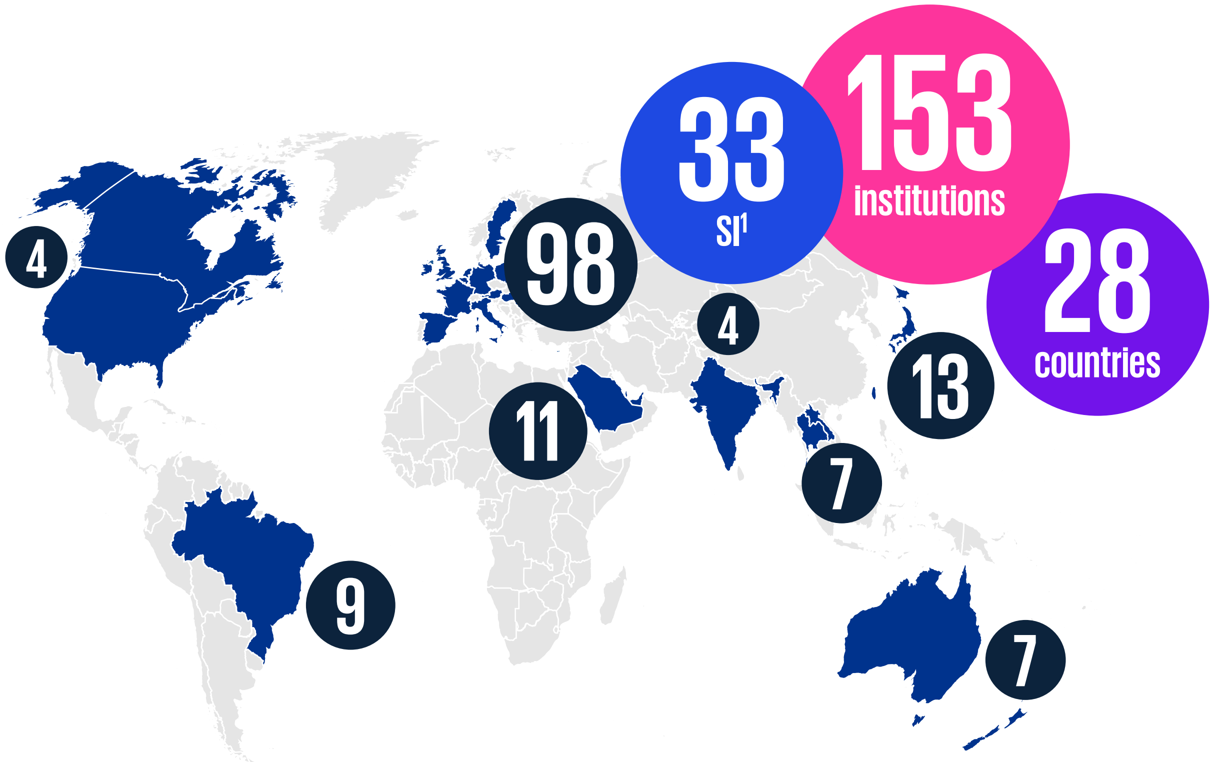
KPMG has conducted a survey – now in its fourth iteration – to assess where banks currently stand in terms of ESG risk management, providing critical insights for the global market. This enables institutions to benchmark their practices, identify gaps and prioritize areas for immediate improvement, ensuring they meet both regulatory expectations and societal demands for greater accountability and sustainability.



Introduction

> **The far-reaching impacts of climate change and nature degradation are more apparent than ever: 2023 was the hottest year ever recorded, while extreme weather events are becoming more frequent and increasingly these events also leave their mark on the economy"**
>
> - Frank Elderson, Member of the Executive Board of the ECB and Vice-Chair of the Supervisory Board of the ECB[2]

Figure 1: **KPMG's market study participants**



Source: KPMG in Germany, 2024

ESG risks are expected to have deep and long-lasting effects on the financial industry. Both supervisors and financial institutions alike have acknowledged the importance for the banking industry of addressing ESG risks appropriately, motivating them to pursue a path towards an economically and socially sustainable future.

The fourth iteration of the KPMG international benchmark survey supports this process. This year's survey has seen a sharp increase in the number of participating institutions, indicating a continuing rise in interest in the subject. This report is based on anonymized data from 153 institutions across 28 countries. The survey encompasses a broad spectrum of topics related to the implementation of ESG risks within institutions' risk management frameworks.

Note: 1 SI: ECB Significant institutions, i.e. EU institutions directly supervised by the European Central institution

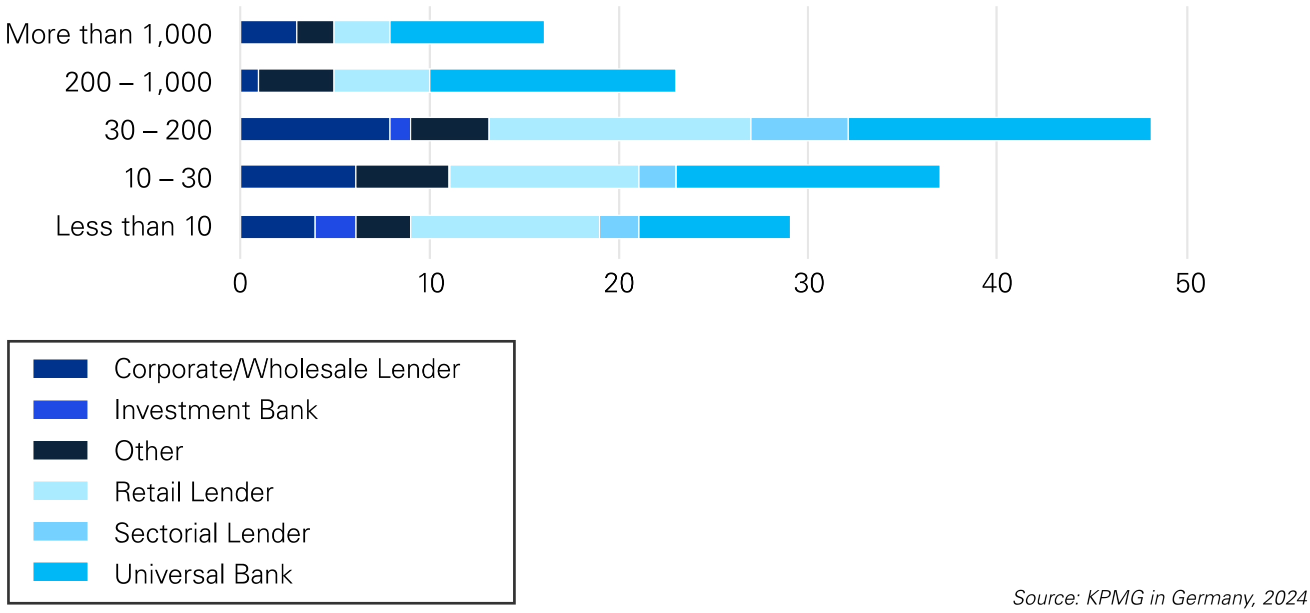
2 The importance of integrating biodiversity risks into banks' risk management is also illustrated by an interview with the Financial Times in June 2023 by Frank Elderson, member of the Executive Board of the ECB and Vice-Chair of the Supervisory Board.
[Interview with the Financial Times](#)

These topics include:

