24 January 2022

To: The Basel Committee on Banking Supervision (BCBS),
Re: Principles for the effective management and supervision of climate-related financial risks

The United Nations Environment Programme - Finance Initiative (UNEP FI) is a strategic public-private partnership between the UN and over 400 global financial institutions. It has established some of the most important sustainability-oriented frameworks within the finance industry, including the Principles for Responsible Investment, the Principles for Sustainable Insurance and the Principles for Responsible Banking. It also convenes leading net zero alliances of banks, insurers and asset owners which form part of the Glasgow Financial Alliance for Net-Zero. Since the issuance of the initial TCFD disclosure guidance, UNEP FI has led pilot programmes for over 100 banks, insurers and institutional investors on climate risk and TCFD disclosures. These programs have convened financial institutions, supervisors, and climate experts with a view to improving climate disclosure and climate risk management across the financial sector.

Overview

UNEP FI welcomes the publication of the BCBS's *Principles for the effective management and supervision of climate-related financial risks*. This document provides actionable guidance to both financial institutions and financial supervisors. We believe that the financial sector has a central role to play in managing climate risk and ensuring an orderly transition to a sustainable future. We also believe that strong regulatory action can help catalyse the financial sector to address the risks posed by climate change and the net-zero transition. Within this document, we particularly welcome the following:

- Continued acknowledgement that climate risks are financial risks and that additional guidance is required within the financial sector for their management
- Recognition that climate change poses capital, liquidity, credit, market, operational, and other risks
- Principles for supervisors on how to evaluate firms' climate risk management practices
- A complete set of operational areas to consider in managing climate risks: corporate governance, internal control framework, capital and liquidity policy, risk management process, management monitoring and reporting, comprehensive management of credit risk, comprehensive management of market, liquidity, operational, and other risks, and scenario analysis
- Guidance to consider various time horizons and different scenarios in assessing the preparedness of an institution to face climate-related financial risks
- Guidance on the monitoring and reporting of climate-related financial risks by financial institutions

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- Consideration of the potential application of these principles to other environmental and nature-related risks

We have a few reflections and recommendations on the principles that we believe would be helpful to share. We have divided these comments into two sections: one containing general themes and the other focused on the specific principles.

1. Comments on general themes

International alignment of principles and standards

COP 26 saw the announcement of the International Sustainability Standards Board (ISSB), which aims to consolidate the work of a number of sustainability initiatives into a coherent standard. This year, the ISSB plans to consult on proposals for a global sustainability standard. Late last year, the TCFD secretariat released consultations on transition plans, disclosure metrics, and portfolio alignment methodologies. Other important organizations have released reports on climate risk management and disclosure from GARP to the NGFS.

The principles in this document are broadly consistent with much of the recent guidance on climate risk management. However, as financial institutions and supervisors look to employ these principles, it is important that there is alignment around both disclosure standards (likely to be covered in the BCBS work on pillar 3 disclosures) and on good practices for climate risk management. It will be valuable for financial actors to understand the relationship, similarities, and differences between different sets of guidance, especially as they are facing growing expectations from their regulators and stakeholders to demonstrate how they are managing their climate risks.

Encouraging strong regulatory action

UNEP FI believes that increased regulatory demands for climate disclosure have enhanced the financial sector's preparedness to confront climate-related risks. In addition, mandatory disclosures have improved the quality of climate-related financial disclosures overall and scenario analysis in particular. While there is some evidence that climate disclosures have led to greener financial practices, huge financial flows continue into heavily emitting industries, posing a growing transition risk.

Although the initial round of supervisory climate stress tests has yielded useful insights, supervisors can and should use these exams to take a more active role in managing systemic climate-related financial risks. Climate stress tests with regulatory consequences and capital adequacy assessments have the ability to directly address climate risks and the potential mispricing of climate risk. UNEP FI would like to see supervisors develop exams that can more fully assess the climate risks of institutions and the financial system and feature consequences that encourage responsible behaviors. Through our work in emerging economies, we have seen the impact that regulatory expectations have on motivating financial actors to enhance their climate risk management capabilities. Given the important work that the NGFS is also doing in this space, we support continued coordination between BCBS and NGFS on the development of supervisory good practices.

Net-zero scenarios

Since the 2018 publication of the IPCC's special report on 1.5˚ C of warming, there has been a growing scientific and policy consensus for the need to limit warming to this critical threshold. Based on IPCC analysis, 1. 5˚ C aligns with net-zero CO2 emissions by 2050. In 2021, net-zero ambition became mainstream as nations that contribute nearly 90% of total emissions committed to some form of net-zero

target, along with over 450 financial institutions. To support these efforts, the IEA and the NGFS developed net-zero by 2050 scenarios for policymakers and financial users alike. When conducting scenario analysis, a 1.5˚ C scenario is of central importance. Not only does 1. 5˚ C reflect an ambitious transition pathway, but it also reflects a policy objective of a growing number of governments. In these regions with net-zero commitments, credible net-zero transition plans are essential for financial institutions. Supervisors should work to ensure that financial institutions and the financial system overall are prepared for a net-zero future, and that requires explicit assessment using credible 1. 5˚ C scenarios.

