



ERA·TOS·THENES

Date: January 31, 2021

Mr. Neil Esho
Acting Secretary General
Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel, Switzerland
Via [web portal](#)

Subject: Principles for the effective management and supervision of climate-related financial risks

Dear Mr. Esho:

My name is Greg Rogers. I specialize in the emerging discipline of accounting for climate change. My relevant background includes: CPA, environmental lawyer, author of *Financial Reporting of Environmental Liabilities & Risks* (Wiley 2005), fellow and advisor to the University of Cambridge Judge Business School, and inventor of Carbon Quotient™ climate risk analytics, an open-source application of established accounting concepts to measure, manage and report climate-related financial risk.

Support for draft principles

I support the draft principles and the Committee's principles-based approach generally and, in particular, support the following findings and principles:

- Banks should identify, monitor and manage all climate-related financial risks that could materially impair their financial condition.
- Climate change may result in physical and transition risks that could affect the safety and soundness of individual banking institutions and have broader financial stability implications for the banking system.
- Banks should develop qualitative or quantitative metrics or indicators to assess, monitor, and report climate-related financial risks.

Introduction

The principal financial barrier to mitigating the worst impacts of climate change is the need to prematurely retire much of the world's vast stock of carbon-intensive assets and either retrofit

or replace these assets with low or zero emission alternatives. Replacing or modifying these assets will require a tremendous amount of capital investment that is not figured into existing business models.

Existing and especially new carbon-intensive long-lived assets are at high risk of becoming impaired or permanently stranded by the energy transition. This poses significant financial risks to banks, bank counterparties, and the overall financial system. Large banks and other systemically important financial institutions should measure climate-related asset impairment risk because *what is not measured is not managed*.

Comments on proposed principles

My comments focus on Management Monitoring and Reporting (Principle #7) and specifically paragraph 31:

31. Banks should develop qualitative or quantitative metrics or indicators to assess, monitor, and report climate-related financial risks....

My comments address four areas: (1) impairment or stranding of financed assets and collateral arising from the transition to a low carbon economy; (2) how to measure climate-related asset impairment risk; (3) legal and reputational risks arising from potentially misleading climate-related financial disclosures; and (4) data quality and availability.

Climate-related asset impairment risk

The energy transition increases the probability that bank financed assets and collateral will become impaired or stranded prior to loan maturity. These risks could negatively impact borrowers' ability to repay loans as well as the value of collateral if they default. Also, because asset impairment risks are likely to be correlated across exposures and asset classes, the transition to a low carbon economy may threaten the safety and soundness of individual banks, bank counterparties, and the overall financial system.

Measuring climate-related asset impairment risk

In addition to scenario analysis, which assesses financial risk based on the range of reasonably foreseeable *future* conditions and events, banks need forward-looking measures of climate-related asset impairment risk that are based on *existing* conditions and events that have already occurred. For banks, the *future that has already happened* includes the acquisition, construction, development, and financing of carbon-intensive long-lived tangible assets (e.g., commercial real estate, homes, autos, factories, electric power plants, fossil fuel reserves, machinery and equipment, energy and transportation infrastructure, etc.).

To identify and measure climate-related asset impairment risk, banks should measure and price the *unrealized emissions* embedded in the long-lived assets they finance and accept as collateral. Unrealized emissions are the greenhouse gas (GHG) emissions that will come from existing physical assets over their remaining useful lives. The methodology and rationale for

measuring and pricing unrealized emissions are further explained in [Carbon Quotient – how to create accountability for net zero across the investment value chain](#).

The Partnership for Carbon Accounting Financials (PCAF) [Global GHG Accounting and Reporting Standard for the Financial Industry](#) recognizes that, in the case of project finance, portfolio accounting of emissions occurring in the reporting year does not consider unrealized lifetime emissions and recommends that financial institutions assess the total lifetime emissions for projects financed during the reporting year. Unrealized emissions, however, are relevant to all asset classes, including listed equity and corporate bonds, business loans and unlisted equity, commercial real estate, mortgages, and motor vehicle loans.

Climate-related financial disclosure

In addition to the need to identify, measure, monitor, and control their climate-related financial risks, banks are under rising pressure to publicly disclose their financed emissions in connection with investor efforts to prepare the global financial system for a net-zero carbon economy.

Climate-related financial disclosures and net zero ambitions may be unrealistic and misleading if they do not account for the unrealized emissions embedded in bank loan portfolios. A just-released [report](#) from the Center for American Progress warns:

Due to the lack of concrete targets, campaigners have warned [Glasgow Financial Alliance for Net Zero](#) leadership that signatory banks may use the voluntary initiative to greenwash their image by promising to meet ambiguous and largely rhetorical commitments that fail to translate into meaningful reductions in financed emissions.

Banks, many of which have investment management divisions, should also be aware that regulators are increasingly worried about financial greenwashing. For example, Reuters recently [reported](#) that “European financial regulators say they are uncovering more cases of greenwashing by asset managers cashing in on booming demand for sustainable finance, and some are starting to turn the screw on funds that cannot back up what they claim.” The U.S. Securities and Exchange Commission Division of Examinations recently issued a [risk alert](#) on environmental, social and governance (ESG) investing, citing a lack of standardized ESG definitions, unsubstantiated and misleading claims, and a lack of internal controls.

Data quality and availability

Estimation of unrealized emissions requires a combination of financial and GHG emissions data. High quality financial data is widely available, either from audited financial statements, borrower loan applications, or third-party sources. High quality GHG emissions data is less widely available, particularly for certain asset classes, but can be collected in borrower loan applications.

PCAF provides the following recommendations to address GHG emissions data gaps:

Financial institutions shall ensure their GHG accounting appropriately reflects the GHG emissions of their loans and investments and serves the decision-

making needs of internal and external stakeholders. To safeguard these outcomes, financial institutions should use the highest quality data available for each asset class for calculations and, where relevant, improve the quality of the data over time. PCAF recognizes that high quality data can be difficult to come by when calculating financed emissions, particularly for certain asset classes. However, data limitations should not deter financial institutions from taking the first steps toward preparing their inventories, as even estimated or proxy data can help them identify carbon-intensive hotspots in their portfolios, which can inform their climate strategies. Where data quality is low, financial institutions can design approaches to improve it over time.

Under the EU Non-Financial Reporting Directive (NFRD), companies, including banks, are expected to disclose relevant information – including direct and indirect GHG emissions data – on the actual and potential impacts of their operations on the environment, and on how current and foreseeable environmental matters may affect their development, performance or position.

Thank you for addressing the emerging risks to banks and the financial system from climate change and the transition to a low carbon economy and for the opportunity to comment on the Committee’s draft principles.

Best regards,

A handwritten signature in blue ink, appearing to read 'Charles Greg Rogers'.

Charles Greg Rogers
Founder and President

Attachment