Linking Climate & ESG to Decision-Making and CPM 2023

Select High-Level Result

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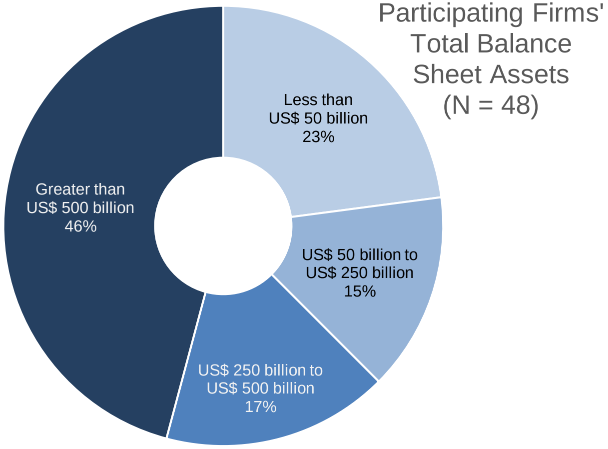
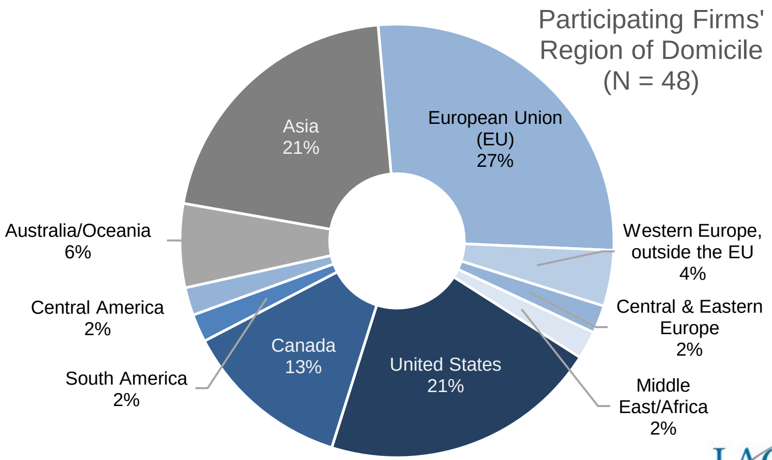
Survey Goals and Demographics

- In December 2022, the IACPM conducted a survey on Linking Climate & ESG to Decision-Making and Credit Portfolio Management (CPM) - today and looking forward.
- The survey explores the usage of climate & ESG risk criteria, policies and frameworks, as well as risk appetite and limit setting approaches.
- Results provide insights into the current state of ESG & Climate Risk Management across an array of firms and offer an opportunity for IACPM members to confidentially benchmark their practices with those of other leading financial firms.
- Globally, 48 IACPM member firms participated, including 36 banks, six development banks, five funds/asset managers, one insurance company.
- Some 60% of the participating banks/investment banks have a total balance sheet size above US$ 500 billion.





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Key Findings (1)

Climate & ESG risk policies have been established at most large banks at an enterprise level and often also specific to different lines of business and geographies.

Smaller banks (<US$ 500bn assets) are almost evenly split between those that have established climate & ESG risk policies at an enterprise level and those that have not yet established these policies.

More than half of participating banks domiciled in the Americas have not yet established climate transition and physical risk policies, while banks in all other regions have established at least enterprise level policies as a minimum for climate transition risk.

Respondents without existing climate & ESG risk policies expect an introduction within the next three years.

Credit risk management systems at some 40% of respondents globally capture at least some information necessary to manage climate & ESG risks in their credit portfolios, with plans in place for further expansion. About half of respondents have identified, or are in the process of identifying, new data elements and will update systems accordingly.

Climate & ESG risks are captured in client risk rating criteria, either implicitly or explicitly, at three-quarters of survey respondents globally. Around one quarter of survey respondents, regardless of region and size, do not yet capture these risks.

The integration of physical risk seems to be more advanced, with 17% of participants conducting explicit sensitivity analyses.

Of the roughly 85% of larger bank respondents in the Americas that do not, or only implicitly, capture climate & ESG risks in their client risk rating criteria, more than half have no plans yet to explicitly capture these criteria.

Transaction level decision-making applies climate transition risk criteria often explicitly, by either estimating how a transaction will facilitate a client's transition plan or by assessing the underlying facilitated emissions. Climate physical risk criteria as well as other ESG risks are utilized more often implicitly.

(1) The Glasgow Financial Alliance is a global coalition of leading financial institutions in the UN's Race to Zero that is committed to accelerate the decarbonization of the world economy and to reach net-zero emissions by 2050.

Key Findings (2)

Clients' external disclosures are the preferred source for climate & ESG related client data across all ESG risk types. For climate transition and climate physical risks, firms purchase relevant data and utilize proxies when data is not available. Only a very small number of participating banks are not yet collecting climate & ESG related client data.

A potential ESG industry data utility is of high interest for smaller bank respondents (79%), while larger banks, especially in EMEA, expressed lower expectation to utilize such a utility (64%).

Standalone climate and/or ESG credit risk frameworks have been established by more than half of participating large banks, while some two-thirds of smaller and non-bank participants are incorporating or are planning to incorporate these risks into existing credit risk frameworks.

Supporting existing clients in the transition to a less carbon intense business model is the focus of all respondents globally. At large banks, DFIs and funds/asset managers around half of respondents decided to exit select carbon-intensive industries. This ratio is much lower for smaller banks (14%).

Banks' existing enterprise-wide Risk Appetite Statements (RAS) capture qualitative *or* quantitative climate transition risk metrics, while standalone climate & ESG RAS remain the exception. One-third of banks - mostly larger institutions – capture qualitative ***and*** quantitative climate transition risk metrics. For other ESG risks banks rely more heavily on qualitative metrics only.

The coverage of portfolio alignment to the Paris Agreement (published interim or Net Zero targets etc.) by firms' RAS varies by region, with EMEA leading by a significant margin.

