American Bankers Association

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The Basel Committee on Banking Supervision

Via electronic submission: www.bis.org/bcbs/commentupload.htm

RE: Consultative Document – *Disclosure of Climate-Related Financial Risks*

To The Committee:

The American Bankers Association[1] appreciates the opportunity to comment on the Consultative Document – *Disclosure of Climate-Related Financial Risks* ("CD"). Within the objective of Pillar 3 of the Basel Committee on Banking Supervision's ("Committee," or BCBS) Framework of International Supervision on capital measurement and capital adequacy (the BCBS Framework),[2] the CD seeks comments on specific proposed qualitative and quantitative disclosure requirements intended to promote a common disclosure baseline for climate-related financial risks across internationally active banks.

Our members consist of lenders, investment bankers, asset managers, investment analysts and custodians and, consequently, bring perspectives from a wide range of stakeholders of all sizes. We strongly support the BCBS Framework on capital adequacy and, in particular, the objective of Pillar 3 within the BCBS Framework, which is to complement the minimum capital requirements (Pillar 1) and the supervisory review process (Pillar 2) with market discipline through supplemental disclosure. We also support the Committee's *"Principles for effective management and supervision of climate-related financial risks,"* (2022 Principles) and the BCBS report *"Climate-related risk drivers and their transmission channels,"* (2021 Risk Driver Report[3]) which conclude that climate-related risks are drivers of the traditional banking risks,[4] but are not separate risks themselves.

SUMMARY

With this in mind, we express significant concerns related to key elements of the CD and urge the Committee to work with banking institutions to assess and then propose alternative disclosures that are meaningful within the context of the stated Pillar 3 objectives and overall

[1] The American Bankers Association is the voice of the nation's $23.7 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2.1 million people, safeguard $18.8 trillion in deposits and extend nearly $12.5 trillion in loans. Learn more at www.aba.com.

[2] This framework was most recently revised through *BCBS International Convergence of Capital Measurement and Capital Standards*, June 2006.

[3] See https://www.bis.org/bcbs/publ/d517.htm

[4] The banking risks are credit risk, market risk, liquidity risk, operational risk, and reputational risk.

BCBS framework. We believe the proposed disclosures in the CD potentially compromise both the integrity of the BCBS Framework objectives, which are specifically targeted to capital adequacy and related risk exposure, and the Pillar 3 principles, which address banking risks and not risk drivers. As currently drafted, the proposed disclosures effectively misrepresent climate-related information as relevant to banks' financial risk exposures and capital adequacy.

The CD also appears to ignore both the Committee's 2021 Risk Driver Report and the 2022 Principles, conflating climate-related information with banking financial risks, and treating climate risk (both physical and transition risk) as standalone risks that can be separately measurable. How market participants are supposed to use such information to assess banks' financial risk exposure with respect to a traditional banking risk, especially considering the 2021 Risk Driver report refers to highly uncertain transmission channels and sources of variability that would impact the factors, is never discussed. The proposed framework would result in disclosure of nonmaterial and noncomparable climate information that is not reflective of a bank's risk exposures and capital adequacy and could also subject banks to heightened legal and reputational risks. While prudential regulators in many local jurisdictions may request much of this information for their own supervisory purposes, we believe the proposed information is inappropriate for public consumption in the Pillar 3 context.

These concerns are not raised to debate the merits of climate disclosure or of climate risk management more broadly. We believe the integrity of the BCBS Framework is at risk of being damaged, significantly undermining stakeholder confidence in the BCBS Framework's objectives of bank capital adequacy and overall safety and soundness of the banking system. In other words, we believe the proposed framework is fatally flawed. Before imposing these significant new Pillar 3 disclosure requirements, more work is needed to develop a revised proposal that substantiates how any new disclosures are necessary to achieve Pillar 3 objectives.

