Sustainability Blog

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ECB Takes a Stand Against Climate Risk Laggards

Final call: ECB imposes financial penalties and announces additional enforcement measures for banks that lag in climate risk management

ECB board member Frank Elderson announces financial penalties and more for banks lagging in climate risk management emphasizing the urgency to address deficiencies.

In his latest speech on 7th December 2023, ECB board member Frank Elderson stated that, beyond fines, the ECB possesses an array of enforcement tools, with the ability to escalate penalties on a scale towards entities falling behind in addressing climate risks.

Already on 14th November 2023, Elderson announced that the ECB started to adopt enforcement measures. Subsequently it was reported that around 20 major banks have received letters in the past two months indicating potential fines if they fail to rectify climate risk-related deficiencies within specified timeframes, with penalties potentially amounting to 5% of daily average revenue.

For now, the identified shortcomings relate to the insufficient categorization of climate and environmental risks and the failure to conduct a comprehensive assessment of their impact on the banks' activities. The completion of these assessments was anticipated to occur no later than March 2023 as this was the first deadline for the first step of implementation of the ECB expectations which was communicated by the ECB in November 2022.

In that speech Elderson explained: “We have told those banks to remedy the shortcoming by a certain date and, if they don’t comply, they will have to pay a penalty for every day the shortcoming remains unresolved”.

“It is a step that we do not take lightly,” he added. “It is not about forcing banks to do something that is merely nice to have. It is about compelling banks to manage material financial risks adequately and in a timely manner.”

The ECB's frustration due to banks' hesitancy in addressing climate change risks has grown. Elderson noted that several banks failed to conduct a sufficient materiality assessment of climate risks in their portfolios, which he identified as the fundamental starting point for managing any form of risk. Those banks that undertook such assessments discovered significant risks.

Elderson highlighted various areas where banks have been slow to act, signaling a potential stern approach in addressing weaknesses. These areas include internal governance, data aggregation and reporting, risk management, and sustainability business model.

It is implicitly suggested that banks should enhance and refine their approach to climate and environmental risk management as they accumulate more data, including information gathered from their customers. This underscores a continuous process of evolving the approach, gradually shifting towards a higher proportion of quantitative assessment rather than qualitative assessment.

Now, the ECB emphasizes the possibility of additional enforcement measures for banks that lag in climate risk management. Elderson highlighted the diverse set of potent tools available to the ECB, citing binding supervisory measures outlined in Article 16 of the SSM Regulation. Qualitative requirements empower the ECB to reinforce arrangements, restrict business operations, demand divestment of risky activities, and more.

What’s next?

As per ECB deadlines set in November 2022, in a second step, and at the latest by the end of 2023, the ECB expects banks to include climate and environmental risks in their governance, strategy and risk management. In a final step, by the end of 2024 banks are expected to meet all remaining supervisory expectations on climate and environmental risks outlined in 2020, including full integration in the Internal Capital Adequacy Assessment Process (ICAAP) and stress testing.

Thus, banks need to push the enhancement of their risk management processes further and should take the deadlines of the ECB seriously.

It's noteworthy that the ECB to date has never enforced periodic penalty payments on a bank. Despite issuing threats, all banks subjected to such warnings have promptly complied with the ECB's requirements within the specified timeframe.

Banks that are affected by the ECB’s recent warnings should focus on the comprehensive integration of climate and environmental risks within the next months showing major improvements and at the same time be aware of the steps that will follow the assessments within risk management.

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