Banks domiciled in EMEA are ahead of their peers globally in establishing Carbon/emission targets. Three-quarters have either already established or will be establishing targets within the next twelve months. This is almost double compared to banks domiciled in APAC and five times more than for banks domiciled in the Americas. Targets are at least partly driven by firms' sustainability commitments, including the Net-Zero Banking Alliance (NZBA) commitment.

Banks are planning to mitigate emissions at the portfolio level by developing programs of sustainability-linked loans, reducing exposure to carbon-intensive activities and increasing exposure to carbon-removal activities.

Purchasing carbon credits is considered in 33% of American banks, but only 6% of banks in EMEA.

(1) The Glasgow Financial Alliance is a global coalition of leading financial institutions in the UN's Race to Zero that is committed to accelerate the decarbonization of the world economy and to reach net-zero emissions by 2050.

Key Findings (3)

Climate transition risk limits have been established by half of the responding banks domiciled in EMEA and to a lesser extent in other regions. For climate physical risk and other ESG risks, limits have been established to a much lower extent.

To monitor climate risk limits (transition and physical risks), respondents in the Americas put almost equal emphasis on exposure to carbon-intensive industries and climate stress scenario losses, while firms in other regions rely more heavily on exposure to carbon-intensive industries alone.

To mitigate limit breaches, a majority of respondents with established limits will use origination screening and strategy review at least for the next 1-2 years.

The use of syndication/loans sales is expected to increase, especially for banks located in EMEA where two-thirds of respondents are planning to utilize this tool.

Financial Planning at three-quarters of responding firms domiciled in EMEA is expected to incorporate climate risk considerations within the next 1-2 years, while for firms domiciled in APAC and the Americas this number is less than half. Interestingly not much variation can be detected across type and size of the participating institutions.

A correlation can be observed for respondents with climate transition risk policies in place to support credit risk adjudication, at an enterprise level and specific to different lines of business/geographies, and respondents that are targeting to incorporate climate risk considerations into financial planning (revenues, reserves and/or capital projections) within the next 1-2 years.

(1) The Glasgow Financial Alliance is a global coalition of leading financial institutions in the UN's Race to Zero that is committed to accelerate the decarbonization of the world economy and to reach net-zero emissions by 2050.

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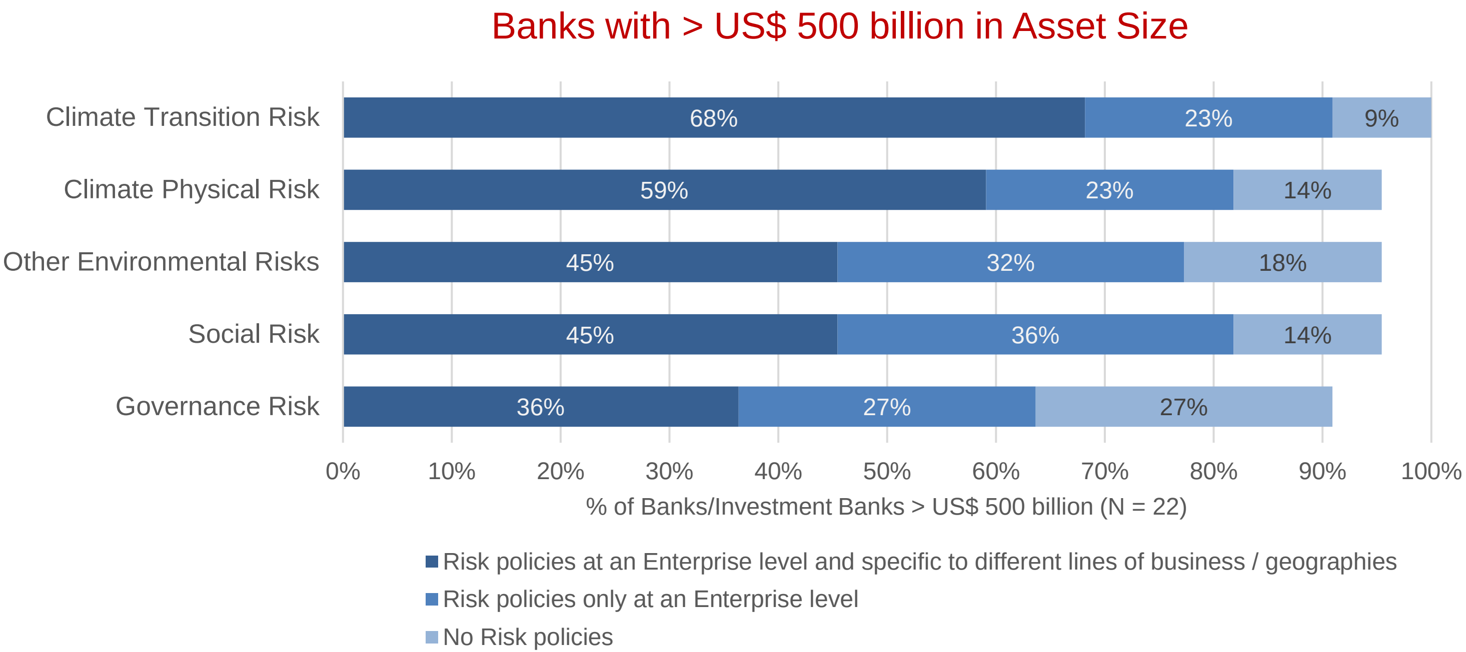
Climate & ESG Risk Policies to Support Credit Risk Adjudication

