I4CE – **Special issues**

I4CE answer to BCBS consultation on the disclosure of climate-related financial risks

The Institute for Climate Economics (**I4CE**) strongly supports the Basel Committee on Banking Supervision in its initiative to integrate climate-related risks within Pillar 3 disclosure requirements. This evolution is essential to ensure financial stability and proper functioning of the market in a context of intensification of transition and physical climate risks. Now is time to move from voluntary commitments to regulation to secure global resilience.

I4CE welcomes the work that has been done to improve climate-related management and supervisory practices. **I4CE** support the current approach of the Basel Committee to gather both quantitative and qualitative information, with a forward looking vision. On the basis of their understanding of climate-related risks, banks should take action. Their practices should evolve to support the transition of their clients and reduce their risk exposure. This is why **I4CE** recommends to the Basel Committee to strengthen its qualitative elements on transition plans.

Finally, such work on Pillar 3 is a first and necessary step for the international banking regulation and supervision. However, **I4CE** recommends to further deepen this work by integrating climate-related risks within Pillar 1 and 2 of the Basel framework. This can be done by building on the Network for Greening the Financial System (NGFS) work.

General

Q1. What would be the benefits of a Pillar 3 disclosure framework for climate-related financial risks in terms of promoting comparability of banks' risk profiles within and across jurisdictions and promoting market discipline? What other benefits have been identified?

Faced with the challenge of climate-related risks, regulators should require changes in the bank risk management and bank operations. Many jurisdictions have already taken this road and **I4CE** supports the Basel committee initiative to build common ground for the evolution of Pillar 3 disclosure requirements. Transparency in financial markets is essential to improve resilience and prevent the depths of future crisis in a context of polycrisis.[1]

Pillar 3 disclosure framework will enable the comparability of banks risk profiles and will build common understanding of climate-risks issues at a global level. It is essential to understand the exposure of banks at the micro level and for supervisors to be able to gather data at a macro level.

Q2. What are the risks of a Pillar 3 disclosure framework for climate-related financial risks not being introduced?

In the past years, many voluntary, market-led initiatives have emerged, such as those put forward by the Glasgow Financial Alliance for Net Zero (GFANZ) and the Task Force on Climate-related Financial Disclosures (TCFD). However, these initiatives haven't brought the expected changes from the banks and are acknowledging legal issues.

I4CE strongly support the Basel Committee is the establishment of comprehensive climate disclosure requirements at a global level. The Basel Committee should plays its role to mitigate climate-related risks and avoid fragmentation between jurisdictions. It should look for inter-operability with the

[1] Gardes-Landolfini, Charlotte, Pierpaolo Grippa, William Oman, and Sha Yu. 2023. "Energy Transition and Geoeconomic Fragmentation: Implications for Climate Scenario Design." IMF Staff Climate Note 2023/003, International Monetary Fund, Washington, DC
https://www.imf.org/en/Publications/staff-climate-notes/Issues/2023/11/16/Energy-Transition-and-Geoeconomic-Fragmentation-Implications-for-Climate-Scenario-Design-541097

current existing framework such as the ISSB disclosure and the NGFS recommendations on climate management.

In addition, previous experience on mandatory disclosure in France (introduced through article 173-VI of the Act on Energy transition for green growth) has shown that imprecise disclosure requirements were insufficient for the financial actors to disclose quality information[2].

Q3. Would the Pillar 3 framework for climate-related financial risks help market participants understand the climate-related financial risk exposures of banks and how banks are managing these risks?

Yes, the goal of Pillar 3 is to disclose the appropriate information to enable market participants and supervisors to better assess banks exposure and management of risks. Integrating climate-related risks within the Pillar 3 framework would help market participants with comprehensive quantitative and qualitative information.

It should require banks to provide quantitative metrics and targets. It should also require banks to disclose qualitative and forward-looking elements on bank's strategy to better assess what action the bank is actually implementing to manage such risks.

In addition, the banks use unstandardized methodologies to assess their risk and build their risk management strategy. Therefore, market participants would gain a better understanding of the banks' approaches thanks to Pillar 3 requirements for the banks to disclose their key choices.

Q4. Would the Pillar 3 framework for climate-related financial risks be sufficiently interoperable with the requirements of other standard-setting bodies? If not, how could this best be achieved?

