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Tata Consultancy Services,
Mumbai

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Response to Consultative Document – "Principles for the effective management and supervision of climate related financial risks"

Tata consultancy services, a global IT services and consulting organization would like to take the opportunity to respond to the Basel Committee's request for comments on the Consultative Document ''Principles for the effective management and supervision of climate related financial risks" published on 16th November 2021. We are working with a number of banks globally helping them identify and manage financial risks from climate change, and would like to bring in practical aspects associated to some of the suggested principles.

We've been advising banks since early 2020 to start considering the potential impact of climate risks on their capital, as we believed this was inevitable. The focus until recently has been limited to the impact on provisions via scenario analysis, besides the governance and enterprise risk policy update. We therefore wholeheartedly welcome Basel Committee's recommendation that Banks must consider the potential impacts of climate-related risk drivers on their individual business models including capital management.

In this response we share our thoughts and practical challenges faced by the banks to effectively integrate climate related financial risks into their enterprise risk management framework.

Our view on proposed BCBS Principles on climate financial risks

Principle 3: Banks should adopt appropriate policies, procedures, and controls to be implemented across the entire organization to ensure effective management of climate-related financial risks. [Reference principles: BCP 14, SRP 30, Corporate governance principles for banks].

TCS's Viewpoint: Since most banks have acknowledged the climate financial risks as cross-cutting in nature, we notice a significant systemic impact within the bank across siloed teams and business units. This renders the implementation process a complex collaborative exercise between multiple stakeholders within the organization. Lack of granular principles leave a significant gap resulting in maneuverability and interpretations suited to each set of stakeholders.

We request BCBS to elaborate this principle to include granularity to helps banks with clarity. This will also help with industry benchmarking and consistency of application of principles.

<u>Principles 4 and 7:</u> Banks should incorporate climate-related financial risks into their internal control frameworks across the three lines of defence to ensure sound, comprehensive and effective identification, measurement, and mitigation of material climate-related financial risks. [Reference principles: BCP 26, SRP 20, SRP 30]

Risk data aggregation capabilities and internal risk reporting practices should account for climate-related financial risks. Banks should seek to ensure that their internal reporting systems are capable of monitoring material climate-related financial risks and producing timely information to ensure effective board and senior management decision-making. [Reference principles: BCP 15, SRP 30, Principles for effective risk data aggregation and risk reporting]

<u>TCS's Viewpoint:</u> This is key for the banks regardless of their size, complexity, or business model. We note a significant understanding and skill gap across frontline. It is not uncommon to hear senior management managing business lines at leading banks to outrightly downplay the impact of climate change to their business. Such comments obviously translate into the steps taken to manage and mitigate climate financial risks. A complete lack of regulatory guidance and/or legislation on climate capital impact does not help. This is where we believe BCBS as a key role to play.

A standardization in the identification and measurement of climate related financial risks remains another key challenge. We note different banks using significantly different datasets to carry out climate assessment, largely driven by their understanding, and more importantly availability of climate related data sets.

Risk control teams across the three lines of defense tend to have varying understanding of climate risk transmission channels impacting the business. This is particularly true across the first lines teams. As you'd have guessed by now, we once again underscore the need for standardization.

While the banks can leverage existing internal controls framework and processes set out for credit risk, we strongly believe it would help institutions if BCBS can provide a climate specific guidance note for the banks and FIs.

Based on our experience in controls management and control assurance across banks and financial institutions globally, we understand that one-size-fits-all approach will not work out for internal controls design. For a new risk category with a systemic impact like climate risk, it is critical to consider a broad range of factors like complexity, sector considerations, obligor/asset level assessments, etc.

We suggest BCBS and other industry and regulatory bodies to come up with guidance, even if in the form of 'common minimum requirements. This will also help significantly reduce the resource costs and timelines as firms like TCS can help the banks build standardized automated control framework in line with that for existing risk types viz. credit, market and operational risks.

<u>Principle 5</u>: Banks should identify and quantify climate-related financial risks and incorporate those assessed as material over relevant time horizons into their internal capital and liquidity adequacy assessment processes.

<u>TCS's Viewpoint</u>: Currently, the inclusion of climate risk assessments into ICAAP is largely qualitative in nature currently, along with references to the outcomes of climate scenario analysis as more and more banks are opting for scenario analysis. It is key to note here that based on our industry engagements, most banks use scenario analysis for ECL provision impact only, and conveniently leave the capital impact out of scope, given the lack of any regulatory ask.

There is a significant lack of clarity around the need and approach to assess and report any kind of P2a charge from climate risks. We, alongside many of our banking clients acknowledge the need and significance of this, but a complete lack of any regulatory ask undermines it. We believe BCBS can and should lead the way forward here and provide guidance on assessment and reporting of climate RWAs, even if they don't result in additional capital charge for the banks at this stage. We believe this will also in turn trigger the targeted action by the banks towards reduction in their climate RWAs.

Lastly, we thank BCBS for the opportunity to share our views on the Consultative Document. Should you wish to discuss any of the above perspectives in further detail, please do not hesitate to reach out. We would love to hear your thoughts on our response, and hope that you find the above inputs useful.