



KPMG Survey on Banks' ESG Risk Management in the SSM

March 2022



Contents

01

Background and Introduction

KPMG's market survey on banks' progress with ESG risk management

02

Overarching Survey Results

Banks' top priorities, and progress compared to 2021 KPMG survey

03

Survey results: Deep Dive

Detailed results for key ECB expectations

04

Next steps for banks

The path forward in the current supervisory environment





01 - Background and Introduction

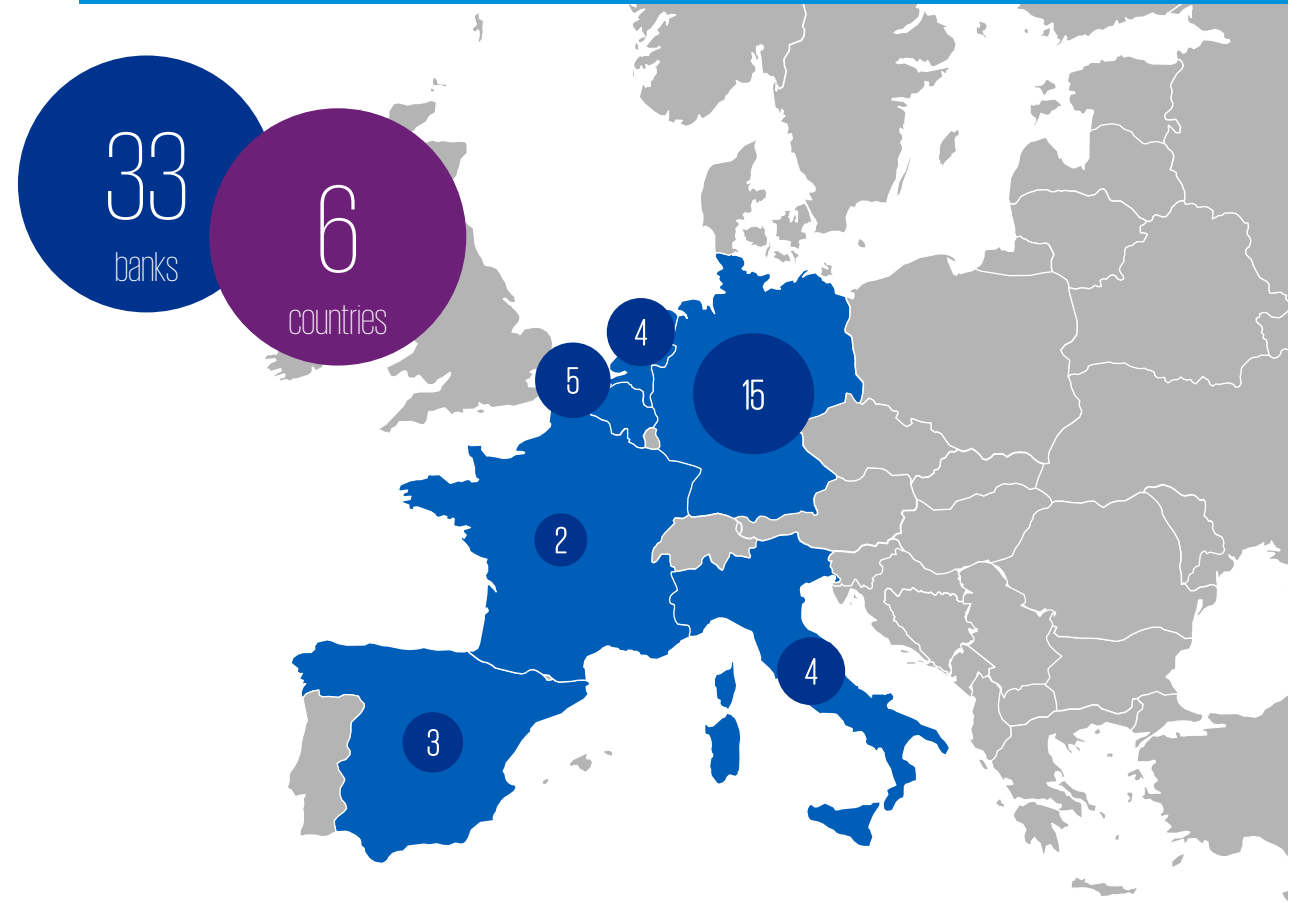


KPMG's market study on the implementation of ESG risk

Background

- ESG risks have rapidly gained importance in recent years.
- The ECB once again asked all banks within the SSM to fill out the “**thematic review**” a self-assessment questionnaire on this topic until **March 18, 2022**.
- In order to support this process KPMG set up an international benchmark survey beforehand.
- Many banks within the SSM had the opportunity to participate anonymously.
- The focus of our benchmark survey lies on the **ECB's 13 expectations** on ESG risk management and banks' progress with their implementation.
- It follows the ECB's questionnaire closely in some aspects, while also bringing up further topics.
- It is mainly centered around risk management which corresponds to sheet “3. RM” in the ECB's questionnaire.

