February 14, 2022

Via electronic mail

Mr. Pablo Hernández de Cos, Chair
Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Re: IIF Public Comment on BCBS Consultative Document on Principles for the effective management and supervision of climate-related financial risks

Dear Mr. Hernández de Cos:

The Institute of International Finance (IIF) and its members, which broadly represent the global financial services industry, appreciate the opportunity to provide public comments to the Basel Committee on Banking Supervision (BCBS) on its Consultative Document on *"Principles for the effective management and supervision of climate-related financial risks"*[1] (hereafter "the consultation"). The IIF is the global association of the financial industry, with more than 450 members from over 70 countries, including commercial and investment banks, asset managers, insurance companies, ratings agencies, market infrastructure providers, and professional services firms.

Our feedback is structured in three parts: (1) overarching messages, which are relevant to all the consultation questions, and specifically to Consultation Questions 1 and 2; (2) specific feedback on the draft principles, which responds to Consultation Question 2; and (3) reflections on the transmission of broader environment-related financial risks to banks' risk profiles, which responds to Consultation Question 3.

1. Overarching Messages[2]

The IIF appreciates the Basel Committee's comprehensive and analytical approach to considering the implications of climate-related risks for individual banks, the wider banking system, and the prudential framework. This includes the Committee's analytical reports and ongoing analysis of the extent to which climate-related risks can be addressed within the Basel Framework, spanning the regulatory, supervisory, and disclosure dimensions. More information about the progress of the Committee's investigations into the sufficiency of the Basel Framework for addressing climate-related risk drivers would be welcomed by the industry, given the impact that work will inevitably have on the BCBS's and jurisdictional authorities' future approaches. Additional information about how the final principles for effective management and supervision of climate-related risks will fit into the BCBS's framework review would be helpful, as would an indication of whether the BCBS intends to

[1] https://www.bis.org/bcbs/publ/d530.pdf.
[2] Specifically related to Questions 1 and 2 in the consultation.

reassess the principles at a future date as knowledge, data, and tools related to climate risks mature.

Supervisory engagement, risk management guidance, disclosure, and scenario analysis exercises are core tools that supervisors can use to approach climate-related and environmental risks. Taken in aggregate, and with a firm foundation in data, these could provide an effective toolkit for both the banking industry and prudential authorities to measure, manage, and help mitigate climate-related risks.

The IIF welcomes a global principles-based approach in these areas to strengthen coordination and harmonization of supervisory efforts globally, which would support progress on climate-related risk management. The BCBS has a unique role in terms of developing principles for the supervision of climate-related risks in order to promote an internationally harmonized approach to supervisory engagement. As summarized in reports by the Network for Greening the Financial System (NGFS)[3] and others, numerous jurisdictional authorities have already moved ahead to develop and implement prudential responses to climate-related risks and opportunities that face the banking, and broader financial, sector.[4] It is encouraging that many authorities are seeking to move swiftly on these extremely important and pressing topics; however, an uncoordinated and rapid proliferation of new policies – given significant uncertainties and knowledge gaps – could create a fragmented, and potentially less effective, policy landscape. **Steps towards greater policy and supervisory coordination are particularly important with respect to cross-border banking institutions, many of which are currently facing a multitude of differing supervisory expectations and requirements.** While full alignment of supervisory approaches may never be achieved, the BCBS could set out clearer expectations on how the home/host supervisory relationship could work through challenges should there be residual differences in jurisdictional approaches.

In addition to supporting the coordination and harmonization of supervisory approaches, the BCBS can also engage with the banking industry to develop principles for the effective management of climate-related risks; while common general principles are helpful, it is important that they are used and referenced by supervisors in a way that permits each bank to implement them proportionately. Such an approach should be accommodating enough to recognize that a variety of practices can be appropriate for managing risks and that banks' current risk management frameworks, which vary, can be leveraged to do so. It is important that the BCBS principles addressed to banks are used and referenced by jurisdictional supervisors in a proportionate way. We agree with the BCBS's observation that *"banks are potentially exposed to climate-related financial risks regardless of their size, complexity or business model"* (para. 8). However, a range of factors can affect the materiality of certain climate-related risk drivers as sources of microprudential risk, such as a bank's business model and portfolio, geographical footprint, and general risk profile. **Our members do not consider overall bank size to be a good measure of exposure to material climate-related risks**, although size may in some cases be linked to a bank's resources and capacity (with respect to personnel, modelling, and data acquisition) which may influence the speed with which they are able to respond to climate-related risk drivers. **More generally, it**

[3] NGFS 2021, "*Progress Report on the Guide for Supervisors*", October (hereafter referred to as "NGFS (2021)".

[4] In this letter we will refer to a recent consultation released by the U.S. Office of the Comptroller of the Currency (OCC) on "*Principles for Climate-related Financial Risk Management for Large Banks*" (December 16, 2021). These will, hereafter, be referred to hereafter as "OCC (2021)".

would be helpful for the BCBS to provide additional clarification – for example, in paragraph 6 and principle 16 – on what proportionate application means in relation to the supervision of foreign subsidiaries and branches. On this, we would suggest that host supervisors consider the characteristics and potential climate-related risk exposures of the local entity rather than defaulting to a certain treatment based on overall group size.