The Pillar 3 framework will need to engage regularly with actors such as regional or national financial regulators and supervisors to build on their work and reach common minimum disclosure on climate-related issues. For example, the Pillar 3 transition plan requirements could build on UK TPT Disclosure Framework, the EU ESRS, ongoing work by he Singapore MAS and the EU EBA on prudential transition plans.

Q5. Would there be any unintended consequences of a Pillar 3 framework for climate-related financial risks? If so, how could these be overcome?

Q6. What are your views on potentially extending a Pillar 3 framework for climate-related financial risks to the trading book?

In order to provide a comprehensive view of the bank's sources of income and of risks, Pillar 3 framework must cover all business lines: the traditional lending activities (banking book) and investment activities (trading book), including both active and passive management. Off-balance sheet activities related to investment banking but generating income for the bank, such as derivatives, should also be included.

The rest of the off-balance sheet activities, such as the structuring of bonds, guarantees, advisory activities for IPO, mergers and acquisitions, etc must be included as well.

[2] https://www.i4ce.org/en/publication/taking-climate-related-disclosure-to-the-next-level-minimum-requirements-for-financial-institutions/

The supervisor may apply a proportionality approach in the early years of implementation of climate-related disclosure. This proportionality approach should reflect the main sources of income for banks and be in line with their business profile.

Q7. What are your views on the proposed methodology of allocating exposures to sectors and geographical locations subject to climate-related financial risks?

I4CE supports the disclosure of exposures to transition risks based on sectors, of exposures to physical risks based on geography, and would also support a sector-geographic allocation for exposures to both physical and transition risks as further detailed in answers to Q24 and Q30.

Q8. What are your views on which elements should be made subject to national discretion and which should be mandatory? Why?

I4CE agrees with the general approach of having both quantitative and qualitative elements that are made mandatory. They should apply to all the banks with activities at the international level and systemic banks. The disclosure should apply for all their activities: at a consolidated level and at the national level.

National discretion should only be allowed for less significant institutions who only operate national operations.

Q9. What are your views on whether potential legal risks for banks could emanate from, or be mitigated by, their disclosures as proposed in this consultation, and why?

Banks could mitigate legal risks from their disclosures by adding disclaimers to explain where their analyses remain exploratory and with specific explanations in terms of methodological limitations.

Such disclaimers should necessarily come with the disclosure of the plans of the bank for specific actions to make progress on these key limitations and a calendar for implementing these plans.

Q10. Would the qualitative and quantitative requirements under consideration need to be assured in order to be meaningful? If so, what challenges are foreseen?

Yes, assurance is needed, as illustrated at the EU level with the CSRD. This assurance requires specific training of auditors, based on precisely defined specifications. This also requires clarifying the appropriate sanctions to the auditors if they fail to provide the relevant information. The managers of the company that discloses information should also be made accountable for communicating the relevant information to the auditors, as well as disclosing information. Appropriate sanctions at the level of the company should be clearly defined in that perspective.

Qualitative discolure requirements

Q11. What are the benefits of the proposed qualitative Pillar 3 climate-related financial risk disclosure requirements?

I4CE fully supports the requirement to disclose qualitative information and calls for strengthening some of the proposed requirements.

Such information is necessary for the bank to explain fully its rationale and its internal organization for identifying and managing its risk exposures with a forward-looking approach from the short to the long-term.

It also helps putting in perspective the quantitative information with the banks' strategic approach. In addition, this qualitative information is necessary to explain a range of key analytical choices given the heterogeneity of the available methodologies to assess and manage climate-related risks.

I4CE supports the approach of requiring elements on the governance; strategy; risk management; and concentration risk management. The Basel Committee should seek consistency with the existing work on transition plans by the NGFS and FSB that has reached a large consensus. It should integrate, when possible, the key elements for more advanced frameworks on transition plans such as the UK TPT' Disclosure Framework, the European ESRS, as well as ongoing work by the Singapore MAS and the EU EBA on "prudential transition plans".

Regarding governance:

Qualitative information on the governance is key to ensure that climate-related risks are analyzed and effectively managed. The relevance of such information has been confirmed by market participants for example in the re-imagining disclosure project that took the example of information disclosed by non-financial companies[3].