DISCUSSION

The Purpose of Pillar 3 and the Reporting of Banking Risks

The purpose of Pillar 3 is to complement the minimum capital requirements (Pillar 1) and the supervisory review process (Pillar 2) with market discipline through supplemental disclosure. Such disclosures should be consistent with how senior management and the board of directors assess and manage the risks of the bank.[5] Within the overall objective of safety and soundness, the BCBS has historically focused disclosure on the traditional risks of banking – credit, liquidity, market, and operational risk – and how they support capital adequacy. With this in mind, we are concerned that many aspects of the Pillar 3 climate risk disclosure framework proposed by the Committee in the CD are not consistent with the objectives of Pillar 3 and would imply a meaningful link between the disclosures and a bank's risk exposures and regulatory capital adequacy, which would be inaccurate and misleading to the market.

[5] See BCBS International Convergence of Capital Measurement and Capital Standards, June 2006.

Quantitative Disclosures

1. *Proposed climate metrics are not meaningful indicators of banks' financial risk and, so, do not align with Pillar 3 objectives. (Proposed Tables CRFR1, CRFR4, and CRFR5)*

The proposed disclosures go beyond the stated Pillar 3 objectives of providing market participants with information on banks' capital adequacy and related material risk exposures. Regarding quantitative emissions disclosures, market participants must understand that aggregated measurements of financed emissions (gross emissions, emissions intensity) and facilitated emissions are substantially irrelevant to a bank's transition risk (and, ultimately, to credit risk). In other words, a disclosure of financed emissions will normally obfuscate a bank's credit risk.

Financed Emissions

A. Limitations in Measuring Bank Transition Risk Through Financed Emissions.

A proposal to disclose emissions metrics seems to be based on an attenuated, multi-step chain of assumptions on how client emissions transmit into financial risk to a bank. Financed emissions exposure first acts as a proxy for potential transition risk by representing an aggregate measure of clients' business risk related to transition; the clients' aggregate business risk then must be assumed to transmit into risk of financial loss to the bank, for example via credit risk; the portfolio-level financed emissions must then be assumed to be relevant to assessing that credit risk exposure.

With this in mind, a client's absolute emissions are not a straightforward measure of risk to their business. As they are more reflective of bank and customer size, neither financed nor facilitated emissions levels are indicative of bank safety and soundness. Indeed, increasing levels can often be inversely proportional to credit risk because larger customers may be more likely to withstand or adjust to adverse changes in the economic and competitive environments. Conversely, customers shedding highly emitting products and activities may be abandoning the cash-positive aspects of their business that limit their long-term credit risk. With these things in mind, banks' decarbonization targets (which seem to be referenced as "forecasts" in the CD) may provide color to its business strategies, but they are not risk management tools and are not reflective of capital adequacy.

Under the process above, there remains an outstanding question regarding through which transmission mechanism the aggregate client emissions will translate into risk of financial loss to a bank. While the CD points to credit risk, a higher level of financed emissions is not an indicator of a higher probability of default. A bank's credit risk – the risk of a borrower's default on loans – is limited by the length of the bank's risk exposure[6] and any risk mitigants[7] the bank has in place. This is a key difference between the financed emissions of credit institutions and those of equity investors: Decreased long-term profitability of a borrower does not often result in a loss to the lender.

B. Limitations in Assuming Enactment of a Carbon Tax to Measure Transition Risk.

As an example of the lack of direct translation of transition risk factors into financial risk exposure, while some analogize emissions levels to the financial vulnerability in the event of a carbon tax (a commonly cited transition risk), such a relationship is inherently non-linear (the impacts may be small over certain tax rates as well as changes to rates) and complicated (industry competition can often be a big factor). Vulnerability to a carbon tax also does not take into account the likelihood that a carbon tax will be implemented, or that it will be implemented suddenly in a way that the market will not be able to adjust to and that will cause a material portion of a bank's loans to default. Many jurisdictions have imposed increased carbon prices, for example, without causing widespread loan defaults.