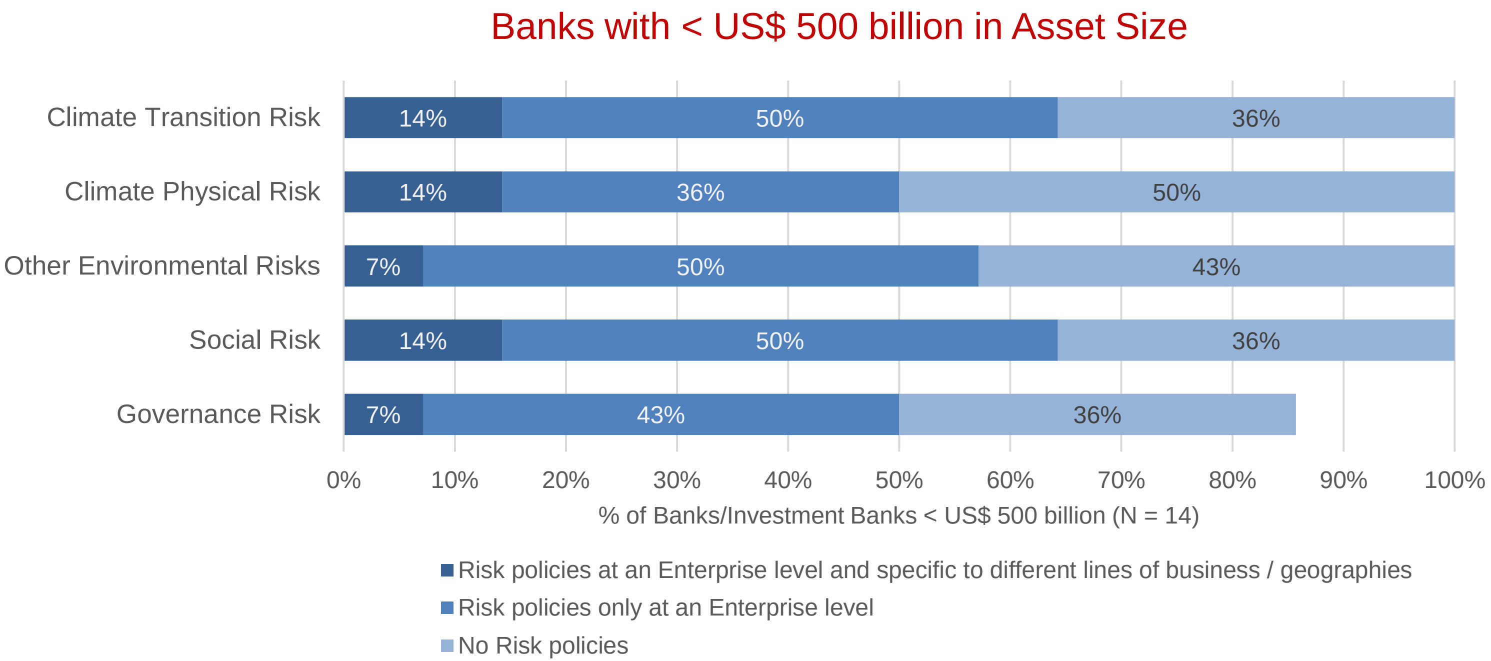
To support credit risk adjudication of climate and other ESG risks, many larger bank respondents have established climate & ESG risk policies at least at an enterprise level and often also specific to different lines of business and geographies.



Source: IACPM Research ESG Survey Series 2022/2023: Linking Climate & ESG to Decision-Making and CPM
Question: Does your firm have Climate & ESG Risk policies that support credit risk adjudication of these risks? (Q11)

Climate & ESG Risk Policies that Support Credit Risk Adjudication

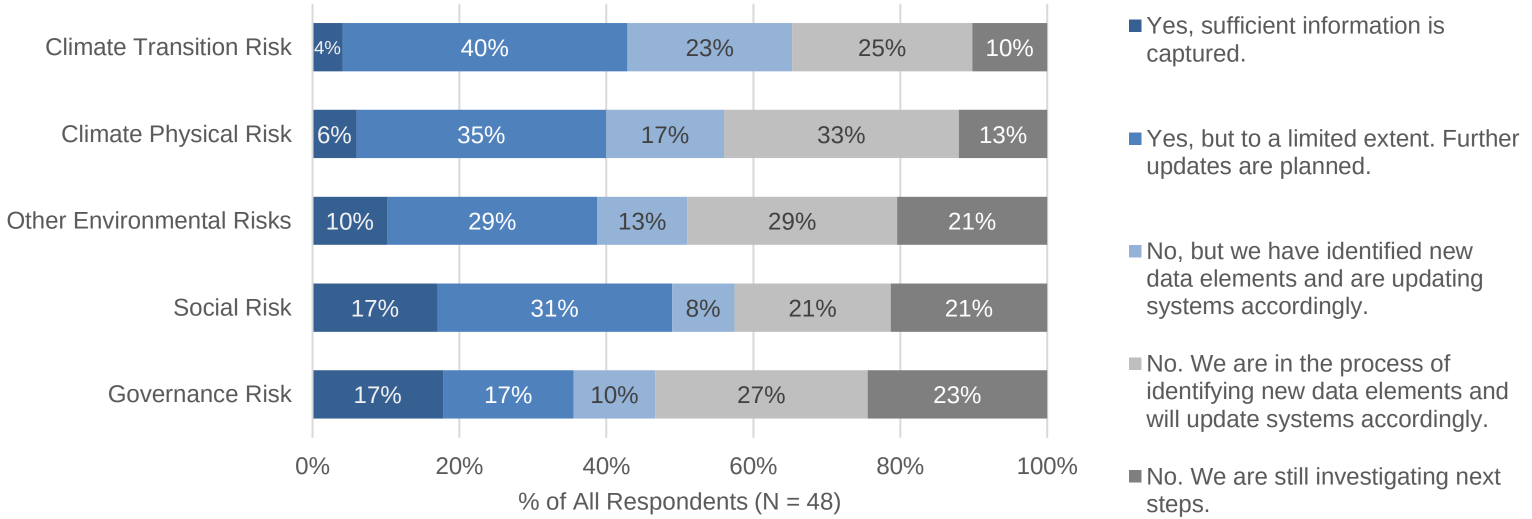
Smaller banks are almost evenly split between those that have established climate & ESG risk policies at an enterprise level and those that have not yet established these policies.



