FitchRatings

14 March 2024

Subject: **Response to the Consultative Document on Disclosure of Climate-related Financial Risks (the 'Consultative Document')**

Dear Members of the Basel Committee on Banking Supervision,

Fitch Ratings ('Fitch') is grateful for the opportunity to provide comments on the Consultative Document regarding the proposed disclosure of climate-related financial risks.

Fitch observes that banks are increasingly reflecting climate-related financial risks into their own business and lending decisions and their Pillar 2 assessments. As a credit rating agency, it is important for Fitch's analysts to understand these risks and their potential impact on credit; moreover, investor interest on the likely impact of climate change on credit risk is increasing.

Overall, we believe that the framework proposed will aid market participants in understanding climate-related exposure and related financial risks.

We provide some detailed responses to individual questions in the Annex and are happy to discuss further if helpful. We have only responded with respect to those elements about which we have specific comments.

We are happy for our response to be public.

Yours faithfully

Shampa Bhattacharya

Senior Director

Financial Institutions

shampa.bhattacharya@fitchratings.com

Annex: Feedback on Selected Questions

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?

Fitch, as a regular user of bank Pillar 3 and other financial disclosures, concurs with the Basel Committee's guiding principles for Pillar 3, which emphasize clarity, comprehensiveness, meaningfulness, consistency over time, and comparability across banks.

Fitch acknowledges the potential benefits of globally harmonized implementation of climate-related risk disclosures to help market participants assess a bank's exposure to climate-related risks under Pillar 1 and banks' own internal capital adequacy assessments and supervisory reviews under Pillar 2, and differentiate between banks accordingly.

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

Users of bank disclosures value consistency of standards and definitions. The absence of a global prudential standard may lead to fragmented disclosures that will make it more difficult to user of disclosures to compare and assess banks' relative exposure to climate-related financial risks.

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?

Fitch believes that globally-harmonized disclosures, aligned to key risk drivers of climate-related financial risk, could help market participants obtain appropriate metrics to aid credit analysis and support credit decisions.

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 in the interests of users of these proposed disclosures for sufficient interoperability be established between metrics used at an international level within the ISSB's S1 and S2 templates to aid reconciliations between the prudential and financial accounting disclosures to a reasonable degree (although noting the differing objectives of each reporting regime). Criteria and terminology used for the templates would ideally be sufficiently detailed and clear to reduce the scope for national interpretation that could negatively impact comparability of banks' disclosures across jurisdictions.

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

Sector exposure is valuable to understand potential exposure to climate related financial risks and the proposed methodology seems appropriate. A standardised approach to determine geographical locations subject to physical risk would help to avoid inconsistencies and promote comparability. In some jurisdictions users of bank disclosures would additionally benefit from a standardized sub-jurisdictional split where there is material intra-jurisdictional divergence, e.g. to differentiate Florida from California, with a view to allowing market participants to apply their own physical risk assumptions.

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

Whilst we recognize that national discretion can accommodate local financial system variations, it can potentially lead to divergence that may impede comparability. In light of this, standardised quantitative disclosures that use fixed-form templates are often more useful to market stakeholders, supported as needed by qualitative disclosures.

Qualitative disclosure requirements

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

Yes, we believe this would be helpful to users of disclosures.

Quantitative disclosure requirements

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

We believe market users would value the disclosure of templates CRFR3, CRFR4 in addition to CRFR1 and CRFR2. Market users are likely to find template CRFR5 for facilitated emissions less critical, given the methodology for facilitated emissions is still evolving, although the Basel Committee could guide supervisors to request this disclosure for banks where ECM/DCM is a material part of their business.

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?

We view the proposed disclosures as relevant to the understanding of the climate-related financial risk exposures of banks. We believe that high quality disclosures of underlying exposures will allow market participants to apply their own assumptions to make their own assessments of the risks and comparisons using these proposed templates.

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?

We believe market participants would find this disclosure template useful.

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

We believe the following enhancements to CRFR1 could improve the usability of the template by market participants:

Segregation of the combined exposure by loans/debt securities/equity or by traded v/s untraded or by liquidity classifications (level 1, 2 or 3) as they represent somewhat different set of risks;

More definition around what to include in the off-balance sheet exposure including outstanding commitments, JVs, SPV's, derivatives etc;

Financed emissions can be important especially if associated with corresponding targets as it also provides insight into the nature of climate risk management and monitoring;

Market participants may also find it useful to understand which exposures within a sector are "environmentally sustainable", e.g. to oil and gas companies that are transitioning towards cleaner fuels and less carbon intensive business models (as seen in the similar EU disclosure templates), although it is acknowledged there may be subjectivity regarding criterion selection.

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

The Committee could consider a split on CRFR4 by material jurisdictions, otherwise users of disclosures will receive averages across portfolios, that could mean users miss jurisdictional-related sensitivities. In addition, the measures for CO_2/GHG by sector use could benefit by ensuring alignment to other climate-related disclosures, such as the ISSB template's guidance for individual sectors.

