Consultation on the draft Basel Committee on Banking Supervision disclosure of climate-related financial risks disclosure under Pillar III of the Basel Framework

20th March 2024

RMI is an independent non-profit founded in 1982 that transforms global energy systems through market-driven solutions to align with a 1.5°C future and secure a clean, prosperous, zero-carbon future for all. RMI works in the world's most critical geographies and engages businesses, policymakers, communities, and NGOs to identify and scale energy system interventions that will cut greenhouse gas emissions at least 50 percent by 2030. With more than 500 staff, RMI has offices in Basalt and Boulder, Colorado; New York City; Oakland, California; Washington, D.C.; and Beijing.

The consultation response is submitted by the PACTA team under RMI´s Climate Finance programme. PACTA (the Paris Agreement Capital Transition Assessment) is one of the leading climate scenario analysis approaches and tools in the world, applied by banks, investors, supervisors, and governments in all major financial markets. PACTA measures a financial portfolio's alignment with climate scenarios by comparing 5-year forward-looking production plans of financed companies in climate-critical sectors with required decarbonization efforts prescribed by climate change mitigation scenarios.

PACTA is both a tool and methodology that is open-source, independent, science-based, and actionable. Since its launch, the concept promoted by PACTA has been integrated into the practices of major financial institutions (with more than 1,500 users worldwide), as well as by supervisors and central banks (European Central Bank, European Insurance and Occupational Pensions Authority, California Department of Insurance, United States Department of Treasury's Federal Insurance Office, Bank of England, and more). PACTA has been used by a quarter of the world's 100 largest banks and investors, as well as having been endorsed by the Austrian, Swiss, Luxemburg, Norwegian, and Swedish governments as part of their market alignment tracking work involving over 400 European financial institutions.

Please do not hesitate to contact Nicholas Dodd (ndodd@rmi.org) and Daisy Pacheco (dpacheco@rmi.org) for further information on any of the comments made in this response or to find out more about PACTA and the Climate Finance programme at RMI.

Executive summary points of our consultation response

- **Overall, the proposal represents an important move towards the integration of climate risk into the Basel III risk management framework.**
- The proposals have a number of positive features that represent a step forward from the ISSB IRFS S2 disclosure standard, including:
  - providing a first view on emissions-based exposures,
  - analytics for supervisors such as maturity horizons and concentration risk,
  - a forward-looking emissions intensity alignment metric, and
  - the inclusion of facilitated emissions.
- **The proposal should be seen as a first step towards further integration of climate risk into prudential risk management**. Given the BIS position that climate risk can be mapped onto financial risk channels, there is opportunity to build further on the Pillar 1 guidance from 2022 and identify opportunities for greater integration with existing Pillar 3 financial disclosures.
- Overall, **the proposal would benefit from a stronger focus on climate critical sectors and economic activities,** as these are the most material from a risk management perspective.
- The introduction of a forward-looking perspective on transition risk is welcomed. **The quantified use of forward-looking information should be extended to counterparty targets and production plans**, as this is essential in order to analyze the potential for future financial risks under different scenarios for the transition – for example, the extent of asset stranding and impairment.
- Next steps should include further metrics based on the use of forward-looking scenario analysis and forward looking asset-based company data that reflects announced capital expenditure plans – as demonstrated by the ECB in their January 2024 alignment report to analyze exposure of banks in the Euro area to transition risk.
- These types of data and metrics would provide more decision-useful information to enable the quantification of risk using existing financial risk metrics used by banks and supervisors – for example, CR5 risk-weighted adjustments for high emitting sectors.

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1. The overall meaningfulness of the proposals

This proposal for a Pillar 3 disclosure on climate-related risk represents **a significant opportunity to further operationalize the BIS´s mapping of climate risk onto existing risk channels**, rather than to establish climate risk as a specific category on its own.

However, the disclosure requirement should go further towards mapping climate risk onto traditional risk management categories.

If effective action is to be taken to manage climate and specifically transition-related risks on the balance sheet of banks then the disclosure will need to provide clear information on ***how these risks and the associated vulnerabilities have been identified, quantified, and evaluated for their financial impact.***

The current proposal does not fully reflect the original intention of Pillar 3 to provide *´public disclosure requirements that seek to provide market participants with sufficient information to assess an internationally active bank's material risks and capital adequacy.´* This may limit the proposals potential to effectively manage financial risk arising from transition risk factors.

