



Verein fossil-free.ch
Idaplatz 3
8003 Zürich

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

For the attention of

Pablo Hernández de Cos, Chair of the Basel Committee
Neil Esho, Secretary General

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BCBS consultation on revision to the core principles of effective banking supervision

Dear Mr. Hernández de Cos and Mr. Neil Esho

Thank you for giving us the opportunity to express our considerations with regard to the revisions to the core principles for effective banking supervision.

⇒ CP9 Supervisory Techniques and Tools

Forward-looking approaches and scenario analysis are key instruments to address climate-related financial risks. We want to highlight the importance of transition plans that are aligned with the goal of limiting global warming to 1.5 °C. We would appreciate if transition plans were included as a tool to support supervisors in assessing climate-related financial risks.

In general, we would like to stress the importance that all instruments that are used are aligned with the goal of limiting global warming well below 2°C by 2100 compared to the pre-industrialization level.

A growing body of evidence suggests that flawed economic models may mislead supervisors and financial service providers to substantially underestimate climate related financial risk.

With reference to a recently published OECD working paper¹, we suggest supervisors make sure users of climate change mitigation scenarios in the financial sector accurately account for and communicate gaps, limitations and uncertainties in their scenario-based targets and assessments.

¹ Noels, J., et al. (2023), "Climate change mitigation scenarios for financial sector target setting and alignment assessment: A stocktake and analysis of their Paris-consistency, practicality and assumptions", *OECD Environment Working Papers*, No. 223, OECD Publishing, Paris, <https://doi.org/10.1787/bcd25b82-en>.

While the diversity of available mitigation scenarios helps reflect the range of possible pathways to net-zero emissions, supervisors must ensure that the scenarios used by financial service providers are both Paris consistent and provide at least some of the granularity needed to assess specific financial assets and asset classes.

More specifically, supervisors must make sure that users of scenarios in the financial sector:

- **Select high-ambition Paris-consistent scenarios for climate target setting and alignment assessments:** Providers of target setting and climate-alignment assessments in finance must prioritise scenarios with high levels of ambition in temperature and emissions outcomes. This entails selecting scenarios that avoid or have limited overshoot of 1.5°C, maintain a very high likelihood of staying below 2°C, peak emissions early, and achieve net-zero GHG emissions. Aligning with ambitious scenarios is needed in the face of high climate uncertainties.
- **Select scenarios that are comprehensive in scope and granular in the output data they provide:** Providers of target setting and climate-alignment assessments in finance should prioritise scenarios that account for all emissions sources and all GHGs. The sectoral and geographical granularity of scenarios should be evaluated against the needs relating to different financial assets, asset classes and portfolio sectoral segments. Where gaps in granular output variables remain, scenario users should communicate to scenario providers their priorities in seeing those gaps being filled.
- **Make use of multiple scenarios to better reflect diversity and uncertainty in mitigation strategies and assumptions:** Recognising the inherent uncertainties in scenarios' climate outcomes and in their proposed mitigation strategies and underlying assumptions, financial stakeholders can consider a range of scenarios. This could entail considering scenarios with different assumptions, models, and mitigation strategies to account for different future real economy developments, as different mitigation strategies face different feasibility challenges.
- **Transparently communicate climate outcomes, likelihoods, and uncertainty when disclosing scenario-based targets and alignment assessments results.** Such information should further include the critical difference between peak and end-of-century temperatures. In this context, standardised and transparent disclosure should be used to express the level of climate ambition associated with alignment results or net-zero targets, building on practices from climate modellers.
- **Communicate narratives and uncertainties of mitigation strategies and assumptions:** Building on enhanced harmonisation of narratives on mitigation strategies and assumptions by scenario providers, scenario users in the financial sector can qualify their targets and assessments using such harmonised narratives. This can also contribute to shed light on associated uncertainties and feasibility challenges.
- **Apply scenarios taking into account design characteristics:** An improved understanding of design characteristics and limitations, as well as the inherent differences between GHG accounting in scenarios and GHG accounting in the financial sector, can prevent their misuse and reduce greenwashing. For example, targets relying on offsets cannot be compared to climate change mitigation scenarios.

- **Make use of non-emissions data and pathways provided by scenarios:** Scenarios provide a wealth of variables of how to achieve mitigation across emitting sectors, other than GHG emissions pathways. Such variables can be used by the financial sector to develop complementary metrics for assessing the overall climate performance of financial assets. **Climate policymakers** can further enable accurate use of mitigation scenarios and support
- **Promote standardised disclosure of climate outcomes of targets and alignment assessment, grounded in the latest science:** This can be done through encouraging a consistent interpretation of the Paris Agreement, as well as standardised data disclosure across scenario-based financial analyses, in particular in terms of temperature and emissions outcomes. This will increase consistency and comparability across different scenario-based analyses in the financial sector, as well as across jurisdictions.
- **Support improved availability of granular input data for scenarios:** Policymakers can provide mechanisms to support the availability of geography and sector specific input data to inform the design of global scenarios. For example, they can support improved data disclosure in national energy accounts and support data collection in developing countries. Access to granular and accurate data is essential for scenario development and analysis in the financial sector.
- **Contribute to reduced scenario uncertainty and increased scenario granularity, while maintaining international comparability:** Climate policy makers can contribute to reducing scenario uncertainty by ensuring climate policy certainty and specificity within their jurisdiction, which could include sector-specific climate change mitigation targets. Developing a range of national-level sector-specific scenarios, reflecting planned and potential policies, would go even further in informing the development of global scenarios more reflective of geographical specificities and circumstances. Combining this with standardised disclosure of climate outcomes and scenario information would allow maintaining international comparability.
- **Make use of enhanced scenario information and applications for assessing progress towards Article 2.1c of the Paris Agreement:** Harmonised scenario disclosure, information and data, as well as improved granularity, comprehensiveness and applicability of scenarios can better inform climate policy makers when tracking progress on aligning financial activities with climate policy goals, i.e. both investments into economic sectors of their national economy, as well as capital stock and new investments by investors and financial institutions domiciled within their jurisdiction. Such efforts could in turn contribute to informing aggregate-level assessments of progress, including under the UNFCCC (e.g. Global Stocktake and Biennial Assessment and Overview of Climate Finance Flows).

Further we would like to stress the importance of specifically mentioning the limitations of models provided by the Network of Greening the Financial Sector (NGFS). NGFS scenarios are increasingly seen as the «market standard» in the climate scenario landscape. It is therefore important to sensitize supervisors that NGFS scenarios are substantially underestimating the economic cost of climate change and in consequence of climate related financial risk. Because they do not integrate the potential second order effects from climate impacts related to nature and social risks these scenarios potentially understate the economic impacts of climate change by a factor of 2-3x².

² Thomä, J. & Fischer, F. (2023). Make or Break – Challenges to NGFS Scenarios and A Way Forward. Theia Finance Labs