SARASIN
& PARTNERS

Basel Committee consultation on the "Disclosure of Climate-related financial risks"

Sarasin & Partners LLP response
14th March 2024

1. Introduction

Sarasin & Partners is a London-based investment manager serving charities, private clients and other institutions. Our goal is to deliver sustained investment returns through an active long-term and thematic investment approach, which emphasises responsible stewardship.

We welcome the Basel Committee on Banking Supervision's work to address climate-related financial risks to the global banking system[1], and the particular focus of this consultation on strengthening the disclosure pillar of the framework to bolster financial stability. Investors require reliable, prudent and consistent disclosures by banks to enable an accurate evaluation of risks to banks' financial position, as a foundation for both capital allocation and robust oversight and accountability. This underpins the market discipline element of the prudential architecture.

Sarasin and Partners LLP's interest in promoting climate-resilient banks is reflected in our stewardship work, which has prioritised engagements with banks to promote more responsible climate risk management. Specifically, we are seeking to ensure banks' strategies and financing activities are supportive of the goals of the Paris Agreement to cap global warming at 1.5°C above pre-industrial times. We view this as important to supporting long-term economic growth, and thus future returns for our clients.

In 2019, we became co-chair for the Institutional Investor Group on Climate Change's (IIGCC's) Net Zero Banking initiative. Following consultation with global investors as well as banks, IIGCC last year published a Net Zero Banking Standard to provide a clear set of investor expectations for how banks can ensure their activities are credibly aligned with the Paris Agreement goals[2]. In parallel, the Transition Pathway Initiative (TPI) published an assessment framework based on the Standard to offer a mechanism for tracking banks' performance[3].

In January this year, Sarasin coordinated a collective investor letter to the Bank of England's Prudential Regulation Authority to seek its support in promoting improved climate risk disclosures at banks to enable investors to fulfil their role under Pillar 3 of the Basel Framework[4]. The letter set out key

---

[1] For instance, the Basel Committee on Banking Supervision, "Principles for the effective management and supervision of climate-related financial risks", June 2022.
[2] https://www.iigcc.org/banks-engagement
[3] https://www.transitionpathwayinitiative.org/banks
[4] https://sarasinandpartners.com/stewardship-post/investors-could-play-a-key-role-in-promoting-banks-climate-resilience/

Juxon House 100 St. Paul's Churchyard London EC4M 8BU
T +44 (0)20 7038 7000 | sarasinandpartners.com

Sarasin & Partners LLP is a limited liability partnership registered in England and Wales with registered number OC329859 and is authorised and regulated by the Financial Conduct Authority

impediments we see as investors to effecting market discipline currently, and suggests the following potential actions:

- Explicit guidance to banks that they use severe but plausible climate scenarios in their stress testing work that consider the latest scientific understanding on tipping points and other non-linearities;
- Requirements for banks to disclose the key conclusions from regulatory climate stress-testing exercises they have undertaken, including implications for capital adequacy in more severe climate and transition scenarios; and
- Proactive enforcement of existing accounting and audit rules to ensure that material climate risks are properly reflected in banks' financial statements (particularly with relation to banks' Expected Credit Loss assumptions) and auditor reports[5] [6].

Alongside the above steps, we also underlined our support for a forward-looking approach when it comes to regulatory capital requirements, which supports system resilience to climate risks[7].

Against this backdrop, we welcome the Basel Committee's timely consultation. This submission sets out our responses to specific questions (Section 3), starting with some headline reflections that we hope prove useful to the Committee.

2. Summary of key points

We would like to offer the following high-level reflections, which we hope prove useful in the Committee's deliberations.

- **A precautionary approach is critical**. As persuasively argued in the consultation document, climate risks are unique in the scope of their impacts and uncertainty due to complex interlinkages between transmission channels, longer time horizons (though not always), non-linearities/tipping points driven by self-reinforcing feedback loops. As a long-term investor, we are strongly supportive of a precautionary approach which favours early action to ensure more harmful and economically damaging outcomes are avoided.

[5] We note multiple concerns, including inadequate data and controls, that bank auditors raised with the PRA as part of its thematic review on climate accounting in 2022 (https://www.bankofengland.co.uk/prudential-regulation/letter/2022/october/thematic-feedback-2021-2022-written-auditor-reporting).

[6] Investors have made clear their expectations for companies to provide climate-related financial disclosures in general (https://sarasinandpartners.com/row/wp-content/uploads/sites/6/2021/06/Investor-Expectations-for-Paris-aligned-Accounts.pdf), and specifically at banks in the investor-led Net Zero Banking Standard (https://www.iigcc.org/banks-engagement).

[7] https://www.bankofengland.co.uk/prudential-regulation/publication/2023/report-on-climate-related-risks-and-the-regulatory-capital-frameworks

It is also vital that this precautionary approach incorporates stress testing for severe but plausible scenarios to build system resilience. Current reliance on excessively optimistic modelling risks feeding a false sense of complacency[8].

We are aware, and supportive, of the need for regulators to strike a balance between reinforcing system resilience and avoiding overly onerous requirements which impede economic growth. Currently, however, our experience is that too little attention is being paid to known and potentially highly material climate-related risks, so there is a need for enhanced disclosures as proposed. We also note that the proposals build in an iterative approach, which permits adequate flexibility to modify requirements as experience is gained.

