

February 14, 2022

VIA ELECTRONIC SUBMISSION

Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Re: Principles for the Effective Management and Supervision of Climate-Related Financial Risks

Ladies and Gentlemen:

On behalf of its members, the Risk Management Association's Climate Risk Consortium ("RMA Consortium") thanks the Basel Committee on Banking Supervision ("BCBS") for the opportunity to comment on the BCBS's proposed principles for the effective management and supervision of climate-related financial risks ("Proposal").

Launched in September 2021, the RMA Consortium seeks to assist banks in integrating climate risk management throughout their operations, preparing the industry to help economies transition to a low-carbon future. The RMA Consortium, representing 25 leading U.S. and Canadian banking organizations, aims to advance climate risk management practices in the banking industry by facilitating the development of industry-wide taxonomy and standards. The RMA Consortium appreciates the BCBS's efforts to improve risk management and supervisory practices related to climate-related financial risks and welcomes guidance in this space.

The RMA Consortium broadly supports the Proposal, including its principles-based approach and that it promotes the development of risk management practices that are commensurate with banks' size, complexity and exposure to climate-related financial risk.¹ Nonetheless, our members believe the final guidance should include the following important clarifications, which we summarize below and then explain in greater detail throughout the letter. In sum, the final guidance should:

¹ See, e.g., Proposal, supporting commentaries 8 and 11, respectively ("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" and "Banks should continuously develop their capabilities and expertise on climate-related financial risks commensurate with the risks they face.")

1. Clarify that stress testing and inclusion in internal capital and liquidity adequacy assessment processes of climate-related financial risks should not impact a bank's capital or liquidity buffer requirements or trigger other regulatory consequences;
2. Acknowledge more explicitly that banks will require a reasonable timeframe to implement data- and model-driven risk management practices and processes;
3. Clarify that banks should have flexibility to structure their implementation of the practices outlined in the Proposal in a manner that is consistent with their respective operating models for risk management and risk classification systems; and
4. Further promote coordination among supervisors while acknowledging the differences in supervisory mandates across jurisdictions.

We believe these modifications are consistent with the BCBS's objectives, the Proposal and related work of BCBS. Like previous issuances of BCBS, the final guidance will set the standard for climate-related regulatory regimes across the globe, making these clarifications all the more important. The clarifications would strengthen the balance sought by the BCBS in the Proposal between "improving practices related to the management of climate-related financial risks" and "maintaining sufficient flexibility given the degree of heterogeneity and evolving practices in the area."²

I. The final guidance should clarify that stress testing and inclusion in internal capital and liquidity adequacy assessment processes of climate-related financial risks should not impact a bank's capital or liquidity buffer requirements or trigger other regulatory consequences.

A. Observations and Considerations

Principles 12 and 18, as well as supporting commentaries 6, 41, 54 and 60, suggest that banks utilize scenario analyses, including stress testing, to help assess and manage climate-related financial risks. Principle 5 and supporting commentary 53 state that banks should incorporate climate-related financial risks into their internal capital and liquidity adequacy assessment processes.

Quantitative assessments offer important insights into the impacts of risk drivers on banks. Accordingly, the RMA Consortium supports scenario analysis as a useful tool for evaluating the potential economic and financial risks posed by different climate outcomes, and recognizes the value of stress testing as an exploratory tool, as discussed in the BCBS's April 2021 report on climate-related financial risk measurement and

² Proposal, supporting commentary 5.

methodologies (“BCBS Methodologies Report”).³ By contrast, traditional regulatory stress tests inform the size of capital and liquidity buffers banks are required to maintain.⁴

The BCBS Methodologies Report draws the appropriate distinction between traditional supervisory, or regulatory, stress testing and climate stress testing, by stating, “[w]hile traditional supervisory stress testing is used by supervisors to determine the resilience of banks’ capital positions to financial losses, or inform the calibration of additional capital requirements, climate scenario analysis and stress tests are typically exploratory – and not used for any such specific policy purpose at this juncture.”⁵

The RMA Consortium agrees with the BCBS Methodologies Report and opposes assessments of, or incorporating, climate-related financial risks that impact a bank’s capital or liquidity requirements at this time. There are a number of challenges, including significant gaps, with available climate data. As the BCBS explains in the same report, “[a]ssessment of climate-related financial risks will require new and unique types of data, different to the data banks have traditionally used in financial risk analyses,” including data describing physical and transition risk drivers, data describing the vulnerability to exposures and financial exposure data.⁶