Forward-looking information and metrics that analyze the underlying drivers of transition risk within banking books are needed to fulfill the intention of Pillar 3. As recently demonstrated by the European Central Bank (ECB), metrics that are based on bottom-up information about counterparties and their assets would enable banks to quantify material risks arising from climate change, including the potential impact on, for example:

- the collateral value of counterparty assets
- the risk-adjusted cost of capital
- the probability of default
- the capital adequacy to cover defaults

The first steps taken by banks to integrate climate risk in this way were highlighted by the ECB in their 2022 report on good practices [1].

It is important for effective prudential risk management that the link between exposure and vulnerability to transition risk factors that could strand or impair assets is quantified. This would then inform the disclosure of climate risks as a component of existing Pillar 3 metrics such as risk-weighted adjustments.

So, while requesting information on bank and corporate transition plans is important for understanding how banks are preparing for the long-term impacts of climate change, **more specific and granular information would be needed than is currently proposed in order to quantify how a bank is analyzing and managing transition risks**. Moreover, while financed emissions metrics are a familiar metric to introduce and can provide a first step towards quantifying potential exposures to transition risk, many banks have expressed the view that they are not decision-useful and so more granular metrics are needed for risk management purposes.

[1] ECB, *Good practices for climate- related and environmental risk management*, November 2022.

2. Prudential management metrics

The proposed metrics and the underlying data provide a first hot spot view on exposure to high emitting counterparties across portfolios.

However, additional data and metrics will be needed for external parties to be able to determine if a bank is materially exposed to misaligned counterparties or assets, and if those same corporates have forward capital investment plans to bring themselves into alignment.

Moreover, the metrics as currently proposed do not readily support analysis that can provide quantified inputs to traditional risk categories.

2.1 The need for forward-looking metrics to analyze transition risk

While we understand and support the arguments for ensuring consistency and interoperability with existing climate-related disclosures, it is also important to consider **whether the proposed framework will contribute to the information needed to quantify risk under the existing Pillar 3 disclosures**.

The disclosures in template CRFR1 are proposed as being based on financed emissions. Financed emissions are a static or look-back metric that represents a weighted exposure to a corporate´s emissions. Financed emissions represent a familiar metric that banks are increasingly used to working with. It can provide a first view of exposure to potential risk hot spots across a portfolio. Beyond this initial use case, it has limited application for risk evaluation.

In the context of Pillar 3, the main drawback we see is that this exposure on its own does not support the identification and quantification of the possible forward-looking exposure of a bank to transition risk. For example, it does not provide the ability to quantify specific forward risks associated with, for instance, stranded or lock-in assets. It does not therefore pinpoint whether the emissions are aligned with a remaining carbon budget or whether there are hot spots of misaligned assets on the balance sheet of a counterparty. Moreover, this metric has two further well-recognized drawbacks when used as a metric:

- It can **create problematic incentives** to divest or reweight exposures, rather than engage with clients and mobilize capital to mitigate the risks.
- For listed companies, it is also **sensitive to fluctuations in the denominator**, which includes the market value of listed equity.

In terms of transition risk, **banks will be exposed to the extent that they interact with or invest in counterparties that are vulnerable because of their assets to transition and/or physical risks.** As recently demonstrated by the ECB in their January 2024 alignment report, making this information operational for risk management requires metrics that analyze the potential sensitivity of the economic activity to future changes in the energy economy, as anticipated by energy and transition scenarios. This will in turn potentially lead to the stranding of production assets and reserves, which could lead to losses or a probability of default on lending. The methodology and metrics used by the ECB are briefly showcased in the box below.

Prudential risk management metrics

How the ECB has used bottom-up, forward looking scenario analysis to analyze transition risk

The ECB used the PACTA scenario analysis approach to evaluate how well the phase-out, build-out, and decarbonization plans of counterparties of euro area banks align with climate transition scenarios. The analysis focused particularly on six sectors and fifteen technologies that are expected to be impacted the most by the transition. The analysis is based on forward looking, granular data that reflects the production assets of counterparties. The alignment metrics directly measure the transitions expected by granular sectoral decarbonization pathways.

By conducting this type of alignment assessments, it is possible to determine the compatibility of banks' financing of physical production capacities with the climate goals, such as those outlined in the Paris Agreement. Any observed misalignments pose heightened risks, stemming from factors such as policy interventions and technological transformations aimed at meeting the Paris goals.