In response to the arguments being made by some that the data is too uncertain to publish, and that doing so could increase market volatility[9], we would make two observations. First, banks are already forecasting a range of economic variables forward and, if these ignore climate factors, they are likely to be less reliable than if climate is considered. Second, as the market becomes more aware of potential climate risks, the lack of transparency is more likely to fuel uncertainty, potentially leading to greater volatility. In short, fear of the unknown is likely to be far more damaging to financial stability than transparent disclosure of climate-related financial risks.

- **Systemic risks demand enhanced capital requirements**. The safety and soundness of the banking system depends on a recognition and management of system-wide interactions today and through time. In other words, banks need to not just focus on the immediate climate risks they face but they also need to ensure they are not exacerbating future risks to capital through their current financing decisions. This requires a long-term mindset.

  Markets are not very good at dealing with such longer-term threats, even where they are potentially severe. Consequently, Pillar 3 disclosures underpinning market discipline, while important, can only help up to a point. Further action to enhance capital requirements would be important to align market incentives with more prudent behaviour that is necessary given the endogeneity of banks' financing decision today for climate risks tomorrow. We should stress that, this may not necessarily mean an increase in capital requirements overall for the sector, but that requirements are tilted to reflect the level of climate risk being taken, creating incentives for more rigorous climate risk management.

---

[8] See, for instance, Exeter University and Institute and Faculty of Actuaries report on flaws in mainstream modelling leading to the omission of the most dangerous climate impacts linked to tipping points and socio-economic feedback loops: https://actuaries.org.uk/emperors-new-climate-scenarios

[9] Contributions at the BiS EMEA outreach event, Frankfurt, 14th February 2024.

- **Prudent financial statements are the foundation on which effective Pillar 3 disclosures rest**. A clearer emphasis is needed on the inter-dependencies between prudent, climate-aware, financial statements and the effectiveness of the Pillar 3 regime. Not only does the capital adequacy regime build from a presumption that the financial statements are prudent, but investors rely on financial statements to provide a reliable view of financial strength, given ongoing climate change. In short, the financial statements need to include foreseeable losses and/or liabilities that come from the physical or transition impacts of expected climate change.

  Currently, the majority of bank accounts make no, or minimal, mention of their consideration of climate risks[10]. There is no discussion of how critical accounting assumptions considered the consequences of climate change, e.g. how expected credit loss (ECL) assumptions were adjusted to reflect lower long-term economic growth in the current 2-3°C pathway, or the transmission risks for particular high-carbon borrowers. We have seen no disclosure in the Financial Statement notes of sensitivities of the stated financial position to changes in critical assumptions that might be climate-vulnerable.

  This lack of disclosure in financial statement has been flagged as a concern by the UK's PRA and the European Securities Market Authority (ESMA)[11] [12]. Global investors have also clearly articulated their expectations for climate-related disclosures in financial statements[13].

  While the consultation document emphasises the inter-dependency with ISSB-driven disclosures, for the above reasons we would urge a focus on the inter-dependency with the banks' accounting numbers. In the end, it is the financial statements that determine capital allocation; remuneration and are the basis for investor accountability. These numbers therefore need to incorporate material climate risks.

- **Impacts for capital and climate stress testing results should be disclosed** – Aside from a passing reference, the current proposals do not include a requirement for banks to disclose how they

---

[10] See, for instance, TPI's review of 26 global banks, including their accounting disclosures published in September 2023: https://www.transitionpathwayinitiative.org/publications/2023-banks-and-the-net-zero-transition-tracking-progress-with-the-tpi-net-zero-banking-assessment-framework#:~:text=In this context, in June,global banks using the framework.

[11] We note multiple concerns, including inadequate data and controls, that bank auditors raised with the PRA as part of its thematic review on climate accounting in 2022 (https://www.bankofengland.co.uk/prudential-regulation/letter/2022/october/thematic-feedback-2021-2022-written-auditor-reporting).

[12] https://www.esma.europa.eu/sites/default/files/library/esma32-63-1320_esma_statement_on_european_common_enforcement_priorities_for_2022_annual_reports.pdf

[13] Investors have made clear their expectations for companies to provide climate-related financial disclosures in general (https://sarasinandpartners.com/row/wp-content/uploads/sites/6/2021/06/Investor-Expectations-for-Paris-aligned-Accounts.pdf), and specifically at banks in the investor-led Net Zero Banking Standard (https://www.iigcc.org/banks-engagement).

expect climate risks to impact their capital strength[14]. In keeping with the precautionary principle and the goals of Pillar 3 of the Basel framework, we would advocate for 1) disclosures to the market of how the climate-related risks translate into risks to capital adequacy; and 2) disclosure of the results from stress testing work undertaken for bank supervisors.

- *The market needs to understand risks to capital* - The disclosures proposed in this consultation offer information on climate transition and physical risk exposure (e.g. financed scope 1-3 emissions intensity by sector; proportion of corporate loan book exposed to physical risks), but do not provide visibility on how this translates into risks to capital. In the end, investors need to understand the financial consequences, to be in a position to exert market discipline. These disclosures should be consistent with banks' financial statements, in particular through adjustments to ECL (see above).

