School of Business
University of Dundee

Bank for International Settlements

Aeschenplatz 1, 4052 Basel, Switzerland

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Re: Consultation on a Potential Pillar 3 Disclosure Framework on Climate-related Financial Risks

Dear Mr Agustín Carstens

The School of Business at the University of Dundee welcomes the opportunity to comment on the Basel Committee's initial step towards developing a Pillar 3 framework for the disclosure of climate-related financial risks. The School of Business strongly supports the Basel Committee's initiatives to pursue a holistic approach to address climate-related financial risks to the global banking system, which includes work across all three pillars of regulation, supervision, and disclosure. We are also looking forward to the post-implementation review of these Pillar 3 Disclosure Framework on Climate-related Financial Risks. The University of Dundee is a world-leading institution, transforming lives through research and responding to the needs of a wide range of stakeholders; we are especially keen on informing policymakers by producing impactful research. This letter has been prepared by the undersigned members of the Accounting & Finance discipline within the School of Business, who are actively involved in researching and investigating corporate finance, green finance, and corporate environmental responsibility.

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?

Without this disclosure framework senior bank employees, investors, regulators, related businesses, capital markets would not have adequate, appropriate, and comparable data with which to inform their decisions, and where appropriate take actions when there is a misalignment with climate related financial risk preferences. In addition, the framework facilitates transition financing and sustainable investment by guiding capital towards eco-friendly ventures, thereby aiding societal shifts towards sustainability, and creating new financial opportunities for banks in green finance. Given this we consider this proposal as an important initiative in relation to climate risk exposures, however, would the Pillar 3 disclosure framework for climate-related financial risks be more helpful if structured on a country-by-country basis (as in the Capital Requirement Directive IV for the banking industry within the EU) in order to facilitate the comparability of banks' risk profiles across jurisdictions as the question suggests? We are concerned that country breakdowns were dropped having been proposed for template 2.

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

We believe that omission of a Pillar 3 disclosure framework for climate-related financial risks would hamper the ability of investors to assess the risk profile of banks, and to compare the different risk profiles of banks operating in various countries; relying on each individual banks framework will lead to lack of comparability of any climate related risk disclosures produced. Without these disclosures, Banks will be limited in their ability to contribute to national and international efforts to reduce local, national, and global climate risks. Further, banks may soon be required to produce some of this information in order to comply with IASB/ISSB disclosure requirements; it would seem odd therefore, not to include this in the Pillar 3 disclosure framework.

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?

The answer to this question depends on the disclosure requirements which are eventually agreed. These may be less helpful if they are not reported on a country-by-country basis, and if banks report boilerplate type statements on their aggregate climate-related financial risks. Furthermore, the lack of disaggregated, by-country, climate-related financial risk disclosures, may penalise those banks which operated in countries where climate-related risks may be higher. Indeed, the current proposals might cause some banks to pause about expansion into countries or regions with high climate-related financial risks if such expansion increases aggregate disclosure measures produced by a bank. There is a need to consider the capacity of market participants to meaningfully interpret these new disclosures and integrate them into their evaluation models. There is a need to support this disclosure framework with targeted professional educational programmes with all relevant market participants.

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?

It is vitally important that the Pillar 3 framework for climate-related financial risks disclosure should be interoperable with those of other standard-setters. This would reduce costs and encourage banks to comply fully in the provision of detailed disclosures on the topic. To optimise interoperability and future proof this disclosure framework it should incorporate the widest scope and most granular of data required of all the standard setting bodies, avoiding a potential race to the bottom dynamic. Further, if standard setters as well as banking authorities, mandate the same climate-related risk disclosures, the importance of this issue will be highlighted for banks.

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

This depends on the answer to Question 4. If they need to be done anyway because of requirements from standard-setting bodies, then the level of the scale of any unintended consequences should be minimised. Such unintended consequences can be reduced further via the consultation process being conducted over the Pillar 3 framework for climate-related financial risks for instance liaising with assurance bodies over the any checks on these disclosures would be needed in order to ensure that auditing standards will be in place. The main unintended consequences are likely to arise from a narrow definition of climate risks and greenhouse gases attributable to the actions and responsibilities of Banks. Therefore, care must be taken in relation to decisions to omit any categories of greenhouse emissions from these disclosure requirements and to revisit these categories in line with developments in climate science, such as those included in reports by Intergovernmental Panel on Climate Change and from discussions at the annual COP.

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

It seems sensible to break down the task requiring climate-related financial risks disclosures for banks into a number of component areas; extending it to the trading book at present might only delay the provision of any such disclosures since the task of drawing up a framework for climate-related disclosures linked to a bank's trading book is sizeable, complex and liable to lead to disagreement.