Participants



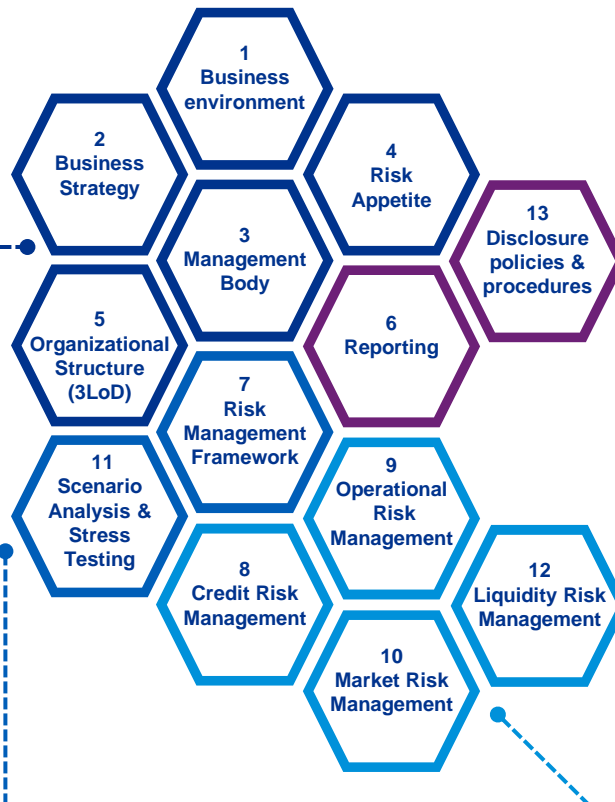
ECB's 13 expectations on ESG risk management

Strategy and Organization

- 1 Understand the impact of climate-related and environmental risks on the **business environment** to make informed strategic and business decisions.
- 2 Integrate climate-related and environmental risks into the **business strategy**
- 3 Responsibility of the **management body** for the integration and effective oversight of climate-related and environmental risks
- 4 Explicitly include climate-related and environmental risks in their **risk appetite** framework
- 5 Assign responsibility for the management of climate-related and environmental risks within the **organizational structure** in line with the 3LoD

Overarching Risk Management & Framework

- 7 Incorporate climate-related and environmental risks as drivers of existing risk categories into their existing **risk management framework**
- 11 **Scenario analysis & stress testing**: Evaluate appropriateness and incorporate climate-related and environmental risks into baseline and adverse scenarios



Internal and External Reporting

- 6 Reflect their exposures to climate-related and environmental risks in the internal **reporting** to management
- 13 **Disclosure policies & procedures**: Publish meaningful information and key metrics on climate-related and environmental risks

Risk Type Specific Expectations

- 8 **Credit risk**: Consider climate-related and environmental risks at all stages of the credit-granting process and in monitoring portfolios
- 9 **Operational risk**: Consider the adverse impact of climate-related events on business continuity and on reputational and/or liability risks.
- 10 **Market risk**: Monitor the effect of climate-related and environmental factors and develop related stress testing scenarios
- 12 **Liquidity risk**: Incorporate material effects of climate-related and environmental risk on net cash outflows and liquidity buffers into liquidity risk management and buffer calibration.



02 - Overarching Results



Overarching Results

Banks set especially high priority on climate-related risks

Survey question: What priority does each of the following risk types have for your institution?



Climate-related risks

0% 10% 20% 30% 40% 50% 60% 70% 80% 90% 100%



Environmental risks (e.g., loss of biodiversity)

