Climate disclosure at banks – Risks are clear, but what are the opportunities?

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Now that climate change has led the world's major banks to overhaul their governance structures and risk frameworks, attention is focusing on the risks and opportunities of this new reality. To manage and capture these, many banks have started using climate scenario analysis focusing on specific portfolios and are considering what new metrics to use to measure and track progress towards targets.

Disclosures about climate change have become a much more pressing issue for banks over the past year. As our **previous analysis** has shown, banks have made significant progress in disclosing the impact of climate change in their annual reports.

But what are banks disclosing in their separate reports now?

Our first finding is that the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD) are emerging as the leading disclosure framework, with all banks in our sample referring to them.

Therefore, in this **second part** (PDF 2 MB) of our analysis we have looked at the separate TCFD or sustainability reports for 25 banks from Australia, Canada, Europe, the UK and the US. We have assessed the banks' relative progress on the different TCFD disclosures in their separate reports.

Our review of these reports shows four major trends.

- Banks have overhauled their governance structures and risk frameworks to deal with climate-related risks. Although board-level and top management involvement is highlighted as a key success factor for the surveyed banks, scenario analysis has been highlighted as an area that's still evolving and banks are yet to fully quantify the climate impacts on their strategy.
- Banks are aware of the risks that climate change poses to them and their customers and they are adapting their strategy to deal with these risks. There is less clarity in the disclosures about the opportunities, though.
- Although most surveyed banks have set a net zero target for 2050 that includes financed emissions, it is not yet clear how these emissions will be measured – or indeed how these can be measured.
- UK banks are leading the pack when it comes to the nature and level of detail of their disclosures. In 2021, for prime listed UK banks, the TCFD recommendations will become mandatory, and the prudential supervisor expects banks to disclose their climate-related financial risks and opportunities. This is reflected in their progress.

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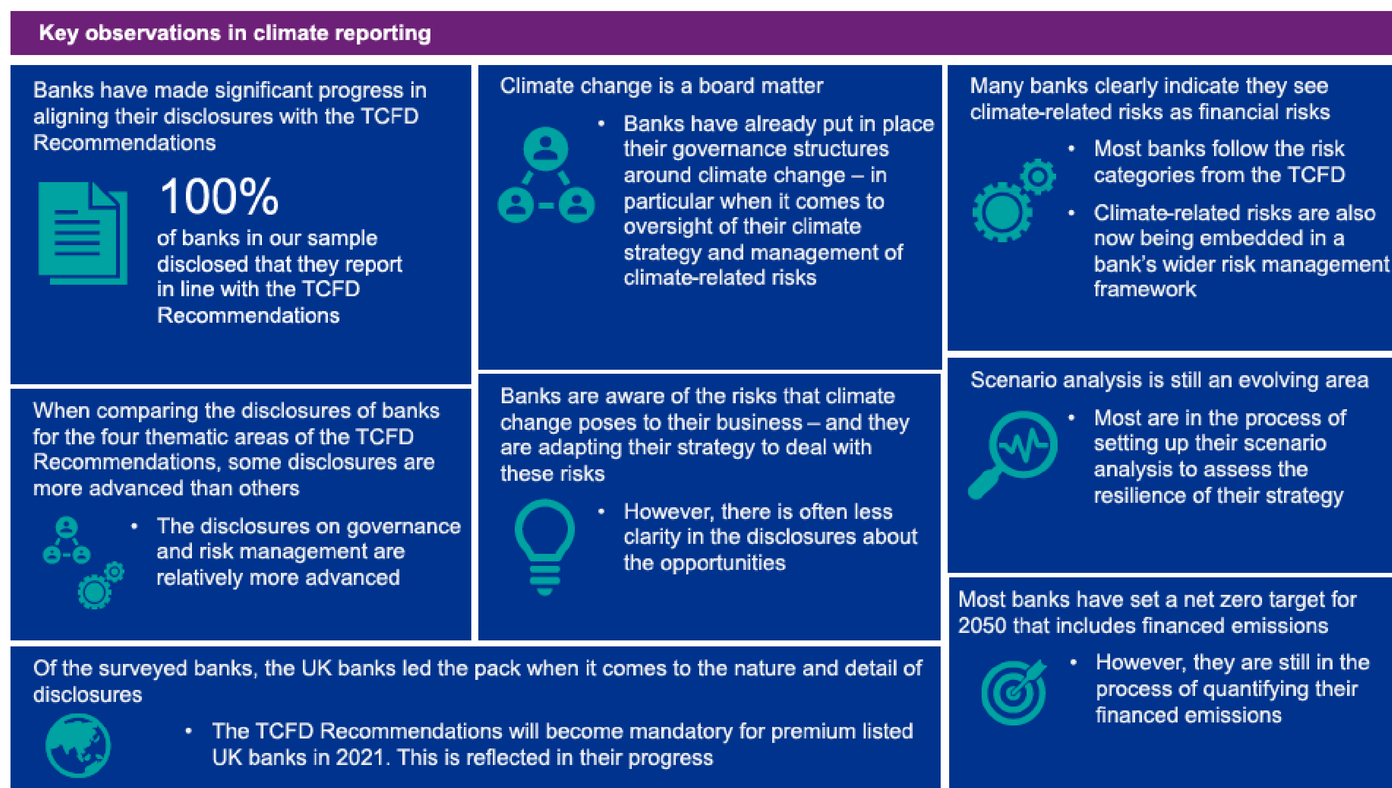
So, let's take a closer look at the banks' TCFD disclosures.