In some respects, the proposed BCBS principles reflect a set of 'end-point' expectations in terms of banks' practices. However, it is important that near-term supervisory expectations recognize that:

(a) **financial institutions are working to overcome several challenges at present which influence the maturity of their approaches with respect to climate-related risk drivers.** These include: securing relevant and high-quality data; choosing and developing appropriate methodologies and metrics; and integrating and mainstreaming new data and metrics into decision-making. The data and tools to measure and quantify climate-related financial risks remain nascent and not fully developed. These challenges have been widely recognized by global standard-setting bodies and individual jurisdictions,[5] including the Financial Stability Board (FSB) in recent reports[6] and its *Roadmap for Addressing Climate-related Financial Risks*.[7] Working within the constraints of these challenges, and working to overcome them, will require a multi-year effort as banks try to identify and assess climate-related risks and build a better understanding of how they relate to financial impacts across different risk stripes (credit, market, liquidity, etc.).

(b) rapid increases in the scope and volume of regulation and supervisory expectations, which are underway in many jurisdictions, can redirect banks' resources from internal analysis and capacity building. For example, numerous supervisory authorities are currently piloting supervisory climate scenario analysis exercises, with significant variation in terms of their objectives, methodologies, time horizons, firms and risks in scope. Global banks may be subject to differing exercises across jurisdictions, which require significant resources to engage with, at the same time as they are working quickly to develop their capabilities to identify, measure, and mitigate climate-related financial risks. For banks to engage with and make the necessary progress across these multiple fronts requires significant financial and human resources. Greater regulatory and supervisory stability and, to some extent, phasing is important to ensure that financial institutions can plan and allocate resources efficiently in order to deliver effective changes that support safety and soundness; the BCBS can help provide such stability for the banking industry at the global level.

It would, therefore, be helpful for the BCBS to provide more guidance and clarity on how their principles can be implemented in a phased-in manner, recognizing the possibilities and limitations at any time. It is apparent that expectations and practices will evolve and

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[5] Bank of England Prudential Regulation Authority 2021, "*Climate-related financial risk management and the role of capital requirements: Prudential Regulation Authority Prudential Regulation Authority*" (October), pp. 12-13; BCBS (2021), "*Climate-related financial risks – measurement methodologies*" (April), hereafter referred to as "BCBS (2021a)"; FSB (2021), "*The availability of data with which to monitor and assess climate-related risks to financial stability*" (June), hereafter referred to as "FSB (2021)"; IMF 2021, "*Staff Climate Notes: Strengthening the Climate Information Architecture*" (September); NGFS 2021. "*Progress report on bridging data gaps*" (May).

[6] FSB (2021).

[7] FSB 2021, "*FSB Roadmap for Addressing Climate-Related Financial Risks*" (July).

mature as experience is developed and the above-mentioned foundational elements come into place. A common international timeline and interim milestones for phased supervisory expectations, which are dynamically reassessed, could provide a useful anchor and greater regulatory certainty.

Furthermore, considering the global impact of BCBS standards and principles – even beyond those jurisdictions which are direct members of the Basel Committee – **it would be valuable for the Committee to consider to what extent these draft principles may be applicable to banks in emerging markets and developing economies (EMDEs)** in particular. Further guidance and engagement by the BCBS in this regard (for example, in regional outreach events) – accounting for the specific challenges that banks in EMDEs may face and the high degree of cross-jurisdictional variation across EMDEs (in terms of climate-related risk exposure, economic structure and level of development) – could support the acceleration of sound climate risk management practices across the world.

Principles addressed to Supervisors[8]

Specific drafting feedback on the individual principles is provided in Section 2 below but, overall, the proposed principles for supervisors seem to provide a helpful basis to start discussions on the coordination of supervisory approaches across jurisdictions, provided that the proposed principles for banks are modified as suggested below given the interplay between supervisory expectations and bank practices. Several jurisdictions, including the European Union, Hong Kong, Singapore, and the United Kingdom to name a few, have already issued supervisory expectations for climate-related risk management. Other jurisdictions, including Japan and the United States, are currently working on developing supervisory expectations for banks. It is valuable that the BCBS recognizes this existing body of work in the consultation as it is important that the enduring global work on this topic serves to coordinate the many ongoing jurisdictional approaches. **It is equally valuable that individual jurisdictions engage in the process of multilateral discussion to develop, and later refine and adapt, BCBS principles with a view to ultimately accommodating those global principles within their jurisdictional frameworks** to harmonize, as far as possible, jurisdictional supervisory approaches in this important and complex area.

We also strongly support an emphasis on supervisory cooperation and collaboration, including between home and host supervisors bilaterally and in supervisory colleges. The draft principles could in fact place greater emphasis on opportunities for information sharing and collaborative work, and for deference between supervisors, in relation to climate-related risks, in addition to what is already mentioned under draft principle 16 (para. 56) and draft principle 18 (para. 65). Additional text would be welcome to provide principles-based guidance on how the home/host supervisory relationship could work through challenges should there be residual differences in jurisdictional approaches.

The principles place significant emphasis on climate-related risk scenario analysis as a tool for both banks and supervisory authorities. Many IIF member banks agree that scenario

[8] For the purposes of structuring our overarching messages, we have provided high-level comments on the principles addressed to supervisors first and on the principles addressed to banks second, although these are organized in the reverse order in the draft BCBS principles. Section 2 includes detailed drafting comments on the draft principles in chronological order.

analysis exercises, including supervisory learning exercises, can play a critical role in enhancing understanding of the dynamics of future climate-related risks. However, as the BCBS recognizes in the consultation, scenario analysis practices are at a nascent stage and, although developing quickly, remain a highly complex and challenging pursuit.

