CLIMATE & SUSTAINABILITY

Integration into Risk and Credit Portfolio Management
IACPM Continental Europe Roundtable
25 January 2023

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FINANCIAL SERVICES

CONFIDENTIALITY

AGENDA

1 REGULATORY ENVIRONMENT

2 OW GLOBAL NATURE STUDY

3 PRICING AND CREDIT DECISIONING

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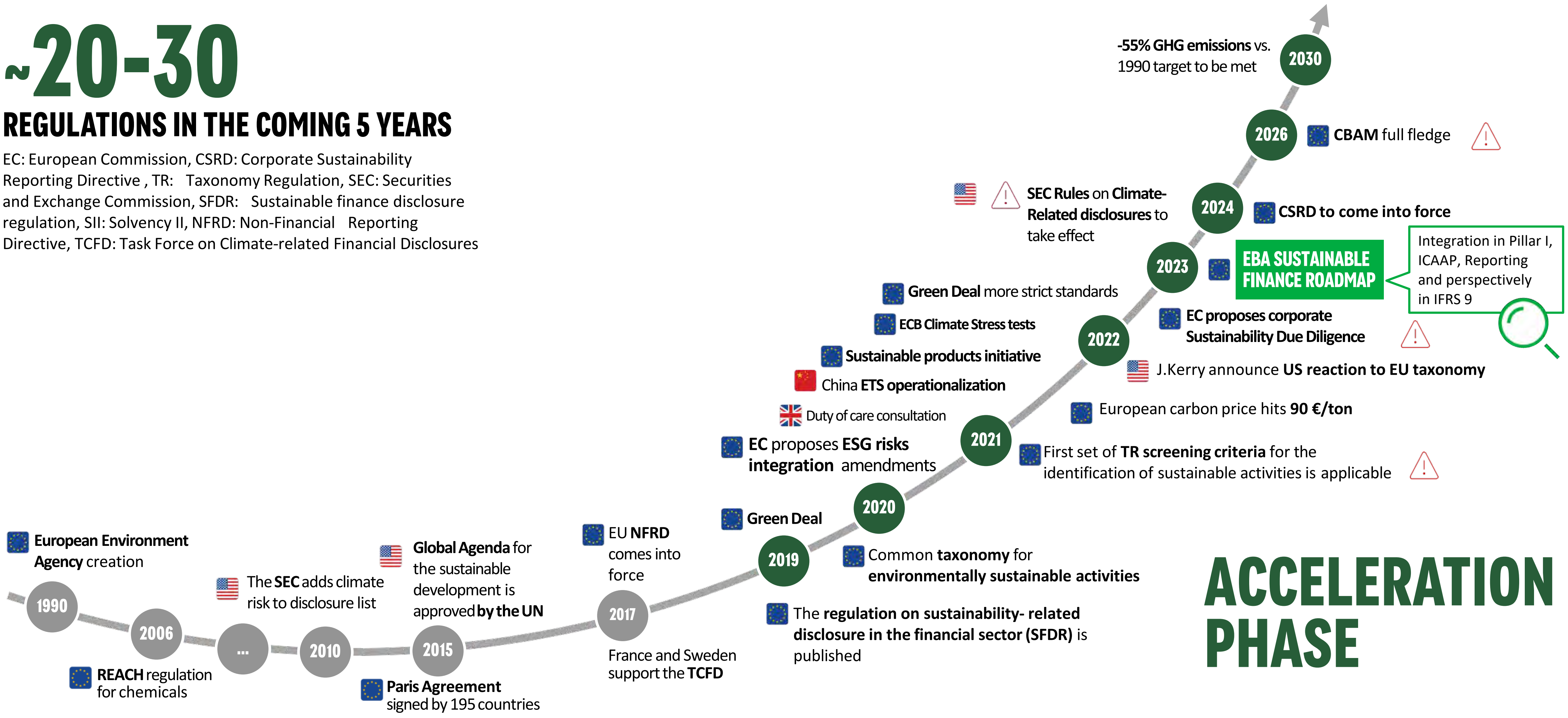
REGULATORY ENVIRONMENT

ESG REQUIREMENTS WORLDWIDE AND ESPECIALLY IN THE EU ARE INCREASING RAPIDLY

~20-30

REGULATIONS IN THE COMING 5 YEARS

EC: European Commission, CSRD: Corporate Sustainability Reporting Directive , TR: Taxonomy Regulation, SEC: Securities and Exchange Commission, SFDR: Sustainable finance disclosure regulation, SII: Solvency II, NFRD: Non-Financial Reporting Directive, TCFD: Task Force on Climate-related Financial Disclosures