Source: IACPM Research ESG Survey Series 2022/2023: Linking Climate & ESG to Decision-Making and CPM
Question: Does your firm have Climate & ESG Risk policies that support credit risk adjudication of these risks? (Q11)

Credit Risk Management Systems' Ability to Capture Sufficient Information for Effective Climate & ESG Risks Management in Credit Portfolios

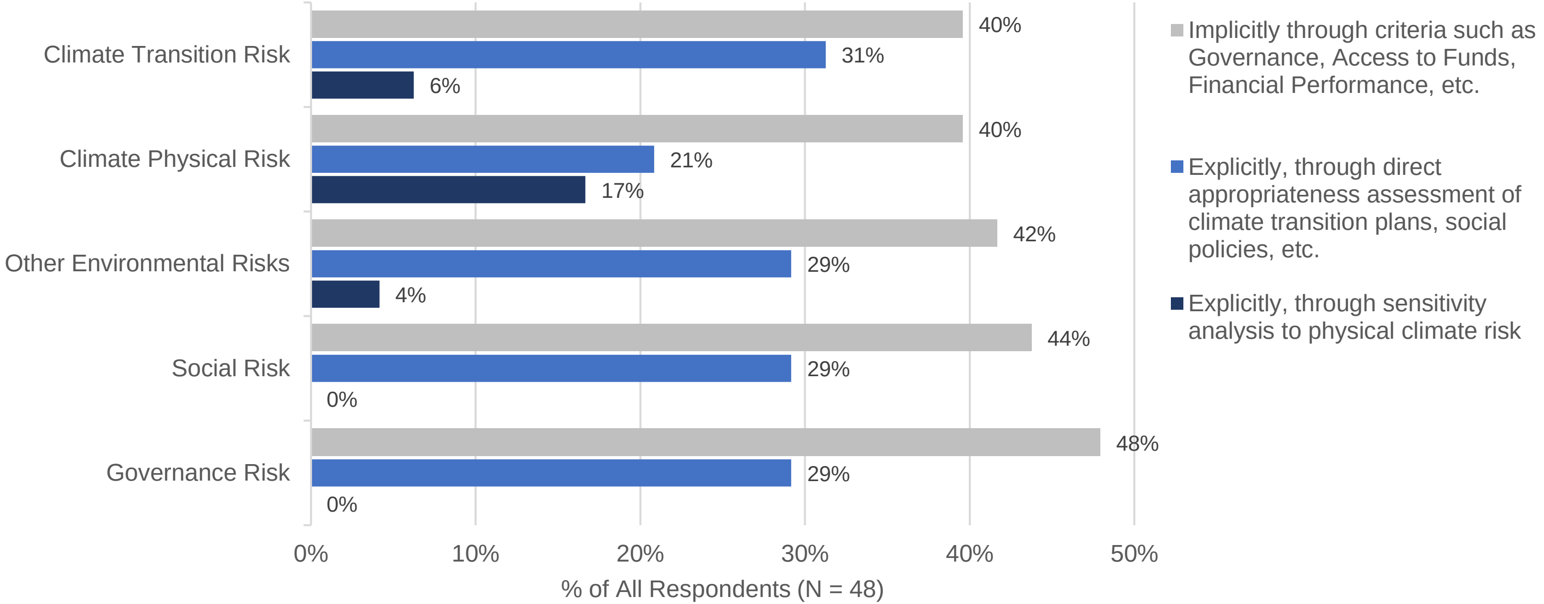
Some 40% of respondents' credit risk management systems across regions and industries capture at least some information necessary to manage climate & ESG risks in their credit portfolios, with plans in place for further expansion. About half of respondents have identified, or are in the process of identifying, new data elements and will update systems accordingly.



Source: IACPM Research ESG Survey Series 2022/2023: Linking Climate & ESG to Decision-Making and CPM
Question: Do your credit risk management systems currently capture sufficient information to effectively manage Climate & ESG risks in your portfolio? (Q8)

Climate & ESG Risks Captured by Client Risk Ratings Criteria

Some three-quarters of survey respondents globally capture climate & ESG risks, either implicitly or explicitly, in their client risk rating criteria. Around one quarter of survey respondents, regardless of region and size, do not yet capture these risks. The integration of physical risk seems to be more advanced, with 17% of participants conducting explicit sensitivity analyses.



Source: IACPM Research ESG Survey Series 2022/2023: Linking Climate & ESG to Decision-Making and CPM
Question: To what extent do your firm's client risk rating criteria capture Climate & ESG risks? Check all that apply. (Q2)