- *The market needs to understand the potential spread of outcomes for capital* – In addition to understanding how the disclosed exposures could impact banks' capital strength, investors would like visibility of the spread of these potential impacts. This is because climate change is characterised by uncertainty, irreversibility and the potential for severe outcomes due to tipping points and non-linearities, so using just a single central estimate would leave out critical information on the range of potential outcomes. A point estimate could fuel a false sense of complacency by keeping severe but plausible outcomes hidden, and weaken the pressure investors might otherwise exert to encourage early risk management.

- **Aligning executive remuneration with climate-conscious capital adequacy**: We would suggest consideration of a Net Zero underpin for executives' performance related pay[15]. The concept applies the same logic as applied to the capital adequacy underpin, introduced following the 2007-2008 financial crisis.

  At that time, global prudential regulators were clear that they needed to shift executive incentives away from short-term metrics to an over-riding focus on longer-term capital health. The goal was to discourage risk taking at the expense of financial stability and social wellbeing. In keeping with guidance from the Financial Stability Board, a capital adequacy 'underpin' has been adopted by several banks to ensure that executives do not receive performance-related pay unless capital adequacy tests are met.

  In addition, boards are required to implement malus and clawback mechanisms (the former deals with awards that have yet to vest, the latter where vesting has occurred) for variable pay awarded in the past that later turns out to have come from imprudent activity. These measures

[14] There is a reference to this critical point in Table CRFRA, under Strategy, paragraph d, but this is not then carried through to the quantitative disclosure proposals.
[15] Please see https://esgclarity.com/investors-approve-executive-pay-that-incentivises-global-warming/

seek to elevate prudent capital management to the top of executives' priority list to reinforce banks' financial stability.

We believe that the logic for taking a similar prudential approach for climate risk management is compelling. Rewarding executives for short-term financial gains, achieved by contributing to global warming, puts financial stability at risk. By inserting net zero underpins and/or climate malus and clawback provisions, this could help to neutralise incentives for climate harm.

- **Important to cover both banking and trading books** - Q6 of the consultation asks whether this narrower approach is appropriate. Our view is that climate risks could impact both the banking and trading books, so we would wish to see disclosures covering both.

3. Responses to specific consultation questions

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?

The introduction of a Pillar 3 disclosure framework as proposed would be important to support investors ability to assess individual banks' climate risk exposures and compare relative exposures across the sector. This in turn underpins capital allocation as well as stewardship work focused on holding bank executives and boards to account for risk management, both of which are essential in delivering market discipline under the Basel framework.

A further benefit that we see is that these Pillar 3 disclosures may trigger greater consideration of material climate risks in banks' financial reporting, which investors rely upon in their investment decision-making. As noted in Section 2 above, we lack comfort that material climate risks are being properly considered today in banks' critical forward-looking accounting assumptions, such as Expected Credit Losses. This lack of disclosure in financial statement has been flagged as a concern by the UK's PRA and ESMA[16] [17]. Global investors have also clearly articulated their expectations for climate-related disclosures in financial statements[18].

---

[16] We note multiple concerns, including inadequate data and controls, that bank auditors raised with the PRA as part of its thematic review on climate accounting in 2022 (https://www.bankofengland.co.uk/prudential-regulation/letter/2022/october/thematic-feedback-2021-2022-written-auditor-reporting).

[17] https://www.esma.europa.eu/sites/default/files/library/esma32-63-1320_esma_statement_on_european_common_enforcement_priorities_for_2022_annual_reports.pdf

[18] Investors have made clear their expectations for companies to provide climate-related financial disclosures in general (https://sarasinandpartners.com/row/wp-content/uploads/sites/6/2021/06/Investor-Expectations-for-Paris-aligned-Accounts.pdf), and specifically at banks in the investor-led Net Zero Banking Standard (https://www.iigcc.org/banks-engagement).

While the consultation document emphasises the inter-dependency with ISSB-driven disclosures, for the above reasons we would urge a focus on the inter-dependency with the banks' accounting numbers. In the end, financial statements are critical to directing capital allocation; drive remuneration (and thus executive incentives) and are the basis for investor accountability. These numbers therefore need to incorporate material climate risks.

Q2. What are the risks of a Pillar 3 disclosure framework for climate-related financial risks not being introduced?

A failure to mandate climate-related financial disclosures in Pillar 3 would likely lead to variable disclosure approaches, undermining investors' ability to compare climate risk exposures across banks. Where banks fail to provide any climate-related disclosures, the danger is that climate risks build up hidden in the banking system, posing a threat to financial stability as climate change worsens, and decarbonisation accelerates.

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?

Yes. As noted above, we are strongly supportive of a consistent disclosure framework for climate-related risks under Pillar 3 as outlined in the consultation document to enable investors to better understand banks' exposure and thus resilience to climate change and decarbonisation.

Q4. Would the Pillar 3 framework for climate-related financial risks be sufficiently interoperable with the requirements of other standard-setting bodies? If not, how could this best be achieved?