Managing climate-related risks in an adequate manner and implementing a transition plan to reduce them requires a strong and adequate governance structure. Banks should combine both the involvement of high-level governance and solid implementation at the operational levels.

To ensure that banks are on track, supervisors should require banks to disclose information on:

- Implication of high-level management on climate-related risks (number of meetings on the subject at the board level, the risks department, etc)
- Coherence of the remuneration scheme with the climate objectives of the bank
- Coherence of sectoral policies
- Coherence in the business units structure (oil and gas team or energy team for instance)
- Internal processes (adequate collection of data from the counterparties, granular indicators, integration in the pricing of the credits)
- Training for the teams: bank's team should have both general knowledge on climate-related risks and specific team (often call Climate hub) with strong skills that can provide transversal expertise to the other business units

Regarding strategy:

To manage climate-related risks in an adequate manner, supervisors should request from banks that they disclose and implement their transition plans. [4][5]Transition plans are the tool for banks to build their strategy regarding climate-related risks. It is here to help them anticipate and mitigate the risks of having a disorderly and delayed transition.

Banks should disclose their transition plans with elements on:

- Determination of a global decarbonisation strategy for the bank, broken down into sectoral decarbonisation trajectories;

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[3] I4CE (2020) "Scenario analysis of the issues of the low-carbon transition". Available at: https://www.i4ce.org/en/publication/scenario-analysis-of-the-issues-of-the-low-carbon-transition/

[4] https://www.i4ce.org/wp-content/uploads/2022/04/Include-mandatory-banking-transition-plans-within-Pillar-2-011222.pdf

[5] https://www.i4ce.org/wp-content/uploads/2022/11/Implementing-prudential-transition-plans-for-banks-what-are-the-expexted-impacts_EN.pdf

- Long-term (2050) and intermediate targets (every 5-years) regarding GHG emission reductions
- Sectoral trajectories in relation with the adequate level (national, regional and international), with physical indicators (number of deep retrofitting for instance)
- Action taken by the banks to support the transition efforts of clients (escalation strategy)
- Use of carbon offsetting for residual emissions.

The banks should disclose elements that ensure that internal processes are consistent with this vision.

Regarding risk management:

The information proposed on the risk management process, including in Tables CRFRA 3. and CRFRB, is key to maintain given the diversity of available approaches for integrating climate risk in risk management of a specific bank.

In particular, the efforts to detail the materiality assessment of the risks (for example on physical climate risk through Table CRFRB 2.) are key to maintain as this step conditions the relevance of the scope of analysis that the bank uses to assess its risk exposure and to build its strategy. It is also key to maintain specific disclosure requirements on how the bank manages transition risks in a way that supports its counterparties in climate change mitigation and adaptation, as introduced in section 1.(a) of Table CRFRB. This provides information on how the bank is putting itself in capacity to seize the opportunities of transition finance. Disclosure requirement on how the analytical and monitoring process inform the risk management are also key to maintain (Table CRFRA 3. (b)). Regarding stranded assets: transition plans can also help market participants to better understand how banks plan to mitigate their exposure to assets at risk of stranding – by simply divesting or 'offloading' the risk, or instead engaging their clients to reduce the risk. These relate particularly to strategy on points 2(b), (c), and (d) from table CRFRA and are crucial to maintain.

However, it is necessary to reinforce the requirements on the analytical process and risk management strategy to ensure that the key choices of the bank are properly detailed (see Q14).

Regarding concentration risks:

I4CE supports the integration of concentration risks within the frameworks.

Such disclosure is essential, especially as many studies showed that banks were underestimating climate-related risks and can be significantly involved in some high-risks sectors such as fossil fuel sector, automotive or real estate[6]. Improved disclosure on concentration risks[7] would help supervisors assess banks vulnerability to high-risks sectors and stranded asset risks driven by climate factors. This corresponds to 3(a) from table CRFRB and is crucial to maintain.