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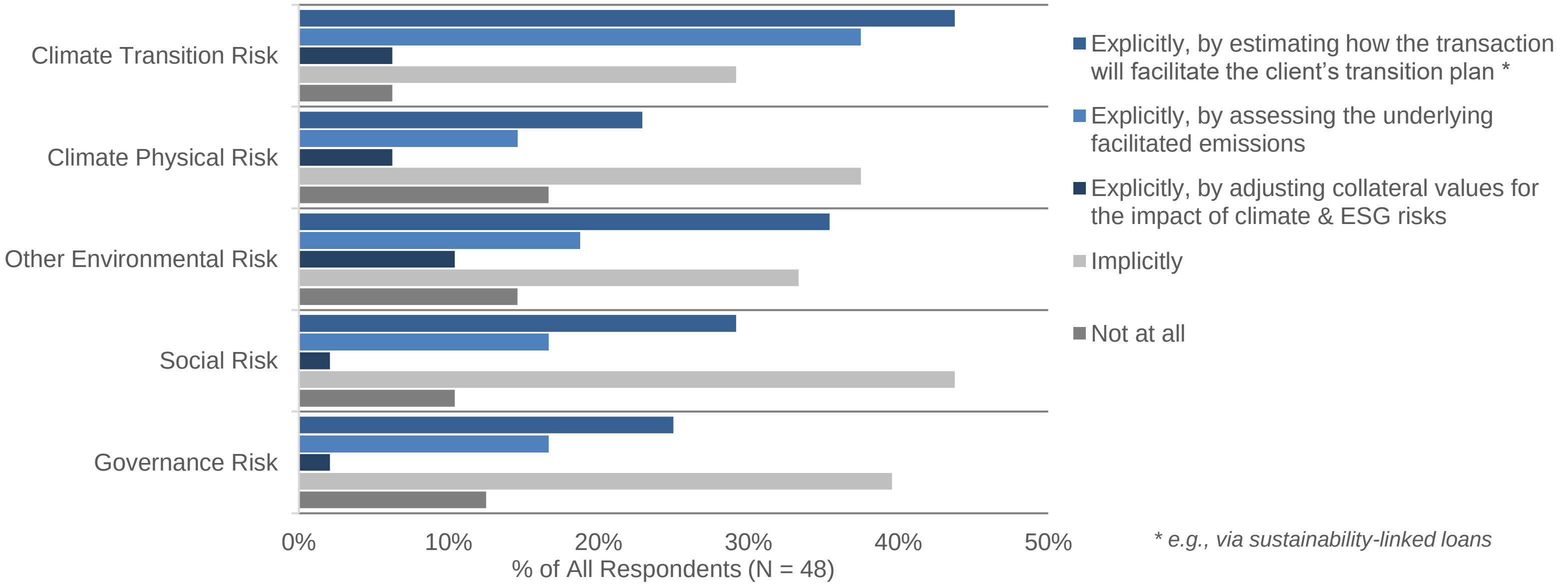
Utilization of Climate & ESG Risk Criteria in Transaction Level Decision-Making

In transaction level decision-making, climate transition risk criteria are often utilized explicitly, by either estimating how a transaction will facilitate a client's transition plan or by assessing the underlying facilitated emissions. Climate physical risk criteria as well as other ESG risks are utilized more often implicitly.



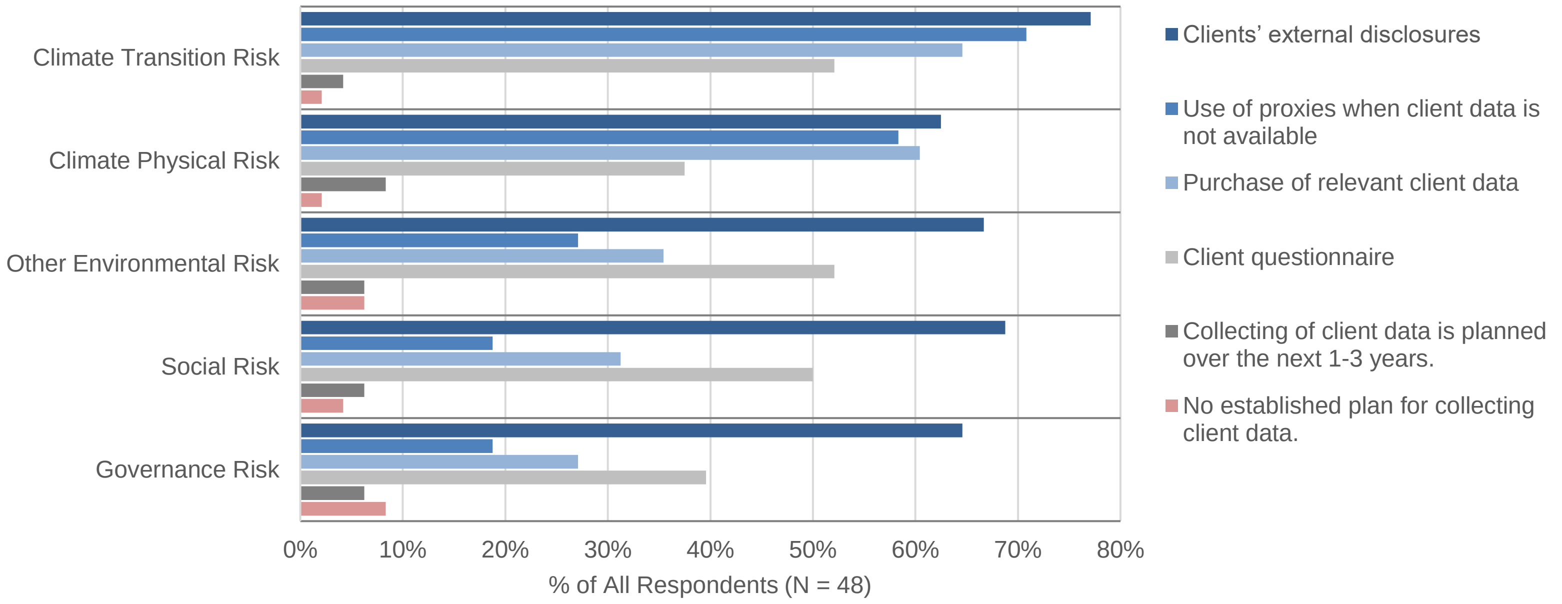
** e.g., via sustainability-linked loans*

Source: IACPM Research ESG Survey Series 2022/2023: Linking Climate & ESG to Decision-Making and CPM
Question: To what extent does your firm utilize Climate & ESG risk criteria in transaction level decision-making? Check all that apply. (Q4)