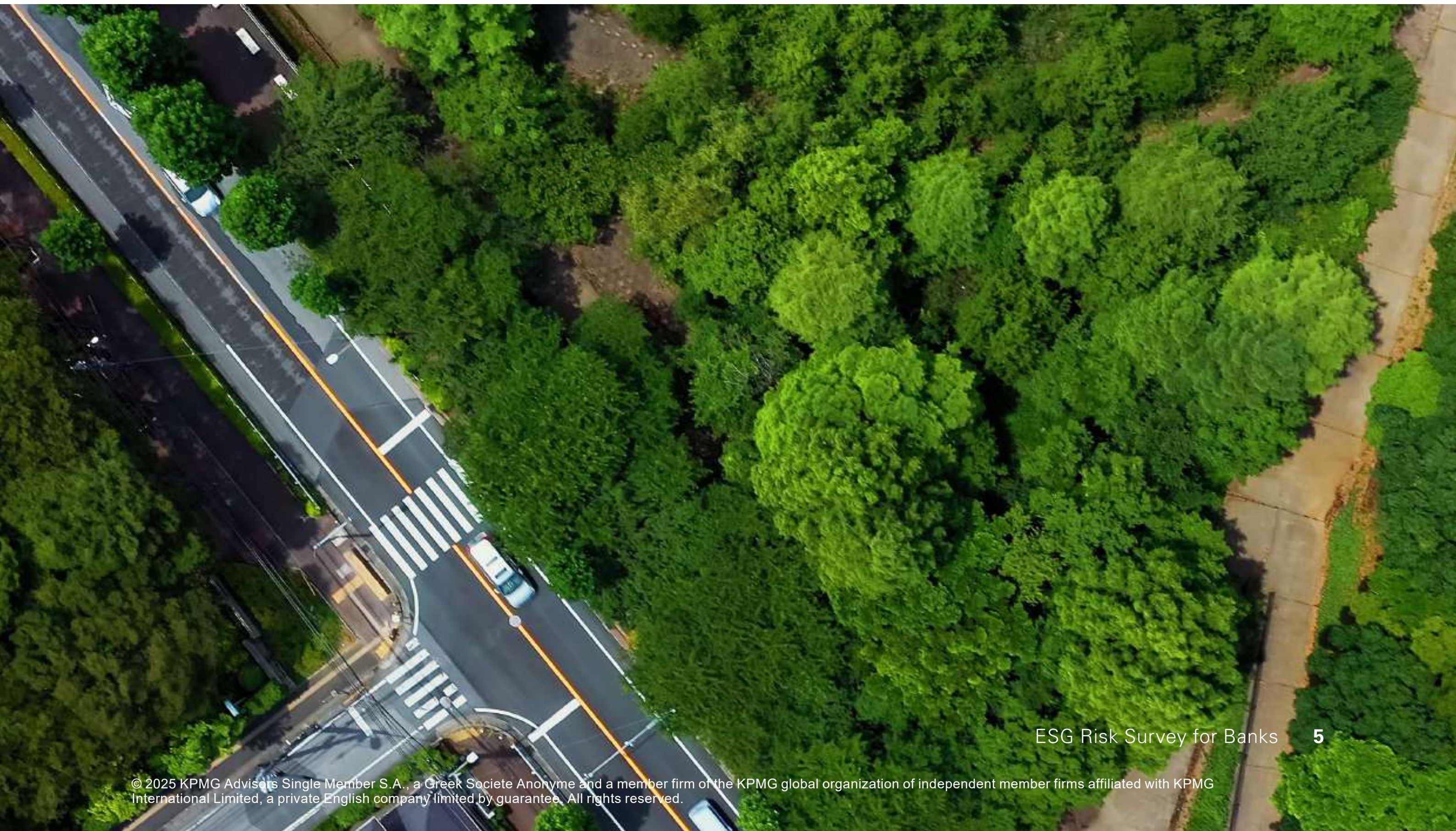
- business and risk strategy,
- risk identification,
- credit risk management and stress testing, with a special focus on data and reporting,
- greenwashing and biodiversity, which will be shown in the following.

The main observations emerging from this survey are enhanced by general trends, specific challenges, best practices and success stories within the financial sector based on market insights from KPMG experts. This whitepaper gives an overview of the key findings from the survey, presenting the results from the global community and, for some aspects, focusing on financial institutions in strongly regulated environments such as European Significant Institutions (SIs).

Figure 2: **Sample repartition by primary business model per total assets (BN USD)**



Source: KPMG in Germany, 2024



Observation 1: Many SIs are adjusting expectations as to when they will be compliant with regulatory requirements

Although SIs are making progress in ESG risk management, they continue to lower their expectations as to when they will fully comply with regulatory requirements.

Figure 3: **Share of SI expecting to comply with regulations over the years (in %)**

	Survey 2022	Survey 2023	Survey 2024	Survey 2022	Survey 2023	Survey 2024
	Achieved by end of 2022	Achieved by end of 2023	Already achieved	Achieved by end of 2025	Achieved by end of 2025	Achieved by end of 2026
Business Environment	45 %	2 %	6 %	97 %	70 %	48 %
Business Strategy	21 %	2 %	6 %	100 %	67 %	48 %
Management Body	61 %	20 %	9 %	100 %	70 %	39 %
Risk Appetite	42 %	2 %	9 %	100 %	80 %	52 %
Organisational Structure	64 %	15 %	9 %	100 %	80 %	45 %
Internal Reporting	24 %	2 %	9 %	88 %	74 %	42 %
Risk Management Framework	27 %	7 %	12 %	94 %	74 %	58 %
Credit Risk Management	30 %	7 %	9 %	91 %	65 %	42 %
Operational Risk Management	28 %	7 %	3 %	97 %	74 %	61 %
Market Risk Management	21 %	11 %	6 %	91 %	65 %	52 %
Scenario analysis & Stress Testing	36 %	4 %	21 %	94 %	76 %	42 %
Liquidity Risk Management	18 %	13 %	9 %	94 %	65 %	45 %
Disclosure	No data	No data	No data	No data	No data	No data

Source: KPMG in Germany, 2024

Achieving full compliance with regulatory expectations regarding ESG risks is a long journey, as it involves the complex integration of new policies, practices and technologies across all levels of banking operations. Additionally, as ESG practices and regulatory frameworks continue to evolve globally, banks must remain agile, continuously updating and refining their risk management strategies to keep pace with emerging standards and expectations.

Our survey shows that in most areas, such as the risk management framework but also in individual risk types, only a small percentage of institutions report that they expect to achieve full compliance with regulations by end of 2024. This signals a continuation of the decreasing trend already visible in last year's survey. This is in stark contrast with ECB's expectations on banks' progress – with many institutions having received threats of fines if compliance is not achieved within 2024. For instance, the table indicates that 42% of all institutions answered for the category "risk appetite" in 2022 that they would be fully compliant by end of that same year. One year later, however, only 2% believed that they would be fully compliant by the end of that year; in this year's survey, only 9% answered that they will have achieved full compliance before the end of 2024.

Furthermore, institutions have also become more pessimistic about meeting regulatory requirements in the coming years. Looking more closely again at the category of risk appetite, 100% of all institutions in 2022 expected to be fully compliant by the end of 2025, whereas in 2023 this decreased to 80%. This year's results also highlight the continuing downward trend, as only 61% of institutions believe that they will be fully compliant by the end of 2026.

According to our 2023 survey, the share of institutions reporting full compliance in the near future has decreased by more than 20% in some areas. These downward adjustments stem from concerns over increasing regulatory requirements, as demonstrated by the findings of recent consultation papers and a heightened supervisory scrutiny observed in various audits. To cope with the rapidly changing regulatory landscape, institutions are investing in enhancing methodologies and processes related to ESG risk. A key strategy in this endeavor is the full integration of ESG risks into risk management frameworks to leverage existing practices.

Spotlight: ECB Significant Institutions (SIs)

Spotlight ECB Significant Institutions (SIs)

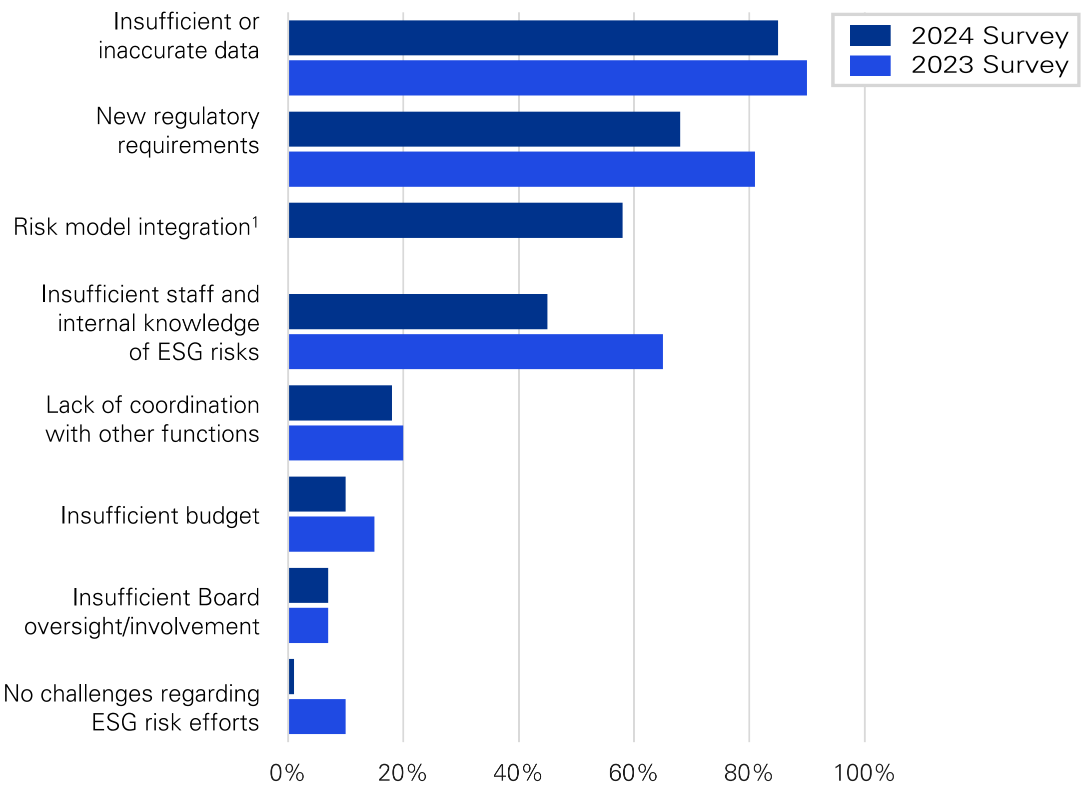
European SIs are trailblazers when it comes to ESG risk management due to the high regulatory requirements they face and strong investor demand for sustainable investments. Nevertheless, they see their practices constantly challenged by the dynamic regulatory landscape and increasing expectations from supervisors, investors and the public.