IIF members generally agree with the Committee's technical perspectives on climate scenario analysis, although we believe that the final principles ought to distinguish more clearly between climate scenario analysis and climate stress testing. While scenario analysis and stress testing tools have things in common – both are forward-looking and involve the use of scenarios to estimate financial impacts – there are important differences between the two tools, which affect their uses, design, and potential applications in a prudential context[9]. Specifically, IIF members consider climate scenario analysis to be a forward-looking risk measurement tool to assess the potential for climate-related risk drivers to give rise to financial stability or institution-specific financial risks under a plausible range of medium to long-term scenarios. Climate stress testing, however, is the assessment of a financial institution's balance sheet resilience, or financial system-wide resilience, to climate-related risks that could plausibly crystallize over the near-term business planning horizon. **Both climate scenario analysis and climate stress testing are distinct from traditional macro-financial stress testing, which typically assesses the potential impacts of transitory shocks to near-term economic and financial conditions.[10]**

It is helpful that under principle 18 (para. 60) clear statements are provided regarding the potential objectives for supervisor-conducted scenario analysis, and that a differentiation is made (para. 61) between the use cases of long-term scenario analysis which involve higher levels of uncertainty (such as gauging exposure to structural economic and financial system changes) as opposed to analysis over shorter time horizons (such as assessment of potential impacts on capital adequacy). In addition, IIF members appreciate that the Committee has recognized the value of accounting for uncertainty in the use and disclosure of analytical results, and the value in supervisors coordinating and sharing the findings of their climate scenario analysis work with other supervisors to foster efficiency, transparency, and decision-useful exercises. We also support the encouragement for supervisors to collaborate with a broad and diverse set of stakeholders, including the climate science community, to keep up with relevant developments outside of the banking sector so that supervisors take account of the broader scientific, macroeconomic, and policy context as part of bank supervision, supervisory climate scenario analysis, and/or climate stress testing.

In the context of supervisory climate scenario analysis exercises, additional coherence across jurisdictions in terms of key exercise design choices (including scenarios, scope, format and specification, key modelling assumptions, and outputs) **via common principles-based standards would be highly beneficial to improve the interpretability and comparability of results**. While there are many benefits of greater alignment in terms of how supervisory exercises are approached and conducted, and in the development of some common technical approaches (for example, in terms of core metrics to present results), a degree of jurisdictional and/or regional specificity and flexibility in these exercises is still

[9] This is further discussed in IIF 2021, "*Navigating Climate Headwinds: Reference Approaches for Scenario-based Climate Risk Measurement by Banks and Supervisors*" (July), hereafter referred to as "IIF 2021."

[10] As described in OCC (2021), page 4.

important to account for geographical differences in climate-related risk drivers, economic and financial system structures, and differences in policy approaches.

However, additional clarifications by the BCBS, including on the potential links between such exercises and the broader prudential toolkit, may be warranted. It would be helpful for the BCBS to clarify the meaning of "short," "medium," and "long" term in the context of its principles, as jurisdictional supervisors employ different definitions. Further, we believe that **supervisory exercises should be differentiated from other prudential activities or applications until data, tools, and understanding have improved to the point at which results are more meaningful and comparable across participating financial institutions.** Specifically, **it would be very helpful for the BCBS to clarify that it would not be appropriate at this stage for climate scenario analysis exercises or climate stress tests to influence the internal capital or liquidity adequacy assessment processes or capital/liquidity requirements** since the foundations are not in place with respect to technical knowledge, conceptual foundations, data, and/or modelling tools. While this fact has been recognized by several jurisdictional authorities so far,[11] additional clarifications on this from the BCBS would be welcome to bring about greater alignment in approaches across jurisdictional exercises going forward. In terms of the outstanding conceptual questions in this area, there are issues with setting capital requirements – which are intended to be a cushion against unexpected losses that could occur in the near-term – for those climate-related risks that could materialize over decades. In addition, the numerous assumptions needed and degree of uncertainty in climate scenario analysis and climate stress testing, particularly over longer time horizons, makes such exercises generally indicative of risks, rather than sufficiently robust to inform prudential requirements for individual institutions; therefore, caution is required to avoid misestimation or coming to misleading conclusions given the importance of the issue.[12]

Developing an initial set of BCBS Principles or Sound Practices for supervisory climate scenario analysis could help set a useful baseline for common approaches in supervisory exercises. These could provide guidance regarding the near-term and potential future relationship between supervisory exercises and the prudential framework, and on technical aspects of supervisory exercise design and execution (for example, the scope of application of jurisdictional exercises, level of consolidation, deference principles, information sharing in supervisory colleges, protocols to standardize data proxying and model assurance, etc.). Such Principles or Sound Practices should also support a principles-based approach to banks' climate scenario analysis. Recognizing the dynamically evolving nature of this field of analysis, these would need to evolve and be refined over time on the basis of shared public/private experience. Related to this, **the BCBS could also play a role in helping to streamline supervisory exercises across jurisdictions** – for example, by facilitating information sharing about the lessons learnt from various supervisory exercises.

[11] For example, see ACPR 2021, "*A first assessment of financial risks stemming from climate change: The main results of the 2020 climate pilot exercise*" (June); EBA 2021, "*Mapping climate risk: Main findings from the EU-wide pilot exercise*" (May); MAS 2021, "*Financial Stability Review*", Special Feature 2 on "Climate Transition Risk Exposure of Singapore's Banking and Insurance Sectors" (December); Bank of Canada and OSFI 2022, "*Using scenario analysis to assess climate transition risk*" (January).

[12] IIF 2021. The BCBS recognizes the analytical limitations associated with this measurement uncertainty throughout the draft principles.

We note the reference in draft principle 17 to regulatory reporting, and the comment that current reporting may need to be expanded to include additional information from banks. **IIF members believe that further discussion between Basel Committee members and the banking industry would be beneficial on the topic of regulatory reporting, including its relationship to Pillar 3 disclosures and other climate-related disclosure requirements and expectations for banks.** For example, the global standards being developed now by the International Sustainability Standards Board (ISSB) for climate-related disclosures may provide some useful inputs to regulatory reporting needs. The industry would welcome an opportunity to further discuss this topic at the global level to prevent fragmentation of jurisdictional approaches to regulatory reporting, which some authorities have already started to design and specify in some detail.

