March 2024

Basel Committee Consultative Document on the Disclosure of Climate-Related Financial Risks (published 29. November 2023): Response by the TPI Centre at the London School of Economics and Political Science

Authors: Nelson Diaz, Ákos Hajagos-Tóth, Valentin Jahn

Introduction

1. About the TPI Centre

The Transition Pathway Initiative Centre (TPI Centre) is an independent, authoritative source of research and data on the progress of corporate, financial and sovereign entities in transitioning to a low-carbon economy.

The TPI Centre is part of the Grantham Research Institute on Climate Change and the Environment, which is based at the London School of Economics and Political Science (LSE). It is the academic partner of the Transition Pathway Initiative (TPI), a global initiative led by asset owners and supported by asset managers. As of March 2024, 151 investors globally, representing around US$60 trillion combined Assets Under Management and Advisement, have pledged their support for TPI.

2. The TPI Centre's Net Zero Banking Assessment Framework and the BIS Consultation

The Net Zero Banking Assessment Framework (NZBAF)[1] is the result of nearly four years of ongoing investor consultation with the Institutional Investor Group on Climate Change (IIGCC) and CERES. The project started in 2021 and will deliver its third assessment cycle in September 2024. The NZBAF is a comprehensive, open-source set of indicators and data that can be used to assess banks' progress in managing the low-carbon transition and mitigating the impacts of climate change. The NZBAF uniquely integrates and aligns with leading standards in the field, notably the IIGCC Net Zero Investment Framework[2], the IIGCC Net Zero Standard for Banks[3] and CERES' Net Zero Standard for North American Banks[4]. This alignment is not merely coincidental but a design principle to ensure coherence, complementarity, and efficiency within the sector's transition efforts and between different stakeholders, most notably between investors and the banks they invest in.

[1] https://www.transitionpathwayinitiative.org/banks
[2] https://www.iigcc.org/resources/tag/net-zero-investment-framework
[3] https://www.iigcc.org/resources/net-zero-standard-for-banks
[4] https://www.ceres.org/resources/reports/net-zero-standard-north-american-banks

The NZBAF builds on the TPI Centre's established expertise in assessing the climate actions of companies in the real economy and follows the Centre's design principles of disclosure-based data, accessible and easy-to-use information, alignment with existing initiatives and disclosure frameworks, objectively assessable indicators, and aggregation to the company level.

3. The TPI Centre's Feedback on the Consultation:

General Comment

The TPI Centre recognises the efforts of the Basel Committee on Banking Supervision (BCBS) to steer disclosure requirements towards a positive direction. Bank transparency is key to effective climate management of climate risk and coordination between different stakeholders in the financial system. Overall, the proposed disclosures support this goal.

As most of the members of the BCBS are central banks and authorities from countries that have signed the Paris Agreement, the TPI Centre suggests that the BCBS reflects on how banks' climate risk management should be aligned with the Paris Agreement, including the goal of limiting global warming to 1.5°C.

Question-specific Comments

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

Climate change is not just a concern for the loan book; it poses a significant risk to banks' entire portfolio, including capital markets activities. The same climate risks that could affect credit defaults can also affect securities traded in financial markets.

Excluding the trading book from the Pillar 3 framework disclosure provides an incomplete picture of banks' exposure to climate risks. Recent estimates[5] confirm that capital markets revenues account for 22-70% of the total revenues of several of the largest European and US banks. Not including the trading book will allow stakeholders to assess only a part of banks' exposure to climate risks, and therefore could result in underestimating the potential losses and systemic risks to the banking system.

The current partial and selective disclosure of climate risks by banks makes it difficult for investors to integrate climate change into their investment process. Therefore, as one of the overarching principles of the NZBAF, banks' climate change disclosures should cover all on- and off-balance sheet activities in all high-emitting sectors[6].

[5] S&P Global: Banks' Capital Markets Revenue May Feel The Strain Of Economic And Industry Uncertainty In 2023

[6] The TPI Centre defines high-emission sectors as oil and gas; power; coal mining; airlines; shipping; autos; steel, aluminium, diversified mining, paper, cement, chemicals; food; and real estate. Our methodologies for the different sectors can be found at: www.transitionpathwayinitiative.org/.