Against this backdrop, flexible frameworks and an agile approach to ESG risk management is paramount in order to stay ahead of the curve.

Observation 2: Integration of ESG into risk models is perceived as a new key challenge

Globally, many institutions perceive the integration of ESG into their risk model as a new key challenge in 2025 and 2026. Data availability and quality, regulatory requirements as well as insufficient internal know-ledge continue to be profound problems for most institutions, even though a slight decrease compared to 2023 is observed.

Figure 4: **Top challenges for the next two years related to ESG risk (in %)**



Source: KPMG in Germany, 2024

Even as new key challenges emerge, financial institutions continue to face familiar issues. Notably, insufficient or inaccurate data continues to be a persistent problem, and is cited by more than 120 institutions as a top challenge in 2024. Critical data gaps include scope 1, 2, 3 Greenhouse gas emissions emissions at the customer level, energy efficiency of buildings in the collateral pool, as well as customers' transition plans.

Challenges with respect to regulatory requirements are also prominent, as new and updated guidelines are frequently issued. For example, the recent EBA consultation paper in Europe has introduced new requirements such as materiality assessments and transition plans. In order to remain compliant, institutions are advised to keep up to date with the latest developments and to invest in advanced risk management and data processes.

Note: 1 in the 2023 survey there was no option to choose "Risk model integration"

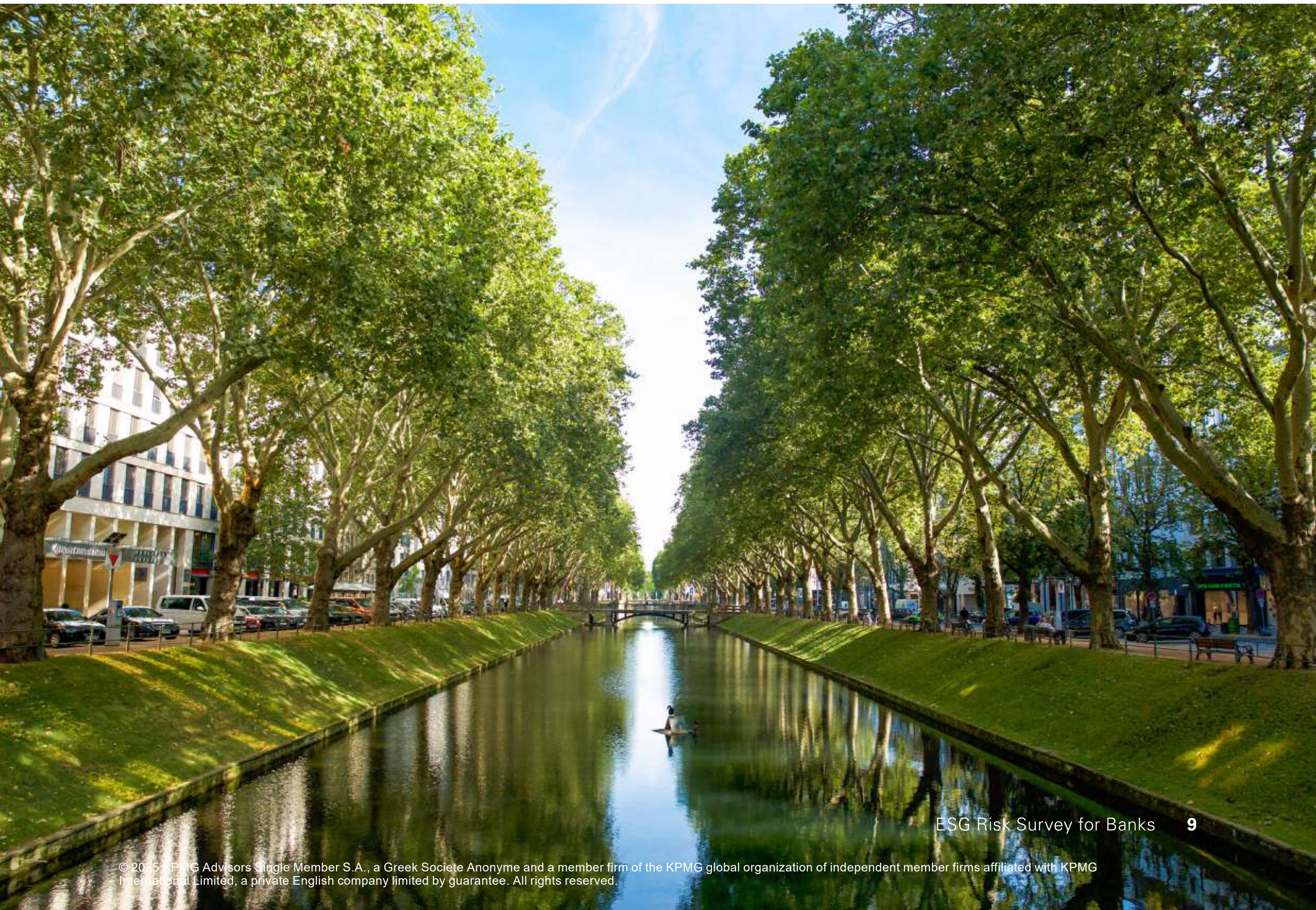
The integration of ESG risk management into already established processes can be particularly advantageous to leverage existing tools. Institutions are also recommended to maintain a dialogue with supervisors to become familiar with their expectations and ambitions.

Insufficient staff knowledge also remains a significant issue for institutions given that ESG risk management requires a specialized skill set that most institutions lack. However, compared to 2023, there has been progress in closing this gap, with institutions educating their employees internally or targeting skilled individuals during their hiring processes.

The integration of ESG into risk models has emerged as a pressing issue for many institutions. This challenge is closely connected to data issues, as insufficient or inaccurate data complicates the development of reliable risk models. Supervisory authorities worldwide, particularly the ECB in Europe, are urging institutions to enhance their efforts to integrate ESG into their respective risk models, thus compelling them to act swiftly to stay ahead of regulatory expectations. As an example, KPMG has recently worked with an SI that has established a holistic roadmap of integrating ESG risks into IFRS9, pillar 1 and pillar 2 models for credit risk.

> **"It would be nice if we had more data, if we had more certainty, more clarity. But sometimes you have to deal with the knowledge that you have."**
>
> - Frank Elderson, Member of the Executive Board of the ECB and Vice-Chair of the Supervisory Board of the ECB[1]