Principles addressed to Banks

Overall, the proposed principles for banks – after some modifications as suggested here and in Section 2 below – align with the direction of efforts within the banking sector in recent years to develop a more systematic understanding of, and response to, climate-related risks and opportunities. As discussed by the BCBS, many banks are increasingly accounting for climate-related risks as potential risk drivers that interact with the "classical risks" banks manage, including credit, market, operational, liquidity, and legal risks. More broadly, many banks have started to actively engage with their clients and counterparties to better understand their climate-related risk profiles, transition strategies, and adaptation plans.

In relation to corporate governance, draft principle 2 requires the board and senior management to clearly assign climate-related responsibilities to members and committees. In our view, this principle as drafted could run counter to the general principle of collective accountability of the board and conflict with the provisions of some national laws. **A central tenet of effective corporate governance is the distinction between, and complementary nature of, the board of directors' responsibility for oversight of the business and affairs of the bank, and management's responsibility for the day-to-day operations of the organization.** Any blurring of this distinction could detract from effective governance by potentially reducing the board of director's ability to perform its oversight role objectively and creating uncertainty as to roles and responsibilities. All the members of the board of directors are inherently accountable for all the functions assigned to it as they are all, collectively, part of the decision-making process with the same rights and responsibilities. For this reason, we consider that this specific recommendation should be modified to accommodate the intrinsic characteristics of the board of directors. Separately, supervisors should have the discretion to apply the spirit of the principles in the context of their jurisdiction's corporate governance laws (for example, where dual board systems are used by banking institutions).

Also, in relation to corporate governance, it is important that the BCBS principles (e.g., draft principles 2 and 3) clearly recognize that **climate-related responsibilities may be assigned to an existing committee of a bank (e.g., risk committee) or members within an existing committee**, as opposed to requiring the creation of a committee(s) specifically focused on climate-related financial risks.

In relation to a bank's internal control framework, draft principle 4 asks banks to incorporate climate-related financial risks across the three lines of defense. While we support this objective,

it is important that sufficient time is allowed for a full implementation of climate risk within each line of defense, and that the unique role that each line of defense plays in the internal control framework is recognized when it comes to incorporating climate-related risk considerations. For example, the language in paragraph 18 describing the front line is not entirely accurate as credit review, portfolio review, and the risk management process are undertaken by the second line of defense.

A specific challenge which ought to be reflected in the principles relates to banks' approaches for quantification of climate-related risks, and how these quantifications could in turn affect evaluation of bank capital or liquidity adequacy. Draft principle 5 seems to imply that banks are able to incorporate climate-related risks into the internal capital adequacy assessment process (ICAAP) and internal liquidity adequacy assessment process (ILAAP). While banks are taking steps to identify, understand and respond to climate-related risk drivers, **we believe it is premature to quantitatively incorporate climate-related risks into formal assessments such as the ICAAP and ILAAP.** Some of the reasons for this are acknowledged elsewhere in the draft BCBS principles, for example paragraph 23 related to principal 5[13] and paragraph 41 related to principle 12.[14] Specifically, at this stage, the precise relationship between risk drivers and actual risk levels for capital and liquidity adequacy cannot be precisely quantified as the following are still lacking:

(i) the required available and reliable data inputs, whether sourced internally and/or from reliable external sources;
(ii) the required methodologies, which are still a work in progress. Methods for integrating climate-related risk drivers need to be defined and implemented by banks as deemed adequate for internal economic risk monitoring and decision-making purposes.

Moreover, there are still a number of uncertainties as to the evolution of climate changes (e.g., their speed, magnitude, non-linear effects) and physical and transition risk drivers (e.g., climate policies, technology, investor and consumer behaviors), as summarised by the Basel Committee in section 2 of its April 2021 report, "*Climate-related risk drivers and their transmission channels,"* which compound the difficulties at this stage in drawing analytical conclusions about financial risks, such as assessing whether there could be any capital or liquidity impacts. These uncertainties should not simply be interpreted as necessarily implying higher capital or liquidity impacts, and it is important not to prematurely emphasize quantification of financial impacts given the important open conceptual, data and methodological questions which need to be addressed.

Several intermediate steps would need to be completed, and outstanding issues resolved, before quantitative integration of climate-related risks into the holistic assessment of risks to capital and liquidity could be considered. In addition to improvements in data availability and risk modelling, analysis is also required on how to coherently reconcile potential longer-term risks with the time horizon embedded in the prudential framework. On this, we welcome the Basel Committee's recognition that only "risks

[13] "*It is recognised that climate-related financial risks will probably be incorporated into ICAAPs and ILAAPs iteratively and progressively, as the methodologies and data used to analyse these risks continue to mature over time and analytical gaps are addressed."*

[14] *"Banks may explore the use of stress testing to assess the adequacy of their financial positions in the near term under severe yet plausible scenarios, though these capabilities are expected to mature more progressively over time as methodologies evolve." (Emphasis added.)*

assessed as *material* over *relevant time horizons*" (paragraph 21, emphases added) should be incorporated into ICAAP and ILAAP processes; however, more research and analysis is needed to make assessments of materiality and to reconcile the time horizons of potential risks with the time horizons reflected in the prudential framework. **There is a risk that a premature emphasis, or overemphasis, on the inclusion of climate-related risks into the ICAAP or ILAAP could generate unintended consequences**, for example incentivizing banks to rapidly divest their exposures to sectors that will remain vital to the Net Zero economic transition rather than working with their clients to encourage transition-necessary investment and adaptation.

