March 14, 2024

Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
4051 Basel, Switzerland

Re: Disclosure of Climate-Related Financial Risks; Basel Committee on Banking Supervision Consultative Document; ISBN 978-92-9259-700-9 (Nov. 29, 2023)

Dear Ladies and Gentlemen:

Better Markets[1] appreciates the opportunity to comment on the consultative document ("Proposal")[2] cited above, issued by the Basel Committee on Banking Supervision ("Committee") of the Bank for International Settlements ("BIS"). The Proposal contains qualitative and quantitative disclosure requirements for climate-related financial risk ("CRFR"). These would increase and improve the consistency, comparability, and reliability of CRFR exposure information among internationally active banks.

We strongly support disclosure requirements as the next step in the Committee's work to address CRFR, specifically its effect on bank safety and soundness, and in turn, the broader banking system, financial markets, and financial stability. Similarly, we supported the Committee's prior work on principles for effective management and supervision of CRFR.[3]

We also agree with the Committee's statement that while the accuracy, consistency, and quality of CRFR data are still evolving, that should not impede progress on disclosure requirements.[4] We will never have perfect, comprehensive data on CRFR. Therefore, we must implement the proposed framework to make the best use of data and information that currently exist and at the same time continue the iterative process to develop better data for use in the future.

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1 Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

2 Disclosure of Climate-Related Financial Risks; Basel Committee on Banking Supervision Consultative Document; ISBN 978-92-9259-700-9 (Nov. 29, 2023), https://www.bis.org/bcbs/publ/d560.pdf.

3 *See, e.g.*, Better Markets Comment Letter re Principles for the Effective Management and Supervision of Climate-Related Financial Risks (Feb. 16, 2022), https://bettermarkets.org/wp-content/uploads/2022/02/Better_Markets_Comment_Letter_BCBS_Climate_Risks-1.pdf.

4 Disclosure of Climate-Related Financial Risks, *supra* note 2, at 1.

BACKGROUND

The Committee is pursuing a holistic approach that includes regulation, supervision, and disclosure to address CRFR in the global banking system. The current disclosure framework and requirements do not provide "distinct or comparable" information on banks' exposure to CRFR.[5] Therefore, with this Proposal, the Committee is developing Pillar 3 disclosures that would:

> [P]romote market discipline and enable market participants to access key information relating to a bank's regulatory capital and risk exposures in order to increase transparency and confidence about a bank's exposure to risk and the overall adequacy of its regulatory capital.[6]

CRFR affects banks through multiple channels, which have been broadly categorized as physical and transition risks:

- **Physical risks** include economic costs and financial losses that result from specific climate events such as storms or drought as well as indirect events such as loss of an ecosystem.[7]
- **Transition risks** include the effects of the adjustment to a low-carbon economy, such as shifts away from certain fossil-fuel industries as well as changes in government policies, technology, business prospects for entire sectors, or consumer and investor behavior.[8]

CRFR materializes through several risk channels and could negatively affect banks through credit risk, market risk, liquidity risk, operational risk, and reputational risk (see Table 1).[9] Therefore, it is critical to have robust and consistent measurement and disclosure of CRFR to fully understand how it is affecting individual banks as well as the banking system as a whole and financial stability broadly. If CRFR is not measured or managed appropriately, it will cause dangerous levels of risk within banks that could lead to bank failures or bailouts and damage the financial system, the economy, and the interests of citizens.

5 Disclosure of Climate-Related Financial Risks, *supra* note 2, at 3.

6 *Id*.

7 Basel Committee on Banking Supervision, *Climate-Related Risk Drivers and Their Transmission Channels* v (April 2021), https://www.bis.org/bcbs/publ/d517.pdf.

8 *Id*. at vi.

9 *Id*. at 1.