C. Forecasts of Financed Emissions are Part of Strategy, Which is Out of the Scope of the BCBS and Pillar 3 Frameworks. (Proposed Tables CRFR1 and CRFR4)

In addition to measurements of absolute financed emissions and emissions intensity, the CD proposes disclosure of emissions "forecasts" which seem to be referring to banks' portfolio decarbonization targets. With this in mind, banks' portfolio decarbonization targets are not forecasts; they are not forecasting their own view of the future, but rather explicitly using external science-based scenarios (e.g., IEA Net Zero Emissions -- NZE) that are aligned with a "net zero by 2050" emissions goal being the target outcome. Banks' targets are reflective of business strategy and are not risk management tools, nor is progress towards such targets reflective of capital adequacy. As a result, it would be wholly inappropriate for banks to provide this information, which is not otherwise required in Pillar 3 disclosure. In fact, there are no other topics or risk drivers for which banks are required to publicly disclose projected medium- and long-term views in a strategic sense.

D. Forecasts of Financed Emissions are Highly Uncertain and Will Subject Banks to Legal Risks. (Proposed Tables CRFR1 and CRFR4)

Disclosure of actual forecasted information would also be inappropriate for Pillar 3 disclosures. Multiyear forecasts of emissions within a bank lending portfolio would be highly uncertain and

[6] In risk management practice, the length of risk exposure is based on expected maturity, which is normally shorter than contractual maturity, and is the basis for credit loss provisions under U.S. GAAP. Outside of the U.S., IFRS 9 requires those loans that have not yet had significant credit deterioration since origination to be measured based on a twelve-month probability of default.

[7] Risk mitigants used by banks will affect both the probability of default and the loss given default.

could potentially open firms to legal risk if those forecasts are not met or are revised as better data and methodologies become available. If banks are required to speculate publicly, the Committee runs the risk of creating negative market impacts given the operational challenge of projecting medium- and long-term actions, particularly considering the need to react to geopolitical and economic changes. Given potential legal or other consequences, requirements to disclose forecasts could disincentivize banks from preparing forecasts that would be otherwise beneficial for business strategy decisions or other internal purposes.

E. Inappropriateness of Financed Emissions in Measuring Financial Stability.

During the BCBS Roundtable/Americas session conducted on February 27, 2024, certain participants expressed the notion that financed emissions represent a financial stability metric and concern. With this in mind, we remind the Committee that Pillar 3 is not a macroprudential disclosure and also does not cover other financial stability risks (e.g., cybersecurity, geopolitical risk, disruption of financial technology, etc.).

Facilitated Emissions

F. Limitations in Measuring Bank Transition Risk Through Facilitated Emissions. (Proposed Table CRFR5)

Facilitating the financing of companies that are in transitory business environments is a natural part of investment banking. Therefore, quantitative disclosure of facilitated emissions metrics will have little to no value to investors in understanding the safety and soundness – whether current or future – of an entity. As key financial intermediaries, bank performance based on these valuable services rendered will also be very difficult to measure, as reported facilitated emissions will largely vary from period to period, based on macroeconomic and geopolitical factors beyond the control of the facilitating entity. While there may be an expectation that aspects of the investment banking business to certain industries may contract over the transition period, it is unreasonable to assume that bank strategies to react to expected market changes will be any different than they are today and that this will adversely affect capital adequacy.

Conclusion on Financed and Facilitated Emissions

With all this in mind, quantitative disclosures relating to financed and facilitated emissions will provide no meaningful decision-usefulness for banks nor for market participants assessing the relevant banking risks. Even in circumstances in which individual banks are subject to net-zero or other climate-related commitments, their financed emission commitments rooted in their corporate strategy will not be relevant to credit or other banking risk. As the many operational challenges in tracking and estimating financed and facilitated emissions will require dramatically high cost with no positive benefits, these measurements and forecasts should be excluded from any final Pillar 3 requirement.