There also are challenges related to making assumptions and developing new methodologies to assess climate-related financial risks. As the BCBS Methodologies Report notes, “the outcomes of scenario analyses and stress tests ... depend crucially on assumptions and methodological choices.”⁷ There is significant uncertainty surrounding the assumptions as a result of the extended time horizons, complexity and non-linear nature of climate risk.⁸ Current limitations of data, assumptions and methodologies

³ Basel Committee on Banking Supervision, Climate-Related Financial Risk—Measurement Methodologies (Apr. 2021), <https://www.bis.org/bcbs/publ/d518.pdf> [hereinafter, “BCBS Methodologies Report”].

⁴ See, e.g., Financial Stability Oversight Council, Report on Climate-Related Financial Risk, at 90 (Oct. 2021) [hereinafter, “FSOC Report”]; Jerome Powell Remarks, Green Swan Conference, hosted by the Bank for International Settlements (Jun. 4, 2021) [hereinafter, “Powell Remarks”] (stating that scenario analysis is “not meant to be setting up a regulatory consequence, which obviously does flow from our regulatory stress tests”).

⁵ BCBS Methodologies Report, *supra* note 3, at 30.

⁶ *Id.* at 10.

⁷ *Id.* at 30.

⁸ See, e.g., FSOC Report, *supra* note 4, at 23; Office of the Superintendent of Financial Institutions, Navigating Uncertainty in Climate Change: Promoting Preparedness and Resilience to Climate-Related Risks, at 19 (Jan. 2021), <https://www.osfi-bsif.gc.ca/Eng/Docs/clmt-rsk.pdf> [hereinafter, “OSFI Discussion Paper”].

impair the reliability of climate-related financial risk assessments, rendering them ill-suited for use in determining a bank's capital and liquidity buffers.⁹

Finally, we note that U.S. and Canadian prudential regulators have been supportive of scenario analyses with respect to climate risk, but not formal stress testing. For example, the FSOC Report strongly recommends that member agencies use scenario analysis, but stops short of recommending climate stress testing akin to the Dodd-Frank Act Stress Tests or the Comprehensive Capital Analysis and Review.¹⁰ Proposed guidance recently issued by the Office of the Comptroller of the Currency ("OCC") also encourages the use of scenario analysis and explicitly distinguishes scenario analysis from "traditional stress testing."¹¹ The Federal Reserve Board ("Federal Reserve") has articulated a similar view¹² and is currently developing a program of climate-related scenario analysis, as discussed further below.¹³ Similarly, Canada's Office of the Superintendent of Financial Institutions ("OSFI") has recognized that climate-specific scenario analysis could be used for identifying and assessing material climate-related risks and setting or evaluating climate-related risk strategy where traditional risk management approaches and stress testing tools are insufficient.¹⁴

Even jurisdictions that have introduced climate-specific stress testing have done so on an exploratory basis, without capital or liquidity consequences. The European Central Bank recently launched a supervisory climate risk stress test that will not impact Pillar 1 capital

⁹ See, e.g., *Id.* at 49 ("While a large amount of potentially relevant data for climate-related physical risks currently exists, more work is needed to improve access to this data and incorporate it into financial risk assessments.").

¹⁰ See FSOC Report, *supra* note 4, at 118–125.

¹¹ Office of the Comptroller of the Currency, "Principles for Climate-Related Financial Risk Management for Large Banks" (Dec. 16, 2021), <https://www.occ.gov/news-issuances/bulletins/2021/bulletin-2021-62.html> ("Climate-related scenario analysis is emerging as an important approach for identifying, measuring, and managing climate-related risks. ... These exercises differ from traditional stress testing exercises that typically assess the potential impacts of transitory shocks to near-term economic and financial conditions.").

¹² See Powell Remarks, *supra* note 4; Lael Brainard, The Role of Financial Institutions in Tackling the Challenges of Climate Change (Feb. 18, 2021), <https://www.federalreserve.gov/newsevents/speech/brainard20210218a.htm> (clarifying that "[t]o be clear, scenario analysis is distinct from our traditional regulatory stress tests at banks. Scenario analysis is an exploratory exercise that allows banks and supervisors to assess business model resilience to a range of long-run scenarios. ... By contrast, traditional stress tests are a regulatory exercise to assess the capital adequacy of banks to specific macroeconomic scenarios and financial market shocks over the short-run.").