Approaches for Collecting Climate & ESG Related Client Data

By ESG Risk Type

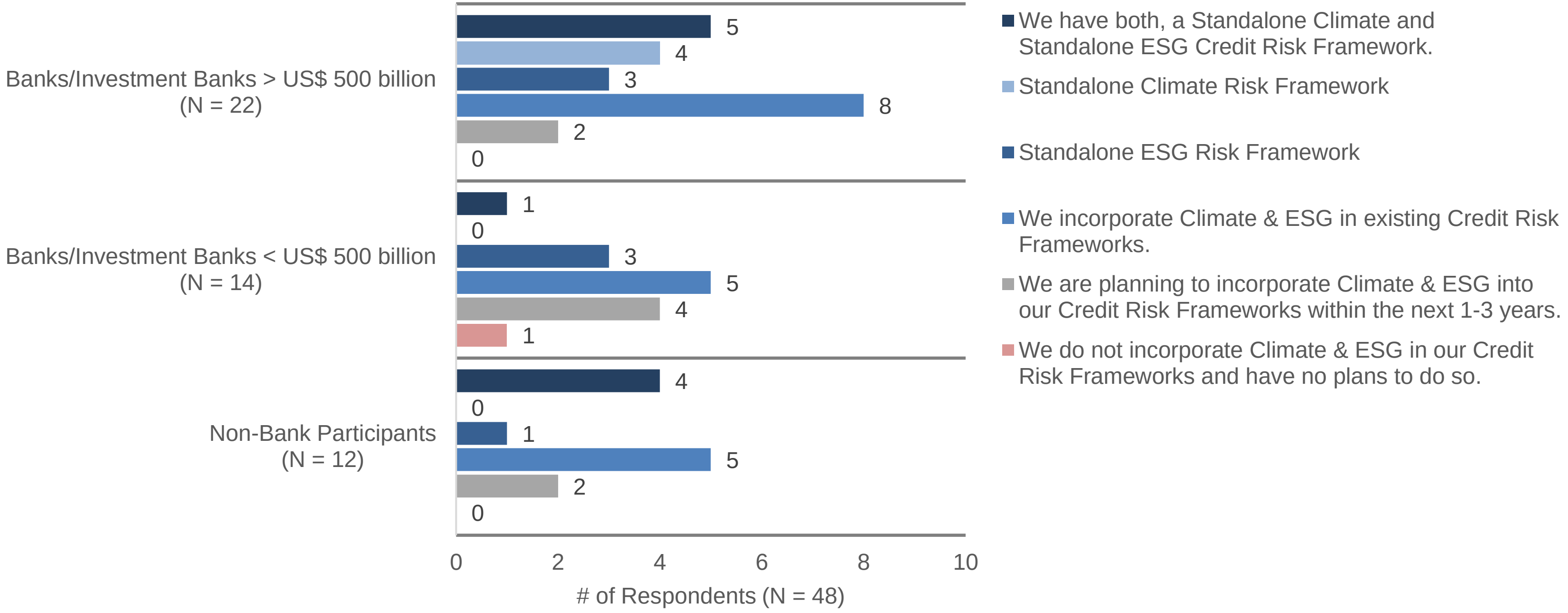
Across all ESG risk types, clients' own external disclosures are the preferred source for climate & ESG related client data. For climate transition and climate physical risks, firms purchase relevant data and utilize proxies when data is not available. Only a very small number of participating banks are not yet collecting climate & ESG related client data.



Source: IACPM Research ESG Survey Series 2022/2023: Linking Climate & ESG to Decision-Making and CPM
Question: What is your firm's current approach to collecting Climate & ESG related client data? Select all that apply. (Q9)

Climate and/or ESG Credit Risk Frameworks

More than half of participating larger banks have established a standalone climate and/or ESG credit risk framework, while some two-thirds of smaller and non-bank participants are incorporating or are planning to incorporate these risks into existing credit risk frameworks.



Source: IACPM Research ESG Survey Series 2022/2023: Linking Climate & ESG to Decision-Making and CPM
Question: Does your firm have a standalone Climate and/or ESG Credit Risk Framework? (Q14)

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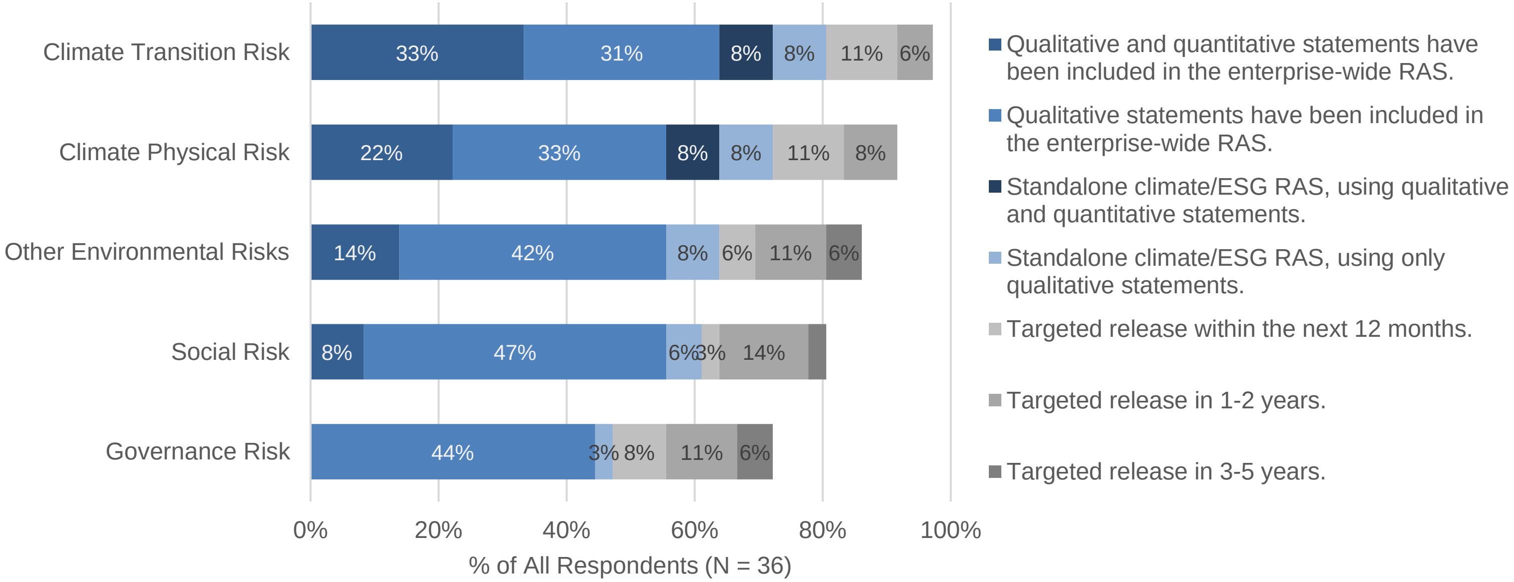
Climate & ESG Integration in Risk Appetite Statements