2. Risk Drivers are Inappropriately Treated in the CD as Standalone Banking Risks

Existing Pillar 3 disclosures focus on measurement of traditional banking risks and not on any of the many specific drivers of those risks. For example, Pillar 3 disclosures on credit risk center on metrics such as probability of default, loss given default, and risk weightings, among other things. Market risk disclosures include value-at-risk measures. There are no quantitative disclosures related to the specific drivers of those risks. As established by the Committee in the 2022 Principles and 2021 Risk Driver Report, physical and transition climate-related factors have been considered by the Committee to be "drivers" of those traditional banking risks and not separate banking risk types themselves. However, the CD proposes quantitative disclosure requirements that include selected metrics that are positioned as being related to physical and transition climate risk drivers rather than metrics reflecting financial risks, which is inconsistent with the approach to existing Pillar 3 disclosures and with the documents just noted. Above we covered the lack of causal chain between financed/facilitated emissions and traditional banking risks, and below we address the challenges with the treatment of risk drivers under the remaining quantitative templates.

A. Limitations of proposed physical risk metrics (Proposed Table CRFR2)

The proposed physical climate risk metrics are not meaningful indicators of a bank's financial risk exposure and they will not improve an investor's ability to assess credit risk above and beyond what is already reported in other corporate financial reports and existing Pillar 3 reports. For example, while certain geographical locations may be subject to greater levels of modeled long-term physical risk, the proposed schedule of exposures by geographic region is not meaningful in market participants' efforts to assess individual or relative bank safety and soundness because of the extremely high uncertainty as to where, when,[8] and how severe the acute or chronic risks will specifically materialize and how micro-and macroeconomic transmission channels and other factors (including any related guarantees or collateral) will mitigate (or amplify) any losses. Even when the intent of the schedule is to highlight exposure locations, the information will not be reflective of financial risk.[9] There are too many other non-climate-related drivers, transmission channels and sources of volatility (many of which will overlap) that translate such exposures into quantitative credit or market risk.

[8] During the February 27, 2024 BCBS Roundtable, a stakeholder noted that uncertainty as to when physical risk conditions and events will occur is not critical, as such events and conditions will, nevertheless, occur at some time. With this in mind, terms such as tenor (maturity) and the time value of money are critical aspects of lending and also are distinct from risks faced by providers of equity capital.

[9] This point is clearly illustrated in the 2021 Risk Driver Report. The drivers, as with non-climate-related risk drivers, impact the traditional banking risks through various microeconomic and macroeconomic transmission channels and are also subject to various significant sources of variability.

Reliance on such information among market participants will quickly diminish as actual events occur outside the stated physical risk regions or losses materialize that are different from the implied loss exposure. At issue may be the broad definition in the CD of physical risk, which includes "extreme climate change-related weather events; (ii) longer-term gradual shifts of the climate; and (iii) indirect effects of climate change." Further, the relationship between exposures subject to physical risk and the risk of financial loss is not necessarily linear. Aggregation of various hazards and physical risk factors ignores the variation in the different sectors' vulnerabilities, as well as whether climate impacts for each sector and location will be positive (e.g., ability to grow crops that previously were not tenable) or negative (e.g., property damage to manufacturing facilities). As such, the proposed disclosures do not effectively link the climate-related risk drivers to financial risk exposure under traditional types.

With this in mind, CD question #45 inquires whether disaggregation of climate-related hazards would assist in the analysis. We believe that further granularity will likely not help and may distract users of the information, since such climate exposures will need significant assumptions to various transmission channels to arrive at credit risk. With granularity, overlapping of exposures will compound and coupled with the challenges in credit loss accounting information (discussed separately), confusing information will be provided, and such information will also require reconciliation with existing Pillar 3 credit risk reporting, which will be challenging.

