POLISH BANK ASSOCIATION

Warsaw, 8 February 2022

Basel Committee

on Banking Supervision

Polish Bank Association position

on the Consultative Document "Principles for the effective management and supervision of climate-related financial risks" prepared by the Basel Committee on Banking Supervision.

Polish Bank Association welcomes the opportunity to express its opinion on the Consultative Document titled "Principles for the effective management and supervision of climate-related financial risks" prepared by the Basel Committee on Banking Supervision. This document is very important for banking industry because it refers to a new area of potential risk for banks – climate – related financial risk. The industry and regulators have to be very interested in setting up the principles which will be useful in the process of managing climate – related risk.

We appreciate the time when the first proposal of principles was delivered. We have to have in mind we are in the moment when the initial moves in the direction to define this kind of risk have been made, the taxonomy in this area is not yet finished and awareness of this risk for banking sector is still more intuitive than defined by the regulators or research centers. These circumstances generates the situation where the general principles should be prepared and discussed at this stage but we are conscious that it's the preliminary principles. We expect the follow up in these principles as the progress in the area of climate – related risk will be achieved by the regulators.

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General remarks

Banks' shifting towards a low-carbon economy is key factor to finance successfully the big transition in whole economy. Banks are ready to finance this transition to the green economy. They are aware of their role and are ready to play it well. However, the banks' responsibility can not be the sufficient factor. The economic policy has to play the most important role. The climate objectives should be express clearly and transposed the industrial policy and preferred way of financing the transition. Banks will be engaged into the shift to green economy but the need for such kind of financing has to come from the industry. The big investment programs are needed. Banks have to have the chance to choose these projects which support the climate policy promoted by the regulators. Without such projects it will be difficult for banking sector to be engaged in the shift to the low-carbon economy and the measurement of climate-related financial risks will be more complicated. The impact of banks on structures of their assets is limited by the projects proposed by the real economy.

We support the regulatory efforts to establish the principles which properly identify, understand, manage and supervise the climate-related risks. However, we are convinced that the identification, measurement of this risk has to big extend the derivative follow the implementation of climate-related taxonomy in whole economy. Without the clear and broadly accepted taxonomy the measurement of climate- related risks will be much more complicated, particularly for international active banks where the objectives and tools of climate policy may be different in different jurisdictions. This situation will cause the situation where the risk measurement will vary in home and host countries. These differences may lead also to the different reporting obligations. These circumstances lead us to the conclusion that the principles for the effective management and supervision of climate-related financial risks may be very general only. These principles have to be consistent with the principles for effective management of other financial risks in banks but the in this area the sufficient level of flexibility has to be maintained, regarding the terms of methodologies and principles of management.

From model perspective, we would like to highlight the mismatch of time horizon of the models applied in the market and long-term climate risk scenarios. This last one covers a time horizon of 30 years and current risk measure models are not adopted to such horizon. The consultative document should provide more details on the time horizons and the obligation for banks in longer period. We have also to remember that planning in banks in such long time horizon may be difficult. The regulation and the real economy change so rapidly that time horizon of 30 years will be big challenge.

It is obvious for us that the level of bank capital has to be determined by the scale of risk generated by banks. However, we have the problem to adopt the level of necessary capital to the climate-related financial risk. This risk can materialize in longer period and this materialization can be higher or lower, depending also on the changing approach to the definition of climate risk. It will be challenge for banks to adopt the suitable level of capital in order to cover the climate risk because it is nowadays difficult to assess the scale of capital losses generated by the climate – related financial risk. It is worth to mention that such prudential regulation does not exist yet and there is not the proper assessment relating to the correlation between needed capital and the level of generated climate-related financial risk. So, we are convinced there are the reasons to demand for solving this matter at later stage, not directly after present consultation of principles.

This long term period when the climate – related risk can materialize leads us to the conclusion that the impact of this risk on the liquidity of banks, particularly on the short term liquidity will be very limited.

Comment to Introduction

We support the application of proportionality principle in the text of the BCBS principles taking in account the size, complexity and profile of different banks. However, it is difficult to find the detailed solutions in the text of proposed principles which can express the application of the proportionality principle in praxis.

Comments to the text of proposed principles

Principle 1

We recommend to include in this principle the definition of the physical and transition risk. These terms are included in the text and they are coming from the taxonomy related to the ESG but it would be good to describe the definitions of both kinds of risk. These definitions are crucial in order to identify, measure and manage these kinds of correctly.

We recommend also to apply the terminology used in other BCBS principles of sound management of risk and to replace words "risk driver" by "factor".

Principle 2

The role and the responsibility of the board and senior management should be more carefully distinguish. We understand that the role of both bodies can vary across jurisdiction but this responsibility should be more divided according to other principles published by the BCBS.

It is not clear if the responsibility should be assigned to the members and committee. We think this approach is not correct. The right version should be to decide by a bank if it assigns the responsibility to member or to committee. To do it both to members and committee seems to be unreasonable. This responsibility is not clear in this situation.

Principle 3

No comment at this stage. We support proposal of this principle.

Principle 4

We recommend to delete in paragraph 18 the word "sufficient". It is difficult to measure what it means the term "sufficient awareness". We are convinced that the expression that "staff should have awareness" is sufficient in order to express the needs concerning the employees.

Principle 5

In this principle we would like to come back to the term "over relevant time horizon" and the necessity to do it in the longer term, for example in 20 years period. We are convinced that such intervals are very long and very difficult to measure for banks. We recommend to adopt this time horizon to the other types of risk existing in banks. The 5 years period will be adequate to the present level of knowledge in area of risk management and climate – related financial risk.