0% 10% 20% 30% 40% 50% 60% 70% 80% 90% 100%



Social risks

0% 10% 20% 30% 40% 50% 60% 70% 80% 90% 100%



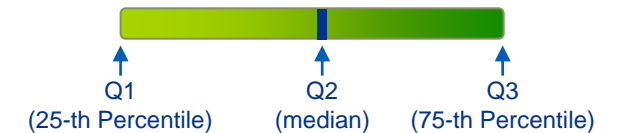
Governance risks

0% 10% 20% 30% 40% 50% 60% 70% 80% 90% 100%



Key messages

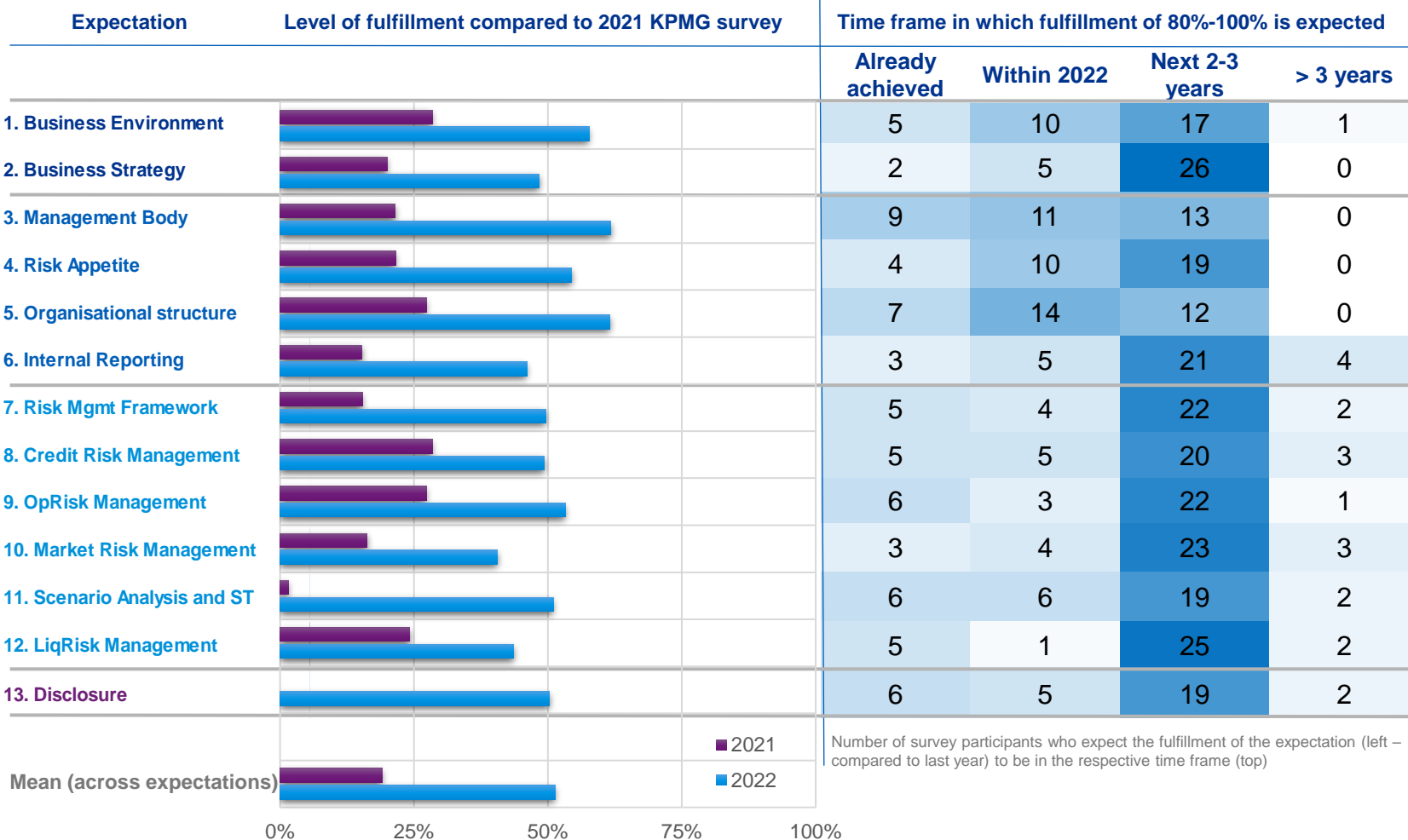
- Participating banks clearly prioritize climate-related risks
- Large variations in prioritization across governance, social and environmental risk types
- Cause-and-effect-relations of other risk types, such as the loss of biodiversity, may be more challenging to establish



Overarching Results

Significant progress perceived in fulfilling ECB's expectations

Survey Question: How high do you rate the current degree of fulfillment of each of the ECB's 13 expectations regarding ESG risks in your institution?



Key messages

- Perceived fulfillment of expectations has increased from 19% in KPMG's 2021 survey to 51% in 2022, on average
- Strong advances especially in Scenario Analysis and Stress Testing since 2021
- Full compliance with expectations by 2025 expected by most participants
- Approx. 25% of participating banks have achieved desired level of fulfillment in a number of expectations (3, 5, 9, 11)

Governance, KPI frameworks and strategy prioritized

Survey Question: In what order of priority does your institution plan to meet the following expectations, and how challenging do you rate these for your institution?

| Priority | Expectation | Very challenging | Challenging | Moderately challenging | Unchallenging |
|----------|--|------------------|-------------|------------------------|---------------|
| 1 | Consideration of ESG risks in business goals | 3 | 17 | 13 | 0 |
| 2 | Definition of clear responsibilities and integration of the consideration of ESG factors in all three lines of defence | 1 | 4 | 20 | 8 |
| 3 | Definition of risk appetite with regard to ESG risks | 2 | 17 | 14 | 0 |
| 4 | Definition of ESG risk indicators | 2 | 20 | 10 | 1 |
| 5 | Internal reporting on ESG risks | 2 | 14 | 15 | 2 |