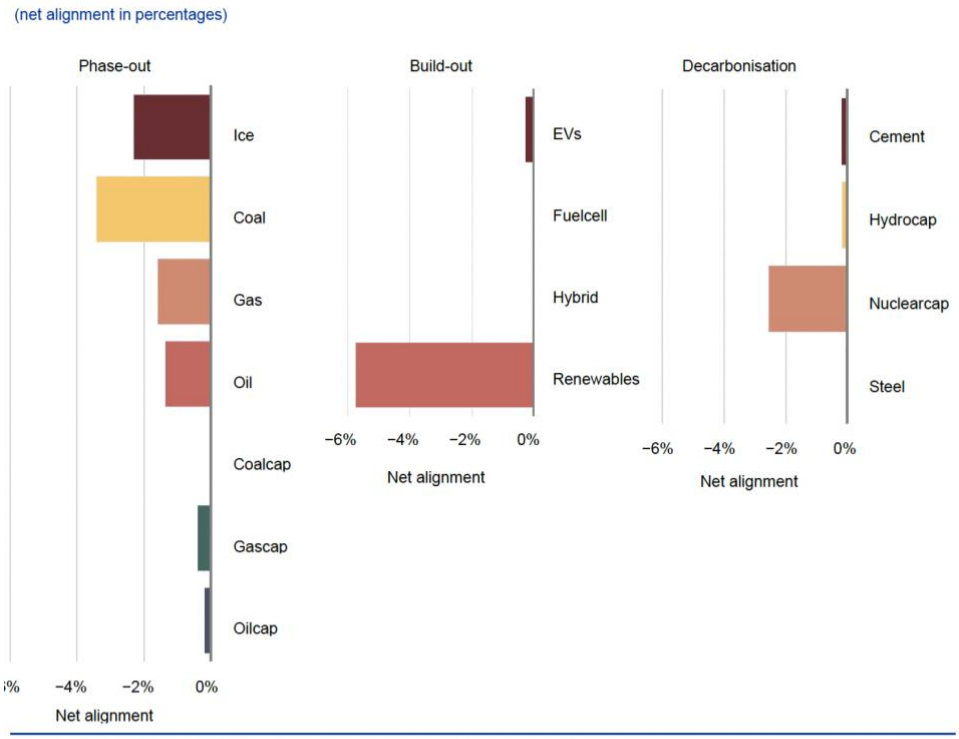


Figure 1. Net alignment contribution by technology analysed

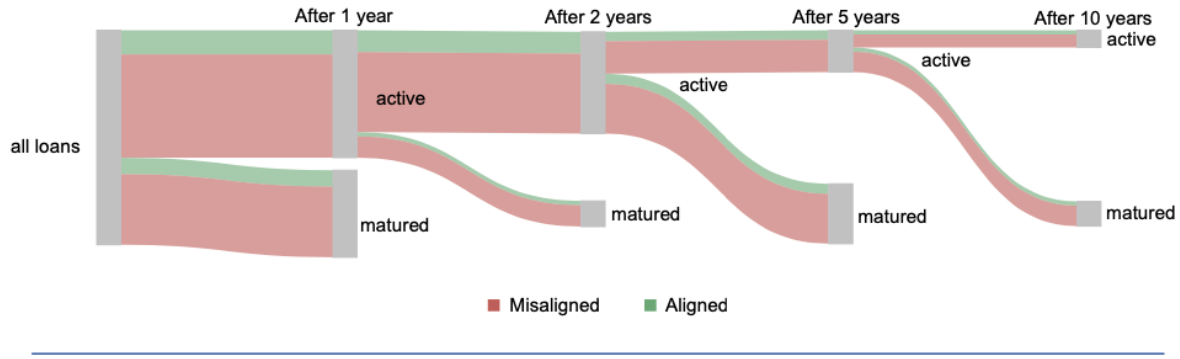
In contrast to other methods of quantifying transition risks, bottom-up scenario alignment assessments provide information about the trends and pace at which companies in a corporate loan book portfolio are managing the phaseout of high emitting production assets and advancing their buildout of low-carbon production.

Source: ECB, *Risks from misalignment of banks' financing with the EU climate objectives*, January 2024

2.2 Bank-specific metrics and supervisory analytics

The following proposals on bank-specific metrics and analytics can potentially be decision-useful to supervisors:

- **Maturity analysis** is important to include and may need to vary on a jurisdictional basis, considering that different jurisdictions have different norms around loan term length. This is illustrated by the ECB's recent combination of forward-looking alignment results with counterparty credit maturity horizons. This type of analysis is likely to be useful to informengagement strategies to manage risk at sector rather than entity level.



