Banks need to step up to meet new reporting challenges

About 200 entities in New Zealand are now busily getting ready to present their first mandatory climate financial statements. We acknowledge that several entities have already prepared voluntary reports over the last couple of years, but it is surprising that a limited number of banks feature as part of this reporting group. We look forward to seeing whether this statistic will be turned on its head as part of the 2023 reporting cycles.

One question we get asked a lot is about what is happening in the rest of the world. In this article we provide an overview of our findings in the first phase of our annual survey of 35 global banks' climate-related disclosures, including comments about progress in different parts of the world[1].

The overarching messages are simple: Banks need to step up to meet new reporting challenges; and those banks reporting their climate-related disclosures under heightened regulation are powering ahead, leaving behind those in jurisdictions with less of a climate-related regulatory focus. New Zealand is one of the forerunners when it comes to regulation of climate-related disclosures. Our survey did not include any New Zealand reports, but we will endeavour to provide a comparison as part of next year's survey if New Zealand banks step up to the challenge and provide voluntary climate statements during the 2023 reporting cycle.

Observations across jurisdictions

UK banks continue to take the lead

- In 2021, the Task Force on Climate-related Financial Disclosures (TCFD) recommendations became mandatory for UK premium listed banks on a comply or explain basis (which includes a statement in the annual report on whether or how they have complied with the TCFD recommendations). This is reflected in the nature and extent of climate-related disclosures of UK banks.
- UK banks appear to be ahead in the following areas:

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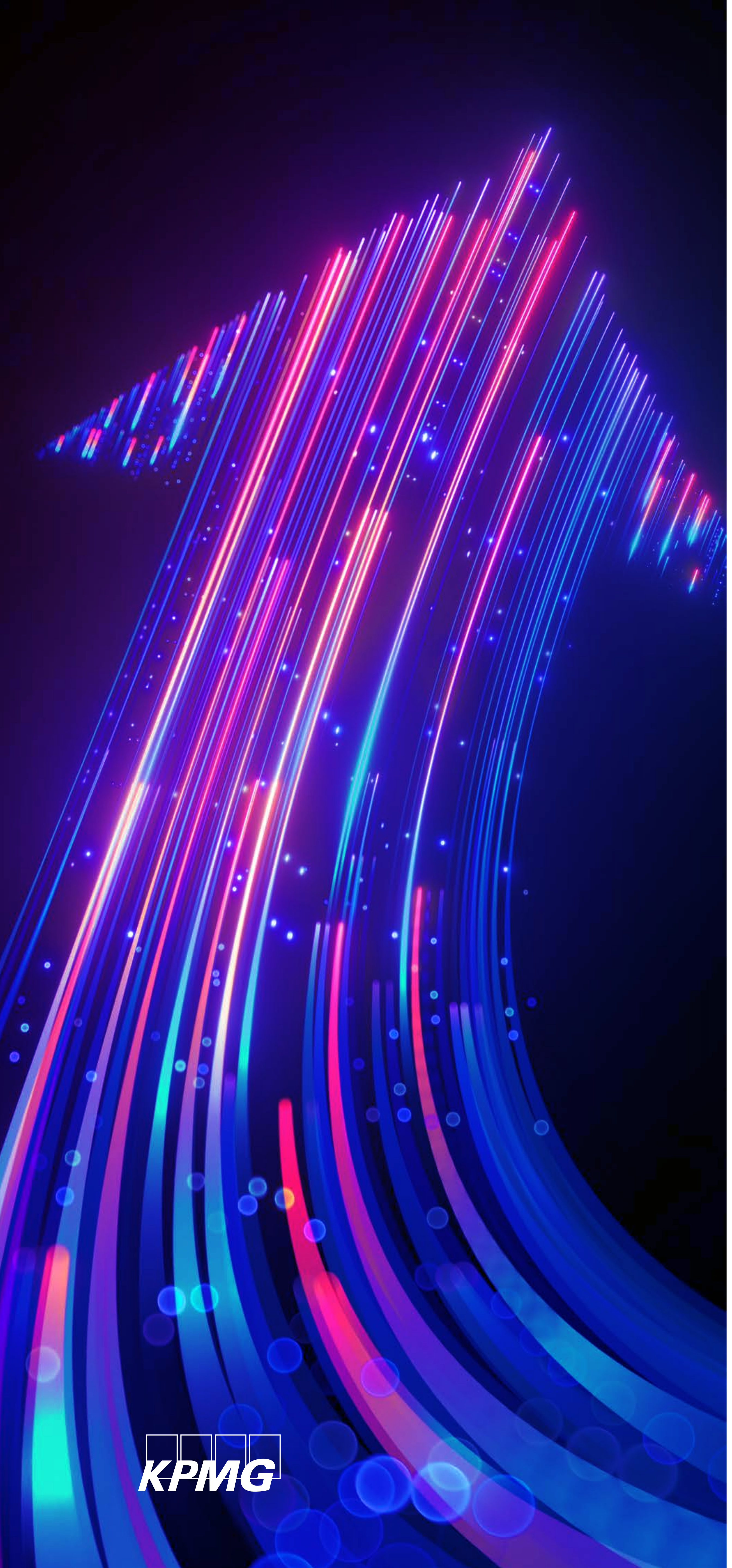
- All banks included in our analysis publish climate-related disclosures (including those in other standalone reports) on the same date as their financial statements.
- Continued progress is generally observed in climate-related disclosures made as part of 2022 annual reports – including:
  - although still limited, UK banks have started to disclose climate-related impacts within their financial statements;
  - they provided more clarity on the TCFD recommendations they have disclosed verses not disclosed (with explanations); and
  - they show continuing progress on the more challenging areas – e.g. quantification of financed emissions for certain loan portfolios, sharing insights from scenario analysis to date, and development of initial transition plans, which are already released or will be released in 2023.