Number of survey participants who assigned the expectation to the respective level of difficulty

Key messages

- Participants’ top priority, consideration of ESG risks in business goals, was perceived among the most challenging expectations
- High priority and less challenging is the definition of clear responsibilities and integration of the consideration of the ESG factors in the 3 LoD – whereas participants seem to be struggling with the definition of risk indicator frameworks, risk appetite, and reporting frameworks

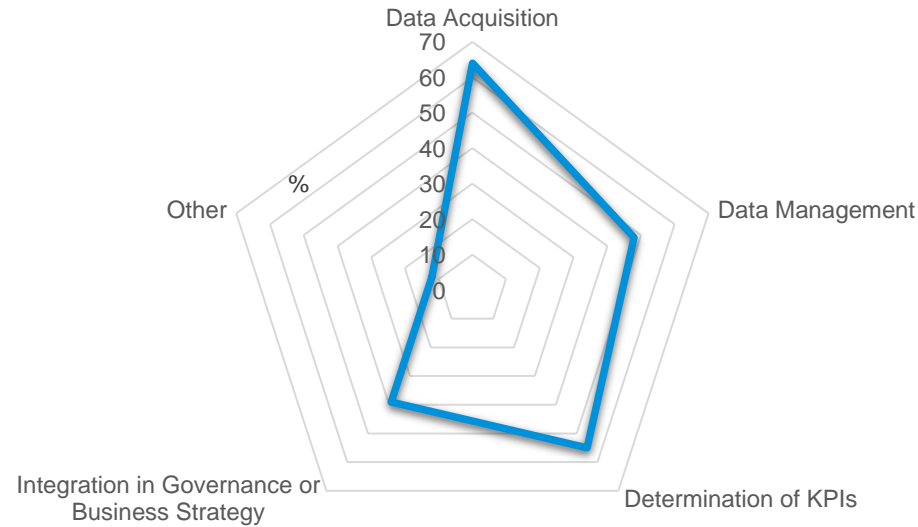


03 - Survey Results: Deep Dive

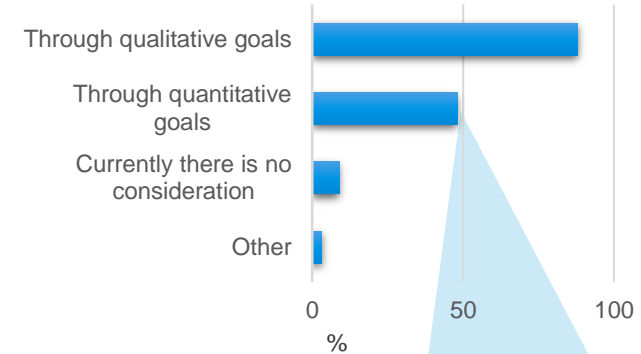


Business Models and Strategy (Expectations 1 & 2)

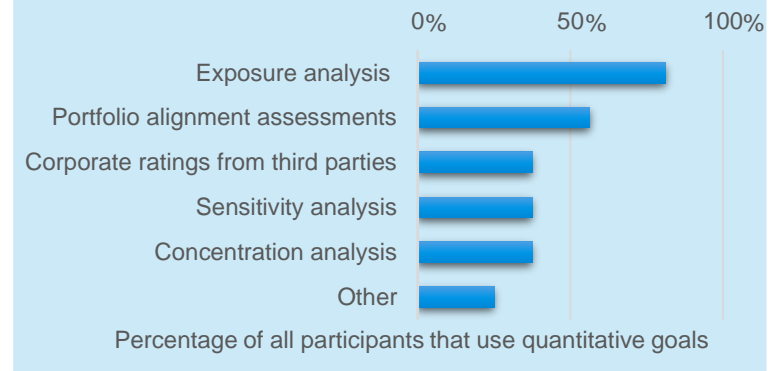
What are currently the largest gaps for your institution to meet expectations 1 & 2?



How are ESG issues and factors addressed in your strategy?