B. Limitations of real estate portfolio metrics (Proposed Table CRFR3).

Likewise, a bank's real estate exposures in the mortgage portfolio by energy efficiency level would not provide meaningful information about the bank's risk exposure with respect to transition risk as a driver of traditional risk types. While the energy efficiency level of a bank's portfolio may have some value in assessing the current competitive qualities of certain properties used as collateral underlying mortgages, it does not necessarily affect a bank's credit risk exposures. As such, a standardized table that does not consider the myriad other factors that impact the value of underlying collateral and associated risk – such as note terms, risk mitigants, and specific locations[10] – will do little to assist investors in assessing safety and soundness. Availability of consistent and comparable data on properties' energy efficiency will also be extremely limited in many jurisdictions, impacting the relevance and meaningfulness of such disclosures in any context.

Conclusion on Risk Drivers Within the CD

Physical and transition climate-related factors have been considered by the Committee to be "drivers" of those traditional banking risks, but are highlighted in the CD and effectively treated as separate banking risk types themselves, contradicting the Committee's own documents

[10] During the February 27, 2024 Roundtable for the Americas, a stakeholder acknowledged that in some locations, energy efficiency of the underlying collateral is becoming difficult to differentiate due to the increased use of insulation that mitigates differences resulting from home-specific sustainable energy appliances and infrastructure.

published in 2021 and 2022. Coupled with the significant credit loss accounting challenges that are discussed below, users of such information will be confused not only as to how the reported results should translate into credit risk, but also on how management is expected to respond going forward. Much more detailed information related to the transmission channels of climate risk and the related amplifiers and mitigants would be needed. These lie, however, outside the scope of Pillar 3. As a result, we believe more work will be needed before a final Pillar 3 standard is issued.

Qualitative Disclosures

3. *Directly leveraging the ISSB's[11] corporate climate disclosure standard into Pillar 3 disclosures will create challenges related to meaningfulness and comparability. (Proposed Table CRFRA)*

It is unclear how the ISSB's corporate standard for climate disclosure (IFRS S2), which is imported nearly exactly in proposed Table CRFRA, would meet the Pillar 3 objectives of market discipline as it pertains to providing market participants with information to assess a bank's capital adequacy. Corporate disclosure, as addressed in IFRS S2, has a broad objective of providing decision-useful information to investors, and the disclosure elements under this standard were developed to align with that objective. Replicating this standard into a Pillar 3 framework implies that these disclosures meet the much narrower Pillar 3 objective of assessing bank capital adequacy, without substantiating their connection to this goal.[12]

ISSB's corporate climate disclosure standard is also subject to the general materiality principle in its broad sustainability disclosure standard (IFRS S1). The CD, however, does not have the same materiality qualifier and appears to require disclosure regardless of materiality. BCBS would effectively be signaling to the market that supervisors view this information as per se material, which would be misleading to the market where this information is not material. This would also result in inconsistent disclosure for banks subject to both ISSB-based corporate disclosure and the BCBS-based Pillar 3 disclosure.

4. *Proposed strategies and emissions forecasts are unrelated to transition risk and excluded from the BCBS Framework. (Proposed Table CRFRA)*

In addition to the problems with quantitative disclosures of bank targets (forecasts), the proposed qualitative disclosure regarding banks' strategy – including banks' transition plans and scope 3

[11] The International Sustainability Standards Board (ISSB) was formed by the IFRS Foundation to develop a global baseline for corporate sustainability disclosures and has issued two standards: *IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information* and *IFIRS S2 Climate-Related Disclosures*.

[12] We also caution the Committee that items 1(b) and 1(d) under Table CRFRA (certain board responsibilities related to strategies and to management of climate-related financial risks) appear to go beyond ISSB-based disclosure and require specific Board conduct that misunderstands differences in the role of the Board, as compared to that of management. In short, these items appear to presume the described activities as tasks of the Board, and do not recognize that day-to-day decision-making regarding a bank's business strategy with respect to climate is the responsibility of management and not of the Board of Directors.

decarbonization targets – is inappropriate in the Pillar 3 context. While disclosing strategic risks may be appropriate for corporate disclosure, it is not relevant for Pillar 3 disclosure, where the focus is on informing the market about banks' risk profile and capital adequacy. In fact, the BCBS Framework explicitly excludes strategic risk from its definition of operational risk[13]. Banking regulators also do not ask for similar disclosure under Pillar 3 for business strategy and planning with respect to factors such as pandemics, potential recession, emerging markets business risk, etc. Pillar 3 disclosure related to a bank's business strategy on climate should, thus, be consistent with the level of disclosure of other business strategies.