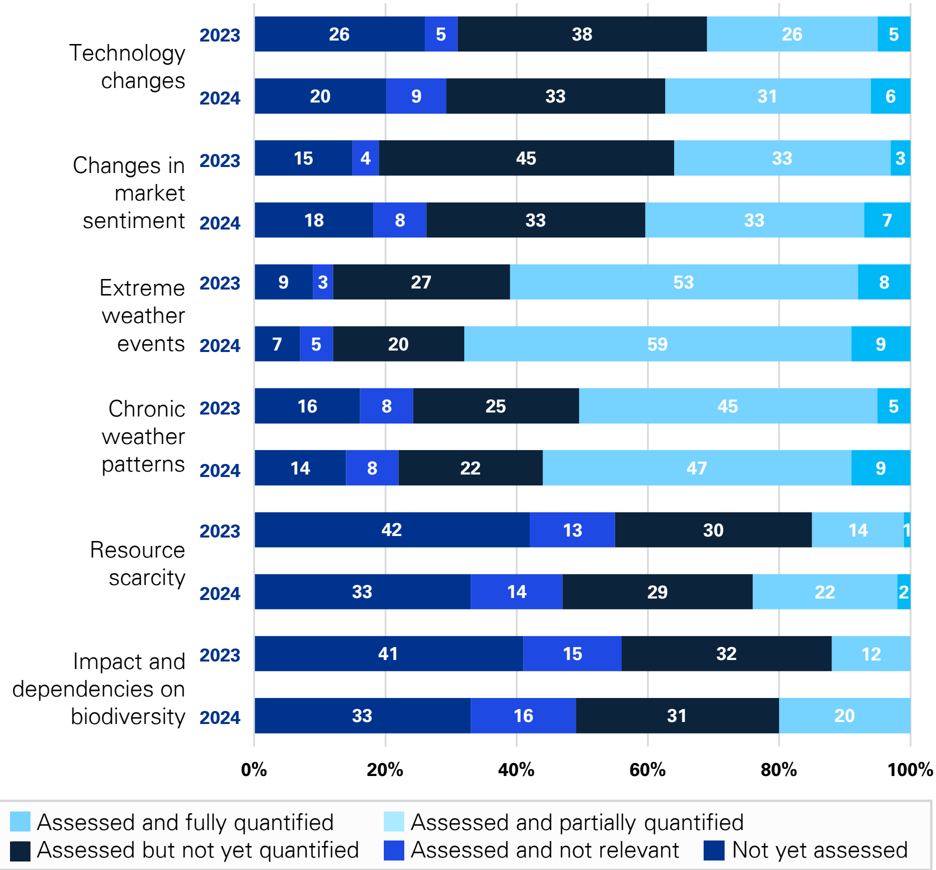
Note: 1 The importance of integrating biodiversity risks into banks' risk management is also illustrated by an interview with the Financial Times in June 2023 by Frank Elderson, member of the Executive Board of the ECB and Vice-Chair of the Supervisory Board.
Interview with the Financial Times



Observation 3: Quantification of E-Risks is advancing, but full quantification of key drivers is still a long way ahead for most.

Institutions worldwide have made progress in quantifying the impact of E-Risk drivers. In particular, partial quantification has advanced for all risk drivers compared to last year. Full quantification remains a challenge, however.

Figure 5: **Comparison of assessment of E-Risk drivers in portfolio of institutes in 2024 and 2023 (in %)**
The deviation from 100 is due to rounding differences.



Source: KPMG in Germany, 2024

> **Most banks have now drawn up materiality assessments that are in line with the supervisory expectations we published in 2020 […] But it is only the first step and a great deal more work lies ahead."**
>
> - Frank Elderson, Member of the Executive Board of the ECB and Vice-Chair of the Supervisory Board of the ECB[1]

Note: 1 The importance of integrating biodiversity risks into banks' risk management is also illustrated by an interview with the Financial Times in June 2023 by Frank Elderson, member of the Executive Board of the ECB and Vice-Chair of the Supervisory Board. [Interview with the Financial Times]

KPMG market perspective

Compared to last year, the analysis of environmental risk drivers has significantly progressed, especially for factors such as resource scarcity, impact on and dependence on biodiversity, and extreme weather events. Institutions have made considerable advances in quantifying risk drivers for both physical and transitional climate risks over the last three years, a development driven by high supervisory pressure. For example, the ECB's thematic review of climate-related and environmental risks in 2022 specifically targeted the quantification of these risk drivers, leading to significant observations for many institutions.

Institutions have also become more advanced in the partial quantification of environmental risks, something which can be attributed to the availability of better external proxy data for environmental risk drivers, such as hazard maps and CO2 expectations. However, the full quantification of environmental risk drivers has seen little progress compared to last year and has been achieved by no more than 10% of all institutions. Among other challenges, the lack of adequate data combined with difficulties in mapping out all possible material impact chains make full quantification a difficult task. KPMG has therefore worked with multiple SIs in the past year to improve the process according to which ESG risks are identified and quantified, as shown in Figure 6 below. Having the interconnection between the risk driver analysis and CSRD in mind, proved to be especially important.

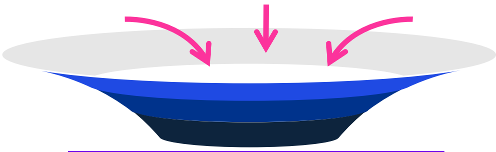
Figure 6: **Example process of risk driver analysis**

Creation of ESG risk driver short/long list

Interlocking CSRD

- Creation of a longlist of potential ESG risk drivers
- **Longlist is a list of currently 102 potential ESG risk drivers** based on **market practice, supervisory expectations, regulatory requirements, internal guidelines,** etc.
- Expert-based **prioritization and selection** to derive shortlists
- Derivation is based on **risk profile, portfolio analysis(s), business model,** etc. and should be extensively documented

ESG risk drivers longlist



ESG risk drivers hortlist

Impact chain analysis & materiality assessment

Interlocking CSRD

- The **impact chain analysis shows** how the risk drivers on the shortlist affect the institution's key risk types
- In the target picture, there is a **close link between ESG risks and established risk measurement methods** (e.g. integration in Pillar I/II models)
- Analyses and materiality classification considers **impact on all material risk types in different time horizons**
- Materiality is assessed using the dimensions of **severity and probability of occurrence**, which are combined to form a materiality score

Severity...

0	None
1	Minimal
2	Low
3	Moderate
4	High
5	Very high

X

... and probability...

Very likely	1
probably	.85
Rather unlikely	.7
Unlikely	.65

=

... results in Materiality Score

5	Critical
4	Substantial
3	Important
2	Informative
1	Minimal

Creation of ESG risk driver matrix

- Presentation of the materiality rating in a risk driver matrix for all risk drivers on the shortlist, material risk types and time horizons
- **Consideration of the risk drivers assessed as material in the further risk management cycle**

illustrative example

Relevant ESG risk drivers	Credit risk			Market Price risk		
Subcategory II	short	mid	long	short	mid	long
Sea level rise	A		A			
Coastal erosion						
Storm events (intensity an frequency)	A		A			
Forest fires (intensity an frequency)	A		A			
Heat wave (intensity an frequency)	A		A			
Drought (intensity an frequency)	A		A			
Colt waves (intensity an frequency)	A		A			
Heavy rain (intensity an frequency)	A		A			
Hail events (intensity an frequency)						
Flood events (intensity frequency)	A		A			

Source: KPMG in Germany, 2024

Spotlight: Identification of ESG risks

Identifying ESG risks and assessing their impact is crucial for financial institutions as it forms the basis for subsequent steps in risk management. By recognizing and assessing risks early on, banks can develop proactive strategies to minimize potential negative impacts on their financial performance and reputation.

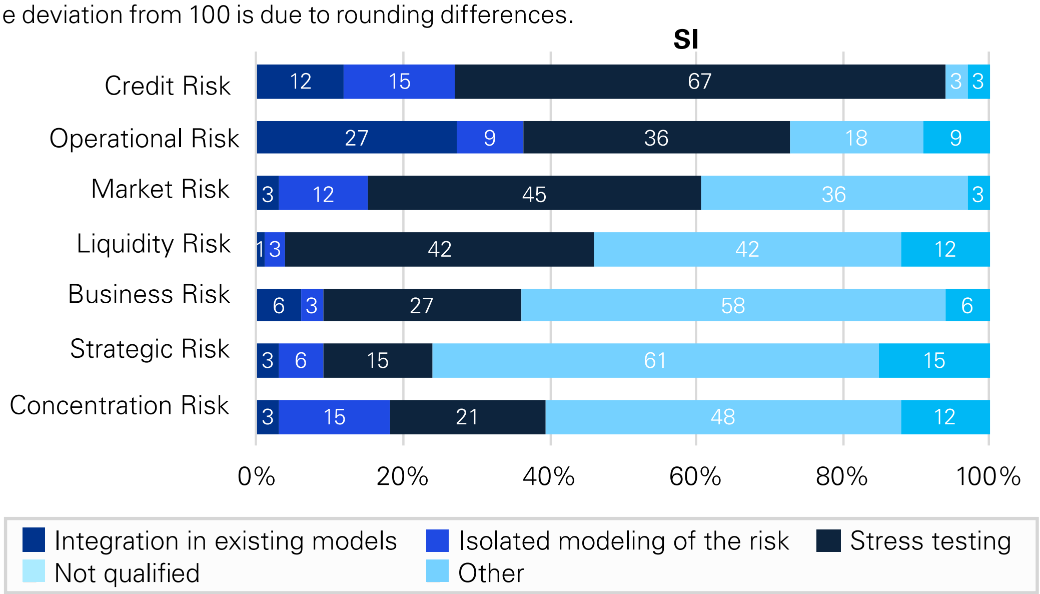
ESG risks are not stand-alone risks, but rather they are drivers for each traditional risk type reflected in the Basel framework. Financial institutions should therefore make explicit judgements about the impact of ESG risks through various transmission channels on other material risks.