Table 1

Risk	Potential effects of climate risk drivers (physical and transition risks)
Credit risk	Credit risk increases if climate risk drivers reduce borrowers' ability to repay and service debt (income effect) or banks' ability to fully recover the value of a loan in the event of default (wealth effect).
Market risk	Reduction in financial asset values, including the potential to trigger large, sudden and negative price adjustments where climate risk is not yet incorporated into prices. Climate risk could also lead to a breakdown in correlations between assets or a change in market liquidity for particular assets, undermining risk management assumptions.
Liquidity risk	Banks' access to stable sources of funding could be reduced as market conditions change. Climate risk drivers may cause banks' counterparties to draw down deposits and credit lines.
Operational risk	Increasing legal and regulatory compliance risk associated with climate-sensitive investments and businesses.
Reputational risk	Increasing reputational risk to banks based on changing market or consumer sentiment.

Leaders of central banks, banking regulators, and international consortiums agree with the Committee about the severity of climate risk and the importance of measuring and managing CRFR within the banking system. Better Markets has also long supported this effort.[10] United States Treasury Secretary Janet Yellen recently summarized the severity of climate risk:

> The threat of climate change has been something that I've spoken about for decades, and it's something that we increasingly see in our daily lives. I believe it is imperative that we continue to take decisive action to fight climate change, for the sake of our planet and for the benefit of the global economy.[11]

Federal Reserve ("Fed") Chairman Jerome Powell directly linked CRFR with bank supervision responsibilities and emphasized the need to measure and monitor the risk:

> The Federal Reserve has narrow, but important, responsibilities regarding climate-related financial risks, which are tightly linked to our responsibilities for bank supervision. Banks need to understand, and appropriately manage, their material risks, including the financial risks of climate change.[12]

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10 *See, e.g.*, Better Markets Comment Letter re Principles for the Effective Management and Supervision of Climate-Related Financial Risks Better Markets Comment Letter, *supra* note 3; *Principles for Climate-Related Financial Risk Management for Large Financial Institutions* (Feb. 6, 2023) https://bettermarkets.org/wp-content/uploads/2023/02/Better_Markets_Comment_Letter_Climate_Related_Financial_Risk_Management_For_Large_Financial_Institutions.pdf; Better Markets Comment Letter, *Principles for Climate-Related Financial Risk Management for Large Financial Institutions* (June 2, 2022) https://bettermarkets.org/wp-content/uploads/2022/06/Better_Markets_Comment_Letter_Principles_for_Climate_Related_Financial_Risk_Management_for_Large_Financial_Institutions.pdf.

11 Press Release, U.S. Department of the Treasury, *Treasury Announces New Climate Counselor* (July 27, 2023), https://home.treasury.gov/news/press-releases/jy1650.

12 Press Release, Board of Governors of the Federal Reserve system, *Statement by Chair Jerome H. Powell on Principles for Climate-Related Financial Risk Management for Large Financial Institutions* (Oct. 24, 2023), https://www.federalreserve.gov/newsevents/pressreleases/powell-statement-20231024b.htm

SUMMARY OF THE PROPOSAL

To support its goals of strengthening the regulation, supervision, and practices of banks worldwide and enhancing financial stability, the Committee has proposed a set of disclosure requirements for internationally active banks that would provide information on CRFR, including:

- **Qualitative Factors**
  - Governance structure and responsibilities related to CRFR, specifically for the board and senior management;
  - Strategy for reducing and mitigating CRFR, including forecasts and transition plans;
  - Risk management processes and procedures related to CRFR; and
  - Concentration risk measures and strategies related to CRFR.
- **Quantitative Factors**
  - Transition risk: Exposure by sector to specific non-financial industries with sensitivity to the transition to a low-carbon economy;
  - Physical risk: Exposure to physical risk by geographic area; and
  - Financed emissions: Scope 3 emissions,[13] beyond direct and energy emissions, which emanate from a bank's loan or investment portfolio.
- **Bank-Specific Factors**
  - Credit exposure by maturity or credit quality, to provide insight on layered risk that could negatively affect the safety and soundness of individual banks.
- **Forecasts**
  - Forward-looking information to assess the resilience of banks to CRFR over time.
- **Additional Quantitative Factors Subject to Jurisdictional Discretion**
  - Real estate exposure by energy efficiency level;
  - Emission intensity as a proxy for transition risk; and
  - Facilitated emissions from fee-generating business lines such as capital markets, underwriting, or securitization activities.