5. ***Reporting effects of climate-related financial risks is highly complex and unlikely to provide useful information. (Proposed Table CRFRA, step 2d)***

Though listed under the qualitative disclosure table CRFRA, Step 2d requires reporting "The effects of those climate-related financial risks on the bank's financial position, financial performance and cash flows for the reporting period, and their anticipated effects on the bank's financial position… over the short, medium and long term, taking into consideration how those climate-related financial risks have been factored into the bank's financial planning." This is effectively a quantitative disclosure or it requires significant quantitative analysis to determine whether and what to disclose.

With that in mind, however, the proposed disclosure requirement again mischaracterizes climate risk as its own risk type, rather than a driver of traditional banking risks, and is inconsistent with the approach BCBS has taken in the 2022 Principles and the 2021 Risk Report. Specific climate risk – or any other risk driver – is not normally tracked or measured separately from other risks. Further, it is not currently feasible for banks to disaggregate the financial impact of climate risk from other impacting factors with any certainty. The proposed disclosure would require such tracking and then go well beyond by effectively requiring the bank to estimate what reported amounts *would have been* as a result of climate risks. A 2022 study, for example, released by staff at the Federal Reserve Bank of New York[14] indicates that climate-related events generally provide a net benefit to banks over time, due to the increased subsequent investment in the affected region.

As such a disclosure requirement can also include pricing, the potentially complex and detailed nature of such processes is overbearing, and it is difficult to imagine how investors will use such information. It is also not feasible for banks to project those financial impacts in any meaningful way given reliance on highly speculative forward-looking estimates and projections which would

[13] Per *The BCBS Framework (2024),* "Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people, and systems or from external events. This definition includes legal risk but excludes strategic and reputational risk."

[14] https://www.newyorkfed.org/research/staff_reports/sr990.html

be dependent on factors that are likely to change over time and may be outside of banks' control. Resulting disclosures could be misleading to the market and open banks to potential legal risk.

Other Significant Concerns

6. *Conflicts with Accounting Standards and Jurisdictional Practices will Obfuscate Credit Risks (Proposed Tables CRFR1 and CRFR2)*

The accounting-related information (credit loss allowances and non-performing status) proposed in the transition risk schedule (CRFR1) and physical risk schedule (CRFR2) will not only be subject to a high level of incomparability between companies, but also their mere inclusion will confuse market participants. First, there will be differences in accounting standards. Under IFRS 9, credit loss allowances for loans whose credit risk have not increased significantly since initial recognition are based on a 12-month probability of default. In contrast, banks applying U.S. GAAP will estimate credit loss allowances for all loans – no matter the credit risk or change in credit risk – on a lifetime loss expectation. As a result, the differences of credit loss allowances between IFRS 9 and U.S. GAAP for loans can be stark. Additionally, available-for-sale debt securities under U.S. GAAP are recorded at fair value, with no credit loss allowance unless there is "other than temporary impairment." Further, even between banks that follow common accounting standards, jurisdictional differences in charge-off practices and the definition of "non-performing" can make any analysis frustrating for investors or other market participants.[15]

More importantly, no matter the accounting standard, banks normally do not estimate credit loss allowances on a loan-by-loan basis for all but non-performing loans. Credit loss allowances are estimated in pools in which other drivers and factors of credit risk will normally have a much more significant impact than climate risk drivers. In other words, there will often be no perceivable difference in credit loss allowances for most exposures attributable to the climate-related risks related to their geographic location or industry sector.[16] Therefore, not only will the accounting information confuse market participants that are interested solely in climate-related information, but also those who currently rely on existing Pillar 3 disclosures. Due to these significant issues, we recommend that any standardized table of disclosures omits credit loss accounting information.