The KPMG approach to ESG risk identification involves three main steps as shown below. We accompany institutions from establishing an ESG risk driver longlist until the creation of a ESG risk driver matrix, showing the materiality of relevant risk drivers. The risk driver matrix then informs follow-up actions in the risk management framework and allows for these risks to be addressed adequately.

Observation 4: The impact assessment of ESG risks on traditional risk types is advancing especially for credit risk, but full integration has only been achieved by a minority

SIs in particular are making progress in quantifying the impact of ESG risks on traditional risk types, especially via stress testing. While the impact on credit risk is already studied by most institutions, other risks such as business and strategic risks are lagging. The integration into existing models is a major challenge.

Figure 7: **Assessment of ESG risk on other risk types (in %)**
The deviation from 100 is due to rounding differences.



Source: KPMG in Germany, 2024

KPMG market perspective

Integrating ESG risks into the overall risk management framework is essential since these risks can significantly influence other types of risks such as credit, market, and operational risks. For instance, environmental risks can affect the collateral value in credit risk, while social risks can impact market perceptions and customer behavior, thereby influencing market risk. By fully embedding ESG considerations into the risk assessment process, institutions can achieve a more holistic view of potential vulnerabilities. This comprehensive approach helps to make informed decisions that align with both financial stability and sustainability goals.

Within our survey, institutions were asked how far the assessment of ESG risks on other risk types has proceeded. Generally, participating institutions analyze the impact of ESG on credit risk, but other risk types such as operational, market, liquidity, and concentration risk are being assessed by less than half of all questioned institutions. The situation is even more dire for business and strategic risk. Institutions should be careful not to neglect these risks to better understand their exposure to ESG risk and to be prepared for upcoming supervisory attention.

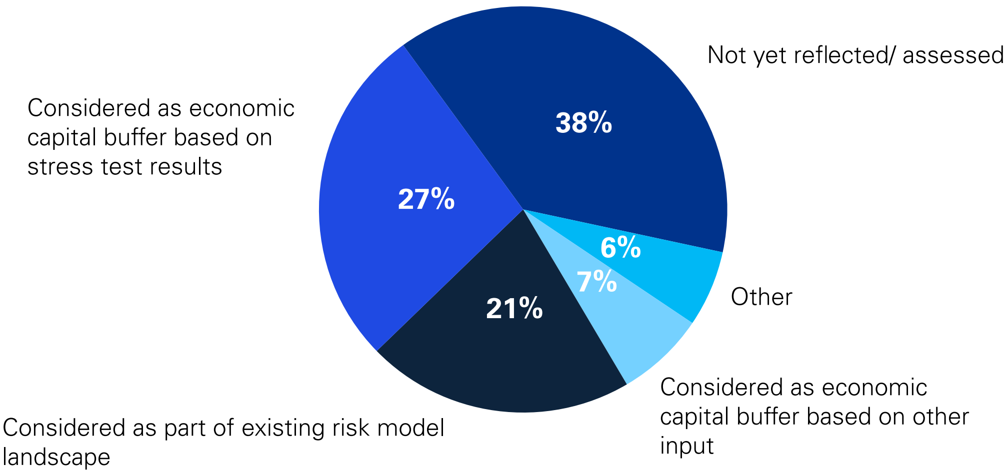
Driven by regulatory pressure, institutions initially carried out isolated modeling of ESG risks and stress testing. However, the supervisory authority is now increasingly focusing on more integrative approaches. Institutions should therefore stay ahead of the curve and focus on integrating ESG risks into their existing risk models. While some institutions are prioritizing such an integrative approach for operational risk, the integration in existing credit, market, and liquidity models is less prevalent. Institutions struggle to link traditional modeling approaches with ESG risk drivers in a quantitative manner, as impact chains are not yet fully understood and adequate data is not yet available.

The integration of ESG risks is increasingly under supervisory scrutiny, with initial findings being issued. In fact, the ECB recently issued concrete findings to several SI that ESG risk drivers should be quantified more systematically. Institutions are encouraged to increase their efforts to consider all risk types and to pursue an integrative modeling approach. This proactive stance will not only align them with regulatory expectations but also enhance their risk management capabilities in the face of evolving ESG challenges.

Observation 5: Institutions are beginning to take ESG risks in their capital requirements into account using ECAP buffers

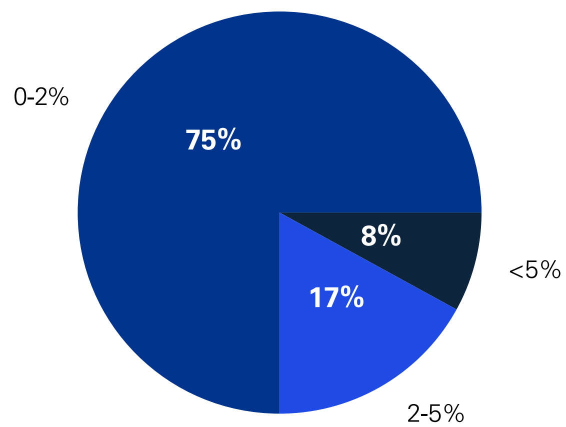
Institutions are beginning to consider ESG risks in capital requirements. ECAP buffers are trending with about 34% of participating institutions having introduced buffers of about 1.5% of total ECAP

Figure 8: **Reflection of ESG risks in capital requirements (in %)**
The deviation from 100 is due to rounding differences.



Source: KPMG in Germany, 2024

Figure 9: **Size of internal ESG risk capital buffer relative to overall internal capital requirement (in %) (n = 34 % of the 100 % above)**



Source: KPMG in Germany, 2024

KPMG market perspective

The impact of ESG risks can lead to significant financial losses for financial institutions. By incorporating ESG risks into capital adequacy assessments, banks can ensure they maintain sufficient capital to absorb potential losses arising from these risks, thereby safeguarding their solvency and stability. This proactive approach not only aligns with regulatory expectations but also enhances investor confidence by demonstrating a commitment to sustainable financial practices.

About one third of participating institutions have introduced an Economic Capital Adequacy Plan (ECAP) buffer to reflect the additional capital impact of ESG risks. The size of these buffers is usually determined using stress testing, which yields buffers of less than 2% for most participating institutions.

Using economic capital buffers is considered a temporary fix and should eventually be replaced by a full integration of ESG risk drivers into Pillar II models. As this integration requires the advancement of methodological approaches, institutions are improving their modeling techniques and reflecting advancements in their capital requirements.

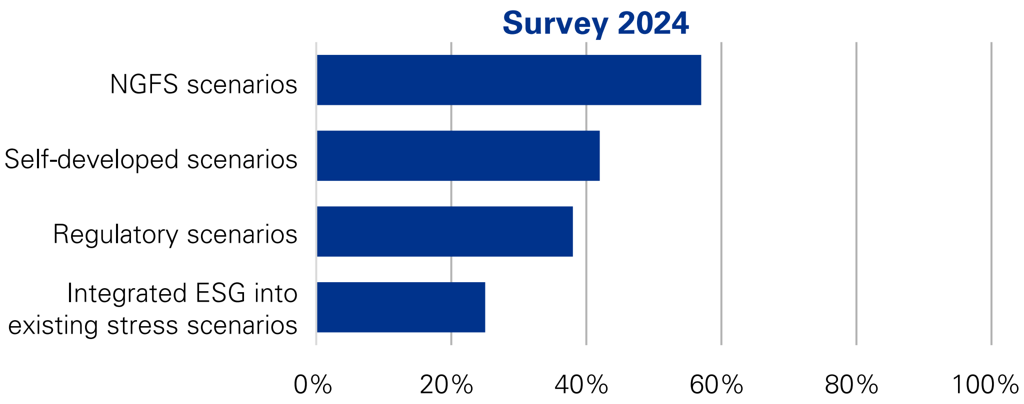
Some institutions have reported that they already consider ESG risks as part of their existing model landscape. This approach is likely to undergo heavy supervisory scrutiny in terms of conservatism, comprehensiveness and overall adequacy, since it requires sound methodologies for all risk types, something which most institutions are only beginning to develop.