Quantitative goals:

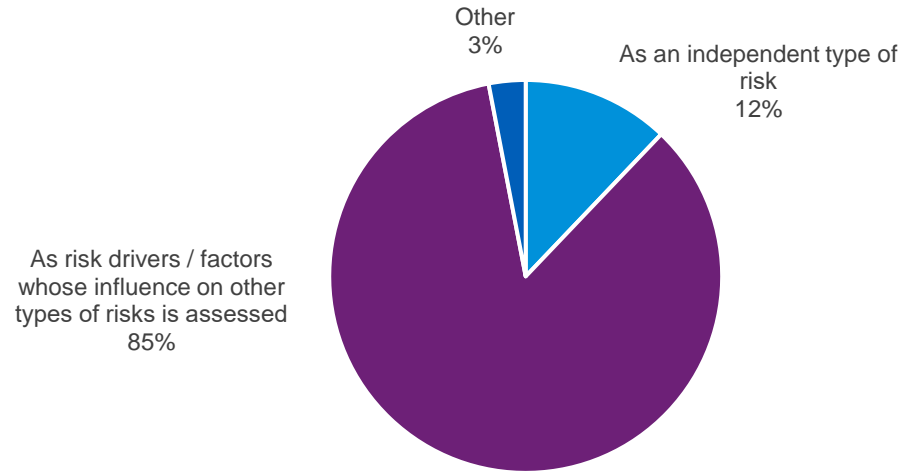


Key messages

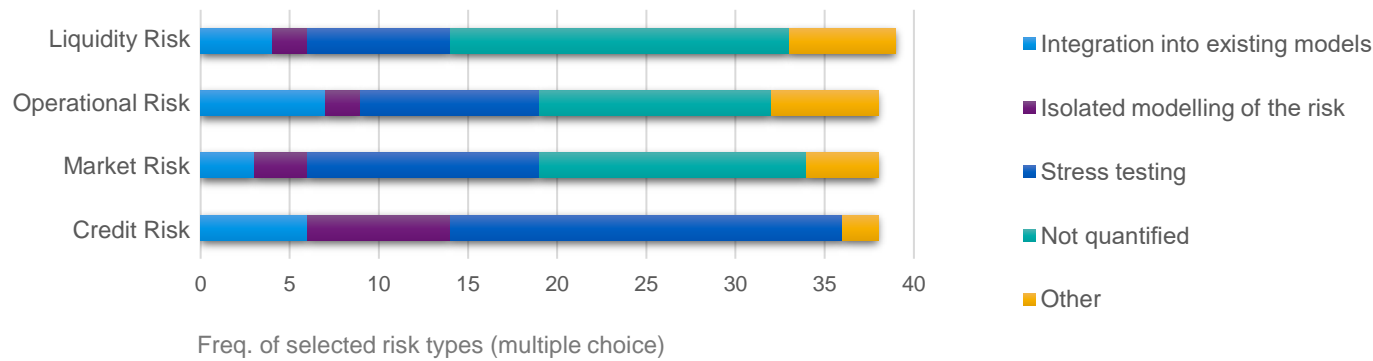
- More than 50% of participants identified large gaps related to data acquisition and the determination of KPIs
- Qualitative goals are the most prominent means to address ESG issues in participants' risk strategies
- Among the 50% of participants addressing ESG issues quantitatively, exposure analysis and portfolio alignment assessments are most common

Risk identification and quantification (Expectation 7)

Survey question: How are ESG factors or risks taken into account in your institution's risk inventory?



Survey question: How are ESG risks quantified by your institution for the following risk types?

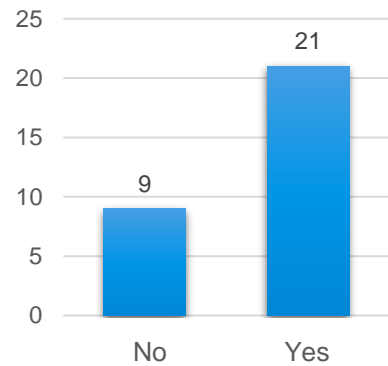


Key messages

- ESG factors and risks principally considered as risk drivers rather than as an independent risk type
- Quantification of ESG risks primarily implemented in existing risk types within stress testing or by integrating ESG risks into existing models
- Apart from credit risk, the quantification of ESG risks in other risk types has not yet been fully implemented

KRI frameworks and data sources (Expectation 7)

Survey question: Has your institution established KPIs or KRIs in the context of ESG risks?



Example KPIs and KRIs include:



GAR, carbon footprint (scope 1-3), sustainability criteria tracked in new business