Source: European Commission website, press releases, Oliver Wyman analysis

THE EBA SUSTAINABLE FINANCE IS OVERARCHING SHOWING A CLEAR TREND OF INCORPORATING ESG IN THE ENTIRE REGULATORY FRAMEWORK

	2021	2022	2023	2024	2025
Transparency and disclosures	EBA advice on disclosure under Article 8 of Taxonomy Regulation	ITS on ESG Pillar 3 prudential disclosures	Implementation support RTS on ESG disclosures for STS securitization	Review of ITS on ESG Pillar 3 prudential disclosures	
Transparency and disclosures – SFDR	RTS on sustainability disclosure for financial products and investment decisions	Review of RTS on sustainability disclosures – fossil gas and nuclear energy investments	Review of RTS on sustainability disclosures – principal adverse impact indicators	Support for the implementation of disclosure requirements	
Risk management and supervision	Report on ESG risks management and supervision	Second revision of SREP GL Report on ESG risks in SREP for IFs	CP on the Guidelines on ESG risks management	Final GL on ESG risks management Third revision of SREP GL	
Prudential treatment		DP on environmental risks in prudential framework	Final report on prudential treatment of exposures		
Stress testing	Pilot climate exercise		CP on GL on institutions' stress testing	One-off joint exercise Final GL on institutions' stress testing	Preparation and launch of regular climate stress testing GL on supervisory ESG stress testing
Standard and labels	Updated report on monitoring of AT1 instruments	Report on green securitization	Advice on green loans and mortgages		
Greenwashing		Survey to stakeholders and to CAs	Advice on greenwashing – progress report	Advice on greenwashing – final report	
Supervisory reporting		DPM for Pillar 3 quantitative disclosures		ITS on ESG reporting Ad-hoc collection of P3 quantitative data	Ad-hoc collection of P3 quantitative data Preparation and launch of regular supervisory reporting on ESG
ESG risks and sustainable finance monitoring		Development of the monitoring framework for ESG risks and sustainable finance			

Source: EBA Roadmap on sustainable finance

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OW GLOBAL NATURE STUDY

FROM THE ECB 2022 REPORT, EMERGING OR LEADING PRACTICES FOR ENVIRONMENTAL RISK MANAGEMENT SIGNIFICANTLY LAGS BEHIND CLIMATE

SUMMARY OF WALKING THE TALK (ECB REPORT)