Therefore, a degree of coordinated phasing in supervisory expectations would be appropriate, with a focus on securing a firm foundation in terms of banks' governance and risk management approaches, before moving to consideration of incorporation into the formal ICAAP and ILAAP processes; this is an area on which global supervisory recognition and coordination is especially important. This would also ensure that ICAAP and ILAAP assessments remain rigorous and empirically based. Specific wording suggestions in relation to draft principle 12 are provided in Section 2 of this response.

Nevertheless, the IIF strongly welcomes the Committee's intention to take a risk-based approach when considering how climate-related risks should be reflected within the ICAAP and ILAAP processes. This would be consistent with the general BCBS approach to Pillar 1 and Pillar 2 capital and liquidity standards, which are intended to be risk-based and data-driven, and should reduce the risk of unintended consequences stemming from the prudential regime.

We also agree with the reference in principle 12 to the fact that banks can make use of climate scenario analysis to diagnose data and methodological limitations in climate risk management, and inform the adequacy of their risk management framework, including risk mitigation options. In the near-term, this can be a very important objective of climate scenario analysis and can help to lay the foundations for more advanced analysis later when better data and tools are available.[15] In general, a principles-based approach to banks' climate scenario analysis, which can leverage common standards, can allow for comparability of industry practices while offering individual banks the flexibility to develop and consider different scenarios and analytical techniques most appropriate for their own businesses and risk management. For example, some banks have found that focused analysis of their largest counterparties, or of particular sectors, has been informative for risk management purposes in their businesses. Recognizing the multiple possible objectives of these tools (which are set out in draft principle 12), it is important that banks have flexibility to explore the range of relevant applications of climate scenario analysis and/or climate stress testing for their own businesses.

With respect to the **risk management process**, as discussed in draft principle 6, IIF members agree on the importance of identifying, monitoring, and managing potentially material financial risks driven by climate-related risk drivers. However, scope should be allowed for individual banks as to whether, how, and to what extent they incorporate these considerations into their risk appetite framework and adopt specific measures such as internal limits; we

[15] We note that this was also recognized in the recent OCC consultation – OCC (2021), page 4: *"In the near term, a climate-related scenario analysis framework can also assist the bank in identifying data and methodological limitations and uncertainty in climate risk management and informing the adequacy of its climate risk management framework."*

support the Basel Committee's reference to considering risk mitigation measures *"where appropriate"* (paragraph 26). There is unlikely to be a "one-size fits all" approach for all climate-related risks and, depending on the risk scenario being analyzed and the type of risk (credit, market, liquidity, etc.), the nature, time horizon, and materiality of the financial risk to the bank will differ and so too will the appropriate risk mitigation response.

It would be helpful and reasonable for supervisors to take an explicitly proportionate, phased and incremental approach to the introduction of new expectations with respect to climate-related risks. This is due to the developing nature of this area and the current technical challenges to certain aspects of risk management, as well as differences in the nature of certain risks (particularly physical risks) across jurisdictions and individual institutions. For example, **banks may start with a more qualitative approach to risk assessment** until they have better data and more experience with key risk indicators and metrics, before taking steps to fully integrate risk quantification. It would be helpful if the Committee recognizes that integration of climate-related risks into the credit granting and monitoring process is nascent and will improve with the maturity of climate risk measurement techniques. **Banks may also take a risk-based approach when assessing the incremental climate-related risks associated with their clients** in onboarding and transaction assessment, for example by starting with those in carbon-intensive sectors. **Supervisors could also take an incremental approach in the supervisory review process**, for example by first focusing on aspects such as governance, business model analysis and risk management frameworks (draft principles 13 and 14) and allowing more time for consideration within the ICAAP and ILAAP processes (draft principle 15). Similarly, credit could be given where applicable for banks' engagement in supervisory climate scenario analysis exercises considering that banks in multiple jurisdictions have prioritized resources on participation in supervisory exercises in recent years.[16] In general, as mentioned above, the supervisory approach should account for banks' different starting positions, business models, geographical footprints, and general risk profiles, which affect the materiality of certain climate-related risk drivers as sources of microprudential risk.

2. (a) Specific Drafting Suggestions on Draft Principles 1 to 12 addressed to banks[17]

With respect to Principle 1:

As acknowledged by the Committee, climate-related risks can act as risk drivers that will impact the existing risk categories (credit risk, operational risk, etc.), and which may positively or negatively impact those risk categories. The text should be clarified in that regard with the addition of the following **underlined bold** text to principle 1: *"Banks should develop and implement a sound process for understanding and assessing the potential* ***positive or negative*** *impact of climate-related risk drivers on their businesses and on the environments in which they operate."*

With respect to Principle 2:

[16] The NGFS identifies 27 distinct exercises initiated by central banks or supervisors that are taking place or concluding between 2021 and 2023; about half of these involve direct engagement from banks in those jurisdictions. See NGFS 2021, "*Scenarios in Action: a progress report on global supervisory and central bank climate scenario exercises*" (October).

[17] Specifically relates to Question 2 in the consultation.