Sources: IEA, AI, RMI and ECB calculations.
Notes: For the purposes of this chart, it is assumed that all loans end when they mature and that no loans will be rolled over. The size of the flow between the nodes shows the exposure volume.

Figure 2. Credit maturities for the banks analyzed

- **Non-performing exposures (NPEs) and total allowances** can provide insightful information for the assessment of capital requirements related to climate-related exposures. NPEs metrics help assess whether banks hold sufficient capital to cover potential losses from defaulted loans in climate-critical sectors. Regulators can then adjust capital requirements based on disclosed information.

- Qualitative information on how **concentration risks** are being identified and managed is considered useful. However, the risk management use case would be better served by focusing the disclosure on sector-specific risks. **The existing Pillar 3, 1(a) disclosure should be repurposed to provide information for potential sector concentration risks;** this could potentially also include capital allocations to support climate change mitigation.

The disclosure framework could also go further in seeking to **encourage banks to start to adapt internal ratings methodologies and to signal to high-emitting counterparties via adjustments to the cost of capital**. For example, in the existing Pillar 3 disclosure guidance, there is a component addressing Credit Valuation Adjustments (CVA). Pillar 3 climate disclosures should be used to encourage banks to disclose how climate risk considerations are being factored into CVAs. This could take the form of a qualitative description of its risk management objectives and policies for CVA risk. The form of disclosure made in templates CR4 and CR5 could be emulated in a simplified form in this new disclosure framework – potentially by sector under each asset class (see the simplified example below).

Possible example climate risk weighted adjustment disclosure table (based on existing Pillar 3 template CR5)

High emitting sectors in the disclosure scope	0%	20%	50%	100%	150%	Other	Total credit exposure amount
Sector a							
Sector b							
Sector c							

3. Features of the proposal

In this section we provide overall comments on the following elements of the proposal:

- Strategy and risk management (CRFRA/B)
- Materiality of the sectors in scope (CRFR1)
- The importance of forward looking information (forecasts)
- The geographical component of disclosures (CRFR2)

3.1 Statements on entity-level strategy and risk management

The overall statements on strategy and risk management in the proposed CRFRA/B are supported, as they emulate those in the existing Pillar 3 guidance and include an emphasis on forward strategy and the use of scenario analysis.

To strengthen the decision usefulness of this information, BIS should including the implementation strategy component of the GFANZ Financial Institution Transition Plans framework (see Figure 3). This should focus on providing information on internal activities and decision-making processes, such as how lending is made to counterparties.

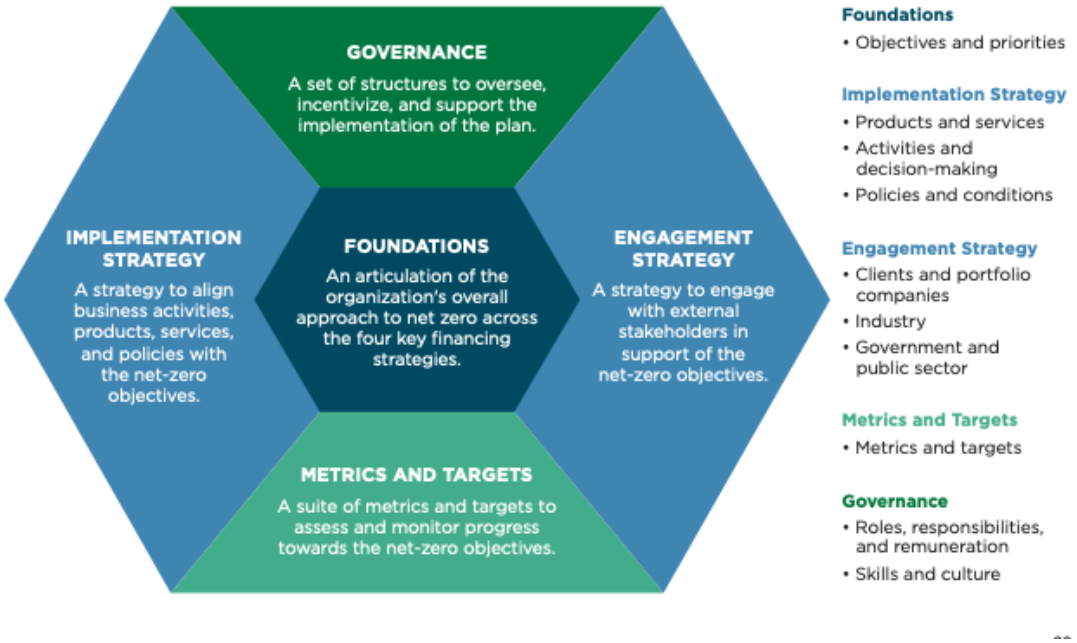


Figure 3. GFANZ financial institution net zero transition plan framework

3.2 The materiality of the sectors within scope

The disclosures should have a stronger focus on risk evaluation for the most material sectors, activities, and assets.