Governance and risk frameworks are in place

It's all about the board

The banks in our survey have made climate change a board-level matter. They describe the board's oversight of the strategic direction that they are taking to address climate change risks and opportunities, both when it comes to their own operations and dealing with financed emissions.

It's clear from the disclosures that it's not just the board that's getting more involved. Senior management are also playing their part, as shown by the many additional roles and committees that banks have created. Additionally, several banks made disclosure of specific training programmes they have rolled out to their board members and senior management to upskill them on climate matters.

Or all about risk?

Not surprisingly, given banks' traditional focus on risk management, many of them clearly indicate that they see climate risks as financial risks. Most banks follow the TCFD risk categories and divide climate risks into either transition risks or physical risks. It is clear from the disclosures that climate-related risks are now being embedded in the banks' normal risk management processes.

Many banks have used the more traditional risk categories for banks (such as credit risk, market risk, liquidity risk and operational risk) to capture climate-related financial risks. However, although the climate impacts on credit risk have received the most focus in the disclosures, there is less clarity on the impact on market or liquidity risks.

But what about scenario analysis?

Although the banks we surveyed have embedded their climate risks in their risk management frameworks and governance structures, many are not yet as far advanced when it comes to climate-related scenario analysis. Most are in the process of setting up their scenario analysis to assess their resilience. Some have

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disclosed the scenarios they're using, but data availability and lack of granularity seem to be holding back meaningful quantitative analysis at this point, and there is little disclosure of the outcome.

Most scenario analyses provided are generally qualitative in nature and focus on specific sectors and/or larger customers.

Those banks that disclosed details of their climate-related scenarios commonly applied a three-scenario approach, using the following scenarios published by the Network of Central Banks and Supervisors for Greening the Financial System:

- orderly: early, ambitious action to a net zero CO2 emissions economy;
- disorderly: action that is late, disruptive, sudden and/or unanticipated;
- hot house world: limited action leads to significant global warming and, as a result, strongly increased exposure to physical risks.

Scenario analysis for climate change is still an evolving area in the banking industry, and we are yet to see the results of such analysis. It is certainly an area to watch in the coming years as banks further develop and refine their methodologies and capabilities in this area and explore the interconnectivity with other scenario analyses. For example, how do the COVID-19 recovery scenarios that are being used for the calculation of expected credit losses interact with the climate transition risk scenarios?

Risks are clear – So what about the opportunities?

Transition risks – Sectors and portfolios are identified

Looking further into the banks' risk and strategy disclosures, the majority have highlighted the sectors that they believe will be significantly impacted and that could therefore pose a risk for their business models.

Most commonly mentioned are sectors such as thermal coal, mining, oil and gas, automotive and transportation. These sectors are exposed specifically to transition risks because they are more reliant on a high-carbon economy. Some banks also mention sectors such as agriculture and commercial real estate (and to a lesser extent retail mortgage portfolios).