¹³ See, e.g., Federal Reserve, Financial Stability Report, at 63 (Nov. 2021), <https://www.federalreserve.gov/publications/files/financial-stability-report-20211108.pdf>.

¹⁴ See OSFI Discussion Paper, *supra* note 8, at 18.

requirements.¹⁵ The Bank of England began using climate scenarios as part of its stress testing framework to explore the risks posed by climate change to the financial system, explaining that the results of these exercises would not be used to set capital requirements and noting that “[e]xperience and expertise in modelling climate-related risks is still relatively immature.”¹⁶

B. Recommendation

The final guidance should state explicitly that climate-risk stress testing and inclusion of climate risk in internal capital and liquidity adequacy assessment processes should not impact a bank’s capital or liquidity buffer requirements or trigger other regulatory consequences at this time.

II. The final guidance should acknowledge more explicitly that banks will require a reasonable timeframe to implement data- and model-driven risk management practices and processes.

A. Observations and Considerations

The Proposal promotes the use of best practices for identifying, measuring, monitoring and managing climate-related financial risks, many of which banks use to manage other traditional risks.¹⁷ The practices and processes often are quantitative, relying heavily on data and models. At the same time, as discussed above, the Proposal acknowledges that data, models and methodologies are continuing to develop.¹⁸

¹⁵ See European Central Bank, ECB Banking Supervision Launches 2022 Climate Risk Stress Test (Jan. 27, 2022), https://www.bankingsupervision.europa.eu/press/pr/date/2022/html/ssm.pr220127~bd20df4d3a.en.html?utm_source=ecb_twitter&utm_campaign=220127_pr_climate_stress_test. The stress test could indirectly impact Pillar 2 requirements through the supervisory risk and evaluation process. See *id.*

¹⁶ Bank of England, Bank of England Publishes the Key Elements of the 2021 Biennial Exploratory Scenario: Financial Risks from Climate Change (June 8, 2021), <https://www.bankofengland.co.uk/news/2021/june/key-elements-of-the-2021-biennial-exploratory-scenario-financial-risks-from-climate-change>. See also Bank of England, Climate Change, <https://www.bankofengland.co.uk/climate-change>.

¹⁷ See *e.g.*, Proposal, Principles 4, 5, 6 and 7. Supporting commentary 25 to Principle 6 calls for banks to “develop appropriate key risk indicators for effective management of material climate-related financial risks.” Supporting commentary 31 to Principle 7 recommends that banks “develop qualitative or quantitative metrics or indicators to assess, monitor, and report climate-related financial risks.”

¹⁸ See, *e.g.*, Proposal, supporting commentaries 23, 27, 63 and 64; BCBS Methodologies Report, *supra* note 3, at 22 (discussing that methodologies for measuring climate-related financial risks are evolving at both bank and supervisory levels.); Task Force on Climate-Related Financial Disclosures, Final Report: Recommendations of the Task Force on Climate-Related Financial Disclosures, at 41 (June

One of the five key findings in the BCBS Methodologies Report highlights that future analytical exploration of climate-related financial risks relies on data and methodology development.¹⁹ As to data, the BCBS indicates that “new and more granular data collections will probably be needed for both physical and transition risk assessments” and that banks and supervisors face challenges in applying consistent risk differentiation across jurisdictions.²⁰ As to methodologies, the BCBS explains that “approaches suitable for capturing climate-related financial risks will require further investment,” including “granular climate risk exposure analysis” and “enhanced scenario analysis capabilities bridging climate science with financial modelling.”²¹

The FSOC Report also identifies a number of challenges that banks face in identifying, measuring, monitoring and managing climate-related financial risks, including the following:

- Limitations on data, in particular, data “connecting the science of climate change to the financial risk assessments and real-world economic impacts”;²²
- Uncertainty about the time horizons over which certain risks (e.g., transition risks, longer-term risks) may manifest;²³ and
- The non-linear and complex nature of the impacts of climate change, which make it difficult to forecast the frequency and intensity of severe climate events and assess the interlinkages between climate-related pathways and economic and financial variables across the financial system.²⁴

Risk management processes relying on data and models have diminished utility and reliability until the underlying data and modelling capabilities are more mature. Banks will need sufficient time to develop their assessment tools and data in order to, for example, effectively incorporate climate-related financial risk into liquidity and capital planning assessment processes.²⁵ Supporting commentary 28 to Principle 7 advises that

2017), <https://assets.bbhub.io/company/sites/60/2021/10/FINAL-2017-TCFD-Report.pdf> (noting that the Task Force’s recommendations are “flexible enough to accommodate evolving practices”).