Scenarios for the transition suggest that **the most significant risks will be driven by a small number of sectors and economic activities along value chains that are associated with the greatest CO_2 emissions**. The commercial viability of operators in these sectors could be significantly exposed to future changes in energy and carbon prices. Companies in their value chain could also be impacted by changes in demand for components – for example, the mass adoption of electric vehicles implies a drop in demand for gearboxes.

The transition will also fundamentally be dependent on a shift in the demand for the fossil fuels coal, oil, and gas. Changes in their supply and demand could have a significant impact on the balance sheet of counterparties in the energy sector, including for example the future commercial viability of reserves held by oil and gas companies.

3.3 The importance of forward-looking information to analyze transition risk

Forward-looking information on different time horizons is essential in order to analyze potential transition risks. **Whilst the forward-looking components of the proposal are supported, a clearer definition of forecasts should be included for guidance.** Forecasts can be interpreted in a wide range of ways and can be derived using different models and assumptions. These can refer to forecasts as outputs from stress testing models or forward-looking information such as CAPEX or future production plans. Forward-looking information is critical in assessing climate-related risks, hence the importance of precise formulation of the data that is expected to be included as forecast, as well as the underlying inputs used in its calculation.

To analyze asset stranding the time horizon and additional data points may need to be specified. In the case of the oil & gas sector, for example, medium-term (10-15 years) time horizons from forward-looking transition scenarios may need to be used. For example, to identify the parameters

for potential price adjustments or the impact of carbon taxation in the future. This information can then be used to model the proportion of potentially stranded production assets.

3.4 The geographical component of transition risk

Transition risk has a geographical component that will influence exposures and alignment. This is important because the disclosure proposal will have a global reach. Both physical and transition risks can have wide-ranging impacts across sectors and geographies. The difference in the scale, nature, and timing of the transition in emerging and developing countries means that more granular scenarios and counterparty data will need to be used. This strongly suggests that scenarios with regional granularity should be recommended, with JRC GECO and NGFS offering this additional granularity.

4. Discretional quantitative requirements:

In this section we provide overall comments on the following elements of the proposal:

- Emissions intensity per physical output
- Facilitated emissions

4.1 Emissions intensity per physical output

The proposal to include disclosures using emissions intensity metrics is welcomed. This type of metric is an important means to track and measure the alignment of high-emitting sectors with sectoral decarbonization pathways. It is already an important operational reporting and tracking metric for banks and is also included within existing target-setting and disclosure frameworks, such as that of the NZBA. One major weakness of the ISSB S2 standard is that it does not advocate the use of physical emissions intensity, so inclusion in this framework could redress this.

Whilst the proposal for an alignment metric is welcomed, building on the approach introduced by the EBA in their Pillar 3, Template 3 disclosure, the PiT distance alignment metric would benefit from greater definition as it is not clear whether the forecast refers to a target value or a scenario and the time horizon is not fixed. The reference to a *´science-based benchmark considered by the bank to set forecasts´* is likely to require further guidance on what would be accepted.

Obtaining data should not be a barrier to the use of physical emissions intensity metrics. However, consistency between different providers and the blend of data and methodologies used can differ. Transparency on the make-up and time stamps of the data used will therefore be an important complement.

The data for physical activity emissions intensity metrics is generally sourced from third-party providers, who typically blend company-reported emissions (with low coverage) with modeled estimates for the remaining companies in scope (to raise overall coverage). Major providers such as CDP and Asset Impact model emissions intensities' according to a consistent emissions factor methodology. Regional or nationally representative input data points from companies are substituted for default or representative values e.g. electricity generation capacity factors.

4.2 Facilitated emissions

The inclusion of facilitated emissions is welcome. Off-balance sheet facilitation is an important source of revenue for Banks from high emitting sectors such as oil & gas production, in some cases accounting for more than half of income from some sectors. It is also a potentially important source of transition finance to make capital investments. Until recently, the emissions facilitated by banks were neither disclosed nor had a methodology to attribute them. The inclusion of facilitated emissions in the disclosure framework would have a number of potential benefits:

- It could be a strong driver for transparency on potential flows to off-balance sheet services,
- It could stimulate further methodological development, and
- It could allow banks active in transition finance to demonstrate how they are managing these emissions.