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

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

One of the main challenges facing the financial community in assessing climate-related risks is the lack of standardised information and incomplete data that would enable investors to compare and contrast banks' performance on climate-related issues and associated risk management. To overcome this challenge, the TPI Centre stresses that all elements of the consultation should be mandatory to ensure comparability and to enable constructive engagement with banks on the implementation of their climate-change commitments.

Through the assessment of banks using the NZBAF, the TPI Centre has found that the lack of external standardised methodologies and insufficient data from clients are hampering banks' progress. However, these challenges should not prevent banks from generating estimates or proxy data to support their net-zero strategies. In several cases, the TPI Centre has identified banks that are already developing their own methodologies and proxy data to assess their climate risk exposure[7].

Moreover, whilst acknowledging the challenges associated with estimating financed and facilitated emissions, we also want to stress the importance and feasibility of such disclosures going forward. Reporting on emissions intensities and facilitated emissions no longer faces major methodological barriers – especially for G-SIBs – considering the recent publication of PCAF methodologies for estimating and reporting on facilitated emissions. Additionally, data availability and quality are improving rapidly. Recognising that banks' emissions disclosures are the basis for risk assessments as well as supervisory policies and highlighting recent improvements and efforts to lower the obstacles for banks to estimate these emissions, we recommend that banks should be required to disclose these metrics. This will also ensure the requirements under consultation are future-proof. Banks should disclose these quantitative metrics based on their materiality assessments (e.g. whether capital market facilitation is a material business activity) and not on where the bank is domiciled.

Q14.What additional qualitative Pillar 3 climate-related financial risk disclosure requirements should the Committee consider[8]?

Based on the TPI Centre's experience with the NZBAF and engagement with various stakeholders in the financial system, primarily investors who are interested in understanding banks' climate risk profiles, the TPI Centre suggests the following additional qualitative disclosures:

Table	Section	Suggestion	Priority
CRFRA	Governance	Item (1e): Banks should disclose whether they have established a remuneration scheme at the C-suite level that takes account of climate change performance. Supplementary information is recommended to explain how climate-related objectives are incorporated specifically into executive remuneration policies, e.g. which performance metrics/objectives are included, their weights and which roles the policy applies to.	High

[7] ING, Citibank, Goldman Sachs, and Barclays developed their own methodologies to estimate facilitated emissions. Barclays, ING, Credit Agricole and Citi developed their own methodologies to estimate financed emissions in the real state sector, and ING, HSBC and JP Morgan did so for airlines.

[8] Additional proposals can be found in the appendix.

		This is to avoid generic disclosures that either do not quantify the climate performance-related remuneration at all or that leave the actual KPIs vague. We have found several banks who do not provide these details although they do state that their executive remuneration is tied to climate-related performance. The TPI Centre further recommends emphasising that banks should provide disclosure specifically on climate-related objectives. General ESG or sustainability initiatives should not be considered sufficient if they do not specifically mention climate.	
	Strategy	Item 2(d): The impact of climate-related financial risks on the bank's financial position, financial performance and cash flows for the reporting period should also be reflected in its financial statements. This is intended to enable non-climate-focused investor groups to assess banks' exposure to potential climate-related financial risks. Currently, banks' financial statements do not usually refer to climate-related financial risks in their financial statements and it is therefore unclear as to whether or to what extent these risk drivers have been incorporated into expected credit loss (ECL) assumptions and calculations. The lack of internalisation of these potential cost items might expose banks to potentially underestimating the impacts of climate change in their financial statements.	High
	Risk Management	Item 3(a): Along with the input parameters used by the bank, clear policies and guidelines should be disclosed regarding the bank's climate risk appetite and how it is integrated with the bank's traditional financial risk drivers (i.e. credit, market, operational and liquidity risks).	High
CRFRB	Fossil Fuel Sector	Item 1(a): Banks should disclose their approach to financing the fossil fuel sector, specifically, if the bank has implemented financing conditions that support clients' transition in these sectors.	High
CRFRA	Strategy	Item 2(e): For scenario analyses to be useful in assessing potential exposure and to ensure comparability across banks, these should be conducted based on "minimum standards", such as a 1.5°C scenario when assessing transition risks and a high emissions scenario (i.e. RCP 8.5) for physical risks.	Medium
		Just Transition (additional item): Policymakers and investors are increasingly recognising that just transition considerations are essential to achieving net zero and climate resilience. Recognising the emergence and importance of Just Transition, the TPI Centre would like to emphasise that banks should report and explain whether and how they take into account Just Transition objectives and the steps they have taken to ensure integration of such considerations.	Medium
	Risk Management	Item 3(a-b): Although the proposed framework increases transparency across jurisdictions with regard to methodological reporting, that is only one aspect. Qualitative and quantitative elements of materiality test results (such as expected credit losses, loan provisioning and risk weighting), that inform banks' climate risk management are equally important for stakeholders and should therefore be reported on. Here, the TPI Centre emphasises that narrative disclosures/commentary alone are not sufficient, as investors and other stakeholders should be transparently informed about banks' climate risk integration strategies and the effects of climate-related scenario analyses.	Medium