Average trainings days/costs per employee per year

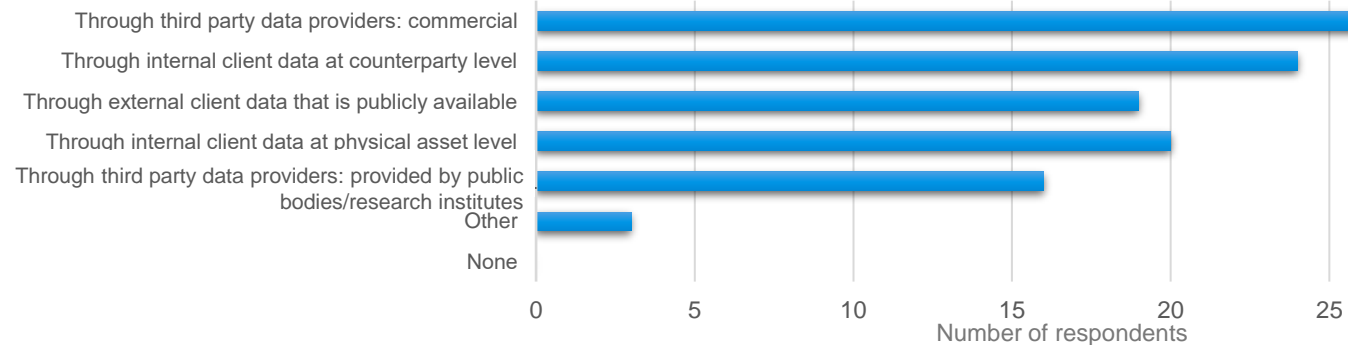


Number of customer complaints; Number of female board members/members of the supervisory board

Key messages

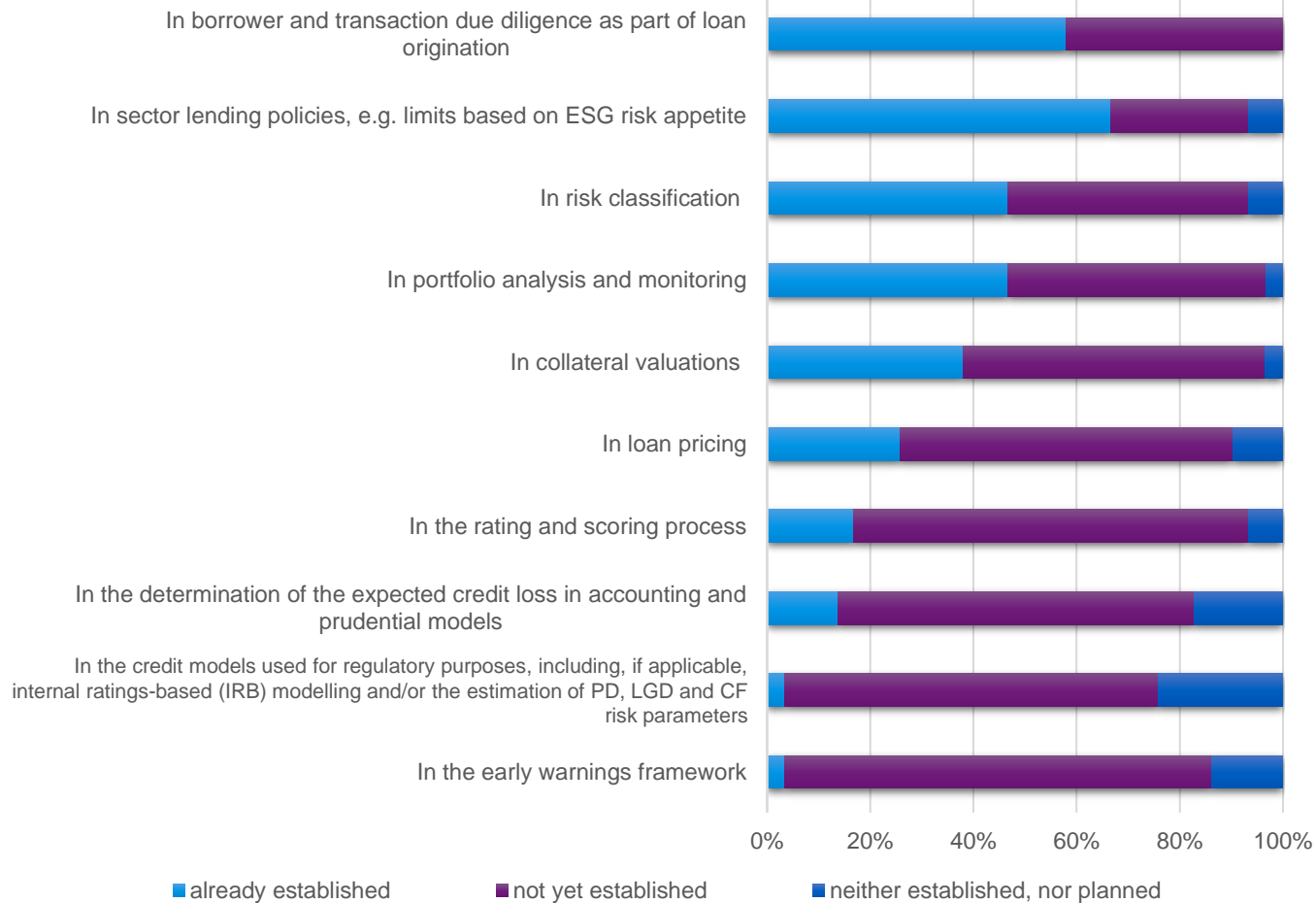
- More than half of participating institutions have already developed KPIs or KRIs that address ESG risks
- Sourcing data is a key challenge for all participants. The most relevant data sources institutions rely on to measure ESG risks are
 - Commercial data from third-party providers
 - Internal data at counterparty level
 - External client data from publicly available sources

Survey question: What kind of data sources does your institution use to measure ESG risks?