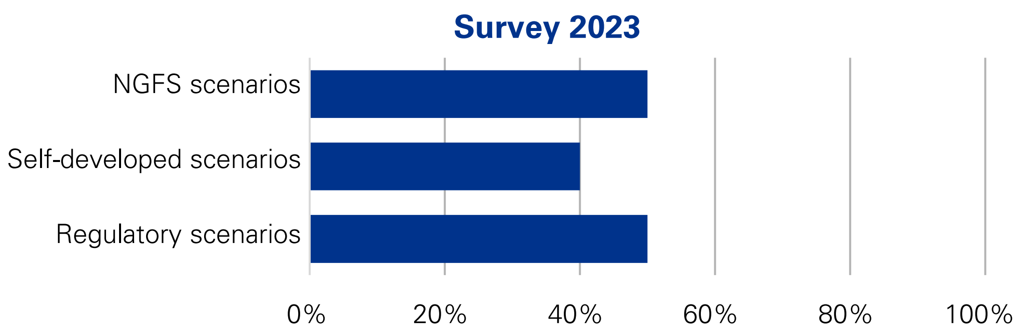
Institutions should also be mindful that auditors are already questioning whether capital buffers are sufficient to steer ESG risks. Additional steering instruments, such as triggers on ESG stress test results that would lead to adjustments on buffers, are advisable until integration into risk models has been achieved. This proactive approach will help institutions to better manage their ESG risk exposure and align with evolving regulatory and supervisory expectations.

Observation 6: The NGFS and related scenarios remain the standard for climate risk stress testing

The reliance on NGFS and related scenarios has increased even more in 2024. Institutions are still struggling to establish self-developed scenarios without strong reliance on NGFS scenario input.

Figure 10: **Scenarios that form the basis of ESG stress tests (in %)**





Source: KPMG in Germany, 2024

KPMG market perspective

Stress testing ESG risks is crucial as it allows financial institutions to evaluate how extreme but plausible ESG-related scenarios could impact their financial stability and operational resilience. Stress testing helps banks to identify potential vulnerabilities and develop strategies to mitigate these risks, ensuring they remain robust in the face of ESG challenges.

From a KPMG market perspective, institutions globally predominantly use the NGFS and regulatory scenarios, often derived from NGFS scenarios, in their ESG stress test exercises. Self-developed scenarios typically also rely on NGFS scenario input. However, the strong reliance on NGFS scenarios has been criticized in audits for several reasons.

Firstly, the idiosyncratic vulnerabilities of institutions are not sufficiently considered. Institutions should design scenarios that target their own specific vulnerabilities in stress tests to ensure a more tailored and effective risk assessment.

Secondly, NGFS scenarios do not account for certain disruptive and/or sudden developments. Therefore, institutions should extend their scenario pool to include these elements, thereby closing any gaps in their current stress testing frameworks.

Lastly, NGFS scenarios are not linked to macroeconomic stress scenarios. Institutions are encouraged to simulate adverse developments that relate to both ESG risks and macroeconomic risks, and to recognize that these two types of risks are interconnected and often impact each other.

An example is KPMG's recent collaboration with an SI that utilized their existing stress test framework for ESG stress testing."By integrating NGFS scenarios with idiosyncratic shocks, the institution achieved realistic results that can be more easily compared with other ICAAP stress scenarios.

Spotlight: Stress testing

In line with supervisory expectations, banks are beginning to incorporate ESG risks into their stress scenarios. The timeframe for these stress tests typically extends to 2050, although short-term stress tests can also be observed in the market. Currently, ESG stress tests are primarily focused on individual drivers and impact channels, highlighting the need for a comprehensive approach in managing environmental and sustainability risks.

KPMG offers concepts and tools to support stress testing exercises and to build a holistic stress test framework. For instance, KPMG developed a "CO2 prototype" that dynamically forecasts the financial impact of transition risk scenarios as well as various additional tools addressing different physical risks, which can be used for stress testing, materiality assessments and other quantification tasks.

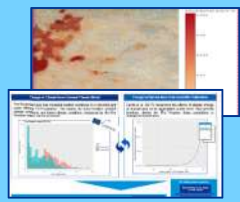
Figure 11: **Selected KPMG modelling prototypes for E-Risks, tested and applied with multiple SIs across Europe.**

Flood Risk Prototype

KPMG prototype to assess financial impact of Flood Risk in real estate or corporate portfolios, under different climate scenarios

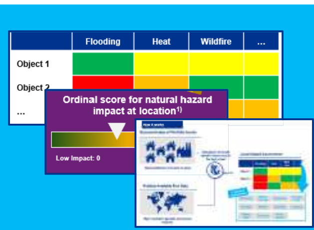
Wildfire Risk Prototype

KPMG prototype to assess financial impact of Wildfire Risk in real estate or corporate portfolios, under different climate scenarios – taking into account scientific wildfire risk indices and burnable vegetation



Natural Hazard Indicator

Qualitative model to score real estate and corporate exposure towards up to 11 physical climate risks – e.g. to be used in risk identification or Pillar III risk disclosure in Europe

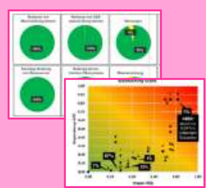


CO2 Risk Prototype

Methodology to simulate financial impact of different transition risk scenarios on corporate or real estate portfolios, including impact on credit quality

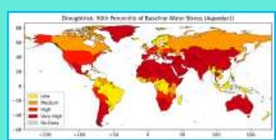
Biodiversity Risk Prototypes

Materiality analysis based on ENCORE and portfolio analysis to identify dependencies on ecosystem services or negative impacts on natural capital. A location analysis is currently being developed



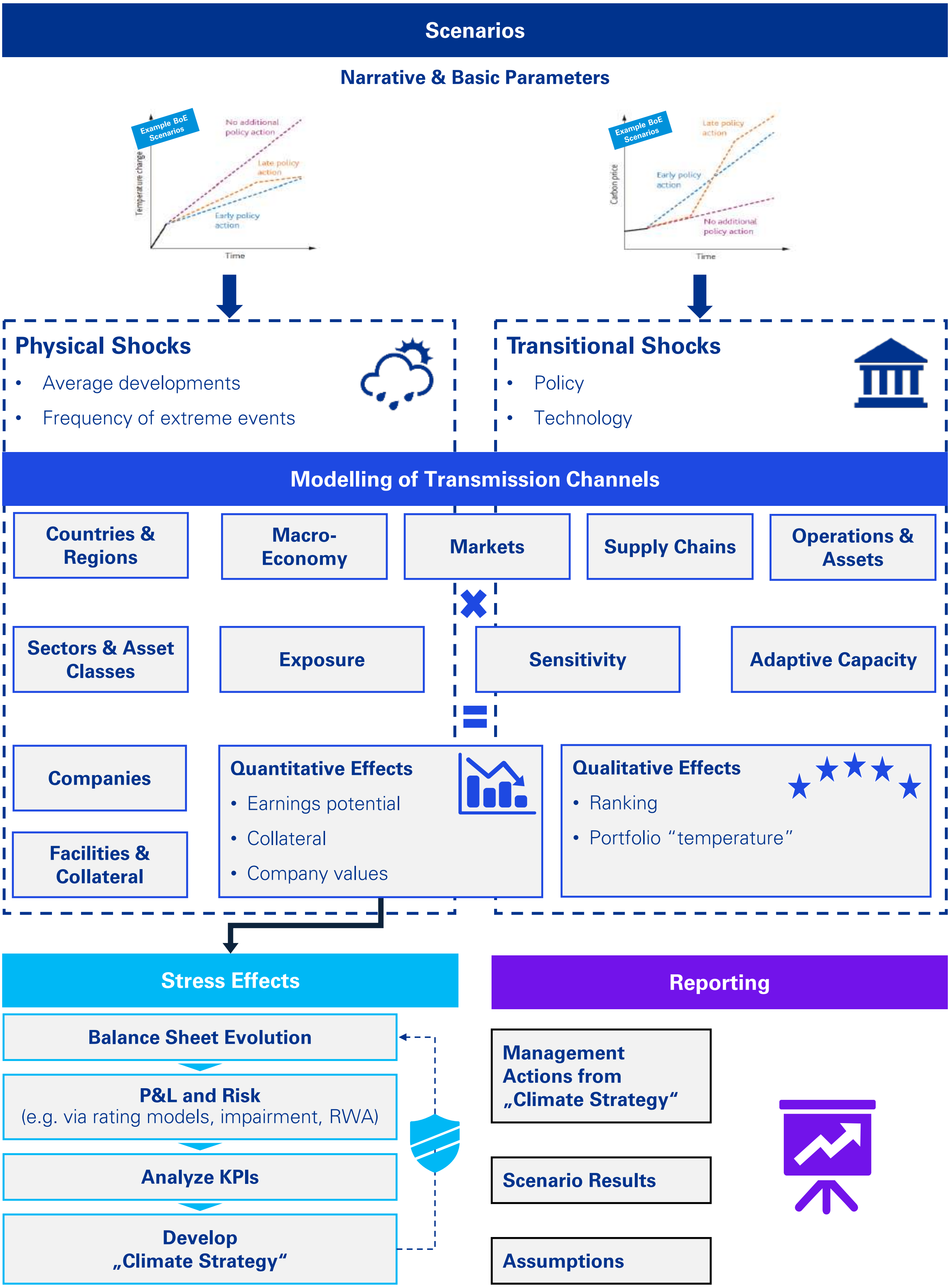
Drought Risk Prototype

Score-based assessment which assesses drought risks for the entire portfolio on the basis of hazard maps and the sector's energy and water consumption