A key concern for us is to ensure consistency between Pillar 3 disclosures and banks' financial statements. The consultation document notes that it is aiming to complement the ISSB framework, which we welcome, but no mention is made on how it is considering consistency with the main accounting standards used globally, for instance the International Financial Reporting Standards, US GAAP, etc.

In the end, as we highlight in Section 2, the prudential regulatory regime takes banks' financial statements as its starting point. If the latter is leaving out material climate risks, it weakens the overall structure. Based on a review of the 26 largest global banks by TPI, it is clear that few banks' financial statements are disclosing how climate risks are being considered[19]*. Where banks do point to consideration of climate risks, they have typically concluded they are not material in the short to medium term*[20]*. However, there is growing evidence that climate risks are materialising sooner, and the impacts are likely to be more harmful, than previously thought.*

---

[19] TPI, ibid

[20] See, for instance, HSBC's Note 1, "Basis of Preparation & significant accounting policies", in 2022 Financial Statements. https://www.hsbc.com/investors/results-and-announcements/annual-report

We would therefore encourage the Basel Committee to work with global accounting standard setters, audit standard setters and accounting and audit regulators to ensure all reporting to the market is reflecting material climate risks, thereby reinforcing the proposed Pillar 3 disclosures.

It is worth noting that global investors have been calling for climate-aware accounting for some time. With regards banks, investor expectations for climate to be considered in financial statements was made explicit in the investor-led Net Zero Banking Standard, launched in 2023[21].

As noted in Section 2, European and UK prudential and accounting regulators have started calling for banks to ensure their financial statements are climate-aware over the past two years. ESMA, for instance, has underlined the importance climate change being incorporated into bank ECL assumptions[22]. The UK's PRA sent guidance to Bank CEOs and CFOs in October 2022[23], which underlined:

> *"[t]he PRA considers that timely incorporation of climate risk in accounting valuations is important in ensuring the safety and soundness of PRA-authorised firms.".*

In these letters, the PRA set clear expectations for banks' financial reporting for 2022 and beyond covering the need for adequate data and modelling capabilities; effective governance and controls; and, critically:

> *"disclosures that help market participants understand the linkage between firms' climate-related disclosures and the impact on their financial statements and Pillar 3 reporting."[24]*

While international accounting and audit standard setters have emphasised the relevance of climate change for accounts and audits since 2019 and 2020, respectively, more could be done to provide bank-specific guidance[25].

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

---

[21] https://www.iigcc.org/banks-engagement

[22] https://www.esma.europa.eu/sites/default/files/library/esma32-63-1320_esma_statement_on_european_common_enforcement_priorities_for_2022_annual_reports.pdf

[23] https://www.bankofengland.co.uk/prudential-regulation/letter/2022/october/managing-climate-related-financial-risks; https://www.bankofengland.co.uk/prudential-regulation/letter/2022/october/thematic-feedback-2021-2022-written-auditor-reporting

[24] These recommendations build on a detailed thematic review involving feedback from bank auditors and others, which found numerous weaknesses around the consideration of material climate factors in accounting processes, as reported in the PRA letter to CFOs. See link above.

[25] https://www.ifrs.org/content/dam/ifrs/supporting-implementation/documents/effects-of-climate-related-matters-on-financial-statements.pdf ; https://www.ifac.org/_flysystem/azure-private/publications/files/IAASB-Climate-Audit-Practice-Alert.pdf

Any new reporting framework may result in unintended consequences. One potential concern is that additional disclosures of climate-related financial risks may result in the curtailment of financing to more exposed entities, e.g. oil and gas companies or entities exposed to flooding, impeding their ability to transition or adapt.

As noted in responses to questions below on the sector and geographical concentration disclosures, we would encourage supplementary information on how the risks are mitigated – e.g. the proportion of the exposure covered by credible transition plans, which would provide more clarity on the actual risk, and help mitigate the risk of financing curtailment for the important transition activities. In essence financing for transition is likely to be less risky, than financing for continued unabated carbon intensive activities.

We believe the proposal to progress iteratively, but without delay, offers a pragmatic approach to retaining sufficient flexibility to respond to any unforeseen impacts.

Q6. What are your views on potentially extending a Pillar 3 framework for climate-related financial risks to the trading book?

We would endorse the need to take a holistic approach, covering both the banking and trading books, when considering climate risk exposures. Looking at just part of banks' exposures could result in hidden risks in the trading book that pose risks to future financial stability.

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

We are supportive of this methodology. What matters in the end is finding the most appropriate reporting structure to expose concentrations of risks. As physical and transition risks will tend to concentrate at both sector/industry and geographic levels, this approach could help surface risks otherwise hidden in banks' balance sheets.
As noted elsewhere, we would also support disclosure on the risk mitigation undertaken for each of these categories of climate risk. For instance, for lending to the energy sector, what proportion is covered by science-based targets or credible transition plans.

Q8. What are your views on which elements should be made subject to national discretion and which should be mandatory? Why?

As international investors, we favour a mandatory and global approach overall to ensure consistency in disclosure, underpinning comparability. Also, we would be concerned that in the event of differentiated national standards, there would be divergent levels of risk management, with risks building up in jurisdictions with weaker disclosure standards. This could in turn raises the dangers of contagion to other countries/regions.

