Climate risk

— banks need to act

Sustainability has been an overarching goal of many global and local organizations together with governing bodies from the mid-2010s. The Paris Climate Protection Agreement, which obliges 195 countries and territories to change the global economy in a climate-friendly manner, marks an important milestone for international climate policy. In December 2015, it was decided to limit global warming to 1.5 or a maximum of 2 degrees celsius compared to pre-industrial times. To the same extent, the United Nations' 2030 Agenda for Sustainable Development, launched in 2015, with the 17 Sustainable Development Goals (SDGs) has a catalytic effect for a global economy geared towards ecological and social goals.

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Banks have long been concerned with sustainability in a mostly fragmented fashion. However, due to the confounding flood of information and speculations about future regulatory changes, it is **difficult for most institutions to develop a comprehensive strategy for ESG factors.**

While the Paris Climate Protection Agreement and the United Nations' 2030 Agenda for Sustainable Development are not industry-specific, initiatives have been started to involve the financial services industry specifically, confronting them with the challenge to reconcile sustainability and economy.

Increasing awareness about issues such as climate change, social inequality or corporate misconduct is changing the market environment rapidly. Investors across the globe are showing a greatly increased demand for sustainable financial products. Sustainability and corporate conduct are influencing the reputation and business success of financial institutions.

The trend toward sustainability has the potential to drastically transform the global banking sector.

Banks that do not act now will hardly have the chance to integrate regulatory requirements concerning sustainability into their frameworks in good time, let alone adapt to the changed market requirements. Furthermore, simple solutions are rare. For example, banks may be targeted for lending to coal companies. This can upset stakeholders (such as NGOS) who may accuse the bank of unwillingness to support the transformation process to a sustainable economy.

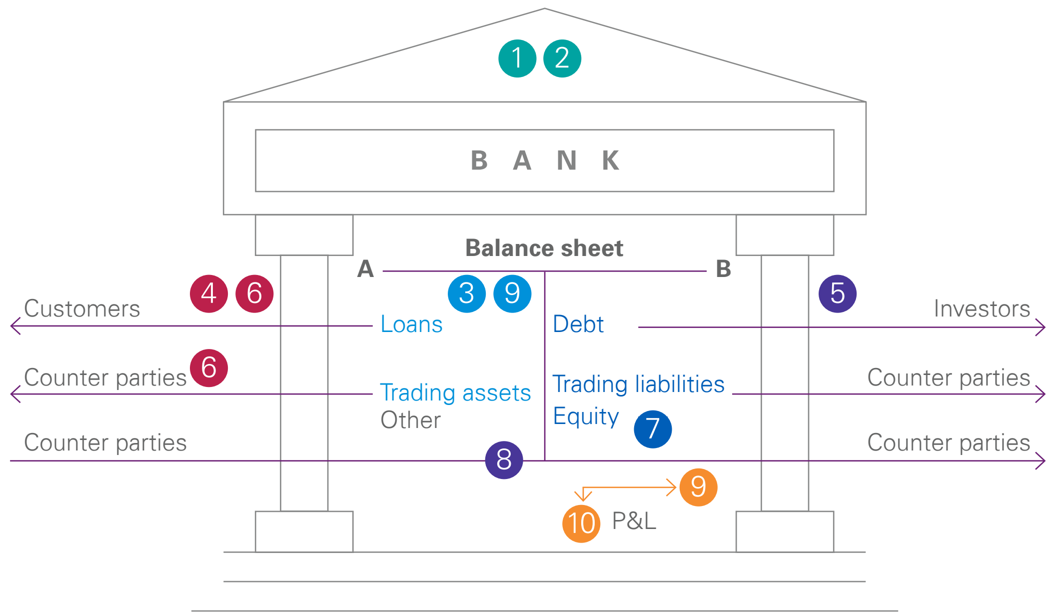
Banks need to respond to this with the following actions:

01
Revision of their business strategies in relation to their target customers, new products, etc.

02
Sharpening of brands and creation of sustainability strategies.

03
Implementation of updated regulatory frameworks along their entire value chains.

Key areas prone to ESG risk



01
Consideration of sustainability in the **business strategy** and the organizational setup/**governance**

02
Adjustment of **product and customer portfolio**

03
Identification/classification of sustainable **assets**

04
Offering of sustainable **financing to customers**

05
Refinancing with sustainable instruments

06
Consideration of ESG risk in **pricing and risk management**

07
Consideration of ESG risks within the **capital charge**

08
Inclusion of ESG criteria in the **distribution process** (including MiFID)

09
Reporting of own ESG risks and their impact to supervising authorities and stakeholders

10
ESG **data management**

Figure 1: ESG risk is expected to affect banks along their entire value chains both from strategic and operational perspectives — and create new opportunities.

Source: ESG risks in banks, KPMG International, 2021