WWF answer to BCBS consultation paper on Principles for the effective management and supervision of climate-related financial risks

The Worldwide Fund for Nature (WWF) is an independent conservation organization active in nearly 100 countries working to sustain the natural world for the benefit of people and wildlife.

WWF collaborates with a wide range of financial institutions to advocate for a sustainable finance sector, providing the necessary tools and methodologies to support the transition to a resilient, healthy, sustainable economic and financial system.

WWF´s Greening Financial Regulation Initiative (GFRI) systematically engages with policymakers, central banks and financial supervisors on the imminent need to fully integrate climate, environmental (including biodiversity loss) and social risks into mandates, operations and monetary policies.

WWF thanks the Basel Committee on Banking Supervision (BCBS) and the high-level Task Force on Climate-related Financial Risk for opening this public consultation and appreciate the opportunity to provide comments on the Principles for the effective management and supervision of climate-related financial risks.

We welcome the work done by the BCBS to promote improvement of risk management and supervisory practices related to climate-related financial risks. We share the Committee vision that the Core principles for effective banking supervision (BCPs) and the supervisory review process (SRP) are important frameworks to accommodate additional supervisory responses to climate-related financial risks, but these frameworks and the proposed approach would not be enough given the urgency to achieve change at scale.

First, Basel Committee should consider both climate change and nature depletion to address the related financial risks to the global banking system. Nature has a relevant role in climate change and needs to be factored when assessing and managing climate-related financial risks.

Second, impacts of financial institutions and markets on climate change and nature depletion should also be integrated as those impacts will translate into future financial risks.

Third, Basel Committee should tackle the mitigation of both idiosyncratic and systemic risks to ensure a full risks coverage.

Fourth, precautionary measures taken by financial supervisors should be recommended and more clearly stated. As BCP are truly stating it, *"supervisors should make assessments that are as accurate as possible given the information available at the time and take reasonable actions to address and mitigate such risks".* This means that supervisors should already act event if data and methodologies are not yet perfect, and they should take preventative measures to mitigate ex ante the risks linked to climate change and nature depletion[1i], focalizing their action on most

[1] Banque de France has shown that ~40% of securities held by French Banks are heavily reliant on ecosystem services. Same demonstration on nature related risks have been made in other countries.

detrimental sectors, worst Co2 emitters and worst nature destroyers. And they should do it now to prevent the building up of future systemic environmental related financial risks. Taking precautionary measures against significant systemic risks (climate, nature) also strengthens the stability of the financial system and mitigates volatility risk of price levels.

Therefore, in WWF view, all Basel frameworks should be adapted to take into account both climate and nature related risks and impacts. This means that all the following frameworks should be adapted:

- **Core principles for effective banking supervision (BCPs)**
- **Pilar 1 on minimum capital and liquidity requirements,**
- **Pilar 2 on supervisory review,**
- **Pilar 3 on market discipline,**
- **All macro prudential tools like Capital conservation buffer,**
- **Specific requirements for Global Systemically Important Banks.**

This would be the only way to ensure timely and impactful change towards a resilient financial system and a sustainable economy

In addition, and consequently, Basel Committee should integrate those new aspects into its regular implementation review thanks to the Regulatory Consistency Assessment program (RCAP) to ensure effective and consistent implementation of all standards for climate and nature.

Coordination with other international standard setters (IOSCO, IAIS) is also key to foster convergence and consistency in approaches and prevent as much as possible financing of detrimental activity and building up of additional risks in shadow banking sector.

Consultative Document – specific questions

Principles for the effective management and supervision of climate-related financial risks

Q1. Has the Committee appropriately captured the necessary requirements for the effective management of climate-related financial risks and the related supervision?

As stated above, WWF believes that more ambitious actions are needed to reach changes at scale in a short timeframe and send right signals to financial markets actors.

First, Basel Committee should consider both climate change and nature depletion, and their interaction, to address the related financial risks to the global banking system.

Second, impacts of financial institutions and markets on climate change and nature depletion should also be integrated as those impacts will translate into future financial risks.

Third, Basel Committee should tackle the mitigation of both idiosyncratic and systemic risks to ensure a full risks coverage.

Fourth, precautionary measures taken by financial supervisors should be incentivized and more clearly stated. As BCP are truly stating it, *“supervisors should make assessments that* *are as accurate as possible given the information available at the time and take reasonable actions to address and mitigate such risks".* This means that supervisors should already act event if data and methodologies are not yet perfect, and they should take preventative measures to mitigate ex ante the risks linked to climate change and nature depletion, focalizing their action on most detrimental sectors, worst GHG emitters and on the most detrimental drivers of nature's depletion . And they should do it now to prevent the building up of future systemic environmental related financial risks. Moreover, paradigm shift for climate analysis that is demanded by regulated Banks (forward-looking /scenario/uncertainty-based methods instead of backward looking/empirical/risk measures) should be applied by supervisors as well

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Are there any aspects that the Committee could consider further or that would benefit from additional guidance from the Committee?

WWF:

Considers that the Committee could provide additional guidance, tools, scenarios, advice and references to the central banks and supervisors to rolling out concrete measures, the right capacities, development of specific metrics and indicators as an example of what they should do.