The Proposal states that the disclosure framework would be implemented on January 1, 2026.

SUMMARY OF COMMENTS

As stated earlier, we strongly support the proposed disclosure requirements. The combination of the large scale and scope of CRFR, as well as the fact that these requirements will apply to internationally active banks that are also very large, supports the need for consistent and comprehensive disclosure requirements. Furthermore, the disclosure framework will provide

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13 United States Environmental Protection Agency, SCOPE 3 INVENTORY GUIDANCE, https://www.epa.gov/climateleadership/scope-3-inventory-guidance (last visited Feb. 27, 2024).

comparability and transparency for bank supervisors, investors, and the public for CRFR that does not currently exist.

We also appreciate and agree with the Committee's statements about the fact that some data elements within the proposed framework are still being developed. More broadly, the accuracy, consistency, and quality of data related to CRFR are evolving. However, this does not justify a delay in disclosure requirements. The size, scope, and urgency of CRFR continues to grow, so it is imperative that the proposed disclosures are implemented as soon as practicable and also allowed to evolve along with the data.

We also urge the Committee to make the following changes to further strengthen the disclosure framework, as well as the overall effort related to CRFR:

- Require forecasts and transition plans from all reporters, and mandate that they are based on standardized parameters. Given that comparability and transparency are key goals of the Proposal, it is imperative that forecasts and transition plans be required from all reporting banks, not allowed to be optional. Furthermore, parameters such as forecast time horizons must be standardized so that the output results can be compared to one another.

- Accelerate the timeline for at least a partial implementation of the disclosure framework to begin in January 2025. CRFR continues to increase and worsen; therefore, we cannot wait to implement disclosures until 2026, as stated in the Proposal.

- Complete the work to incorporate CRFR into Pillar 1 and 2 of the Basel framework. Pillar 3 disclosures are certainly necessary and welcomed. However, the Committee must also complete its work to incorporate CRFR into Pillar 1 and 2 to achieve its mandate of strengthening the regulation, supervision, and practices of banks worldwide and enhancing financial stability.

COMMENTS

I. REQUIRE FORECASTS AND TRANSITION PLANS FROM ALL REPORTERS, AND MANDATE THAT THEY ARE BASED ON STANDARDIZED PARAMETERS.

Forecasts and transition plans are critical components to understanding CRFR and therefore must be mandatory parts of the disclosure framework for all reporting banks. We agree with the Proposal's overall characterization of the use of forecasts and transition plans as tools to understand banks':

> [C]limate-related financial risks in a forward-looking manner, and . . . assess the resilience of banks' business models to any material climate-related financial risks

over various time horizons.[14]

However, we do not agree with the Proposal's stance that "disclosure of forward looking forecasts ***would not be compulsory*** and ***would only be required in instances where banks have established such forecasts***."[15] Forecasts provide necessary insight into the amount and severity of CRFR that an individual bank has as well as the amount and severity of CRFR in the banking system as a whole when aggregated, so they cannot and should not be a voluntary part of the disclosure framework. Similarly, transition plans, which provide a bank's strategy for moving toward a lower carbon economy, must be mandatory for all reporters.