[15] A common metric is the credit loss allowance ratio, which is calculated by dividing the allowance by the amortized cost of the portfolio. Banks in jurisdictions in which charge-offs occur quickly will normally have relatively smaller coverage ratios than banks in other jurisdictions because much of the amortized cost has already been charged-off (the credit risk has largely been realized).

[16] In the U.S., banks disaggregate credit loss allowance processes by industry or geographic region when there are specific risks that require enhanced evaluation and estimation granularity. These circumstances may include climate-related risks, but normally do not in a significant manner. Such processes (under U.S. GAAP) include forecasts of credit losses only to the expected maturity of the respective portfolio, which is normally 3-7 years. Practically speaking, a bank's forecast of macroeconomic factors (unemployment rates, for example) is the most significant driver of period to period changes in the credit loss allowance.

7. *Required Sector Reporting Presents Significant Concerns*

A. Materiality Needs to be Defined. (Proposed Table CRFR1)

The proposed schedules of transition risk exposures also send confusing signals over materiality. Per the 2022 Principles, "banks should consider material climate-related financial risks that could materialize over various time horizons and incorporate these risks into their overall business strategies and risk management frameworks." In this regard, bank risk management processes normally assess materiality levels as well as where the material risks lie. However, by requiring schedules of exposures (and financed emissions) of eighteen specified industry subsectors regardless of materiality, the CD implicitly deems these subsectors as most material to market participants, reinforcing the misperception that these subsectors subject all banks to the greatest transition risks. The requirement naturally begs the question of exactly what materiality means when categorizing other "material" subsectors outside the required eighteen.

The BCBS must clearly define how materiality should be assessed in the Pillar 3 context. While some banks are undertaking materiality assessments in the context of corporate disclosure (e.g., for EU CSRD disclosure, or for ISSB disclosure), Pillar 3 has different and narrower objectives than corporate disclosure and this will impact what information is material in the context of the market assessment of banks' capital adequacy and risk exposures.

B. Industry and Sector Classification Should be Flexible. (Proposed Table CRFR1)

GICS is a reasonable industry coding standard. However, requiring it for Pillar 3 purposes may not be appropriate. Banks will need to implement systems to continually assess the appropriate reporting subsector of borrowers of all sizes. This requires an ongoing analysis of revenues and expenses to assess their appropriate classification, whether or not those operations are material to the bank or to the future plans of the borrower. As GICS essentially classifies all of a company's operations into one subsector, companies that are diversified into two or more sectors present complications.[17]

Practically speaking, emissions will be measured by borrowers based on products and product mixes that are unlikely to neatly conform to GICS classifications. Banks should be allowed to report exposures based on how their risk management processes report them. While this may result in some variability in practice, allowing a bank to report material exposures – as opposed

[17] Per the GICS Methodology: "A company engaged in two or more substantially different business activities, none of which contributes 60% or more of revenues, is initially classified into the sub-industry that provides the majority of both the company's revenues and earnings. To prevent excessive turnover, at least 60% of revenue by a different business activity is the threshold generally needed to consider a change from a current GICS assignment. When a company has business activities in three or more sectors, none of which contributes a majority of revenues, the company is classified either into the Industrial Conglomerates sub-industry (Industrials Sector) or the Multi-Sector Holdings sub-industry (Financials Sector)."

to complying with the specific codes – may be the most efficient way to then communicate with its investors.

CONCLUSION

In summary, the proposed qualitative disclosure of climate-related strategy and related targets addresses information not relevant to capital adequacy. Additionally, the quantitative tables conflate the risk drivers with the traditional banking risks themselves and often will present irrelevant and obfuscating information relating to safety and soundness. Therefore, while certain market participants may have interest in some of the information for more general purposes, the proposal conflicts with the capital adequacy and overall safety and soundness principles that Pillar 3 is designed to address. The market will expect consistent relationships between climate risk factors and credit risk where none exists, will expect actions from management related to certain industries or geographic location when none will be taken, and then will be frustrated in reconciling observations to metrics already reported elsewhere within existing Pillar 3 reporting tables. This is not the objective of Pillar 3 disclosure.