Q28. What are your views on the appropriateness of classifying sectors according to the Global Industry Classification Standard (GICS) with a six- or eight-digit industry-level code?

Although Fitch recognizes varying national approaches to corporate sector classification that would necessitate a mapping exercise, the use of the GICS eight-digit classification, would be sufficiently granular to aid decision-useful analysis, and use of the same granularity across templates CFR1, 2, and 4 would help reduce information asymmetry by enabling analysts to tie exposure sensitivity to transition and physical risks.

Q29. Would it be useful to require disclosure of the specific methodology (such as Partnership for Carbon Accounting Financials (PCAF)) used in calculating financed emissions?

Yes, this could be useful.

Physical risk: exposures subject to climate change physical risks

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

Fitch believes users of disclosures could find CRFR2 useful to gauge exposure to physical risks, and both reporters and users could benefit from more detailed guidance around how to define geographies subject to physical risk and on how the location of factories and offices versus for instance the headquarters of companies and obligors matter in terms of data capture for this template.

Some potential enhancements could be as follows:

Consider a standardized split by "material" physical perils (using suitable threshold, e.g. 10%/20% on uninsured or residual risk basis);

Consider a standardized geographical split (sub-jurisdictional level) with a view to allowing market participants to apply their own physical risk assumptions.

Replicate the sectoral breakdown used for corporates, otherwise there will be an asymmetry when comparing across to transitional risks

State which scenario and what time horizon has been used for forecasting physical risk development, if not determined using a standard prescribed scenario.

Q31. Would there be any limitations in terms of comparability of information if national supervisors at a jurisdictional level determined the geographical region or location subject to climate change physical risk? How could those be overcome?

Variability around definitions for geographical regions, considered perils, and threshold for determining physical risk exposure could lead to less useful disclosures if left to each national jurisdiction.

If agreement around a consistent definition of physical risk vulnerability is difficult to achieve globally, disclosures could provide a breakdown of geographic exposures instead.

Bank-specific metrics for quantitative climate disclosures

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?

Fitch believes users of bank disclosures would find maturity analysis breakdowns useful to understand the extent to which exposures more prone to climate related financial risks are churned or replaced, that could shed more light on the relative vulnerability of certain business models, alongside providing insights on the time horizon of financial risks; similarly, it would be useful to understand the extent to which credit and counterparty risks are transmitted through obligors prone to heightened transition or physical risks.

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?

Fitch believes users of bank disclosures would find it meaningful to better understand the implications of banks' business model and portfolio selection choices as it relates to climate related financial risk concentrations. The inclusion of concentration/materiality by counterparty and jurisdictions, such as "top 10," would be highly valuable.

Q45. In relation to the disclosure of exposures subject to physical risk, would it be meaningful for assessing banks' climate-related concentration risk if these exposures were divided into six or seven broadly defined hazards, eg heat stress, floods, droughts, storms, wildfires etc?

Fitch believes users of the CRFR2 would appreciate the improved comparability of the template were key physical perils to be defined, provided the definitions were clear and consistent. This would remove variability in what perils are considered in determining exposures that are subject to physical risk.

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?

Fitch believes users would benefit from the optimisation of the use of publicly available information on Pillar 3 by all participants in the financial markets, in line with the objectives set out in the Basel framework. To this end, fixed-form templates aid comparability, and making disclosures available within a machine-readable single document/source – ideally online via a similar repository such as that used for the G-SIB buffer regime (or US SEC disclosures, or the data repository developed by the European Banking Authority) - could help make the process of extracting and reviewing the information more efficient for users.

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?

Fitch believes both the energy efficiency of the real estate (CRFR3) and emission intensity (CRFR4) data to be informative and relevant to a more granular understanding of banks' transition risk relative to their real estate and loan portfolios respectively, which materially enhances the exposure data provided in the CRFR1 tables. Therefore, the market could be better informed about transition risk if both these tables are mandatory.

Q51. What are your views on the feasibility, meaningfulness and practicality of banks' disclosure of facilitated emissions?

Fitch believes the proposed facilitated emissions disclosure in CRFR5 could be useful but not critical given the still evolving nature of the methodology which potentially make it less useful as a risk tool. One suggestion would be making these specific disclosures discretionary at first becoming mandatory once accounting is finalized/agreed upon.

Disclosure of the activity amounts are useful.

Notwithstanding noted discretionary, guidance could be provided to supervisors to require this disclosure for banks where ECM/DCM is a material part of their business (e.g. operating income >10% per Operational Risk BIA)

Effective date

Q52. What are your views on the feasibility of the potential effective date of the Pillar 3 climate-related disclosure requirements?

We believe users would prefer to see banks disclose decision-useful templates sooner, and so welcome the iterative approach noted within the consultation, incorporating a suitable phase-in regime rather than waiting for perfection (improve over time)- similar to the approach taken by the EU in relation to the European Banking Authority's disclosures phase-in.

Q53. Would any transitional arrangements be required? If so, for which elements and why?

Please see answer to question 52.