The metrics could go further **to identify if capital market instruments have been used to mitigate emissions and incentivize reductions.** In recent years the potential has emerged to condition the cost of capital on performance against transition and alignment KPIs has gained traction in the market and support the forward management of misalignment risk. BIS should request disclosure of the proportion of both loans and facilitated issuance on the capital markets that is conditioned on forward-looking climate-related KPIs. This would capture the current state of the art in transition planning, whereby companies are incentivized by a lower cost of capital to develop detailed implementation plans to achieve emissions reductions across business units – as demonstrated by this example for cement manufacturer CEMEX [2]. This practice was also highlighted by the ECB in its 2022 climate related and environmental risk management good practices report [3].

[2] CEMEX, *Sustainability linked financing framework*, August 2023, https://www.cemex.com/documents/d/cemex/cx-sustainability-linked-financing-framework-eng-2023

[3] ECB, *Good practices for climate- related and environmental risk management*, November 2022

5. Responses to Consultation Questions

In this section we have compiled the specific responses we have made to *selected questions* from the consultation. These responses complement our overall consultation response, providing more detail and background to our comments.

General

Q1. What would be the benefits of a Pillar 3 disclosure framework for climate-related financial risks in terms of promoting comparability of banks' risk profiles within and across jurisdictions and promoting market discipline? What other benefits have been identified?

Benefits of a Pillar 3 disclosure framework for climate-related financial risks:

- Facilitates consistent approaches to assessing banks' exposures, strategies, and resilience to climate-related risks
- Incentivizes banks to manage their climate-related risks more effectively, as they are subject to greater scrutiny from market participants
- Promotes a common understanding and management of climate-related risks which can help banks enhance their resilience to these risks, by better integrating climate considerations into business strategies, and developing appropriate risk mitigation measures
- Enhances supervisory oversight by allowing regulatory authorities to use disclosures for assessing the overall climate risk profile of the banking sector and identify areas of potential concern.

Q3. Would the Pillar 3 framework for climate-related financial risks help market participants understand the climate-related financial risk exposures of banks and how banks are managing these risks?

The Pillar 3 framework for climate-related financial risks would provide market participants with valuable insights into banks' exposures to and strategies for addressing climate-related risks. However, it is important that the framework incorporates other types of risk metrics that analyze the underlying drivers of transition risk within banks' portfolios, such as forward-looking and bottom-up metrics that provide information about counterparties and their assets. In addition, the framework should provide enough context and a sufficient balance between quantitative and qualitative information to help market participants interpret the disclosed information.

Q5. Would there be any unintended consequences of a Pillar 3 framework for climate-related financial risks? If so, how could these be overcome?

Potential unintended consequences of a Pillar 3 framework for climate-related financial risks include the risk of reducing the investability of banks operating in fossil fuel-dominated economies or net exporters of fossil fuels. Disclosing metrics such as financed emissions could flag these banks as high climate risk, potentially hindering their ability to attract the investment needed to support clients in transitioning to a low-carbon economy. Emphasis on forward-looking and transition plan-based metrics is crucial, as it allows banks to describe how they are supporting clients in transitional activities.

Banks operating in emerging markets may also face unfair disadvantages due to higher administrative costs and less mature sustainability reporting infrastructure. It is important to ensure

that these banks are not unfairly disadvantaged when accessing global capital markets, as they may require preferential access to invest in the transition to a low-carbon economy.

Increased transparency about climate-related risks could impact banks' access to capital if investors perceive them as overly exposed to such risks. Regulators can address this by incentivizing transition-linked financing (i.e., sustainability- or transition-linked bonds/loans), improving market understanding of climate-related risks, and encouraging investors to incorporate these risks into their decisions. However, compliance with new disclosure requirements may impose additional costs and burdens on smaller banks. Regulators can mitigate this by providing guidance and support and considering the proportionality of requirements based on banks' size, complexity, and risk profile.

Another unintended consequence could be defining requirements in a way that rewards stopping finance to companies that should be transitioning but are not yet. Stopping engagement with such companies may look good in the loan book of a bank, but this could shift risk to less regulated parts of the financial system. To mitigate this, disclosing forward-looking metrics by sector and maturity profile could highlight where the transition is happening and where it is not, allowing for renegotiation of financing terms and preventing unintended consequences. Requiring credible transition plans from counterparties can also help prevent such outcomes.