The majority of banks disclosed exposure to these sectors in their current books and provided insight into how they are planning to either exit certain portfolios or support their customers in managing the transition risks. As highlighted above, the risk management framework seems to capture the risks inherent with the transition to a low carbon economy: banks are generally aware of where in their portfolios these risks sit in the first instance and how to manage these risks.

But what about the opportunities?

Although the climate risk disclosures are relatively well developed, what is less clear from the disclosures is where banks see the opportunities in the transition to a low-carbon economy over the short, medium and long term. Most banks have ambitious sustainable finance targets and green financing is growing in importance, with significant numbers up to several trillions in financing being mentioned in the disclosures. However, it is less clear what the banks identify as the more structural opportunities and competitive advantages in the longer term, and how they see themselves seizing these. It may be that these disclosures are still being identified and quantified. Also, there is little clarity on the sectors likely to profit from such financing – will banks be able to find the unicorns?

In our **previous report** (PDF 2 MB) and **blog post** we noted disclosures from a number of banks tying management and board remuneration to the achievement of climate targets. As this becomes more widespread, the opportunities will surely become more tangible and clear.

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Metrics and targets – Can they be measured?

Banks disclose key metrics and targets that they are currently using and developing to measure and manage climate-related risks and opportunities. These generally revolve around sustainable financing, operational emissions and financed emissions. Quantitative metrics and targets are disclosed on the first two, and most banks are still in the process of quantifying financed emissions.

How is progress measured?

Most surveyed banks have now set a net zero target for 2050, which includes their financed emissions. However, based on the current disclosures it is not yet clear how this will (or can) be measured. The measurement of progress, the achievement of these net zero targets and the relevant disclosures may be linked to a bank's capability to seize climate-related opportunities – e.g. through financing companies that operate more sustainably, or those that develop technologies that enable others to better tackle climate-related matters.

A global challenge – So who is in the lead?

The TCFD recommendations are at the moment just that: recommendations. However, all of the surveyed banks have elected to follow the format that the taskforce has provided, and most other banks are doing so, which gives us an opportunity to compare and contrast against a consistent framework.

So when looking across the globe and looking at the banks we surveyed, we note that the UK banks provide the most detailed disclosures. In 2021, for prime listed banks, the TCFD recommendations will become required and the prudential supervisor expects banks to disclose their climate-related financial risks and opportunities. This is reflected in their progress.

However, we also see that different countries and banks have different focus areas. Banks in Canada and Australia have put a specific focus on the impact of their lending portfolios in specific prevalent industries in their region, such as mining and agriculture, with detailed disclosures in those areas that go beyond what we have seen in other countries.

And finally

The pace of climate-related disclosures in the banking sector has clearly increased. Many banks are not only including significant information in their annual reports, but are also issuing separate ESG reports and sometimes even an additional report specifically on the TCFD recommendations. This is interesting in itself because the TCFD recommends that organisations provide climate-related financial disclosures in their mainstream annual financial filings. This appears also to be the general direction of travel chosen by regulators in several jurisdictions. It will be interesting to see how this will impact the future placement and further integration of climate-related disclosures in annual financial reports.

Better climate-related disclosure does not necessarily mean better progress towards a more sustainable, low-carbon economy. However, widespread high-quality climate-related disclosures will highlight those banks that make progress and provide investors with vital insights to make their decisions.

There are areas where data limitations are an issue: work will be needed to overcome some of these limitations. The data challenge may pose an opportunity for those banks that are able to move more quickly in this area. Also, as more regulators get involved and set firm expectations on climate-related disclosures, we should see banks continuing to develop data-driven ways to meet regulatory expectations.

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And now over to you

In our two reports and blog posts we have analysed banks' climate-related disclosures in their annual reports and separate TCFD or ESG reports.

These reporting requirements are not going to go away – so how are you progressing on the climate-related disclosure journey? What are your next steps?

Coming soon: KPMG is currently developing an online climate change financial reporting resource centre, looking specifically at where and how climate-related risk impacts might appear in financial statements.

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