Having said that, we also appreciate that disclosure standards may need to be phased in at different speeds in different markets. We would, however, advocate for a level playing field in terms of the end position, or at the very least a minimum baseline set of disclosures on which national regulators could build.

Q9. What are your views on whether potential legal risks for banks could emanate from, or be mitigated by, their disclosures as proposed in this consultation, and why?

In our view climate risks, whether physical or transition, should be treated like any other risk to capital under existing statutory requirements. In short, if climate risks are material and not disclosed, there would be potential legal risks associated with misrepresentation.

A clear set of disclosure requirements under Pillar 3 of the Basel framework, should both create a level playing field and help to insulate banks from potential legal challenge.

Q10. Would the qualitative and quantitative requirements under consideration need to be assured in order to be meaningful? If so, what challenges are foreseen?

We would wish to see the climate-related data and its implications for financial condition of banks assured by an independent third party, according to robust assurance and ethical standards. Assurance standards for non-financial information are being improved, so we see no reason why independent assurance would not be applicable.

As already highlighted, where this information is in banks' financial statements, then this will be audited, and the auditors already have a duty to ensure materiality is properly reflected, or calling out where it is not.

There are arguments for the financial statement auditor also being made responsible for assuring climate-related disclosures to ensure consistency and also clear and full accountability for assurance. This would also reinforce market discipline, since shareholders typically have the right to appoint auditors at banks' Annual General Meetings. Where assurance standards are inadequate, investors could vote against the auditor's reappointment.

Qualitative Disclosure Requirements

Q11. What are the benefits of the proposed qualitative Pillar 3 climate-related financial risk disclosure requirements?

The key benefit of these qualitative disclosures is they provide critical context for interpreting quantitative disclosures on current risk exposures. Understanding the governance and strategy for managing concentration risks is important for investors to be able to assess whether a bank is taking sufficient action to protect capital.

The additional benefit of the proposed disclosure approach is that it follows the logic of the Task Force for Climate-related Financial Disclosures (TCFD), so have the advantage of having been road tested already by many global banks.

Q12. Should the proposed qualitative Pillar 3 climate-related financial risk disclosure requirements be on a mandatory basis to facilitate comparability across banks?

Yes – we would support these being mandatory.

Q13. What key challenges would exist for preparers or users of the proposed qualitative Pillar 3 climate-related financial risk disclosure requirements? How could these be overcome?

We cannot see significant challenges associated with the proposed disclosures. As noted they mirror requirements under TCFD, which are already being followed by a number of global banks.

Q14. What additional qualitative Pillar 3 climate-related financial risk disclosure requirements should the Committee consider?

***Under Governance**, we would like to see:*

- *Role of the audit committee made clear in ensuring full and prudent disclosures to investors / the market on climate-related financial risks, including how they have ensured consistency between Pillar 3 disclosures and banks' financial statements.*
- *Role of the auditor – confirmation that the auditor has been tasked with checking that material climate risks have been properly reported both under Pillar 3 disclosures and in the financial statements, and they have set out to investors in their annual Audit Report how this has been done and any concerns they have.*

***Under Strategy**, we would like to see:*

- *Systemic risks and bank endogeneity - a disclosure requirement around how the bank considers the systemic nature of climate risks and how its own financing decisions today could impact (and potentially exacerbate) the climate risks tomorrow. This may be captured under its consideration of long-term risks, but we would like to see the banks consider their role in creating that future set of risks in short-term decision-making.*
- *Financial statement impacts – under (d) reference is made to how climate-related financial risks could impact a banks' financial position. It would be good to make clear here that this must be factored into both the banks' financial planning as well as its financial reporting. The latter is not currently referenced.*

***Under risk management**, we would like to see explicit disclosure on whether and how the Bank has considered severe but plausible climate scenarios in light of the NGFS's recent guidance on the importance*

of banks not just using their scenarios 'off the shelf' but adapting them to reflect the realities of the risks they face[26]*.*

Q15. How could the proposed qualitative Pillar 3 climate-related financial risk disclosure requirements be enhanced or modified to provide more meaningful and comparable information?

See suggestions in Q14 above

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?

As previously underlined, we view these qualitative disclosures as offering important forward-looking information around how the bank is managing its climate risks.

Quantitative disclosure requirements

General

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

The proposed quantitative disclosures will provide much needed transparency on potential climate risk exposures embedded in banks financing. This, in turn, underpins investors ability to hold banks to account.

Q18. Should the proposed quantitative Pillar 3 climate-related financial risk disclosure requirements be on a mandatory basis to facilitate comparability across banks?

Yes, we favour mandatory disclosure requirements to ensure comparability and to prevent the build-up of hidden risks in banks that are not required to disclose exposures.

Q19. What key challenges would exist for preparers or users of the proposed quantitative Pillar 3 climate-related financial risk disclosure requirements? How could these be overcome?
We cannot see significant challenges associated with the proposed disclosures. Many banks already provide sector and geographic breakdowns of their banking books. This would ensure consistency.

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

We believe it would be helpful to include additional disclosures in relation to Transition Risk and Physical Risk as outlined under Q27 and Q33 below.