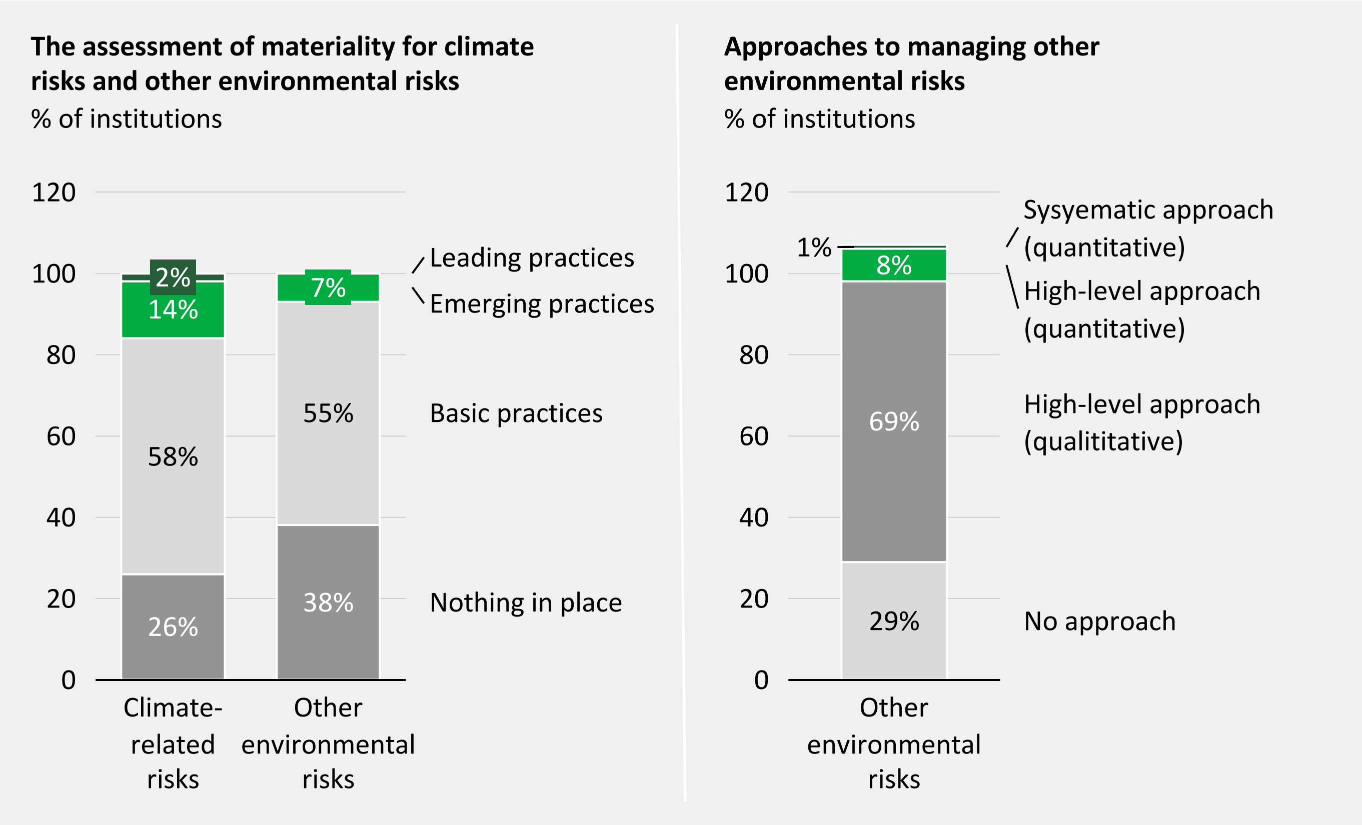
State of environmental risk management

- Standard blueprint follows climate risk management
  A. Assess high-level physical and transition risks
  B. Develop inclusion and exclusion criteria
  C. Build on foundation with heatmapping, due diligence, client-level impact assessments, etc.
- Environmental vs climate-related – *see chart at right*
  – Less than half as many financial institutions show **emerging or leading practices in environmental risk materiality assessment** (**7%** vs **16%**)
  – Basic practices are comparable (55% vs 58%)

Best practices for environmental risk management

- For **exclusion approach**: use available treaties and certifications to set negative and positive criteria
- For **due diligence**: include both impacts and dependencies across environmental areas – biodiversity, pollution, water stress, etc.
- For **risk measurement**: strategic middle-term target of net positive biodiversity impact, monitored through avoidant and positive-impact targets

Walking the Talk (ECB Report): Emerging or leading practices for environmental risk management significantly lags behind climate



Source: Walking the Talk ECB report; Notes: Sample of 107 institutions that were within the scope of the 2022 thematic review on climate-related and environmental risks. For the assessment of the materiality of climate-related risks (left panel), the average is taken across all five risk types (credit, market, liquidity, operational and strategic risk).

FROM THE BENCHMARKING EXERCISE, WE HAVE OBSERVED COMMON THEMES ACROSS FINANCIAL INSTITUTIONS GLOBALLY

Europe had a head start in nature

Similar to climate, European financial institutions are generally further along on environmental risk management.

We can likely attribute this to a stricter regulatory environment, especially the ECB requirement to conduct an initial environmental risk materiality assessment by year end 2022.

Domestic/regional banks are leading the way

All of the European regional banks respondents have conducted/conducting an initial environmental risk materiality assessment. Most are also progressing with environmental policy updates and starting to leverage ERMA findings for risk management and corporate strategy.

Overall, development banks showed more progress to nature-positive targets and have allocated a higher number of resources towards nature issues.

The road to robust nature risk management is untraveled

75% of respondents have conducted or are conducting an initial nature risk materiality assessment. But there is still a long way to go with incorporating time horizon considerations, integration of environmental taxonomy, and bridging the data gap for location specificity.

Few have applied findings across TNFD pillars, leaving room for improvement on accountabilities and metrics used, to name a few

Roadblocks for those behind the curve

For the remaining 25% of respondents without a well-progressed risk management vision, 3 foundational gaps stood out: allocating resources to nature/environment, understanding existing guidance (e.g. double materiality of nature) and defining a fit-for-purpose environmental risk taxonomy.

Without these early steps, it's difficult to assess environment/nature risk hotspots.

3

PRICING AND CREDIT DECISIONING

EMBEDDING ESG COMPONENTS INTO CREDIT DECISION MAKING

ESG COMPONENTS

NEW COMPONENTS EXISTING FRAMEWORK

Financial risk	*Expected and unexpected physical and transition risks*
Reputational risk	*Greenwashing and conduct*
Funding cost impact	*Use for green bonds, social-linked bonds, etc.*

NEW COMPONENTS NEW FRAMEWORK

Net-Zero Targets contribution	*Contribution of credit to net-zero pathways*
Sustainability target contribution	*Contribution of credit to sustainable lending commitments*
Revenue	*New lending opportunity due to transition funding demand*

EMBEDDING

Incorporate into existing credit decision framework

Risks will eventually be incorporated in ratings, provisions, stressed capital
Funding cost impact incorporated via FTP
Short term solutions will differ

Requires new methodology

E.g. "ESG charge": Internal charging/benefit mechanism based on transition plan assessment and carbon intensity or ESG score

EXPLAINING THE ”ESG CHARGE”: CLIENT ARCHETYPES

Risk

Funding

Emission intensity

“THE RELUCTANT POLLUTOR”

Corporate in high carbon sector that has not committed to investing into transition. Potential drag on banks’ ESG reportings and limited future funding demand

“THE INVESTMENT CASE”

Corporate in high carbon sector that has set ambitious, yet viable targets across ESG metrics, requiring significant new funding from banks

“THE ALSO-RANS”

Corporate in low carbon sector that has not set further transition goals

“THE SUSTAINABLE STAR”

Corporate in lower carbon sector with ambitious ESG targets, yet the total size of the opportunity is smaller given good current position. Lending to this type of client helps banks net zero and sustainability commitments, but market might be crowded

Transition plan score