Believes that the principles should develop an "implementation guide" of these principles where they go through each principles providing some concrete examples of quantitative and qualitative risk metrics and indicators for example, and they can reference standard, frameworks, etc. Suggests mentioning a more explicit reference of what should be considered timely and updated regularly (e.g. annual basis) for management monitoring and reporting for example.

Considers that the banks and supervisors should set science-based, time-bound climate targets for the portfolio alignment and to mention and set as reference the goals of the Paris Agreement.

Consider that financial supervisors should ask for financial institutions' science-based transition plans and review those regularly.

Provide more concrete guidance on time horizons which should be considered for capital and liquidity adequacy. One example could be the one provided in EBA in their SREP-guidelines:https://www.eba.europa.eu/eba-publishes-its-report-management-and-supervision-esg-risks-credit-institutions-and-investment

In this report the relevant time horizons for business strategies and risk management frameworks are 10 to 30 years, much longer than the one to five years currently assessed by banks and their supervisors. Moreover, not only the financial risks to the banks themselves, i.e. the consequences of their financed activities, but also the adverse impact they cause, the harm that their finance does to the planet, must be incorporated and priced, as it is the latter that jeopardizes the financial stability across the globe.

On the capacity building processes, could emphasize the capacity building activities for the frontline staff for example.

For each of the above suggestions WWF would be pleased to provide support.

Q2. Do you have any comments on the individual principles and supporting commentary?

Corporate governance

Principle 2. Suggested wording:

The board and senior management should clearly assign climate-related responsibilities to members and specialized committees or dedicated unit and exercise effective oversight of climate-related financial risks.

Paragraph 13

…should be clearly assigned to board members and committees or specialized unit

Paragraph 14

"...banks should build capacity and upskill the staff, the board and senior management conducting regular training on climate and other environmental related topics, including internal workshops and external collaboration with expert organizations"

Internal control framework

Risk management

Paragraph 25

"These risks may include those posed by concentrations, in particular those related to industry, most problematic sectors and geographic regions"

Principle 16

"To foster cross-border collaboration, home and host supervisors of cross-border banking groups should share information related to the climate risk resilience of banks and banking groups, leveraging existing frameworks for sharing information and undertaking collaborative work". WWF's suggestion could be to provide some references of internationally recognized standards to accomplish this principle.

Q3. How could the transmission of environmental risks to banks' risk profiles be taken into account when considering the potential application of these principles to broader environmental risks in the future? Which key aspects should be considered?

The recognition of the interconnection between climate change and nature is scientifically proven, they are twin emergencies. One cannot tackle climate change without understanding nature and vice versa.

WWF urges Central Banks and financial supervisors to act in consequence and integrate now all environmental aspects (deriving form climate change and nature depletion) into financial regulation and standards. Preventive measures should be taken to mitigate ex ante the risks deriving from nature loss alongside climate change-related risks. Climate and nature risks should be analyzed together. The current regulatory framework provides the tools to do so, across microprudential supervision, macroprudential supervision and monetary policy. But this should now be clearly stated in the whole Basel framework.

Regulation already enables financial market players to consider and manage their risks related to biodiversity loss, even if these risks are not explicitly referred to within regulations. For example, based on the existing regulatory framework, the ECB encourages financial institutions to monitor, on an ongoing basis, the effect of climate-related and environmental factors (such as biodiversity) on their current market risk positions and future investments, and to develop stress-testing scenarios that incorporate risks related to such factors. The same rationale could also be applied to the other major international prudential frameworks such as Basel III and Solvency II, which allow financial market players to consider risks related to nature loss in their risk management systems.

WWF published [Nature's next steward report in July 2021](), in which we describe the transmission channel between nature loss and financial risk at micro and macro level. WWF also defined act now agenda for nature related risks and impacts.

In WWF view, nature loss aspects should be addressed in the same way as climate change aspects in Basel framework and integrated into the whole framework as described above. Both idiosyncratic and systemic related risks should be tackled.

To stop the vicious circle of climate change and nature depletion, supervisors and financial institutions should first focus on sectors that are the most detrimental, on worst GHG emitters and nature destroyers. Supervisors and Financial institutions should:

- Integrate protection of ecosystems into financial regulation and financial risk management, including areas of particular importance such as Key Biodiversity Areas (KBAs)[2], Protected areas[3] and Ecologically or Biologically Significant Marine Areas (EBSAs).

[2] https://www.iucn.org/resources/conservation-tools/world-database-of-key-biodiversity-areas

[3] https://www.cbd.int/protected/overview/#:~:text=Protected%20areas%20are%20the%20cornerstone,natural%20processes%20across%20the%20landscape.

- Ask financial institutions to apply “Do No Significant Harm” approach to evaluating any investment options and calibrating capital and liquidity requirements, to consider climate change and nature loss together.
- Qualify as highly risky all activities linked to deforestation and conversion in financial portfolios and adjust capital and liquidity requirements accordingly.
- Strictly prohibit all financing of activities linked to wildlife trade; overfishing or illegal fishing, introduction, or increased competitiveness, of invasive species; procurement or use of pesticides and chemicals specified as persistent organic pollutants under the Stockholm Convention.
- Adjust systemic capital buffers according to exposure to detrimental actors or in particularly vulnerable regions.