While standalone climate & ESG RAS are the exception, existing enterprise-wide Risk Appetite Statements capture qualitative or quantitative climate transition risk metrics at two-thirds of responding banks globally. One-third of banks - mostly larger institutions – capture qualitative and quantitative climate transition risk metrics. For other ESG risks banks rely more heavily on qualitative metrics only.

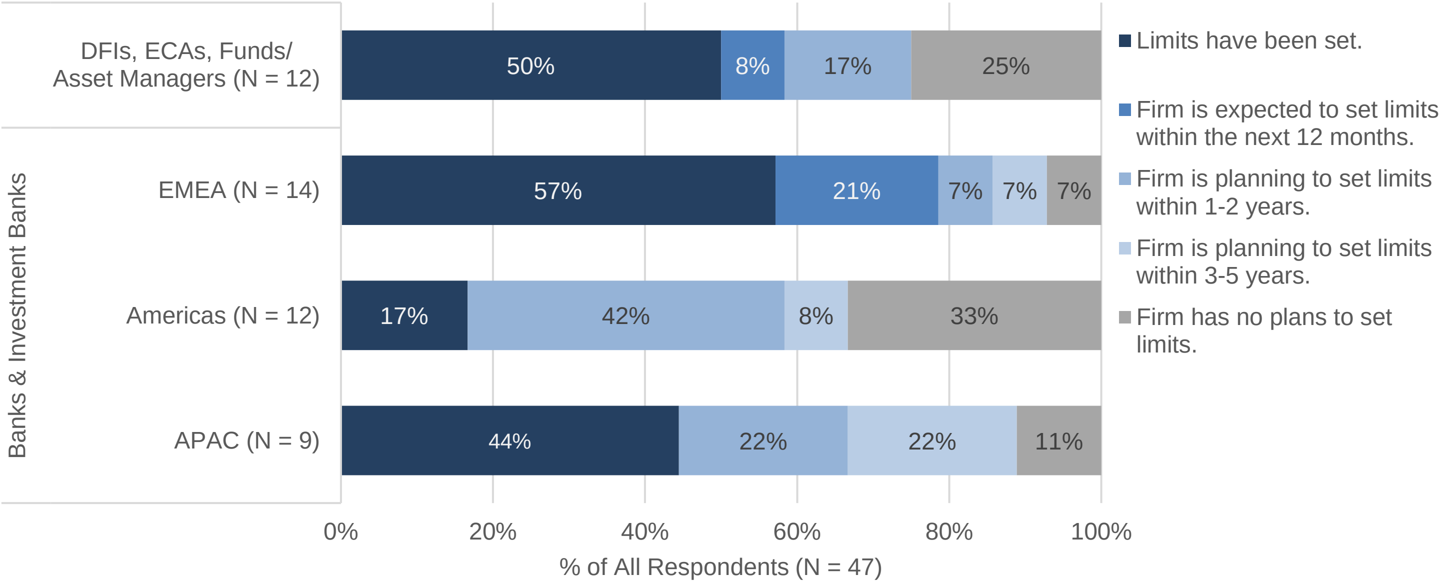
Banks & Investment Banks Globally



Source: IACPM Research ESG Survey Series 2022/2023: Linking Climate & ESG to Decision-Making and CPM | Question: Does your firm have a standalone enterprise-wide Climate & ESG Risk Appetite Statement (RAS) or has your firm included Climate & ESG metrics in existing Risk Appetite Statements? (Q16)

Carbon/Emission Targets

Carbon/emission targets have been established, or will be established within the next twelve months, at three-quarters of responding banks domiciled in EMEA and are at least partly driven by firms' sustainability commitments, including the Net-Zero Banking Alliance (NZBA) commitment. This is almost double compared to banks domiciled in APAC and five times more than for banks domiciled in the Americas.