---

[26] NGFS, "NGFS scenarios: purpose, use cases and guidance on where institutional adaptations are required", January 2024. https://www.ngfs.net/sites/default/files/medias/documents/ngfs_guidance_note_on_the_scenarios.pdf

In addition, as highlighted in Section 2, we would advocate for the disclosure of impacts for capital, including the results from regulatory climate stress testing, or internal stress testing work. This would be helpful for two reasons:

1) ***Need to translate exposures into risks to capital*** *- The disclosures proposed in this consultation offer information on climate transition and physical risk exposure (e.g. financed scope 1-3 emissions intensity by sector; proportion of corporate loan book exposed to physical risks), but do not provide visibility on how this translates into risks to capital. Investors require a clearer picture of how banks' climate exposures might translate into financial consequences. These disclosures should be consistent with banks' financial statements, in particular through adjustments to ECLs.*
2) ***Need to reflect the potential spread of outcomes for capital*** *– In addition to understanding how the disclosed exposures could impact banks' capital strength, investors would like visibility of the spread of these potential impacts. This is because climate change is characterised by uncertainty, irreversibility and the potential for severe outcomes due to tipping points and non-linearities, so using just a single central estimate would leave out critical information on the range of potential outcomes. A central estimate could fuel a false sense of complacency by keeping severe but plausible outcomes hidden, and weaken the pressure investors might otherwise exert to encourage early risk management.*

Q21. How could the proposed quantitative Pillar 3 climate-related financial risk disclosure requirements be enhanced or modified to provide more meaningful and comparable information?

See response to Q20 above.

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?

This information on physical and transition risk exposure is very relevant to investors gaining more transparency on banks' exposure to climate risks, and therefore having a basis for considering whether mitigation is adequate. As highlighted in Q20, however, we would like to see the disclosure requirements to include impacts for capital adequacy and the results of regulatory or internal stress testing work.

Q23. What are your views on the calculations required to disclose the proposed quantitative Pillar 3 climate-related financial risk disclosure requirements?

Transition risk: exposures and financed emissions by sector

Q24. Would exposures and financed emissions by sector be a useful metric for assessing banks' exposure to transition risk?

Yes – we would welcome these disclosures by sector, industry and sub-industry to enhance our understanding of transition risk exposure.

Q25. What are your views on the availability and quality of data required for these metrics, including by sector, activity, region or obligor?

Q26. What key challenges would exist for preparers to disclose these metrics, including by sector, activity, region, or obligor? How could these be overcome?

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

We believe it would be helpful to include the following additional disclosures in relation to Transition Risk (Table CRFR1):

- *Proportion of each maturity category which is rolled over into fresh lending. It would be important to establish the extent to which shorter-term lending is in practice longer-term lending where loans are typically refreshed.*
- *Proportion of different maturity and GHG financed emissions categories that are covered by entities with, for instance, net zero commitments, science-based targets or transition plans. Combining the proposed quantitative data with information on risk mitigation undertaken at borrower-level would provide greater transparency on the actual level of risks. For instance, if over 50% of lending to the power sector is to entities with credible emission reduction commitments and transition plans, this is less risky than if 100% is to entities with no climate risk mitigation.*
- *Proportion of different maturity and financed emission categories where loans include climate related covenants/conditionality. Again, this would provide more clarity on how risky the actual lending to a particular high-carbon sector is.*

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?

We are supportive of this approach as GICS are widely used and understood.

Q29. Would it be useful to require disclosure of the specific methodology (such as Partnership for Carbon Accounting Financials (PCAF)) used in calculating financed emissions?

Yes – as there are a range of potential methodologies, knowing which is used would be important for interpretation.

Physical risk: exposures subject to climate change physical risks
Q30. Would exposures subject to climate change physical risks be a useful metric for assessing banks' exposure to physical risk?

Yes. Having greater disclosure on the proportion of bank lending exposed to more severe (chronic or acute) physical risks would be helpful.

We would also welcome some indication of the extent to which these exposures are being managed. For instance, disclosure of the proportion of these exposures that have been subject to a Physical Climate Risk Assessment would indicate that the bank has taken steps to better understand and manage these risks.

Q31. Would there be any limitations in terms of comparability of information if national supervisors at a jurisdictional level determined the geographical region or location subject to climate change physical risk? How could those be overcome?

There would be potential concerns over comparability if different jurisdictions applied differing frameworks for assessing the level of physical risk. Nevertheless, this also permits the data to be based on potentially more accurate local assessments of physical risks. Over time we would hope to see national level frameworks to converge to best practice.

Q32. What alternative classification approaches could the Committee introduce for the classification of geographical region or location subject to climate change physical risk to reduce variability and enhance comparability amongst banks?

Q33. What additional physical risk disclosure requirements should the Committee consider?

In addition to the aggregate figure of the value of financing exposed, and the breakdown of this between maturity categories and allowances set out in Table CRFR2, it would also be useful if this data on exposure could be split between the major categories of physical risk hazards, e.g. flooding, typhoon, drought, etc.

Moreover, there could be value in disclosing the breakdown of physical risks according to the sector/industry of the borrower, since some borrowers will be far more exposed to physical risks than others, e.g. farming versus telecommunications.

Finally, as noted in Q30, we would welcome additional disclosure that reflects action by banks to mitigate these physical risks.

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?