Source: KPMG in Germany, 2024

Figure 12: **Value chain of a good-practice climate stress test framework**

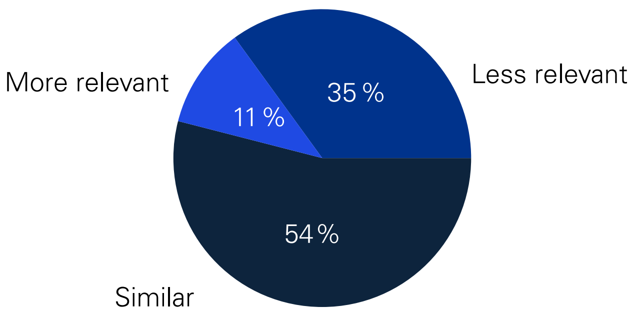


Source: KPMG in Germany, 2024

Observation 7: There is greater awareness of biodiversity risks, but methods and data need to be further developed for proper risk quantification

Most institutions now consider biodiversity risk to be at least as relevant as climate risk. However, insufficient data is affecting proper risk quantification and limits the quality of materiality assessments regarding biodiversity risk.

Figure 13: **Relevance of biodiversity risks for institutes compared to climate risks in the long term (in %)**

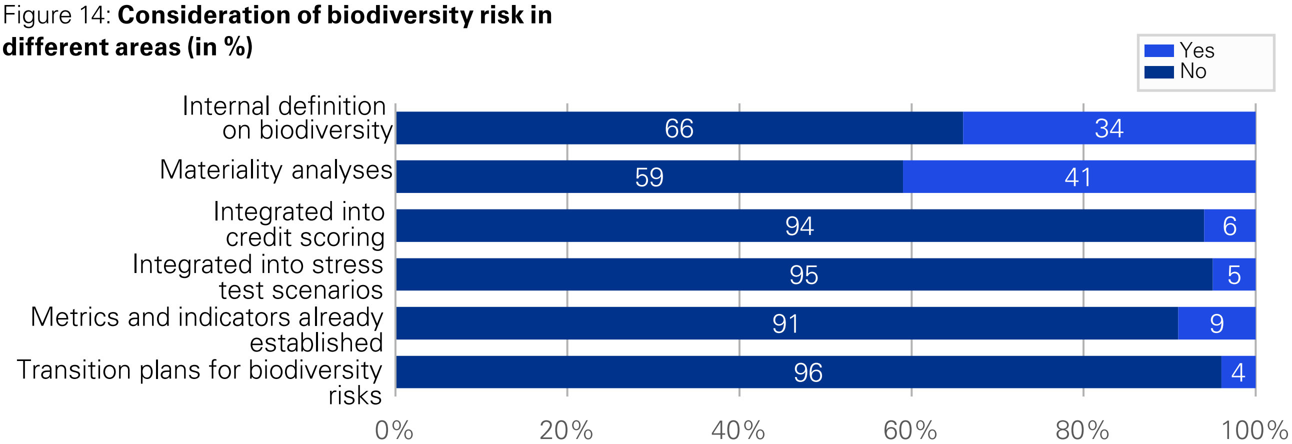


Source: KPMG in Germany, 2024

KPMG market perspective

Although more than half of all surveyed institutions, namely 65%, consider biodiversity risks to be more relevant or equally as relevant as climate risks in the long term, the institutions are still at different stages of integrating biodiversity risks into their risk management framework. For example, of all the institutions surveyed, only 34% have an internal definition of biodiversity and not even half (42%) have carried out a materiality analysis. However, shifting the focus to the SIs and banks in the net-zero banking alliance[1] has revealed that they are already a few steps ahead. For instance, three quarters of "net-zero banks" have an internal definition of biodiversity and 58% have carried out a materiality analysis. Furthermore, the integration of biodiversity into stress testing is much more

Figure 14: **Consideration of biodiversity risk in different areas (in %)**



Source: KPMG in Germany, 2024

Note: 1 Net-Zero Banking Alliance – United Nations Environment – Finance Initiative (unepfi.org)degradation– Publications Office of the EU (europa.eu) established among net-zero banks (25%) than among the total number of institutions (5%). Moreover, a larger percentage of net-zero banks (17%) have derived metrics related to biodiversity risk as well as indicators compared to all institutions (9%). In terms of integration into credit risk, however, the net-zero banks are lagging behind – not one of these banks has stated that they have already taken steps to implement considerations of biodiversity risk into their credit scoring. An analysis of all banks shows that both integration into credit scoring (6%) and the development of transition plans for biodiversity risks (4%) have received very little attention. However, institutions are expected to increase efforts to keep up with the evolving field of biodiversity risk management. Many of the participating institutions are already starting to identify and improve their understanding of biodiversity as a risk driver, yet the current analyses are mostly of qualitative nature and rely on sector-based proxies.

The analysis of specific locations frequently requested by supervisory authorities and the derivation of metrics from quantitative analyses with specific information on quantities or areas continue to pose a major challenge for institutions. Due to the massive threat of the progressive loss of biodiversity on our planet and the basis of human life, it is to be expected that regulatory requirements for financial institutions will continue to increase. Institutions should therefore face up to the challenges of the large number of variables and the lack of meaningful data and develop a concept for assessing their risk exposure as accurately as possible.

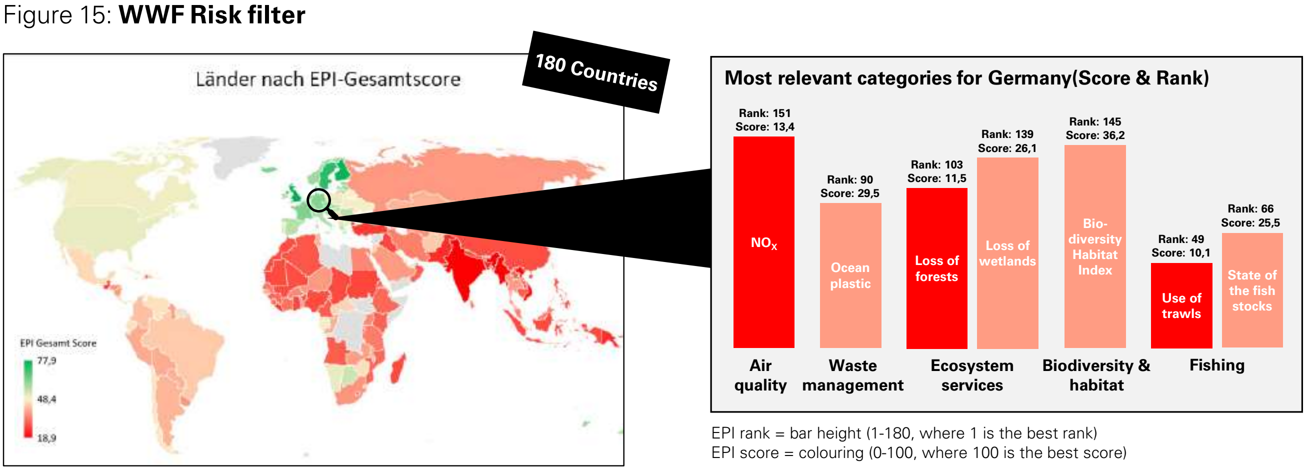
Spotlight: Biodiversity

To meet the challenges of assessing and measuring biodiversity risks and to comply with regulatory requirements, KPMG has developed various solutions for all risk management processes, particularly in the areas of risk inventory, stress testing and KRIs for biodiversity risks.

For example, KPMG offers a prototype for the complete integration of supply chains into the materiality assessment. The tool considers supply-chain data from different databases and automatically links it to sector scores. These databases can also be used to carry out portfolio analyses and derive individual quantitative metrics to create a biodiversity footprint. Moreover, KPMG focuses on country- and location-specific analyses, which can offer valuable information for the risk assessment of sovereign and/or large corporations, as shown in an example below. Germany's critical points regarding physical biodiversity risk are displayed based on the WWR Biodiversity Risk Filters[2].