Other banks continue to make progress in 2022

- Continuing progress is seen in jurisdictions with heightened regulation or where regulators have emphasised the importance of climate-related disclosures.
- Although disclosures are not (yet) at the same level as the UK banks, the banks in Australia and Europe have generally continued to make progress – e.g. some have started to disclose impacts in the financial statements.
- A few banks in Australia and Europe disclose judgemental adjustments to their expected credit losses (ECLs) due to extreme weather events or country-specific regulation.

Some banks lagging behind

Banks in jurisdictions with few or no climate-related regulations generally provide less climate-related information in their annual reports. No significant year-on-year progress is noted for such banks, with the nature and extent of disclosures being consistent with 2021.

Key findings

Our analysis also highlighted three key findings.

- Location and timing of climate-related disclosures make it challenging to understand the big picture – improving connectivity with the financial statements and between different parts of the information in climate-related disclosures remains key.
- Data challenges including availability, reliability and time lags are impacting the scope and extent of scenario analysis and the disclosures on metrics and targets. Going forward, banks will need to improve their data collation or estimation methodologies (and the accompanying systems, processes and controls) to enable them to report the required information at the same time and for the same period as the financial statements.
- Credit risk remains the focus followed by the impacts on reputation and operational risk. In 2022, notably, more banks identify litigation or liability risk as an area impacted by climate-related risks – sometimes mentioned together with greenwashing. However, a limited number of banks disclosed how they identified and assessed material risks and opportunities related to climate, and therefore, what they needed to disclose.

In next quarter's article we will explore in more detail our findings in respect of the four thematic areas of the disclosures: governance, risk management, strategy, and metrics and targets.

What about greenhouse gas (GHG) emissions disclosures?

Globally, many banks currently disclose a target to achieve a committed amount of sustainable financing (usually by 2030) and net zero in operational emissions (usually by 2030). Generally, these banks detail how they plan to achieve these goals through their climate-related strategy.

For financed and facilitated emissions, banks often disclose an overarching target to achieve net zero by 2050. Some banks disclose quantitative details on financed and facilitated emissions, which are then provided for a section (or sub-section) of a bank's loan portfolio. Banks do not yet disclose the total financed and facilitated emissions across their full lending and investment activities. This means it's generally not easy to understand how much of the banks' total operations are captured – i.e. whether a bank is on track to achieve its net-zero targets in 2050 – or to make comparisons between banks.

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Also, in many cases it is challenging to understand how absolute or intensity-based financed and facilitated emissions metrics are calculated (if these are quantified).

We also note that some banks use climate-related or Environmental, Social and Governance (ESG) factors to set variable remuneration. However, financed and facilitated emissions often do not yet feed into the specific climate-related or sustainability metrics and targets used to determine variable remuneration.

More mentions of climate in financial statements

The word 'climate' is starting to appear more frequently in financial statements; however, the disclosures are limited. Many of the banks that mention climate in their financial statements do so in the context of disclosing climate-related impacts on their financial statements. In most cases, these banks note that the quantitative impact on the financial statements is not considered material, either at this time or in the short to medium term.

Credit risk is the most common note in the financial statements in which banks mention climate-related impacts. Some banks disclose how these risks are managed, and/or how these are factored into their measurement of expected credit losses (ECLs). Notably, in the 2022 annual reports, there are a few banks that disclose judgemental adjustments to their ECLs due to extreme weather events or country-specific regulation.

We expect that the quality and sophistication of climate-related disclosures should improve under the forthcoming reporting standards, which in turn will enhance the ability of companies to make connections and identify climate-related impacts in the financial statements.

Also, the focus on connectivity between climate-related disclosures in and outside of the financial statements will become more prominent with the new project recently started by the International Accounting Standards Board on climate-related risks in the financial statements.

This aspect is particularly relevant for New Zealand climate reporting entities given that climate statements are required to be made available at the same time as financial statements and New Zealand financial statements are prepared using the same international accounting standards.

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Leaving you with an interesting finding…

There is an emerging focus on biodiversity. Globally, 74% of banks include biodiversity disclosures as part of their 2022 annual reports. These banks acknowledge its importance when it comes to climate change. Biodiversity may impact climate change – at the same time, climate change may also affect biodiversity. These banks disclose how they have started to address biodiversity loss through their sustainability strategy. More details to follow soon…

End notes

1 More detail are provided here: Banks' climate-related disclosures – KPMG Global

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