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

The document mentions a number of data sources which banks can use to identify geographical areas subject to climate-change-related hazards. However, if different banks use different combinations of these data sources to allocate climate-related risks comparability of disclosures between banks may be hampered in addition, if one bank alters its methodology for allocating exposures to sectors and geographical locations over time again comparability may be hindered making it difficult for stakeholders to draw appropriate inferences.

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

As many as the elements as possible should be mandatory, since the introduction of national discretion may lead to a 'race to the bottom' whereby very little disclosure will result. If national discretion is permitted, then Banks should be required to produce a supplementary report that reconciles their national report with European disclosure standards.

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?

We will leave this question for lawyers responding to the proposal.

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, we believe that the qualitative and quantitative requirements under consideration need to be subject to reasonable assurance in order to be meaningful. Reasonable assurance gives credibility to the disclosures which are made and as long as negotiations are conducted with those who assure such information, the process of introducing reasonable assurance for such data should be smooth. In addition, if all banks have to comply with these requirements, the assurance cost per bank should decrease as the expertise of those providing assurance becomes strengthened. If the disclosure requirements for climate-related financial risks being proposed link with other requirements for the provision of information as currently being mandated by the CSRD, IASB/ISSB this could again reduce any cost associated with the assurance process. While some might argue that the qualitative elements are more difficult to assure, assurance firms seem to be able to provide such assurance in other non-finance related areas (i.e. non-financial reporting). It is important that the level of assurance is consistently applied and given the critical nature of climate related financial risks we consider limited assurance standards to be ineffective and inappropriate.

Qualitative Disclosure Requirements:

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

Given the complexity, level of system interconnectivity and the non-linear dynamics of climate related financial risks, it is very difficult to capture and communicate these in purely numeric terms. To enhance the appropriate use of these calculations there is a need for accompanying narratives that explain any assumptions, discuss trends or issues with quality of available data, levels of uncertainty and the robustness of these assessments in relation to several different future scenarios.

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

It is very difficult to specify mandatory qualitative disclosure as there is risk of boiler-plate statements that add very little to the interpretability of the quantitative disclosures. However, it is possible to specify the attributes of these narrative disclosures, which can form the basis of assurance. For example, these attributes can be:

Does the narrative disclosure:

- accurately represent the trends evident within the quantitative disclosures?
- Explain any omissions or issues with the quality of underlying data?
- Communicate fairly and in understandable terms the data presented?
- Discuss the result over a range of different scenarios?
- Identify any material differences in national, regional or sectoral risks?

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?

The main challenges relate to explaining the uncertainty and sensitivity of risk calculations to drivers of these risks, without undermining the credibility of the data. This can be done through the development of explanatory protocols to guide the preparers, assurers, and users of these reports.

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

The establishment of a standard set of future scenarios against which the quantitative disclosures can be evaluated against.

Q15. How could the proposed qualitative Pillar 3 climate-related financial risk disclosure requirements be enhanced or modified to provide more meaningful and comparable information?

See responses to 12,13,14,15.

Q16. What are your views on the relevance of the proposed qualitative Pillar 3 climate-related financial risk disclosure requirements to understand climate-related financial risks to which banks are exposed?

The proposed qualitative disclosures are critical in shaping how the quantitative disclosures can be usefully appropriated into different decision-making processes. A combination of quantitative and qualitive disclosures is likely to produce outcomes that minimise climate related financial risks.

Quantitative Disclosure Requirements:

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

The benefits of the proposed quantitative Pillar 3 climate-related financial risk disclosure requirements are multifaced. Firstly, they can enhance risk management practices by providing clearer insights into the financial implications of climate-related risks which will allow institutes to better assess and mitigate these risks. Secondly, increased transparency resulting from these disclosures can lead to greater accountability and trust among stakeholders including investors, regulators and the public. Thirdly, by promoting climate action within the financial sector, this can stimulate broader awareness and action on climate issues across various industries, fostering a more holistic approach to sustainability. These benefits can contribute to the transition to a more sustainable and resilient economy aligning financial decision-making with long-term sustainability goals.

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

Making the proposed quantitative Pillar 3 climate-related financial risk disclosure requirements mandatory can promote consistency, transparency, market efficiency, and regulatory oversight, ultimately facilitating comparability across banks and contributing to a more sustainable and resilient financial system. However, it is important to acknowledge that a "one size does not fit all" approach may not be suitable, as some institutions may lack the necessary knowledge, resources, expertise, and capacity to comply with the proposed quantitative Pillar 3 disclosure requirements. Therefore, it is essential to address these concerns by providing special treatment or tailored guidance to ensure that all institutions, regardless of size or capacity can effectively meet the requirements. This could include offering resources, technical assistance, or phased implementation timelines to support in their capabilities in meeting the standards.

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?