The disclosure of biodiversity-related information and raw data by the bank's individual customers will be an essential prerequisite in the future to assess risk exposure accurately. More information about KPMG's work on biodiversity can be found in KPMG Whitepaper „Naturrisiken für Banken - herausfordernd, aber messbar".

Figure 15: **WWF Risk filter**



EPI rank = bar height (1-180, where 1 is the best rank)
EPI score = colouring (0-100, where 100 is the best score)

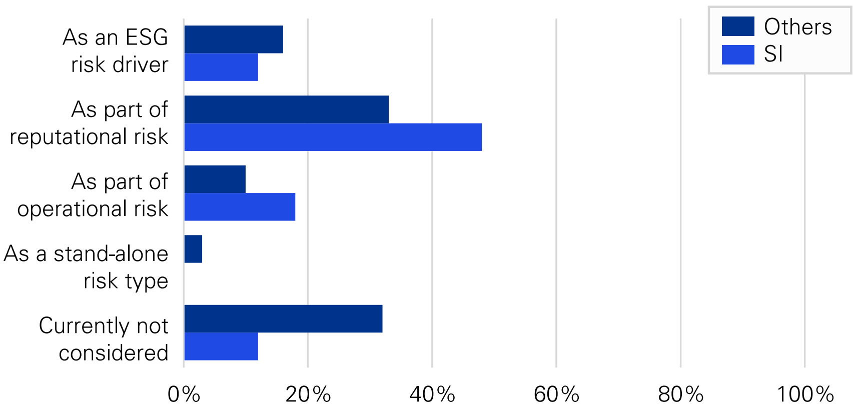
Source: KPMG: Naturrisiken für Banken - herausfordernd aber messbar

Note: 2 Net-Zero Banking Alliance – United Nations Environment – Finance Initiative (unepfi.org)
Study for a methodological framework and assessment of potential financial risks associated with biodiversity loss and ecosystem degradation– Publications Office of the EU (europa.eu)

Observation 8: Most institutions consider greenwashing risks, but not all have processes in place to manage it

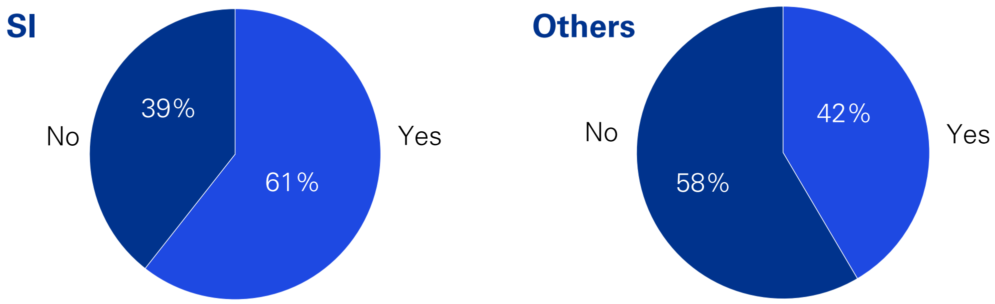
While some institutions are raising internal awareness to tackle greenwashing, a significant number still lack comprehensive processes to effectively identify, prevent, and manage these risks, highlighting a critical area for future development.

Figure 16: **Consideration of greenwashing risks within the institution's risk taxonomy (selected choice) (in %)**



Source: KPMG in Germany, 2024

Figure 17: **Processes in place to identify, prevent and manage risks associated with greenwashing (in %)**



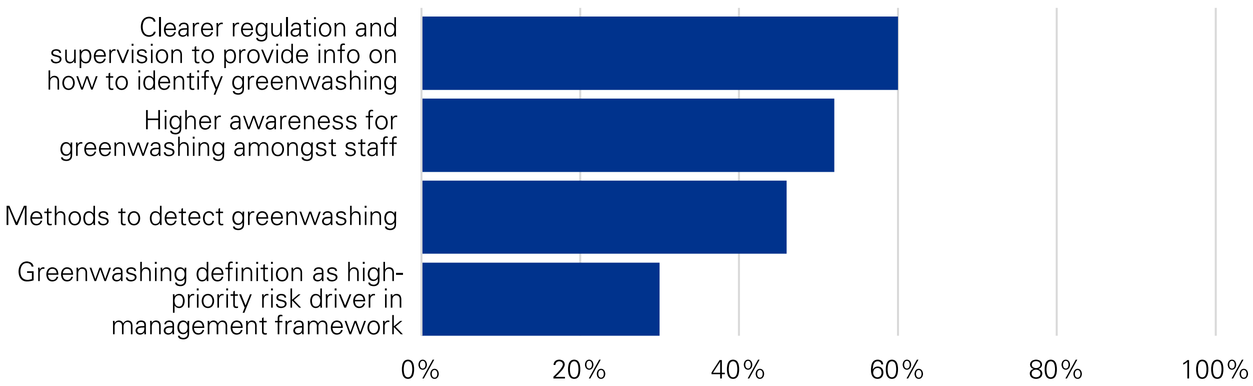
Source: KPMG in Germany, 2024

The way greenwashing is considered by institutions is diverse: some consider it as belonging to another material risk type while some consider it a stand-alone risk. Some institutions also split greenwashing risk into different components for consideration in the event of reputational, operational or compliance risk. More than 30% of other institutions state that they do not consider this risk at all, which partly contrasts with participating SI due to the stronger supervisory challenge for the latter.

Nevertheless, 40% of SI and 60% of other institutions report that they still do not have processes in place to identify, prevent and manage risks associated with greenwashing.

Given the increasing number of greenwashing cases in the past as well as the supervisory attention placed on them, institutions are encouraged to establish risk management procedures to cope with potential accusations of greenwashing.

Figure 18: **Support for detecting potential greenwashing cases in your institution (in %) (multiple choice)**



Source: KPMG in Germany

Participating institutes mostly focus on promoting the awareness and owner identification of greenwashing internally in order to better identify cases where it occurs. Media screening is also popular, with more than 20% indicating that they have already established procedures. However, as only a minority has established ways to detect potential greenwashing cases, there is still room for further development in the future.

As supervisory attention increases, institutions are encouraged to check whether the greenwashing detection procedures they have established so far are adequate. For instance, the latest EBA consultation paper on the mandates in the loss group (EBA/CP/2024/13) presents a revised risk taxonomy, which now also includes greenwashing risk, indicating that the supervisory authority has recognized its significance.

In this context, we supported a German SI in creating a framework designed to prevent greenwashing, establishing them as a leader in this field across Europe. Our efforts concentrated on implementing anti-greenwashing measures that involve the entire bank, its employees, and all relevant departments, ensuring a holistic solution. Through a comprehensive analysis of regulatory requirements, we identified various pathways for potential greenwashing cases or allegations at our client and formulated targeted anti-greenwashing measures that have been embedded into the bank's governance framework.

Spotlight: Greenwashing

Greenwashing risks are critically important for banks to consider due to the potential severe repercussions on their reputation and financial stability. Accusations of greenwashing can lead to a loss of trust among consumers and investors, which can result in severe financial losses as stakeholders might choose to disassociate from the bank.

KPMG has developed comprehensive strategies to address greenwashing risks, focusing on mitigation strategies as well as early detection of potential greenwashing accusations.
Cornerstones of the KPMG approach include a focus on governance, risk appetite, an appropriate risk culture underpinned with awareness campaigns as well as automated media screening in order to monitor and manage how banks are portrayed publicly. This technology can alert banks to potential misrepresentations or misconceptions in real time, allowing for swift corrective action.

Figure 19: **Media Screening tool for early identification of ESG-related reputational risk**

Media Screening tool for early identification of ESG-related reputational risk

- Screening of news, web and social-media data
- Machine-learning based filters for extradiction of relevant articles
- Automated determination of public sentiment based on articles
- Interactive dashboard showcasing results

Source: KPMG in Germany, 2024

Outlook and next steps

KPMG experts globally have observed that awareness of ESG risk drivers is improving among financial institutions. This is a result of their impact on business models and risk profiles as well as the effort and investment necessary to accurately reflect them within risk management frameworks. Despite the significant progress achieved in recent years, it is evident that, due to growing supervisory pressure and regulations, banks must increase their efforts to manage ESG risks adequately.

A key strategy in this endeavor is the full integration of ESG risks into the risk management framework to leverage existing practices. This proactive approach will enable institutions to meet regulatory expectations and ensure robust and sustainable risk management.

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