Prescriptive guidance

As mentioned previously, UNEP FI concurs with the principles stated in this document and considers them reflective of good climate risk management practices. However, financial institution and supervisory users of this document would benefit from further elaboration of the principles in certain cases (noted in greater detail in the 2nd part of this comment letter). Specifically, greater detail on important metrics to disclose and credible scenarios to use would be of value. In addition, illustrative examples for certain principles would also be beneficial and could be based on work from the multiple regulators have already issued strong guidance around disclosures. While we recognize there is a tension between creating widely accepted principles and giving prescriptive guidance, the publications of the TCFD and others over the past year have shown that the financial sector desires more explicit guidance where possible.

Related areas of environmental and social risks

While the principles in this document are focused on climate-related financial risks, many of them would also be applicable to a broader set of environmental risks. It would be valuable to explore areas where this guidance on climate risk management can be extended to topics such as biodiversity loss, deforestation, pollution, water and human rights issues that can also pose financial risks. UNEP FI believes the BCBS should increasingly consider the wider range of nature-related risks connected to financial activities. A helpful example of extending climate-related guidance to other nature-related areas comes from the development of the TNFD framework, which built on the existing work of the TCFD. Likewise, the ECB's climate and environmental risk guidelines also extend to environmental risks such as biodiversity. Given the interrelationships between different types of environmental risks, supervisors looking to ensure financial stability should also understand the complex ways economic activities can destabilize natural systems.

2. Comments on specific principles

Principle 1
How is "material" defined? Is there a reference or definition that BCBS would like to use to provide clarity on this important term?

Principle 2
We agree with this principle, but also concur with the TCFD framework that climate indicators and climate objectives should be considered in the design and application of board and executive remuneration policies and broader incentive frameworks.

Principle 5
We agree with the importance of assessing climate risks for their impacts on internal capital and liquidity adequacy. We also support the mention of external capital adequacy assessments (e.g. capital stress tests) as an area of future regulatory activity.

Principle 6
It would be valuable to elaborate further on expectations around risk appetite. This can include guidance to include the risks, tolerances, thresholds, and limits and how they are allocated across different parts of the organization. In general, more specific guidance around useful metrics to include would be helpful to practitioners.

In addition to KPIs, consideration should be given to early warning indicators.

Principles 8-11
We believe that the identification of climate-related risk drivers is important in any assessment of climate risk. It would be helpful to provide some potential examples of the key variables and scenarios that are worth considering when measuring and managing these different risk types.
Para 32 notes the importance of counterparty credit risk but could also note collateral valuation, as climate risk may impact both PD and LGD.

Para 38 recognises potential liquidity impacts; potential triggers for contingent liabilities may also be worth highlighting as a factor that can adversely impact a liquidity position.

Principle 11 recognises strategic, reputational and regulatory compliance risk but does not mention legal risk (except in footnote 5); there is evidence to suggest that this is a risk category of growing importance and may warrant more attention.

Principle 12
As 1.5˚ C has become a global climate goal, it would be helpful to make an explicit recommendation that scenario analysis include scenarios aligned to this temperature outcome.

Principle 13
We agree that risk assessment over a variety of different time horizons is necessary in evaluating a firm's climate risks. Other organizations and initiatives have defined short-term, medium-term, and long-term in ways that might be helpful to incorporate into this principle to ensure comprehensiveness.

Principle 14
Due to the rapidly evolving field of climate risk analysis, we suggest that Principle 14 include an assessment that banks' analysis is refreshed at an appropriate frequency, for example in response to major developments in the science (e.g. major IPCC assessments) and policy environment (e.g. NDC updates).

Principle 15
As described above, we suggest that alignment to a 1.5 degree warming scenario is a key systemic risk mitigant worthy of note.

Principle 16
The "range of techniques and tools" in this principle can be elaborated on to the benefit of regulatory users. E.g. making use of a Senior Managers Regime or use of individual or sector-wide skilled persons reports where serious deficiencies are observed. UNEP FI would like to see that supervisory assessments of climate risks increasingly consider the supervisory capital implications of these risks.

Principle 18

Additional detail in this principle would be helpful to regulatory users. UNEP FI believes that the principle can include the mention of 1.5˚ C scenarios, the level of stress within scenarios, and the consideration of impacts over different time horizons.

Should the BCBS have any questions about this response, UNEP FI would be delighted to discuss our perspectives further or answer any related comments or questions.

Sincerely,

Eric Usher
Head, UNEP-FI