Reclaim Finance's comment on the Basel Committee's draft principles for the effective management and supervision of climate-related risks

Reclaim Finance welcomes the Basel Committee's decision to publish principles for the effective management and supervision of climate-related risks. However, Reclaim Finance underlines that the draft principles will not allow for the effective management of these risks and will let them accumulate in the financial system for two main reasons:

1. The principles focus on progressively building expertise and capacity, therefore failing to prevent climate-related risks to accumulate and delaying the management of these risks. While the risks related to certain financing activities/exposures such as fossil fuels are clearly identifiable based on climate science, the principles do not account for these prominent risks. Furthermore, supervisors around the world – like the NGFS and the ECB – confirm they are clear benefits of acting early on climate change, opening the door to precautionary prudential measures to be taken. Such a precautionary approach -notably endorsed by Denederlandse Bank (DNB) - is also the only way to consider the fact that climate-related risks are characterized by a radical uncertainty that makes them especially difficult – if not impossible – to accurately predict and quantify.

2. The principles do not require supervisors to evaluate financial institutions' capital adequacy to cover climate related-risks. This means the principles are not aiming at ensuring financial institutions' resilience against climate-related risks but rather at exploring these risks. The impact of the principles will be very limited if the risks identified are not immediately considered in the prudential requirements. First and foremost, capital requirements for the exposures clearly identifiable as the riskiest from the climate-related perspective - namely fossil fuel exposures - should be increased. The suggested increase is in line with the risk-based nature of prudential capital rules, as the increased capital requirements reflect the high risks associated with fossil fuel financing. This would allow financial institutions to build capital buffers to cover the risks, as well as restore risk-based incentives of banks by incorporating the currently unaccounted for climate-related financial risks.

Furthermore, Reclaim Finance stresses that the Basel Committee should follow the example of the European Union and address the double materiality of climate-related risks. Such a move would entail going beyond the proposed principles and pushing financial institutions to adopt clear policies to align with the Paris Agreement and lower their support to the most polluting activities.

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