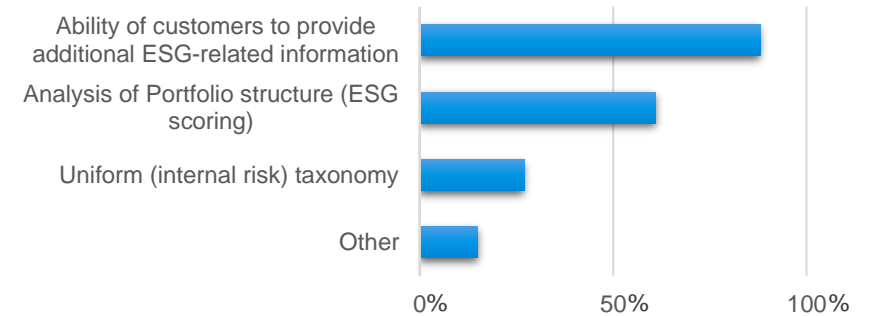


Credit Risk Management (Expectation 8)

Survey question: In which stages of the credit risk management process does your institution include ESG risks?



Survey question: What are the main challenges for your institution when taking ESG factors into account in credit risk management?

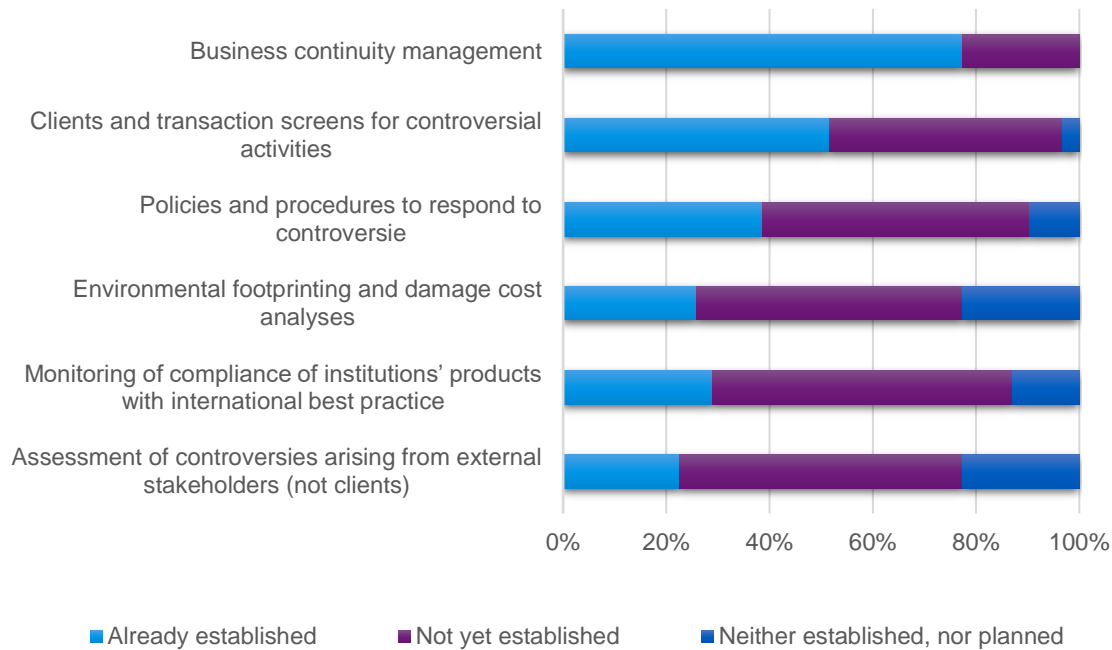


Key messages

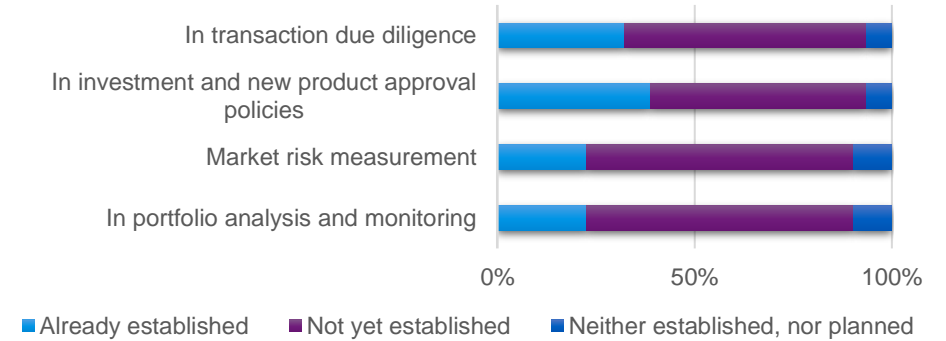
- Most participants intend to integrate ESG risks in all stages of the credit risk management process but have not yet done so
- ESG risks have been included in only five out of ten stages by nearly 40% of participating institutions
- Need to advance on the integration of ESG risks in early warning frameworks among all participants except one
- Within credit risk management main challenges relate to sourcing client-level ESG data