Maintaining BCBS's historical focus on banking risks and not the specific drivers will best allow institutions to communicate to market participants how they manage material risks (including those related to climate) and what metrics they use. Before imposing significant new Pillar 3 disclosure requirements, more BCBS work is needed to substantiate how the proposed disclosure is necessary to achieve Pillar 3 objectives and BCBS should make clear how it is viewing this disclosure as a driver of the traditional risk types with respect to capital adequacy. In the meantime, ABA members stand ready to work with the Committee in educating stakeholders and developing and proposing a holistic framework to provide meaningful information related to capital adequacy.

Certain jurisdictional regulators, in the meantime, will likely request certain information related to net zero targets and strategies. Such information should not be considered for Pillar 3 disclosure, given these disclosures are not relevant to risk exposure or capital adequacy.

RECOMMENDATIONS GOING FORWARD

As the Committee reconsiders the path forward on climate disclosure, the below principles must be adhered to if Pillar 3 reporting will continue to be helpful to market discipline.

1. **The Purpose of Pillar 3 disclosure should remain focused on banking risk and on safety and soundness.**

Disclosure should be limited solely to information that is related to banks' material risk exposures and capital adequacy, through the traditional banking risks. Disclosures of other information (such as financed emissions, facilitated emissions, or energy efficiency within certain portfolios) may be requested through confidential supervisory reporting on a bank-by-bank basis, but are not appropriate for Pillar 3 reporting without further BCBS substantiation of how this information is consistent with Pillar 3's market discipline objectives with respect to banks' capital adequacy. Further, if standardized reporting will be required of risk drivers or detailed transmission channels and sources of variability, it must avoid neglecting other factors and sources and not conflict with other Pillar 3 schedules.

2. Flexibility for jurisdictional discretion will be critical.

While certain central banks may have direct mandates to address climate change and climate-related transition, certain proposed disclosures may not be relevant or appropriate, given varying other central bank mandates. For example, other central bank mandates (e.g., in the U.S.) may focus specifically on financial safety and soundness and bank performance. Additionally, banks based in jurisdictions with greater transition needs may often be located in countries in which their country-specific climate commitments may not align with net zero by 2050. In either case, the proposed disclosures which do not meet the Pillar 3 objectives of assessing banks' material risk exposures and capital adequacy will not be appropriate for certain jurisdictions and their remits.

The CD proposes allowing for national discretion in implementing the disclosures detailed in section 3.5. If the Committee decides to require standardized quantitative disclosures of financed emission measurements or forecasts of financed emissions, or of energy efficiency ratings within the Pillar 3 framework, we urge it to allow jurisdictional discretion to be applied to all proposed disclosures, rather than only those specific quantitative disclosures proposed in section 3.5.

3. Materiality must be clearly defined.

While financial materiality is the bedrock concept underlying corporate reporting to investors and other stakeholders, the BCBS Framework provides specific materiality guidance on selected issues. Due to the granular and prescriptive nature of certain proposed schedules, as well as potentially long-terms in which materiality must be assessed, we urge the Committee to define a principles-based materiality approach that puts safety and soundness and capital adequacy purposes as its basis. This approach also must be clear that qualitative disclosures – such as those on the effects of climate risk on the business model and value chain, etc. –apply only to *material* climate-related financial risks, in line with the 2022 Principles. Disclosing immaterial risk is not consistent with Pillar 3 objectives, burdensome to banks without a corresponding benefit to market discipline and would be misleading to the market.

Thank you for your attention to these concerns and for considering our recommendations. Please feel free to contact me (mgullette@aba.com; 202-663-4986) if you would like to discuss this further.

Sincerely,

Michael L. Gullette