[6] For example on the underestimation of physical climate risks, see Chapter 17 of the EEA (2024) "EU Climate Risk Assessment" available at: https://www.eea.europa.eu/publications/european-climate-risk-assessment

[7] Miller H and Dikau S (2022) Preventing a 'climate Minsky moment': environmental financial risks and prudential exposure limits. London: Grantham Research Institute on Climate Change, London School of Economics and Political Science. https://www.lse.ac.uk/granthaminstitute/publication/preventing-a-climate-minsky-moment/

Q12. Should the proposed qualitative Pillar 3 climate-related financial risk disclosure requirements be on a mandatory basis to facilitate comparability across banks?

Yes. It is crucial that the banks explain their key analytical and risk management choices, since there is no standard for climate-related risk analysis and management and since the available methodologies are not always fully transparent[8].

The qualitative information should be disclosed on a mandatory basis also because this allows the banks to properly explain their rationale and strategic perspective on climate-related risks analysis and management as well as their internal dynamics and organization on that matter. Such information also helps putting in perspective the quantitative metrics with the strategic approach of the bank.

Q13. What key challenges would exist for preparers or users of the proposed qualitative Pillar 3 climate-related financial risk disclosure requirements? How could these be overcome?

There are 2 keys challenges for implementing the qualitative Pillar 3 climate-related financial risk disclosure requirements:

- Current fragmentation of sectoral pathways: some sectors are already well covered with international targets (fossil fuels sector), and some by regional or national targets (house refurbishing for instance). Others on which there is still lack of consensus (tourism, information and communication technologies). This challenge will be overcome by the publication of countries long term strategies and collective effort of multilateral diplomacy. Regulators should keep a holistic approach that covers the whole economy, as all sectors are concerned by climate-related risks and transition planning. Supervisors will adopt a proportionate approach, starting with the sectors that are more mature depending on the banks profile.

- Measuring risk at the counterparty level remains a key challenge as it requires a lot of information on several aspects of the counterparty's capacity to manage its risk exposures and such information is not always publicly available[9]. However, the bank can build on their sectoral and geographic analysis to pre-identify the counterparties with potential key risks, and disclose how they engage dialogue with these counterparties on their specific transition and adaptation needs and how the bank can contribute with appropriate financial services. In addition, disclosure requirements on all types of counterparties should be developed to increase the availability of information on the counterparty's adaptive capacity.

Q14. What additional qualitative Pillar 3 climate-related financial risk disclosure requirements should the Committee consider?

Regarding Risk Management:

Disclosure on climate-related scenario analysis for risk management should be a requirement. Such a forward-looking approach is key for example to anticipate and manage the risks of stranded assets. The word "whether and" should be removed from the sentence "whether and how the bank uses

[8] For a discussion on limited transparency, for example on transition risk analysis, see: I4CE (2022) "Scenario analysis of transition risk in finance – Towards strategic integration of deep uncertainty" https://www.i4ce.org/en/publication/scenario-analysis-of-transition-risk-in-finance-towards-strategic-integration-of-deep-uncertainty/

[9] For more details on these aspects, see for example Figure 5 of I4CE (2022) "Scenario analysis of transition risk in finance – Towards strategic integration of deep uncertainty".

climate-related scenario analysis to inform its identification of climate-related financial risks" in CRFRA 3.(a).

The same sentence should also be completed with "and how this includes an effort to explore the potential climate- and transition-related risks and opportunities in diverse sectors arising from diverse plausible scenarios from the long- to the short-term", perhaps as part of the "Instructions" section under the table. Indeed, as demonstrated in section 2 of the Finance ClimAct report "Scenario analysis of transition risk in finance", the quality of the scenario-based analysis of climate-related risks relies on the bank putting efforts in this first exploratory step.

Disclosure requirements on the materiality assessment should be reinforced on transition risks. As explained in section 3 of the Finance ClimAct report "Scenario analysis of transition risk in finance", the bank should disclose how the materiality assessment builds on the aforementioned exploration of potential transition impacts. It should explain how it selects the material risks considering the following key components: the potential trajectories of transition risk drivers overtime; the portfolio sectoral exposures; the portfolio vulnerabilities; the overlapping of risk drivers with portfolio exposures and strategic horizons overtime.