	Climate Solutions	Item 1(a): An effective way for banks to strengthen their climate resilience is to invest in climate solutions. Accordingly, banks should be required to provide context to their climate financing goals, financing frameworks and how they intend to capitalise on these to mitigate climate transition risks. In addition, banks should disclose the external taxonomy used to define climate solutions or if they have developed an internal taxonomy.	Medium

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

Table	Section	Suggestion	Priority
CRFR1	GHG Emissions (Columns K-N)	GHG emissions are generated at different stages of a particular sector's value chain. Accordingly, we advise the BCBS to consider requiring banks to disclose GHG emissions based on which scope(s) are material for a given sector. For instance, for the electricity utilities sector, the vast majority of the emissions generation derives from owned electricity generation (scope 1), whereas for oil & gas, all scopes are material with the use of companies' sold products (scope 3 category 11) accounting for the largest share (e.g. burning oil and gas to provide energy for buildings, electricity generation, industry and transport). It should further be clarified whether BCBS' interpretation of materiality is determined based on financial materiality (i.e. a given sector's contribution to the entire loan portfolio) or emissions materiality.	High
		The sector-specific GHG emissions materiality approach detailed above also applies to the targets ('forecasts') set by banks. For a science-based approach to determining which scopes are material for each high-emitting sector, as defined by the TPI Centre (see footnote 6), please consult the TPI Centre's sectoral methodologies.	High
CRFR4	Emissions Intensity Metric Methodology	BCBS' proposal states that "Banks' chosen metrics and forecasts shall include their clients' Scope 1, Scope 2 and Scope 3 emissions, where material and data allow." The TPI Centre welcomes the use of emissions intensity metrics per physical output and by sector. However, to ensure comparability, banks should be advised to follow a given set of physical outputs that are relevant to the sector. Please consult the TPI Centre's sectoral methodology documents for our recommended use of physical outputs. Moreover, BCBS notes that banks should provide a "description of geographies covered by the GHG intensity metrics in columns (c), (e) and (g) and description of the sub-sectors covered by the GHG intensity metrics." It is our firm view that sectoral decarbonisation targets should cover all material geographical locations where the bank provides financing in to guarantee the completeness of these targets. Banks should provide a comprehensive explanation in cases where the targets do not cover all geographical exposures. With respect to the technical implementation of target setting in Table CRFR4 (columns D-G), where regional target setting is scientifically justified, e.g. different regional carbon intensity pathways for OECD/non-OECD, North American and EU companies operating in the electricity utilities sector[9], banks may set separate targets.	High

[9] See TPI's methodology note on the carbon performance assessment of electricity utilities (November 2021).