Q7. What are your views on the proposed methodology of allocating exposures to sectors and geographical locations subject to climate-related financial risks?

The proposed methodology of allocating exposures to sectors and geographical locations subject to climate-related financial risks is a good start, as certain climate-sensitive sectors are more vulnerable to transition and physical risks. However, the methodology should consider additional granularity for sectors as the transition to a low-carbon economy will happen at the level of activities/business lines for most companies. This could involve disclosing against multiple business sector classification codes and more specific and granular information about the counterparties' forward-looking capital investment plans.

Qualitative disclosure requirements

Q16. What are your views on the relevance of the proposed qualitative Pillar 3 climate-related financial risk disclosure requirements to understand climate-related financial risks to which banks are exposed?

The proposed qualitative Pillar 3 climate-related financial risk disclosure requirements are relevant as they provide the context and narrative behind the quantitative information. Qualitative context helps explain factors like risk drivers and risk management practices, capturing trends that might not be yet fully reflected in quantitative data.

Qualitative metrics are needed to describe a bank's plan to manage transition risks through transition planning. Such metrics will allow stakeholders to assess the credibility of banks' transition plans and hence evaluate how well they are equipped to manage transition risks.

Quantitative disclosure requirements

Q17. What are the benefits of the proposed quantitative Pillar 3 climate-related financial risk disclosure requirements?

The proposed quantitative Pillar 3 climate-related financial risk disclosure requirements enable stakeholders to compare banks' climate-related risks more easily, facilitating the identification of outliers and trends within the industry. This comparability can lead to more effective risk management practices and policies. However, while the requirements improve understanding of where transition risk emanates from at a high level, the granularity of exposure by sector may obscure significant underlying differences in risk, especially when in-sector differences in transition risk are substantial.

Q20. What additional quantitative Pillar 3 climate-related financial risk disclosure requirements should the Committee consider?

The Committee should consider additional quantitative Pillar 3 climate-related financial risk disclosure requirements that provide insights into future risk. One suggestion is to add forward-looking indicators that assess counterparty transition risk based on their adaptive capacity and credible transition plans. Another suggestion is to include metrics tied to the exposure of misaligned physical production at a future point in time, such as disclosing forward exposure to high-emitting physical assets at 5 years in the future. As illustrated by the ECB's recent report, another suggestion is to add metrics that are based on bottom-up asset-level production information about counterparties which can be mapped into existing credit ratings and risk controls, such as RWA across sector assets.

Q22. What are your views on the relevance of the proposed quantitative Pillar 3 climate-related financial risk disclosure requirements to understand climate-related financial risks to which banks are exposed?

The proposed quantitative Pillar 3 climate-related financial risk disclosure requirements enable stakeholders to benchmark different banks' risk profiles by easily assessing which banks have higher or lower exposure to specific climate risks. These also provide a clear picture of immediate vulnerabilities and give valuable insights for banks to refine their risk management strategies, and prioritize risk mitigation measures.

However, the proposed quantitative requirements may rely heavily on historical data, which may not fully capture the potential future impacts of climate change. This focus on historical data could lead to an underestimation of future risks and vulnerabilities. It is therefore important that a forward-looking perspective on risk is introduced, linked to scenario analysis, and that metrics enable underlying transition risk linked to potential stranded assets to be quantified.

Transition risk: exposures and financed emissions by sector

Q27. What additional transition risk disclosure requirements should the Committee consider?

Exposure by sector is a good starting point to consider in disclosure requirements. However, more specific information related to this exposure can provide a more accurate picture of the potential financial impacts associated with the transition. Forward-looking production information of corporate borrowers offers crucial insights into companies' and sectors' preparedness for this transition. Disclosing aggregated information on borrowers' future plans for phasing out or reducing fossil fuel extraction and production is an example of useful information about future production volumes and technologies that can provide insights into future potential transition risks for companies and therefore for banks with exposure to those.

Q28. What are your views on the appropriateness of classifying sectors according to the Global Industry Classification Standard (GICS) with a six- or eight-digit industry-level code?

GICS has some clear limitations with regard to identifying transition risk in the exposure of a loan book. Particularly once the analysis focuses on counterparties, even 8-digit categories do not sufficiently describe if the counterparty is active in a highly carbon-intensive part of the value chain or not. For example, in the Electric utilities sector there is no division into power generation and power distribution companies[4]. The most relevant shift needs to happen in power generation though, whereas distribution companies will be needed in a low-carbon economy too, thus implying widely varying risk.

