ICAEW
REPRESENTATION 15/22

PRINCIPLES FOR THE EFFECTIVE MANAGEMENT AND SUPERVISION OF CLIMATE-RELATED FINANCIAL RISKS

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ICAEW welcomes the opportunity to provide feedback on the consultation published by the Basel Committee on Banking Supervision which is available from this link.

> 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. Banks are potentially exposed to climate-related financial risks regardless of their size, complexity or business model. They should therefore consider the potential impacts of climate-related risk drivers on their individual business models and assess the financial materiality of these risks. Banks should manage climate-related financial risks in a manner that is proportionate to the nature, scale and complexity of their activities and the overall level of risk that each bank is willing to accept.

This response of 16 February 2022 has been prepared by the ICAEW Financial Services Faculty. As a leading centre for thought leadership on financial services, the faculty brings together different interests and is responsible for representations on behalf of ICAEW on governance, regulation, risk, auditing and reporting issues facing the financial services sector. The faculty draws on the expertise of its members and more than 25,000 ICAEW members involved in financial services.

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ANSWERS TO SPECIFIC QUESTIONS

Q1. Has the Committee appropriately captured the necessary requirements for the effective management of climate-related financial risks and the related supervision? Are there any aspects that the Committee could consider further or that would benefit from additional guidance from the Committee?

1. We are pleased to see that the principles listed in the consultation paper (CP) are consistent with all major similar guides (for example the European Central Bank's Guide on climate-related and environmental risks) and with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). This guidance will help banks within the scope of the supervision of the Committee align their current and future efforts in this space with the current internationally accepted best practice of managing their climate-related financial risks. It also fosters alignment in terms of supervisory expectations for addressing these risks.
2. We agree that the guidelines need to promote a principle-based approach to improve risk management and supervisory practices relating to climate-related risks. This approach will help to ensure consistency and improve comparability and at the same time will allow banks to tailor their approaches according to their different business models, clients and customers. While the principles listed in the CP are high level, the supporting narrative gives banks enough material to enable them to build a structured approach to assessing, managing and mitigating their climate-related financial risks.
3. We also believe it is helpful that the principles related to managing climate-related financial risks (principles 1-12) and the ones guiding supervision (principles 13-18) are included in the same document. This draws attention to the interconnectedness of the internal and external considerations as well as increasing transparency thereby providing a common baseline for banks and supervisors. The emphasis on proportionality enables banks to accommodate the size, complexity and risk profile of their institutions and allows for continuous improvement in their climate-related financial risk practices.
4. The fact that these principles build on the TCFD recommendations and are expected to follow the standard due to be published by the International Sustainability Standards Board (ISSB) later this year should help to align the management, reporting and supervision of climate-related financial risks.

Q2. Do you have any comments on the individual principles and supporting commentary?

5. In our view, the principles listed in the CP successfully combine and build on the recommendations of the TCFD and the work completed previously by the Committee, especially that work published in the April 2021 report "Climate-related risk drivers and their transmission channels". This enables banks to consider their climate-related risks in line with the TCFD but within the framework of the traditional risk categories, namely credit, market, liquidity, operational and liquidity risk. The method followed will assist banks to build the consideration of climate-related risks into their risk management practices.
6. We believe that the supporting commentary is sufficient to enable understanding while allowing for banks to apply the guidance according to their specific circumstances. We find the referencing to the Basel Core Principles (BCP), the Supervisory Review Process (SRP) and the corporate governance principles particularly helpful.

Q3. How could the transmission of environmental risks to banks' risk profiles be taken into account when considering the potential application of these principles to broader environmental risks in the future? Which key aspects should be considered?

7. The principles listed in the document are sound and as they are based on the recommendations of the TCFD they provide a common baseline for managing climate-related risks. Banks (and other financial services institutions) realise that their primary exposure to climate-related risks originate from the finance they provide to their clients and

customers. This makes them vulnerable to individual sectors and industries as well as geographies depending on their business models.

8. When assessing their climate-related financial risks, banks should identify the climate risk drivers by transmission channel (both micro and macroeconomic) and by sources of variability. This will enable them to analyse the combination of different factors that need to be built into their scenario analysis allowing for potentially very different future outcomes which in turn would allow for managing a wide range of potential risks.

9. We applaud the Committee for considering the urgency of the issues and responding by preparing this guidance. While banks make progress and adopt an increasingly more sophisticated system of managing their climate-related risks, we believe that they should also focus their attention on nature-related financial risks too. In an effort to assist financial services institutions, the Task Force for Nature-related Financial Risks (TNFD) has accelerated its work programme and has aligned its framework with that of the TCFD. The four pillars in the TCFD's framework – governance, strategy, risk management, and metrics and targets – are agnostic to climate or nature and, therefore, we believe that these pillars can be applied to the consideration of nature-related risks until such time as the TNFD publishes its own recommendations.