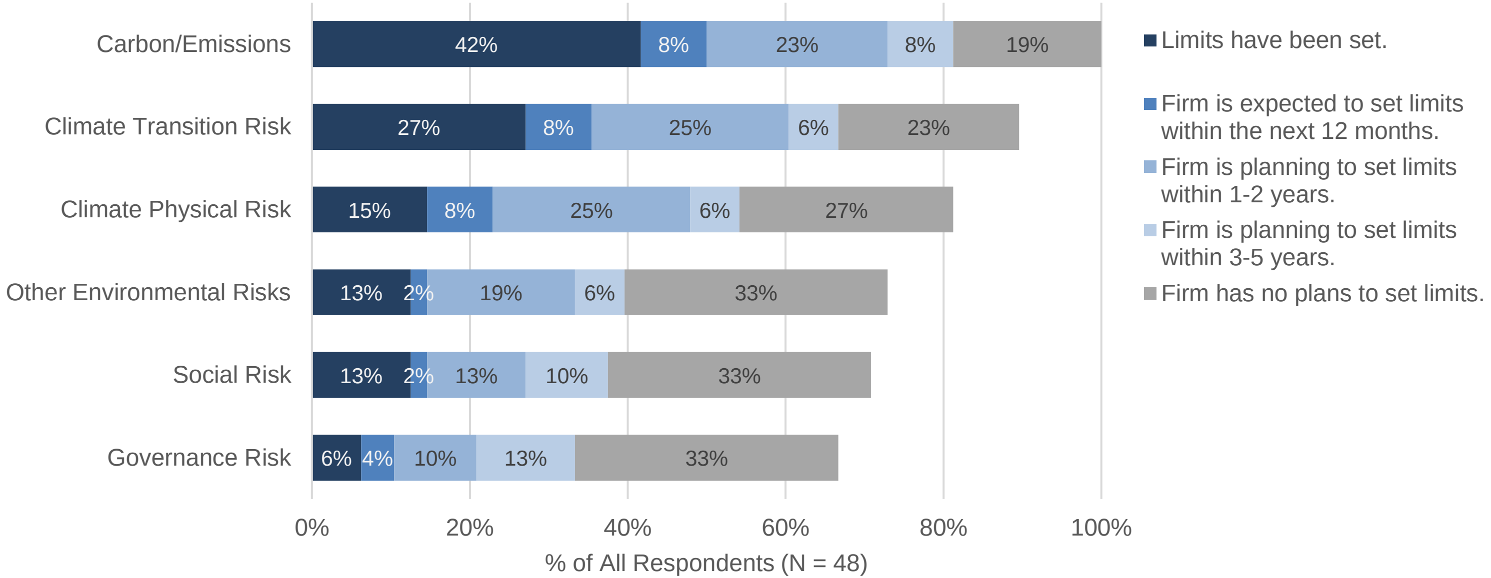


Source: IACPM Research ESG Survey Series 2022/2023: Linking Climate & ESG to Decision-Making and CPM | Question: Has your firm established Carbon, Climate & ESG risk Limits? Please indicate if limits have been set for carbon/emissions, climate transition, climate physical, other environmental, social, and/or governance risks. (Q18)

Limits/Targets for Carbon/Emission, Climate & ESG Risk

While carbon/emissions targets have been established at 42% of the responding firms, climate transition risk limits have been set at 27% of firms. For the remaining four ESG risks, limits have been established by only a small group of firms and some 30% of respondents cite no plans to do so any time soon.

Respondents Globally



Source: IACPM Research ESG Survey Series 2022/2023: Linking Climate & ESG to Decision-Making and CPM | Question: Has your firm established Carbon, Climate & ESG risk Limits? Please indicate if limits have been set for carbon/emissions, climate transition, climate physical, other environmental, social, and/or governance risks. (Q18)

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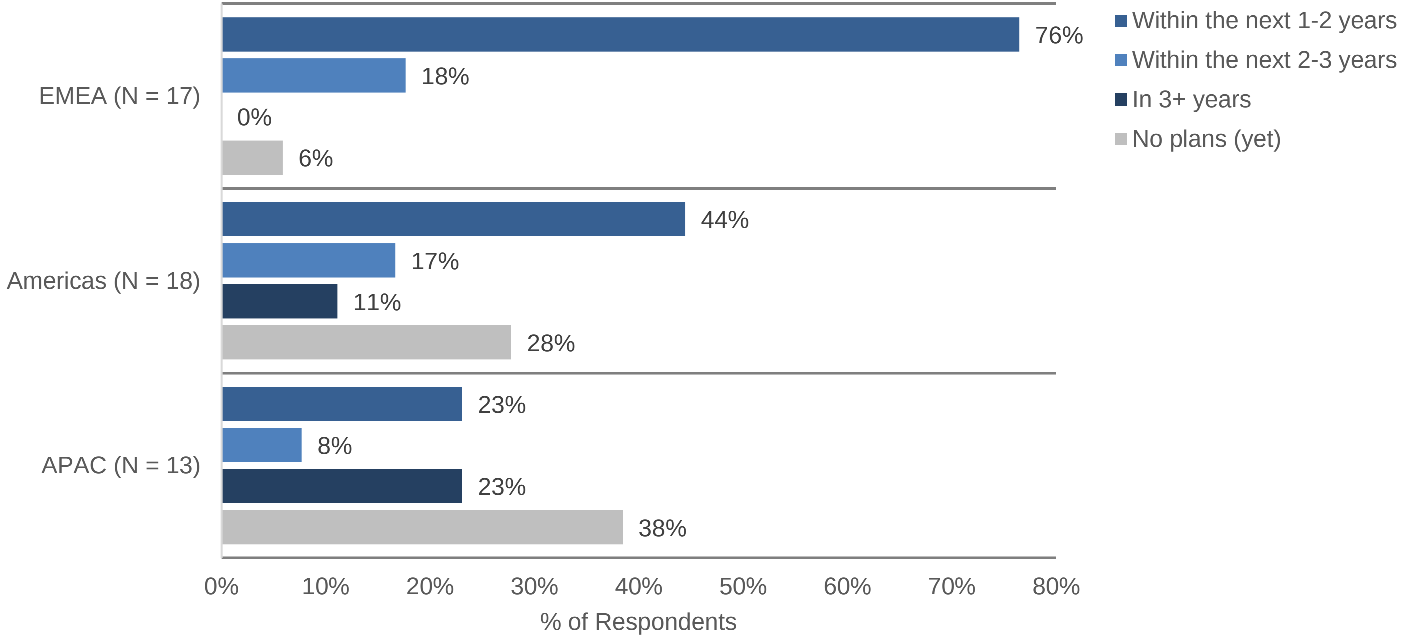
Incorporating Climate Risk Considerations into Financial Planning

Three-quarters of responding firms domiciled in EMEA are planning to incorporate climate risk considerations into financial planning within the next 1-2 years, while for their peers in APAC and the Americas this number is less than half. Interestingly not much variation can be observed across type and size of the participating institutions.



Source: IACPM Research ESG Survey Series 2022/2023: Linking Climate & ESG to Decision-Making and CPM
Question: Does your firm have any plans to incorporate climate risk considerations into financial planning (revenues, reserves and/or capital projections)? (Q24)

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