We believe bank-specific metrics linking sector and geographic exposure to asset quality and loan maturity as proposed in Tables CRFR1 and CRFR2 is important to enable investors' understanding of the potential materiality of climate risks for credit quality. This provides a basis for also assessing risk mitigation by banks.

Q35. What challenges would exist for preparers or users of these disclosures? How could these be

overcome?

We cannot foresee any obvious challenges.

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

Please see responses to Q27 and Q33.

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?

We would welcome these disclosures as they would provide greater visibility on the risk pathway for banks. Forecasts would also provide valuable information around effectiveness of the current risk mitigation measures, as these would be embedded in forecasts.

Where investors have to rely solely on a current snapshot of climate risk exposures, this will fail to reflect the dynamic nature of both how the risks are expected to evolve or banks' efforts to manage climate risks. Forward-looking information would, therefore, help inform investors assessment of climate risks and approach to holding banks accountable.

In addition, as highlighted in Section 2, we would encourage the Committee to require forward-looking climate stress testing results to be disclosed. A key feature of climate change is its uncertainty, and the potential for severe outcomes due to tipping points and non-linearities. Providing the market with only the central forecast from banks (as proposed), may fuel a false sense of complacency and weaken the pressure investors might otherwise exert to encourage rigorous and early risk management.

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

Table CRFR1 *- Proposed forecast information on anticipated financed scope 1-3 emissions by sector/industry category would provide helpful visibility on the risk pathway for banks. Emissions intensity data as proposed under Table CRFR4 (below) is also important to give a clearer sense of financial materiality of these emissions and thus impacts for credit risk.*

As noted under our response to Q27, we would also find the following disclosures helpful in evaluating the risks associated with these finance emissions:

- *Proportion of different maturity and financed emissions categories that are covered by entities with, for instance, science-based targets or transition plans.*
- *Proportion of different maturity and financed emission categories where loans include climate related covenants/conditionality.*

Combining the proposed quantitative data with information on risk mitigation undertaken at borrower-level would provide greater transparency on the actual level of risks. For instance, if over 50% of lending to the power sector is to entities with credible emission reduction commitments and transition plans, this is less risky than if 100% is to entities with no climate risk mitigation.

Table CRFR4 *– Proposed disclosures of forecast carbon-intensity data by sector provides a valuable additional lens on the potential financial materiality of transition risk, and would help investors compare the riskiness of industry lending between banks. A bank, for instance, with a substantially higher carbon-intensity in its airline obligors than peers, would tend to face higher credit risk, without mitigation. As noted above, having additional information on the proportion of exposure covered by mitigation measures, e.g. transition plans, would enable a more complete view of risk.*

Table CRFR5 *– Investors would benefit from greater visibility on facilitated emissions, including forecasts for how banks anticipate this changing in the future. This would ensure a more complete picture of climate risk exposure, and also the extend to which banks are contributing to carbon-intensive financing outside their direct lending activities.*

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

For Pillar 3 to offer an effective form of market discipline, the market needs to be properly informed of the potential risks to capital. An emphasised in Section 2 and Q37, the most useful forecasts for investors would be:

1. *Impacts of the identified transition and physical risks for capital adequacy and ECLs.*
2. *Results from forward-looking stress testing to give investors a better understanding of the potential spread of outcomes for capital adequacy.*

Both the above would provide investors with a sense of the materiality of these risks. We would like to see disclosures in banks' financial statements to provide comfort that ECL assumptions are consistent with their climate risk assessments.

Turning to the proposed disclosures in the consultation document, the forecasts that we would find most useful are anticipated exposures to high-carbon industries (covering the banking book, trading book, capital markets and advisory activities) given the banks' current strategy, supplemented by statistics on the proportion of these they expect to be covered by credible transition plans.

The disclosure of forecast financed emissions (absolute and intensity based), and the proportion of this that would be covered by credible transition plans would likewise provide valuable forward-looking information.

Q40. What challenges would exist for preparers or users of Pillar 3 disclosures in relation to potential forecast information? How could these be overcome?

Forecasts are by their nature judgmental, which inevitable introduced modelling challenges. It would therefore be important to ensure sufficient transparency on the methodologies and critical assumptions that underpin the forecasting.

For example, which climate and economic models have been used and how these are calibrated for tipping points and non-linearities, alongside likely socio-economic responses to climate change and transition. As noted in Section 2, current mainstream modelling has been widely criticised for leaving out the most severe but plausible impacts from climate change, resulting in under-estimation of the risks. Disclosures on how banks' have sought to avoid this problem would be important.

The limitations of current econometric modelling is a strong reason for why we would encourage requirements for climate stress testing results to be disclosed to the market. This would ensure a fuller understanding of risks to capital in more severe climate scenarios (see comments in Section 2).

Q41. Where forecast information is not available, what alternative information might be useful to assess banks' exposure to climate-related financial risks on a forward-looking basis?

As highlighted in the Consultation document, a number of the proposed qualitative disclosures on governance, strategy, and risk management (e.g. Table CRFRA) would offer important information to help investors gauge how banks' climate risks may evolve over time.

Concentration risk

Q42. What are your views on the usefulness banks' disclosure of quantitative information on their risk concentration, i.e. of the bank's material exposures to sectors or industries subject to transition risk or to sectors/geolocations subject to physical risk relative to its total exposure?