We would therefore strongly encourage using a sector classification system, that can identify the differences in carbon intensity – and therefore the variation of within-sector transition risk – along the value chain. At the very least, there should be an openness to adopting other systems and a remark on the drawback of not disentangling sub sectors with strongly varying emission intensities. One option would be to use ISIC rev. 5 classifications, which allow for a clearer split along different steps of the value chain (power sector in ISIC rev. 5 disentangles between "Electric power generation activities" and "Electric power transmission and distribution activities"[5]).

Bank-specific metrics for quantitative climate disclosures

Q34. What are your views on the prudential value and meaningfulness of the disclosure of the proposed bank-specific metrics on (i) asset quality (non-performing exposures and total allowances); and (ii) maturity analysis?

The disclosure of bank-specific metrics on asset quality can help assess whether banks hold sufficient capital to cover potential losses from defaulted loans in climate-critical sectors, enabling regulators to adjust capital requirements accordingly.

Maturity analysis is also valuable, particularly in assessing banks' ability to engage with counterparties exposed to high transition risk. Shorter maturities indicate that banks have more leverage in discussions with clients on de-risking their business models, highlighting opportunities for risk management.

Combining maturity analysis with forward-looking, sector-specific analyses, such as alignment analysis, can help identify future risks related to stranded assets and map them to the maturity ladder. This deeper understanding of counterparties' alignment or transition plans clarifies where banks need to act most urgently to manage risk and where they can help clients transition.

Q36. What additional bank-specific disclosure requirements in respect of banks' exposure to climate-related financial risks should the Committee consider?

Some potential areas for consideration include:

Risk reduction

- Metrics that analyse exposure to high-carbon activities and assets, with additional quantification of what impact this may have on the balance sheet of a bank

[4] GICS: https://www.spglobal.com/marketintelligence/en/documents/112727-gics-mapbook_2018_v3_letter_digitalspreads.pdf and https://www.msci.com/our-solutions/indexes/gics
[5] ISIC rev 5: https://unstats.un.org/unsd/classifications/Econ

- Disclosure of stress test outcomes, scenario analysis, and portfolio alignment results as they relate to the most material, high emitting sectors.

Risk mitigation

- The percentage of capital allocations to transition finance products, including products that incentivize emissions reductions by gearing the cost capital to achievement of climate performance KPIs;

Forecasts

Q37. What are your views on the proposed inclusion of forecast information in the Pillar 3 climate-related financial risk disclosure requirements in instances where banks have established such forecasts?

A clearer definition of forecasts should be included for guidance, as forecasts can be interpreted in various ways and derived using different models and assumptions. When banks have established such forecasts, it is crucial that they also disclose the underlying assumptions made within them.

Q38. Would the proposed forecast information be a useful metric for assessing banks' exposure to climate-related financial risks?

While the intent behind including forecasts on financed emissions and emission intensities in climate-related financial risk disclosures is commendable, relying solely on this type of metrics may not be appropriate for some reasons.

- Forecasting methodologies for financed emissions and emission intensities are not standardized across banks, making it difficult to compare and benchmark banks' performance.
- These forecasts may not capture important factors such as changes in market dynamics, regulatory developments, or technological disruptions that could significantly impact banks' risk profiles.

Alternatively, a more actionable and realistic approach could be to complement these forecasts with forward-looking production-based metrics derived from companies' capital expenditure (capex) plans. This would require banks to collect relevant data from their clients and use standardized methodologies for analyzing and interpreting production-based data.

Q39. What type of forecasts would be most useful for assessing banks' exposure to climate-related financial risks?

Other types of forecasts/forward-looking information should be included in addition to the ones that are cited in the document. Forward-looking information on announced future capital expenditures and/or production should also be considered – as demonstrated by the recent use of this type of bottom-up data on counterparties and their assets by the ECB. The selected time horizon for forecasts should reflect a timeframe that is long enough to consider the forward-looking nature of climate risks, yet short enough to be practical and actionable.

Concentration risk

Q43. What are your views on complementing quantitative disclosure of risk concentrations with qualitative disclosure of contextual and forward-looking information on the bank's strategies and

risk management framework, including risk mitigation, to manage climate-related concentration risk?

Complementing quantitative with qualitative disclosure of risk concentration is helpful to understand the context and idiosyncrasies of banks, as well as their approach to climate-related risk management. Concentration of exposures within sectors can vary according to regional differences (e.g., differences in regulation and sectoral diversification) when comparing banks across the world. By providing additional information on potential sector concentration risk, banks and supervisors can more easily identify capital allocation requirements to support climate change mitigation.