Market and Operational Risk management (Exp. 9 & 10)

Survey question: In which operational risk management processes (including reputation and liability risks) are ESG factors taken into account by your institution?



Survey question: In which stages of market risk management processes are ESG factors taken into account by your institution?

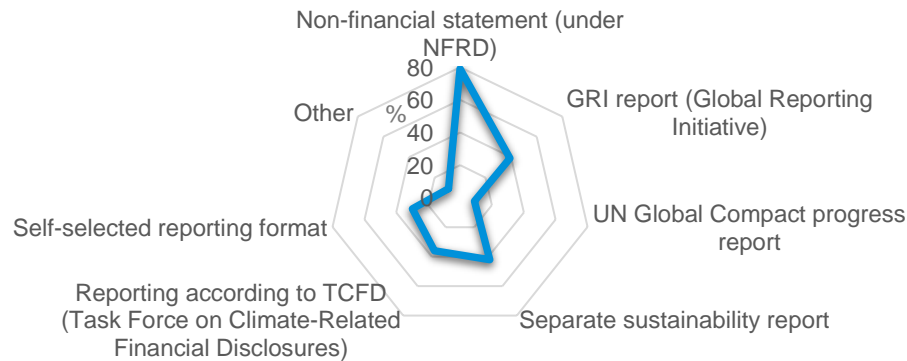


Key messages

- About 40% of the participants already considered ESG factors in two out of four market risk management processes
- Transaction due to diligence and investment and new product approval policies score highest integration of ESG risk
- ESG risks have been included in only three out of six processes by nearly 40% or more participating institutions
- Most institutions intend to consider ESG risks within the operational risk management but still lack implementation

External Reporting on Sustainability (Expectation 13)

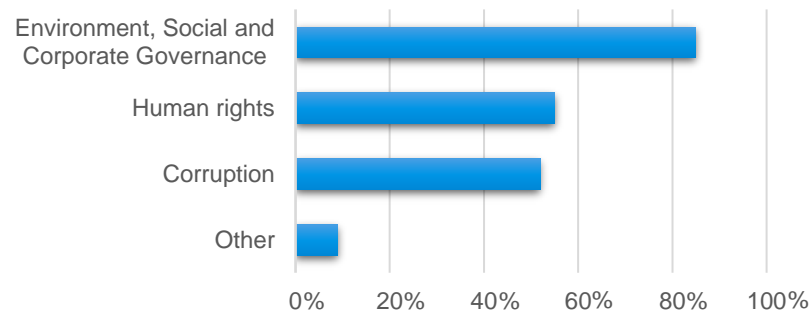
Survey Question: Which reporting formats are used in your institution's sustainability reporting?



Survey question: Which ESG-relevant metrics are used in ESG reporting?



Survey question: Which material topics are relevant for reporting in your institution according to the European Commission's guidelines on non-financial reporting?



Key findings

- Non-financial statements (under NFRD) most popular disclosure format
- Besides ESG, corruption and human rights are important topics in non-financial reporting
- Qualitative goals are used as ESG-relevant metrics in a majority of ESG reports



04 - Next steps for banks



What comes next...

The path forward

- While **significant progress** has been made and recognized by both banks and ECB, institutions participating in KPMG' survey also realize that **substantial work remains in integrating ESG drivers into risk management**.
- **ECB** has come to similar conclusions, and will continue to **analyze and closely monitor banks' progress** – for example in the form of specific case studies to be conducted with banks.
- A dedicated **follow-up process after 18 March 2022** (deadline for the submission of the thematic review) is already communicated: specific **case studies** (e.g. risk-specific modules for credit risk (95 SIs), market risk (17 SIs) and operational risk (48 SIs)) will be conducted and build the basis for an overall **comprehensive feedback letter** and possible targeted requirements.
- Given this environment, banks can expect **further increasing regulatory and supervisory pressure to accelerate their plans** for ESG risk integration – including supervisory measures as a results of 2022's **SREP**.

“Banks are running out of time to complete their preparations”

Keynote speech by Frank Elderson, Member of the Executive Board of the ECB and Vice-Chair of the Supervisory Board of the ECB (18.02.2022)



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