The Challenges for preparers include the following:

- The availability of data concerning the climate-related financial risks and the quality of this data. To overcome this challenge, financial institutions can improve data collection and management processes by leveraging technology (machine learning tools), collaborating with industry peers and experts, and engaging with regulators and standard-setting bodies to develop common data standards and methodologies.
- Considering the varying characteristics of financial institutions, the consistency of applying this Framework on all financial institutions on the basis of "one-size fits all" policy might be an issue. In particular, when this framework is not applied on a country-by-country basis.
- Resource constraints, especially within smaller firms, may lack the resources, expertise, and capacity to comply with the proposed quantitative Pillar 3 disclosure requirements. To overcome this challenge, Regulators can provide guidance and technical assistance to help financial institutions build internal capabilities and capacity for climate risk management and disclosure. Industry associations, academic institutions, and

consulting firms can offer training programs, tools, and resources to assist preparers in meeting disclosure requirements.

The Challenges for users include the following:

- The proliferation of disclosure requirements from various regulators and standard-setting bodies may lead to disclosure overload for not only for preparers but also the users of these information, this might have a negative impact on the usefulness of these information. To overcome this challenge, regulators and standard-setting bodies can collaborate to harmonize disclosure requirements and streamline reporting processes.

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

Financial institutions could be required to disclose their alignment with climate-related goals and targets, such as the Paris Agreement targets or national climate action plans. In addition, the Framework should be aligned with the requirements, whenever applicable, of S1 and S2 of the ISSB, ultimately facilitating the harmonisation and comparability of these disclosures. The Committee may also consider disclosure of specific grievance mechanisms designed for the use of affected communities/high risk sectors to expedite the resolution of concerns regarding their financed emissions projects.

Q21. How could the proposed quantitative Pillar 3 climate-related financial risk disclosure requirements be enhanced or modified to provide more meaningful and comparable information?

There is no one size fit all, therefore, to achieve more meaningful and comparable information, Committee needs to encompass the deep-rooted political and economic factors in different jurisdictions in their disclosure requirements, as well as requires a combination of standardization, transparency, effective monitoring and stakeholder engagement to enhance climate-related financial risk disclosures.

Q22. What are your views on the relevance of the proposed quantitative Pillar 3 climate-related financial risk disclosure requirements to understand climate-related financial risks to which banks are exposed?

The proposed quantitative Pillar 3 climate-related financial risk disclosure requirements would be essential in achieving more informed decision-making outcomes by market participants. While these metrics provide valuable information, they may lack the necessary context to fully understand the implications for a financial institution's operations, strategy and resilience to climate change. Therefore, the integration of quantitative and qualitative disclosures will possibly enhance the quality, relevance, reliability and comparability of climate-related financial risk disclosure requirements which will allow market participants and other stakeholders to move beyond mere compliance with reporting requirements and towards a more holistic understanding of climate-related financial risks.

Transition Risk: Exposures and Financed Emissions by Sector:

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

Yes, measuring exposures and financed emissions by sector is crucial for banks to assess their exposure to transition risk, as it enables the identification of high-risk sectors and compliance with regulatory disclosures. This approach aids in risk management and strategic planning by highlighting areas vulnerable to changes in policy, market demand, and technology in the shift towards a lower-carbon economy. Furthermore, it supports banks in aligning with sustainability goals, enhancing their reputation, and seizing new opportunities in green finance.

Q25. What are your views on the availability and quality of data required for these metrics, including by sector, activity, region or obligor?

In our view, the availability and quality of data required for these metrics are the central issues of the proposed disclosure requirements. First, as far as we are aware, there is no standardization of climate-related disclosure among different sectors. Therefore, climate-related data may be more available in sectors, such as the manufacturing sector, that are more likely to pollute the environment; however, such data is relatively limited in less-polluting sectors. Second, different regions or countries have different requirements for the data required for climate-related disclosure. Additionally, it is a concern that environmental regulators, especially those from developing countries, are still less likely to investigate cases involving insufficient or fraudulent disclosure of climate-related data. This is mainly because of a lack of standardized disclosure requirements, which leads to relatively limited credibility for the climate data they provide to banks and other regulators.

Q26. What key challenges would exist for preparers to disclose these metrics, including by sector, activity, region, or obligor? How could these be overcome?

The key challenges would be the identification and drivers of key transition risks and the quantification of the potential financial implications. It would be necessary to establish mechanisms for ongoing monitoring, review and reassessment of risks by sector, activity and region or obligator.

Q27. What additional transition risk disclosure requirements should the Committee consider?

In our view, the credibility of data provided by counterparts in climate change mitigation and adaptation should be one of the risks that banks need to consider. For instance, in order to ensure the credibility of climate disclosure data, banks are expected to require counterpart firms to provide verification from third parties such as auditors. Upon verification by an independent third party, banks can then make relevant financing decisions.

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