Banks also need to disclose more information on the scenarios that they use for transition risk analysis, with minimum requirements on the characteristics of those scenarios, while taking account of the limited availability of certain types of scenarios. As proposed in section 2.5.4 of **I4CE**'s report "Taking climate-related disclosure to the next level"[10], the banks should:

- Explain if the transition risk disclosure accounts for several scenarios, including: at least one 1.5 and/or 2.0°C scenario; at least one disorderly transition scenario (or explain why it is not currently possible). Explain if NDC scenarios are used when available and usable, either as a baseline when such scenarios are not compatible with a 1.5°2°C objective or as a transition scenario otherwise.
- Disclose the characteristics of the transition scenarios used when the information is not publicly available otherwise (on the narrative; reference baseline scenario; timing, magnitude, the nature of sectoral and macro impacts, their timing and magnitude; the compatibility with a given climate objective; how the objective is attained (e.g. assumptions on CCS, other technological assumptions); how structural changes in the economy are considered; the comparability with other public scenarios).
- Disclose the rationale for using tailored scenarios when they do so.
- Disclose if efforts were made to base the analysis on peer-reviewed material and on databases recommended by the relevant authorities.
- Provide justification (potentially through relevant third parties) on whether scenarios are aligned with state of-the-art modelling capacities.

The bank should disclose qualitative information on the sectoral policies that it uses to achieve its GHG emission forecasts, including how this influences the counterparty's transition strategy (e.g. escalation strategy). This could be mentioned explicitly in Table CRFRA. These sector-specific policies would be an "appropriate supporting context" information for market participants to avoid misinterpretation of the banks' GHG emission metrics including their evolution overtime. For example, if a bank sets itself an objective of retrofitting a certain number of buildings each year, then this justifies that the GHG emissions of assets in portfolios does not decrease linearly overtime.

[10] https://www.i4ce.org/en/publication/taking-climate-related-disclosure-to-the-next-level-minimum-requirements-for-financial-institutions/

Regarding Concentration risk:

As a complement to the formulations in CRFRB 3(a), the bank should also be asked more clearly to explain how it can be exposed to concentration risk arising from the exposure of a specific portfolio to a cumulation of climate hazards or transition risk drivers, explaining how such hazards/risk drivers can materialize at the same time or successively, can occur repeatedly overtime, how their effects might compound and saturate the adaptive capacity of the counterparties.

Quantitative disclosure requirements

General

Q17. What are the benefits of the proposed quantitative Pillar 3 climate-related financial risk disclosure requirements?

I4CE supports the Basel Committee approach to having quantitative elements on exposure by sectors, financed emissions and exposure by geographical area.

This is a relevant first step to acknowledge objectively the situation for a bank. This combination of analysis and of collection of data is crucial to help banks deepen their understanding of climate-related risks and the action they can take to mitigate them by supporting the transition of their client. None of these analyses will bring perfect data, however they will still inform banks and lead to capacity building within the teams.

Q18. Should the proposed quantitative Pillar 3 climate-related financial risk disclosure requirements be on a mandatory basis to facilitate comparability across banks?

Yes

Q19. What key challenges would exist for preparers or users of the proposed quantitative Pillar 3 climate-related financial risk disclosure requirements? How could these be overcome?

A key issue is imperfect data and lack of collection from the banks. Data issues is often brought up to delay action on climate-related risks. However, based on the French climate-related disclosure that started in 2017 and European experience that is starting now, it is actually regulation that is driving the actual production and collection of data. Having clear and specific climate-related disclosure will help banks collecting the appropriate data. The various disclosure and taxonomy initiatives will also help on that matter.

Q20. What additional quantitative Pillar 3 climate-related financial risk disclosure requirements should the Committee consider?

Facilitated emissions should be added to this quantitative elements. Off-balance sheet activities are essential to understand the entire source of revenues from a bank.

Transition risk

Q24. Would exposures and financed emissions by sector be a useful metric for assessing banks' exposure to transition risk?

Regarding Exposure by sector:

It is key to maintain the proposed disclosure of exposure to non-financial corporates according to standardised sectors of economic activity. If this prism of analysis was not explicitly mentioned as the relevant one, the banks might use the traditional prism of classification per asset class which is not appropriate. Indicators on sectoral exposure allows to analyse the cumulative exposure of the banks to climate-related risks across its asset classes. It is also key to maintain it on a mandatory basis given the importance of such a disclosure.