We believe that the BCBS principles should carefully distinguish the roles and responsibilities assigned to the board from those delegated to board members or bank senior management. We would suggest the following drafting changes to principle 2 itself to avoid any ambiguity:

> *"Principle 2: The board and senior management should clearly* ***~~assign~~ delegate*** *climate-related responsibilities to members and committees and exercise effective oversight of climate-related financial risks.* ***According to their respective roles****, ~~T~~the board and/****or the*** *senior management should identify responsibilities for climate-related risk management throughout the organisational structure.*
>
> *13. Responsibilities for managing climate-related financial risks should be clearly* ***~~assigned~~ delegated*** *to board members and****/or*** *committees to ensure material climate-related financial risks are appropriately considered as part of the bank's business strategy and risk management framework."*

Moreover, we understand that principle 2 (at a high level and under para. 13) would require the assignment of climate-related responsibilities to individual board members and specific committees. In our view, this could go counter to the general principle of collective accountability of the board and conflict with the provisions of some national laws. To address this issue, we suggest a general amendment to the wording of the principles so that these responsibilities can be delegated to (board) "*members and/****or*** *committees."*[18]

With respect to Principle 3:
We believe that the BCBS could more explicitly recognize the iterative nature of taking account of climate-related financial risks into the appropriate policies, procedures, and controls considering the evolving nature of the relevant data and methodologies. The BCBS could also clarify that existing policies, procedures, and controls can be updated to reflect consideration of (material) climate-related risks, as opposed to requiring banks to adopt separate ones exclusively focused on climate-related risks Drawing from the recent OCC (2021) consultation,[19] we would suggest the revisions and additional text as shown below in **underlined bold** font to principle 3:

> *"Principle 3: Banks should adopt appropriate policies, procedures and controls to be implemented* ***~~across the entire organisation~~ enterprise-wide*** *to ensure effective management of climate-related financial risks.*
>
> *16. Management of material climate-related financial risks should be embedded in policies, processes and controls across all relevant functions and business units, including, for example, in client onboarding and transaction assessment.* ***Existing policies, processes and controls may be updated to incorporate consideration of material climate-related risks.***
> ***It is recognised that the incorporation of material climate-related financial risks into various planning processes is iterative as measurement methodologies, models, and data for analyzing these risks continue to evolve and mature over time."***

[18] Note that this is in line with the solution defined by European Central Bank (ECB) in its "*Supervisory Guide on climate-related and environmental risks*" (November 2020) applying to Eurozone banks.
[19] OCC (2021), page 3.

With respect to Principle 5:

We welcome the acknowledgement under paragraph 23 that the "probable" inclusion into ICAAPs and ILAAP should be "iterative and progressive." We believe that both paragraph 21 on ICAAP provisions and paragraph 22 on ILAAP provisions should be made consistent with the idea of a gradual inclusion and so we suggest adding "iteratively and progressively" to qualify the inclusion in both processes. Considering this, we would suggest adding the text shown below in **underlined bold** text to principle 5 to clarify that data and methodologies are developing and that, at present, there are challenges to quantitatively incorporating consideration of climate-related risks into ICAAP and ILAAP assessments.

> *"Principle 5: Banks should identify and quantify climate-related financial risks and incorporate those assessed as material over relevant time horizons into their internal capital and liquidity adequacy assessment processes* ***in line with the evolution of data, capabilities and methodologies.*** *[Reference principles: BCP 15, BCP 24, SRP 20, SRP 30]*
>
> *21. Banks should develop processes to evaluate the solvency impact of climate-related financial risks that may manifest within their capital planning horizons.* ***In an iterative and progressive way, Bbanks*** *should include climate-related financial risks assessed as material over relevant time horizons that may negatively affect their capital position (ie through their impact on traditional risk categories) in their internal capital adequacy assessment process (ICAAP).*
> *22. Banks should assess whether climate-related financial risks could cause net cash outflows or depletion of liquidity buffers, assuming both business-as-usual and stressed conditions (considering severe yet plausible scenarios).* ***In an iterative and progressive way, Bbanks*** *should include climate-related financial risks assessed as material over relevant time horizons that may impair their liquidity position in their internal liquidity adequacy assessment process (ILAAP).*
> *23. It is recognised that climate-related financial risks will probably be incorporated into ICAAPs and ILAAPs iteratively and progressively, as the* ***capabilities,*** *methodologies and data used to analyse these risks continue to mature over time and analytical gaps are addressed. To this end, banks should start building risk analysis capabilities by identifying relevant climate-related risk drivers that may materially impair their financial condition, developing key risk indicators and metrics to quantify exposures to these risks, and assessing the links between climate-related financial risks and traditional financial risk types such as credit and liquidity risks."*

With respect to Principle 6:

With reference to paragraph 27, we ask for clarification of the phrase *"may not yet be apparent"* in the sentence *"As such, banks should monitor future developments and seek to understand and, where possible, manage the impact of climate-related risk drivers on other material risks that may not yet be apparent."* We find the current language equivocal as risks need first to be identified in order to be measured and then managed, so the expectations are unclear and potentially too broadly defined. Therefore, we would suggest that the above sentence could be replaced with the following for clarity: *"As such, banks should monitor future developments and seek to understand****, measure*** *and, where possible, manage the* ***potential*** *impact of climate-related risk drivers on other material risks* ***that may not yet be apparent should additional transmission channels be identified****".*

With respect to Principle 9:

We would suggest the BCBS could more explicitly acknowledge that the measurement of climate price risk is still being researched with the addition of the following **underlined bold** text – drawn from the recent OCC (2021) consultation[20] – to principle 9:

"35. Banks should identify and understand how climate-related risk drivers could impact the value of the financial instruments in their portfolios, evaluate the potential risk of losses on and increased volatility of their portfolio, and establish effective processes to control or mitigate the associated impact. ***While market participants are still researching how to measure climate price risk, the board and management should use the best measurement methodologies reasonably available to them and refine them over time.****"*

In paragraph 36, the term "liquidity" may be interpreted in different ways, as can the idea of closing out exposures. We would suggest the following revisions to paragraph 36 to reflect this:

"36. Given the specific characteristics of market risk, analysis of a sudden shock scenario could serve as a useful tool for better understanding and assessing the relevance of climate-related financial risks to a bank's trading book. Such scenario analysis could, for example, feature variation in ***price performance*** *liquidity across assets exposed to climate-related risk and assume variation in the speed at which exposures could reasonably be closed out."*

With respect to Principle 12:
As described above, we believe that the final principles ought to distinguish more clearly between climate scenario analysis and climate stress testing and to acknowledge the evolving nature of the practices in this area. Considering this, we would suggest making the following drafting changes shown in **underlined bold** text:

> *"Principle 12: Where appropriate, banks should* ***start building risk analysis capabilities and*** *make use of* ***climate*** *scenario analysis****, including*** ***and/or climate*** *stress testing****,*** *to assess the resilience of their business models and strategies to a range of plausible climate-related pathways and determine the impact of climate-related risk drivers on their overall risk profile.* ***These approaches should recognise that the methodologies and data used to analyse climate-related risks are continuing to mature over time.*** *These analyses should consider physical and transition risks as drivers of credit, market, operational and liquidity risks over a range of relevant time horizons. …*
> *41. The objective(s) of climate scenario analysis****, including or climate*** *stress testing****,*** *should reflect the bank's overall climate risk management objectives as set out by its board and senior management."*

2. (b) Specific Drafting Suggestions on Draft Principles 13 to 18 addressed to supervisors[21]

[20] OCC (2021), page 5.
[21] Specifically relates to Question 2 in the consultation.

With respect to Principle 14:
As described above, we believe that the final principles ought to acknowledge the evolving nature of practices in this area. Principle 6 already asks banks to monitor other potential risk transmission channels; we also believe that supervisors can perform their unique roles in monitoring future developments and seeking to understand the potential impact of climate-related risk drivers on other material risks, and that the learnings should be shared between supervisors and banks in both directions. Considering this, we would suggest making the following drafting additions to paragraph 52 shown in **underlined bold** text:

"*52. Supervisors should assess the extent to which material climate-related financial risks are included in banks' risk management frameworks and risk appetite along with appropriate processes and procedures to identify, monitor and manage such risks. This may include ensuring that banks' risk management frameworks take into account all material climate-related financial risks to which they are exposed and assessing whether banks' data aggregation capabilities and internal reporting practices can facilitate identification and reporting of climate-related risk exposures, concentrations and emerging risks as well as banks' ability to deploy a range of risk management approaches.* ***Given the evolving nature of climate-related risks, additional channels for transmitting these risks to traditional financial risk categories may yet be undiscovered. As such, supervisors should ensure that banks monitor future developments and seek to understand and, where possible, manage the potential impact of climate-related risk drivers on other material risks should additional transmission channels be identified. Supervisors should also monitor future developments and share their learnings with supervised banks and with their supervisory peers.***"

With respect to Principle 15:
As described above, we believe that the final principles ought to distinguish more clearly between climate scenario analysis and climate stress testing. Considering this, we would suggest making the following drafting changes to paragraph 54 shown in **underlined bold** text:

"54. Where appropriate, supervisors should determine that banks have in place a ***climate*** *scenario analysis* ***and/or climate stress testing*** *programme****~~, including stress testing,~~*** *that is proportionate to their size, business model and complexity, in order to assess the resilience of their business models and strategies to a range of plausible climate-related outcomes. As part of the assessment, supervisors should review and, where necessary, challenge model assumptions, methodologies and results."*

With respect to Principle 18:
As described above, we believe that the final principles ought to distinguish more clearly between climate scenario analysis and climate stress testing, and that both should be differentiated from other prudential activities, including macro-financial stress testing. Further – because of the nascent stage of supervisory exercises, the significant current limitations in terms of data and methodologies, and the necessary simplifying assumptions employed to feasibly undertake exercises under these conditions – there is a real possibility that supervisory exercises and their results may be unrealistic or inaccurate, and so special care should be taken when analyzing, responding to, and communicating the results. We therefore believe that, at

this time, such exercises should not lead to any quantitative impacts on the capital or liquidity requirements of participating banks. It is also desirable that supervisors keep up with relevant developments outside of the banking sector so that the broader scientific, macroeconomic and policy context is taken into account in bank supervision (for example, given the impacts on markets and banks' clients). Considering this, we would suggest making the following drafting changes shown in **underlined bold** text:

*"Principle 18: Supervisors should consider using climate-related risk scenario analysis~~,~~ **~~including~~ and/or climate-related risk** stress testing~~,~~ to identify relevant risk factors, size portfolio exposures, identify data gaps and inform the adequacy of risk management approaches. Where appropriate, supervisors should consider disclosing the findings of these exercises. …"*

*"60. Supervisors should clearly articulate their specific objectives for supervisory climate scenario analysis~~, including~~ **or climate** stress testing~~,~~ which could include, for example: …"*

…

*62. Supervisors should build sufficient capacity and expertise to conduct climate scenario analysis. Supervisors are encouraged to collaborate with a broad and diverse set of stakeholders, including the climate science community, to develop scenarios that can inform comprehensive assessments of climate-related financial risks **and to take account of developments beyond the banking sector which may be relevant to climate-related risk scenario analysis or climate-related risk stress testing. Supervisors ~~and~~** should **also** keep abreast of emerging practices in scenario design and implementation.*

*63. As scenario analysis continues to evolve, supervisors should recognise the limitations of their analyses when communicating their results or using them in supervisory assessments**. It is recognised that it may not be appropriate at this stage to use the results of scenario analysis to inform capital and liquidity requirements, and that more research is needed before that application is considered by supervisors or banks.** Ongoing dialogue among supervisors and between supervisors and banks will contribute to the development of deeper insights on banks' climate-related vulnerabilities and their strategies to mitigate climate-related financial risks."*

3. Consideration of broader environment-related financial risks[22]

Many of the prudential authorities and supervisors that are already active on these topics have so far concentrated on physical and transition-related risks stemming from climate change.[23] Partly, this reflects the relative urgency of climate-related issues given the narrowing window for action to stay aligned with the Paris Agreement's goals for global warming in the coming decades. It also reflects the already strong science-based understanding of the physical risks of unmitigated climate impacts on the economy and the financial system, and of the potential impacts of the transition to a low-carbon economy under different scenarios. **Nevertheless, there are a range of uncertainties inherent in this evidence base, and a variety of critical knowledge gaps**, including empirical details of the transmission channels from climate-related risks between the economy and financial system, and the potential

[22] Specifically relates to Question 3 in the consultation.