This principle is generally correct looking at its high level generality. In praxis it is more complicated because we do not have nowadays the precise relationship between this kind of risk, its risk drivers and the level of capital or liquidity in order to cover this risk. Banking sector do not have the statistical data necessary to measure correctly the risk and the bank clients do not want to get to banks all information needed for proper measurement of this risk and its consequences for level of adequate own capital. These circumstances take us to the conclusion that banks have to include the climate-related risk in the bank capital and liquidity adequacy frameworks but the precise correlation between this risk and capital and liquidity can not be adequate measured. In this context we understand the idea expressed in paragraph 23, that banks should do it progressively. However, we are convinced that the expression "iteratively" is not needed. The expression "progressively" better expresses the idea of progress required in banks over longer period.

Principle 6

In paragraph 27 there is the message which should be treated more generally. It concerns the risk connected with climate which is not yet apparent. We have to have in mind that this risk in the area where the big progress can occur in the near future and the expectations towards banks have to be rationalized. It is impossible to imagine all kinds of risk connected with the climate. This type of disclosure should refer to nearly all consulted now principles.

This specific situation concerning the development of climate – related financial risk leads us to the conclusion that the words "where appropriate" or "where possible" should be more frequently used in the text of these principles.

Other matter is the problem how banks may identify the risk which is not yet apparent. We recommend to substitute the words "may not yet be apparent" by the words "is identified but it is not yet possible to assess as relevant".

Principle 7

This matter is a big concern for banks. We agree that risk data aggregation is necessary to manage the risks. The available data are of insufficient quality in terms of completeness, availability of historic information and representativeness of future evolution. They therefore make the translation of climate-related risk into financial risk and potential losses for banks more difficult. Such statement was expressed also by the Financial Stability Board in the document published in July 2021 and titled "The availability of data with which to monitor and assess climate-related risks to financial stability. In its conclusion the Financial Stability Board indicated that there were significant remaining data gaps.

In this situation banks can not be the unique bodies which are responsible for completeness and availability data related to climate risk. The data has to be collected from the public bodies or from our business partners. This process is not easy. Some clients contest the right of banks to demand some kind of information, for example in the process of granting credit. We recommend to add the general principle that banks should do all the best in order to collect the information form external sources.

We can not make banks responsible for lack of some information, particularly as we read in paragraph 27 that some climate – related risk drivers may not yet be apparent.

In paragraph 29 there is recommendation that banks should consider actively engaging clients and counterparties and collecting additional data in order to develop better understanding of their transition strategies and risk profile. This sentence is not clear if the purpose is to develop better understanding of clients and counterparties. We believe it is not the role of banks to develop better understanding of clients in this area. Banks may play the specific role of the advisor, consultant but create banks as the institutions responsible for better understanding of the climate-related risk is not proper.

As we express earlier, we have also doubts concerning the possibility to collect effectively the fragile information in area of climate-related risk. Banks have to have the possibility to ask the question but the quality of answer is completely other matter and banks will probably have limited capacity to verify the correctness of delivered information.

Principle 8

In paragraph 33 there is the recommendation that banks should identify, evaluate, monitor, report and manage the concentration within and between risk types associated with climate-related financial risks. This topic is not explained broader. The first question concerns the management of concentration. What it means the concentration in this area? Is it geographical concentration, credit portfolio concentration in area polluting plants or other forms of concentration? The second question concerns the relations between different types of risk associated with the climate – related risk. it would be reasonable to indicate the example of these relations which should be included by banks in the management of this risk.

Principle 9

This principle is reasonable. The problem is the access to the information on the capital market. We can imagine that bank can measure the risk connected with the portfolio of green bonds, but to measure the risk connected with other types of securities will be more complicated. The listed companies will have the obligation to issue the report on the climate – related aspects of their activity but as long as the taxonomy is not precise, the reporting standards are not the same for all, it will be difficult to access the climate-related risk on the market risk.

In our opinion the paragraph 35 concerns more the reputation risk than the market risk. The paragraph 36 covers more precisely the matter of market risk. We recommend to adapt these two paragraphs to the main risk associated with the correlation of climate risk and other types of risk in banking activity.

Principle 10

We see the liquidity risk for banks connected with climate-related matters mainly as the risk connected with growing awareness of clients which may decide to withdraw their deposits from the banks investing in the industry generating pollution. We are afraid it will be difficult task for banks to measure the clients' awareness and the potential scale of withdrawals connected with this factor.

Principle 11

We have no comment at this stage.

Principle 12

The level of knowledge concerning the climate-related risk is too low nowadays to make reasonable stress testing. That is the reason why we support the expression "where appropriate" used at the beginning of this principle.

It is interesting to know that the regulator expresses the point of view that the lack of reliable data on climate -related financial risk represents at present a challenge to application of the pillar 1 framework but banks should prepare themselves the stress tests and apply the internal capital requirements concerning the same type of risk.

We are convinced the principles in the consultative documents were prepared in such way that all matter concerning the climate-related financial risk are well identified, understood by banks and these principles can be prepared in the same way as the principles concerning the other types of risk which are well known since many years. That is the reason to demand for more delicate approach used at the beginning of management of climate -related risk, for example by adding more frequently the expression used in this principle "where appropriate".

These principles will have to be many times refined. It is obvious in new area of bank activity, where new kind of risk are identified. This is the reason why these principles can more flexible at this stage of ESG risk, implementation of new rules regarding the definition and scope of this kind of risk.

We hope that the comments delivered by our Association will be useful in the process of preparation of new version of principles. We do not want to express the term “final version”, because we are convinced that the awareness of climate-related financial risk changes so rapidly that these principles will have to be modified more frequently in the near future in comparison to the principles covering other types of banking risk.

Yours sincerely,

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President