It is key to maintain CRDFR1 proposal to disclose information on exposure (and GHG emissions) for the 18 TCFD sectors regardless of the materiality assessment, since this assessment depends on a lot of key assumptions that might limit the clarity of information on key exposures[11].

As transition risk exposure also depends on the country, the sectoral exposures could be further detailed by country to reflect where the most crucial aspects of the counterparty's value chain are exposed.

Regarding Financed emissions:

It should be clarified that Scope 3 emissions by obligors do not inform on every type of transition risk exposures. In particular, they miss the risk that not every green solutions will be competitive on the markets.

While scope 3 emissions are an interesting input for the banks to understand their exposure to transition risks, the banks should also be required to disclose their efforts to understand the transition issues of their counterparty as well as transition potential of these counterparties, including their transition strategy as well as their financial capacity or needs to implement this strategy.

Emission intensity per physical output metrics are also interesting as they invite the user of the disclosed information to focus on the real carbon-intensity of comparable products or services.

If « financed emissions » metrics are disclosed, the bank should also disclose an explanation of the allocation rule of the counterparty's GHG emissions to the financial service that the bank provides. The choice of the allocation rule can indeed impact substantially the level of GHG emissions disclosed by the bank.

Physical risk

Q30. Would exposures subject to climate change physical risks be a useful metric for assessing banks' exposure to physical risk?

Yes, it is key to disclosure exposures subject to physical risk by geographical area.

However, "the geographical location of the activity of the counterparty" mentioned in CFRFR2 is too vague as corporate counterparties can be exposed along their value chain. Specific parts of the value chain can also make more critical contributions to the counterparty's revenues. This level of detailed information is challenging to obtain. Hence, the bank should disclose how it makes efforts to identify the geographic implantation of parts of the value chain that make a key contribution to the counterparty's revenues.

Adding a sectoral exposure prism to the geographic exposure prism would also help market participants connect the dots with the sectoral key vulnerabilities to climate hazards.

[11] 4CE (2022) "Scenario analysis of transition risk in finance – Towards strategic integration of deep uncertainty" https://www.i4ce.org/en/publication/scenario-analysis-of-transition-risk-in-finance-towards-strategic-integration-of-deep-uncertainty/

Bank-specific metrics

Q34. What are your views on the prudential value and meaningfulness of the disclosure of the proposed bank-specific metrics on (i) asset quality (non-performing exposures and total allowances); and (ii) maturity analysis?

The proposed disclosure on the maturity analysis is welcome. It should also be noted that the European ClimINVEST research project highlighted that the banks' strategy also depends on the renewal of financial services to key clients. The information on the maturity of the loans does not convey information on this strategic risk of the company.

Forecasts

Q37. What are your views on the proposed inclusion of forecast information in the Pillar 3 climate-related financial risk disclosure requirements in instances where banks have established such forecasts?

Disclosure of forward-looking metrics and targets as well as scenario-based analysis should be compulsory in all jurisdictions. Indeed, climate-related risks require such an analysis as noticed in the core text of the document.

Concentration risk

Q42. What are your views on the usefulness banks' disclosure of quantitative information on their risk concentration, ie of the bank's material exposures to sectors or industries subject to transition risk or to sectors/geolocations subject to physical risk relative to its total exposure?

Such disclosure is essential, especially as many studies showed that banks were underestimating climate-related risks and can be significantly involved in some high-risks sectors such as fossil fuel sector, automotive or real estate[12].

Templates

Q47. What are your views on the structure and design of the proposed templates in relation to helping market participants understand the climate-related financial risks to which banks are exposed?

The templates clarify the core text of this proposal with essential elements. These elements should be maintained in the final version of the document, regardless of its formatting.

Quantitative disclosure requirements subject to jurisdictional discretion

Q49. What are the benefits of the proposed quantitative Pillar 3 climate-related financial risk disclosure requirements subject to jurisdictional discretion?

I4CE considers that all the requirements in this guidance should be compulsory for all internationally active banks and systemic banks. Flexibility may be considered at national level only for the domestically active banks and when the proposed disclosures do not make sense for that specific jurisdiction.

[12] For example on the underestimation of physical climate risks, see Chapter 17 of the EEA (2024) "EU Climate Risk Assessment" available at: https://www.eea.europa.eu/publications/european-climate-risk-assessment