[23] NGFS (2021). 83% of NGFS member supervisors have developed or are developing supervisory expectations for climate-related risks, whereas the figure stands at 59% for environmental risks (page 6).

contagion effects emerging from significant climate impacts across sectors (for instance, interactions between the cost and availability of insurance for extreme weather events and potential mortgage delinquency or default if a homeowner fails to purchase adequate coverage).[24]

Broader environmental risks, including biodiversity loss, water scarcity, or significant disruptions to unpriced ecosystem services, **are now also recognized as potentially significant sources of economic risks.[25] However, current understanding of the dynamics of these risks is less mature than for climate-related risks.** In October 2021, the NGFS reported *"generally limited progress on identifying and assessing how environmental risks transmit to the economy and the financial sector"* but that some supervisors have started to take actions.[26] Multiple factors complicate efforts to assess the financial impacts of environmental risk, including lack of a common standard for evaluating materiality, geographical considerations and the associated data and analytical granularity required (e.g., to analyze localized impacts with unclear transboundary implications), inconsistent market valuation, the complex sets of potential risk indicators, and their potential interactions with climate-related risks. Corporate disclosures with respect to some broader environmental risks are also less advanced, in particular on topics such as biodiversity-related risks.[27]

There are indications that emphasis on environmental risks in a prudential context may evolve rapidly in the coming years – for example, considering stated intentions of coalitions like the NGFS, the growing interest in nature-related investment risks and opportunities (including the launch of a new Taskforce on Nature-related Financial Disclosures), and the link between Net Zero commitments by financial institutions and natural climate solutions including carbon offsets.

Given this landscape, IIF members are concerned about the potential application of the current consultation principles on climate-related risks to broader environment-related risks in the future. Further work by the BCBS on environmental risk drivers would need to identify any gaps that exist from current risk measurement approaches in order that any proposals are appropriately targeted to any evidenced gaps. Therefore, we ask that the BCBS proceeds, as it is doing with respect to climate-related risks, in a careful and considered way with respect to broader environmental risks. Specifically, the BCBS could:

- Collaborate with BCBS member authorities, the global industry, and other relevant stakeholders that are examining these topics (such as the NGFS) to deepen the analytical foundations and knowledge of how environmental risks can transmit to the

[24] BCBS 2021, "*Climate-related risk drivers and their transmission channels*" (April), hereafter referred to as "BCBS (2021b)"; FSB 2021, "*The Implications of Climate Change for Financial Stability*" (November).

[25] See, for instance, World Bank Group 2020, "*Mobilizing Private Finance For Nature*" (September); World Economic Forum 2020, "*New Nature Economy*" Report Series; "*Economics of Biodiversity: Dasgupta Review*" (February 2021).

[26] NGFS (2021), page 30. Some examples include the Dutch Central Bank (see "*Indebted to nature. Exploring biodiversity risks for the Dutch financial sector*", June 2020), the ECB ("*Guide on climate-related and environmental risks: Supervisory expectations relating to risk management and disclosure*", November 2020) and the Monetary Authority of Singapore "*Guidelines on Environmental Risk Management (Banks)*", December 2020).

[27] As discussed by the Climate Disclosure Standards Board (CDSB) in recent guidance on how to apply the CDSB framework for biodiversity-related disclosures: https://www.cdsb.net/sites/default/files/biodiversity-application-guidance-single.pdf.

economy and financial sector. The IIF would be happy to assist in convening technical discussions between the public and private sectors on this.

- Develop and publish relevant analytical reports, similar to those the BCBS has prepared on climate-related risks;[28] these reports could be used as the basis for wide engagement.
- Account for the even earlier stage of maturity with respect to environmental risk assessment and management than for climate-related risks. Any further BCBS work on environmental risks would need to begin with a clear set of definitions of the environmental risks in question.
- BCBS work in this area should also recognize that the nature and management of environmental risks beyond climate are likely to be even more institution-specific depending on factors such as business model, geographical footprint, and portfolio. Factors such as spatial and local geographical characteristics of the value chain related to a corporate counterpart's business model will influence the counterparty's exposures to environmental risks. Banks, in turn, would need to account for a potentially high degree of heterogeneity across their portfolio and undertake bespoke analysis and risk management accordingly.

Thank you for your consideration of these comments. On behalf of the IIF membership, we hope that these global industry perspectives will contribute to your efforts. We would be happy to discuss any of these matters further and invite you to contact Sonja Gibbs (sgibbs@iif.com) or Andres Portilla (aportilla@iif.com) should you have questions or comments.

Yours Sincerely,

Sonja Gibbs
Managing Director and
Head of Sustainable Finance
Institute of International Finance

Andrés Portilla
Managing Director and
Head of Regulatory Affairs
Institute of International Finance

Cc: Mr. Neil Esho, Secretary General, BCBS

[28] BCBS (2021a) and BCBS (2021b).