American Bankers Association
Building Success. Together.

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Via Electronic Mail

Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 – Basel, Switzerland

Re: Consultative document: Principles for the effective management and supervision of climate-related financial risks.

Dear Sir or Madam:

The American Bankers Association[1] appreciates the opportunity to comment on the *Principles for the Effective Management and Supervision of Climate-related Financial Risks* (the Consultation) developed by the Basel Committee on Banking Supervision (BCBS). The Consultation proposes a set of principles that are collectively intended to improve banks' identification and management of climate-related financial risks and offer a common baseline of climate-related financial risk management for internationally active banks and supervisors.

Overall, we support the Consultation's principles-based approach, and believe it is a positive first step toward assessing climate-related risk exposure.[2] We agree with the BCBS that flexibility is needed to accommodate what will likely be significant changes to consumer and investor preferences, climate-related policy goals, and the practice of climate-related financial risk identification and management. Conceptually, we agree with the goals of the Consultation, and its premise that climate-related risk is a driver of traditional risk. As a practical matter, however, given the nascent stage of climate-related financial risk assessment, a more flexible, principles-based approach is needed.

We appreciate that the BCBS is still contemplating the extent to which climate-related financial risks can be addressed within the Basel framework. However, ABA is concerned that certain principles and supporting text in the Consultation are overly prescriptive and assume a level of analytical sophistication that is challenging. As the BCBS is aware, climate risk drivers "have a number of features that makes their evolution highly uncertain."[3]

Large banking organizations have in place comprehensive, risk management programs to assess and manage the range of their risk exposures and understand the way these exposures interrelate.

[1] The American Bankers Association is the voice of the nation's $23.3 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $19.2 trillion in deposits and extend nearly $11 trillion in loans.
[2] ABA has developed a set of principles guiding our advocacy on these issues: https://www.aba.com/advocacy/policy-analysis/climate-change-and-banking
[3] https://www.bis.org/bcbs/publ/d517.pdf

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These frameworks are well established, and backed by deep and robust business, financial, economic, and other data. Further, the risk metrics that guide a bank's risk management are understood by bank boards and management, bank counterparties, investors, supervisors and other stakeholders.

Climate-related financial assessment tools and approaches are evolving and there is significant uncertainty about the policies governments will take to mitigate climate change, which institutions they will affect, and under what timeframe. There is also an absence of robust market data, standardized definitions surrounding what is meant by climate-related financial risk, or consensus on how climate-related risk can be incorporated into the management of traditional financial risks. Together, these foundational gaps mean that the processes, procedures, and methodologies surrounding climate-related risk identification and monitoring are in the earliest stages of development.

A number of the Consultation's principles, however, seem to direct banks to quantify their climate-related risk, set limits, and take action to mitigate the identified climate risks. For example, principles 8 - 11 describe the comprehensive management of credit, market, liquidity, operational and other risks, and outline prescriptive expectations with regard to identification, management, and mitigation of climate-related risks within these risk categories. To avoid confusion, we recommend that the BCBS broaden the language of the Consultation to reflect that the integration process is iterative and that banks should be embedding climate-related financial risk where possible over a sufficient time frame.

Internationally-active US banks are working to understand their climate-related financial risk exposure through qualitative assessments, development of internal models, and the incorporation of forward-looking climate related into strategy and new business assessment. ABA believes that at this stage, supervisory expectations should be focused on ensuring internationally active banks are progressing with their internal climate-related financial risk analyses, based on risks material to a bank's specific business model, not a full integration of climate-related risk into their overall risk framework over the short-term.

We emphasize that clarification is needed with respect to materiality, board roles, and scenario analysis. Regarding the former, we encourage the BCBS to clarify the meaning of "material" for purposes of risk management by noting that an important component of materiality will be the plausibility and certainty of risk. Additionally, we request that the BCBS differentiate the roles of the Board and management, to align with regulations and practices across jurisdictions.

With respect to "scenario analysis" and "stress testing," we urge the BCBS to better define the terms as they mean different things in different jurisdictions. "Scenario analysis" is typically a forward-looking assessment of a potential future state of the world over time, resulting from a plausible and possibly adverse set of events or sequences of events. "Stress testing" typically assesses the potential impacts of transitory shocks to near-term economic and financial conditions. Stress testing usually has capital planning implications, and also refers to exercises, conducted by the Federal Reserve, that may have regulatory consequences. "Climate scenario analysis" is a tool used to enhance critical strategic thinking and inform strategic decision-

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making to assess business risks and opportunities against a range of plausible future climate scenarios. To avoid confusion, we recommend that the BCBS provide further clarity by using the term “climate scenarios analysis” to connote an exploratory exercise for banks’ assessment of the impact of climate-related risks and opportunities over short, medium and long-time horizons. Moreover, ABA believes it would be premature and counterproductive to attach regulatory consequences to climate-related financial risk exposure or for regulators to generate improbable or unrealistic scenarios in order to hasten a response to climate-related risks. We recommend that until climate-related financial risks are better understood and more market data is available, quantitative assessment and review be performed using banks internal models and processes.

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Internationally-active U.S banks understand the need to identify and manage climate-related financial risk and are devoting significant resources to better understand their exposures. We appreciate the BCBS’s ongoing efforts to ensure banks and their supervisors understand climate-related risks and establish an internationally harmonized baseline for climate–related risk assessment. We stand ready to assist in this important effort. If you have any questions about these comments, please contact the undersigned at (202) 663-5182 or email: atouhey@aba.com.

Sincerely,

Alison Touhey