Forecasts inform how CRFR evolves over time. The results of forecasts also inform strategies to reduce or mitigate CRFR. Therefore, the Committee must work with experts to determine relevant time horizons and other forecast model inputs to use for all reporters. To further illustrate, if some reporters are using a short time horizon in forecast models, such as the next five years and relatively mild climate change variables such as sea-level rise, the resulting CRFR may be limited and indicate that banks face relatively little risk from CRFR. However, if other reporters are using a longer time horizon—10 or 20 years, for example—and more severe deterioration in climate variables, the resulting levels of CRFR will be very different and could indicate higher levels of risk.

Finally, the Committee should ensure that forecast model inputs are reasonable but also sufficiently stressful to fully understand and ***reduce the risk of underestimating*** CRFR. We recommend expanding the scope of consideration to include not only the CRFR that impacts a bank's financial condition and performance, but also consider the impact of a bank's decisions on other banks, society, and the environment because these perspectives inform the assessment of CRFR on financial stability. For instance, a forecast should not stop with simply assessing how a large, diversified bank's retreat from lending in a geographic area that is vulnerable to flooding protects or limits risk for that one bank. The forecasts must also consider how that retreat further concentrates risk among the remaining, possibly smaller and less diversified, banks as well as how that retreat negatively affects people and communities in the affected and vulnerable areas, especially underserved, minority, or low-income individuals. While this may be difficult to model, the results are critical to understanding the systemic nature of CRFR.

II. ACCELERATE THE TIMELINE FOR AT LEAST A PARTIAL IMPLEMENTATION OF THE DISCLOSURE FRAMEWORK TO BEGIN IN JANUARY 2025.

The Proposal states that the disclosure framework would become effective and be implemented by banks on January 1, 2026. Given the fact that CRFR continues to worsen and increase,[16] waiting nearly another two years before reporting begins is insufficient and

14 Disclosure of Climate-Related Financial Risks, *supra* note 2, at 6.

15 *Id*. at 7.

16 *See, e.g.*, Intergovernmental Panel on Climate Change, *Climate Change 2023* (2023) https://www.ipcc.ch/report/ar6/syr/.

unacceptable.

However, we also understand that the data and models are evolving in real-time. Therefore, we recommend that the Committee implement the qualitative components of the disclosures on January 1, 2025, to at least begin to get a baseline understanding of CRFR at individual banks and throughout the system. This will allow both reporters and supervisors to become familiar with the disclosure components and process for one year, with the expectation that complete reporting of both qualitative and quantitative components would begin on January 1, 2026.

III. COMPLETE THE WORK TO INCORPORATE CRFR INTO PILLAR 1 AND 2 OF THE BASEL FRAMEWORK.

The Proposal is a welcome step, but it must be accompanied by completion of the complementary work on regulation and supervision of CRFR in order to achieve the Committee's goals. As explained in the Financial Stability Board's 2023 progress report:

> In July 2021, the Financial Stability Board (FSB) published a comprehensive Roadmap to address climate-related financial risks. The Roadmap was endorsed by G20 Finance Ministers and Central Bank Governors and subsequently by G20 Leaders at the Rome Summit. It addressed the need for coordinated action with the large and growing number of international initiatives underway by outlining key actions to be taken by [standard-setting bodies] and other international organisations over a multi-year period in four key policy areas: firm-level disclosures, data, vulnerabilities analysis, and regulatory and supervisory practices and tools.[17]

This work has been ongoing and steady progress has been made in recent years, with disclosures as well as other components. However, the Committee must remain focused on the objectives related to supervisory and regulatory practices that were promised by the fourth quarter of 2024, including:

- Develop effective regulatory and supervisory practices and tools;
- Achieve cross-sector and cross-jurisdiction consistency of approaches;
- Build regulatory and supervisory capacity.[18]

17 Financial Stability Board, *FSB Roadmap For Addressing Financial Risks From Climate Change Progress Report* 5 (July 13, 2023), https://www.fsb.org/wp-content/uploads/P130723.pdf.

18 *Id.* at 35.

CONCLUSION

We hope these comments are helpful for the prompt finalization and further strengthening of the Pillar 3 disclosures.

Sincerely,

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