As noted elsewhere, we believe these disclosures would provide important visibility for investors on climate risks embedded in banks' balance sheets.

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?

Investors aim to anticipate risk pathways as part of judging value creation potential and holding banks to account. Therefore, we are strongly supportive of requirements for forward-looking and qualitative information around governance, risk management and strategy to complement point-in-time risk concentration data. Forward-looking information offers valuable insights into the steps banks are taking to mitigate climate risks.

Q44. What challenges would exist for preparers or users of disclosures in relation to quantitative and

qualitative information on climate-related risk concentrations? How could these be overcome?

As noted elsewhere, we cannot foresee material challenges to these disclosures. We would expect the information already exists internally to inform bank risk management. If it is lacking, requirements for disclosures would offer an important catalyst for banks to start compiling climate risk information. In line with the goals of Pillar 3 of the Basel framework, it is vital that investors also have visibility on climate risks to enable market discipline.

Q45. In relation to the disclosure of exposures subject to physical risk, would it be meaningful for assessing banks' climate-related concentration risk if these exposures were divided into six or seven broadly defined hazards, e.g., heat stress, floods, droughts, storms, wildfires etc?

Yes – as noted in our response to Q33, we would welcome this transparency to help in the interpretation of physical risks.

Q46. What additional bank-specific disclosure elements on climate-related concentration risk should the Committee consider?

As underlined in Section 2, investors would benefit from disclosures of how concentration risk translates into risks to capital. We would also welcome disclosure of the results of regulatory stress testing exercises to provide investors with a fuller understanding of potential risks to capital in more severe climate scenarios.

As noted in Q27 and Q38, we would also find the following disclosures helpful in evaluating the current quantitative point-in-time risk exposures proposed in the consultation:

- *Proportion of different maturity and financed emissions categories that are covered by entities with, for instance, science-based targets or transition plans.*
- *Proportion of different maturity and financed emission categories where loans include climate related covenants/conditionality.*

Combining the proposed quantitative data with information on risk mitigation undertaken at borrower-level would provide greater transparency on the actual level of risks.

Finally, we would welcome attention by the Committee to ensuring consistency between Pillar 3 disclosures and banks' financial statement disclosures, which are currently lacking detail on how climate risks are considered in forward-looking assumptions.

Templates

Q47. What are your views on the structure and design of the proposed templates in relation to helping market participants understand the climate-related financial risks to which banks are exposed?

Please see comments to earlier questions on the proposed templates.

Q48. Would the potential structure and design of the templates pose any challenges for preparers or

users of Pillar 3 climate-related financial risk disclosure requirements? How could those be overcome?

Please see comments to earlier questions on the proposed templates.

Quantitative disclosure requirements subject to jurisdictional discretion

Q49. What are the benefits of the proposed quantitative Pillar 3 climate-related financial risk disclosure requirements subject to jurisdictional discretion?

We are supportive of the proposed quantitative disclosures for 1) transition risk in real-estate related financing (energy efficiency profiles), 2) emissions intensity per unit physical output and 3) facilitated emissions. As outlined in the consultation document (and responses to questions above), they would offer additional insight on the transition risk profile of banks' activities.

Q50. What key challenges would exist for preparers or users of the proposed quantitative Pillar 3 climate-related financial risk disclosure requirements subject to jurisdictional discretion? How could these be overcome?

As noted elsewhere, we do not see material challenges to these disclosures. Clearly, they will require data collection by banks, but we would view this as important to inform management decision-making in regard to climate-risk management.

Q51. What are your views on the feasibility, meaningfulness and practicality of banks' disclosure of facilitated emissions?

We are supportive of these disclosures to provide a more complete view of banks' climate risk exposures, and role in financing carbon-intensive activities. Please see response to Q38

Effective date

Q52. What are your views on the feasibility of the potential effective date of the Pillar 3 climate-related disclosure requirements?

As investors, we are keen to see greater disclosure rolled out a soon as practicable, and supportive of 1 January 2026 as a deadline for implementation. This would appear to balance the need to ensure early and enhanced climate risk management by banks, with the practicalities of delivering this information. We note that in many cases, banks are already subject to climate-related risk disclosures, and have been undertaking climate stress testing work, so providing the market with more visibility should be relatively straight-forward.

The proposed date is also one year after the effective date proposed by the ISSB and after the expiration of the ISSB's proposed transitional arrangements, which seems reasonable.

We would also underline our view that, under existing accounting standards and company law in many jurisdictions, ensuring material climate factors are incorporated into banks' financial statements is already a requirement. We would encourage the Basel Committee to reinforce this aspect in future communications as there is a danger that banks argue that they will await further Pillar 3 disclosure requirements before acting to improve financial statement disclosures. As noted in Section 2, the UK's PRA, FRC and ESMA have already been making this point but so far few banks have acted to address the short-coming.

Q53. Would any transitional arrangements be required? If so, for which elements and why?

There may be a case for transitional arrangements in jurisdictions where climate risk oversight has been weaker. However, we are cautious about excessive delays in reporting to avoid concentrations of climate risks to build in specific jurisdictions, potentially risking broader system stability.