¹⁹ BCBS Methodologies Report, *supra* note 3, at 2.

²⁰ *Id.*

²¹ *Id.*

²² FSOC Report, *supra* note 4, at 23. These challenges are discussed in the FSOC Report as examples of challenges that *regulators* face, but we believe they are also applicable to banks.

²³ *Id.*

²⁴ *Id.*

²⁵ See Proposal, supporting commentary 23 (“It is recognised that climate-related financial risks will probably be incorporated into ICAAPs and ILAAPs iteratively and progressively, as the

banks “may consider investing in data infrastructure and enhancing existing systems where appropriate to make it possible to identify, collect, cleanse and centralize the data necessary to assess material climate-related financial risks.” This suggests that banks may have to build out the appropriate capabilities before they can adequately assess climate-related financial risks.

B. Recommendation

To account for the time required for, and the challenges associated with, integrating climate-related financial risks into banks’ risk management practices, the BCBS should more explicitly promote an iterative or “phased approach” for the implementation of supervisory expectations regarding climate-related financial risks. The final guidance should advise supervisors of the practical need to phase in certain expectations. We recommend including a statement in the final guidance that advises supervisors to consider the challenges banks face in identifying, measuring, monitoring and managing climate-related financial risks when issuing supervisory guidance or in evaluating banks’ progress toward implementing the principles.

III. The final guidance should clarify that banks should have flexibility to structure their implementation of the practices outlined in the principles in a manner that is consistent with their respective operating models for risk management and risk classification systems.

A. Observations and Considerations

The RMA Consortium appreciates the Proposal’s general support for a principles-based approach to supervision and its guidance that banks “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.”²⁶

Our members maintain enterprise risk management frameworks that align with regulatory expectations and industry best practices, but that nonetheless vary in their operating models and risk classification systems. Similarly, banks should have flexibility to implement climate-related financial risk management responses in a manner that is consistent with their respective risk management architecture.

We believe the Proposal is intended to afford banks this flexibility, and request that the final guidance include a more explicit statement to that effect.

methodologies and data used to analyse these risks continue to mature over time and analytical gaps are addressed.”)

²⁶ Proposal, supporting commentary 8.

B. Recommendation

The final guidance should state that banks should determine the most appropriate approach for implementing the risk management practices outlined in the principles.

IV. The final guidance should further promote coordination among supervisors while acknowledging the differences in supervisory mandates across jurisdictions.

A. Observations and Considerations

As the final guidance will set the standard for climate-related regulatory regimes across the globe, the BCBS is uniquely positioned to encourage harmonization in high-level principles among bank supervisors. We support the BCBS's encouragement of home and host supervisors to "establish frameworks for communicating and coordinating scenario analysis with other relevant domestic and cross-jurisdictional authorities" and ask that the language be broadened in the final guidance.²⁷

Many of the RMA Consortium's member institutions have multinational footprints and therefore must comply with multiple regulatory regimes, which means complying with requirements that are not always similar. Fragmented regulatory approaches across jurisdictions can result in inefficiencies and additional complexities in banks' enterprise risk management. The RMA Consortium acknowledges, however, that the scope of bank supervisors' mandates with respect to climate risk responses vary by jurisdiction and that such differences may result in different requirements for banks across jurisdictions. Nevertheless, consistency among supervisors in evaluating, at a high level, a bank's adoption of climate-related financial risk management practices, would facilitate more efficient and effective compliance and climate-related financial risk management by multinational banks.

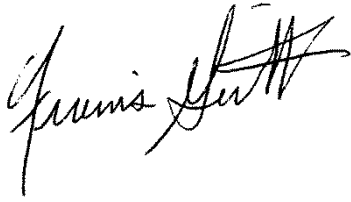
B. Recommendation

The final guidance should encourage coordination among bank supervisors and harmonization in their high-level approaches to evaluating banks' climate-related financial risks and risk management practices.

* * *

²⁷ Proposal, supporting commentary 65.

Sincerely,

A handwritten signature in black ink, appearing to read "Fran Garritt", with a stylized flourish at the end.

Fran Garritt
Director
Risk Management Association