	Bank-wide Revenues Covered by Sectoral Targets	To assess the materiality of banks' sectoral decarbonisation targets, the TPI Centre recommends disclosing the proportion (%) of bank-wide revenues covered by the sectoral targets.	Medium
CRFR1	Gross Carrying Amount (per sector)	Evidence suggests that banks can hedge their exposure to climate-related financial risks (e.g. credit risk) by diversifying their loan books and actively investing in sustainable financial strategies (Umar et al.,2021; Lang et al., 2023). Given this dynamic, a bank's share of climate solutions investments in relation to its lending book can be a good proxy for measuring its progress in mitigating climate-related transition risks. Therefore, the TPI Centre believes that the proportion of sector-level gross carrying amount dedicated to climate/transition finance solutions should be reported in a separate column. Considering the differences surrounding defining climate solutions, we recommend leaving it up to banks' discretion to define their own terms so long as they are transparent about it (e.g. referring to external taxonomies or developing their own). In an ideal setting, however, The TPI Centre highlights the definition provided by IIGCC.	Medium
	GHG emissions reduction targets	The TPI Centre stresses the importance of banks setting credible GHG emissions reduction targets, as it also functions as a proxy for their commitment to achieving net zero financed/facilitated emissions by 2050 or sooner and is a key indicator used by investors. We believe that referring to targets as 'forecasts' is not aligned with current industry best practices and would signal a more passive approach rather than an active intention to realise these forecasts. In some ways, this language appears to contradict the strategy-disclosure recommendations in the consultation report, as strategy implies the active pursuit of a set of objectives.	Medium
CRFR5	Facilitated emission	Similar to CRFR1 and CRFR4, given the importance of banks having set science-based sectoral decarbonisation targets, facilitated emissions should be disclosed in both absolute and intensity units, the latter using the same set of relevant physical outputs as in CRFR4. In addition, the TPI Centre cautions that the BCBS should evaluate its approach to requiring banks to only set one facilitated emissions reduction target per sector given the short-term (one-year) nature of emissions reporting. The TPI Centre suggest that banks should set regular facilitated emissions reduction targets (e.g. in a waterfall manner, at 5-year intervals) to ensure an orderly transition.	Medium

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?

The TPI Centre encourages the alignment of climate-change disclosures with external standards to facilitate comparability and consistency between banks' climate risk disclosures. The TPI Centre supports the initiative's goal of increasing transparency within the financial sector, as illustrated, for example, by the inclusion of the PCAF financial emissions standard in several of the NZBAF indicators.

It is important to recognise that PCAF is guided by industry stakeholders, which suggests that the priorities and perspectives of financial institutions may play a role in shaping the standard's objectives. For example, the recently published Facilitated Emissions Standard is not currently aligned with the TPI Centre methodology. The new standard requires financial institutions to report their facilitated emissions using a 33% weighting factor, which can give a misleading picture of actual emissions facilitated by the bank and also creates inconsistencies in how banks report other climate data such as their green financing, where they use a 100% weighting factor. We therefore recommend BIS adopt a full disclosure requirement for facilitated emissions or consider considerably lifting the threshold above the currently recommended 33%.

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

The TPI Centre's experience assessing the carbon performance of companies has been predominantly based on the Sectoral Decarbonisation Approach (SDA)[10]. The SDA translates greenhouse gas emissions targets made at the international level (e.g. under the 2015 UN Paris Agreement) into appropriate benchmarks, against which the performance of individual companies can be compared. The SDA recognises that different sectors of the economy (e.g. food production, electricity generation automobile, manufacturing, etc.) face different challenges arising from the low-carbon transition, including where emissions are concentrated in the value chain and how costly it is to reduce emissions.

Other approaches to translating international emissions targets into company benchmarks have applied the same decarbonisation pathway to all sectors, regardless of these differences. Such approaches may be misleading, as not all sectors have the same emissions profiles or face the same challenges: some sectors may be capable of faster decarbonisation, while others require more time and resources. Therefore, The SDA takes a sector-by-sector approach, comparing companies within each sector and, from the bank's perspective, comparing the emissions intensity of a given portfolio in a given sector with the sector's international emissions targets. Please see the TPI Centre's alignment matrix for banks as an example of a practical implementation of the SDA for banks as shown in Figure 1 below.

In this context, from a transition perspective, the TPI Centre highlights that sectoral finance and facilitated emissions estimates, using a relevant sector-specific physical intensity unit, can help compare the bank's overall financial emissions pathway with temperature goals. This helps to identify the banks' misalignment and it could serve as a proxy for the potential transition risk that the bank may face.

[10] The Sectoral Decarbonisation Approach (SDA) was created by CDP, World Resources Institute (WRI) and the World Wide Fund for Nature (WWF) in 2015. See Science-Based Targets Initiative [SBTi]: https://sciencebasedtargets.org/resources/files/Sectoral-Decarbonization-Approach-Report.pdf

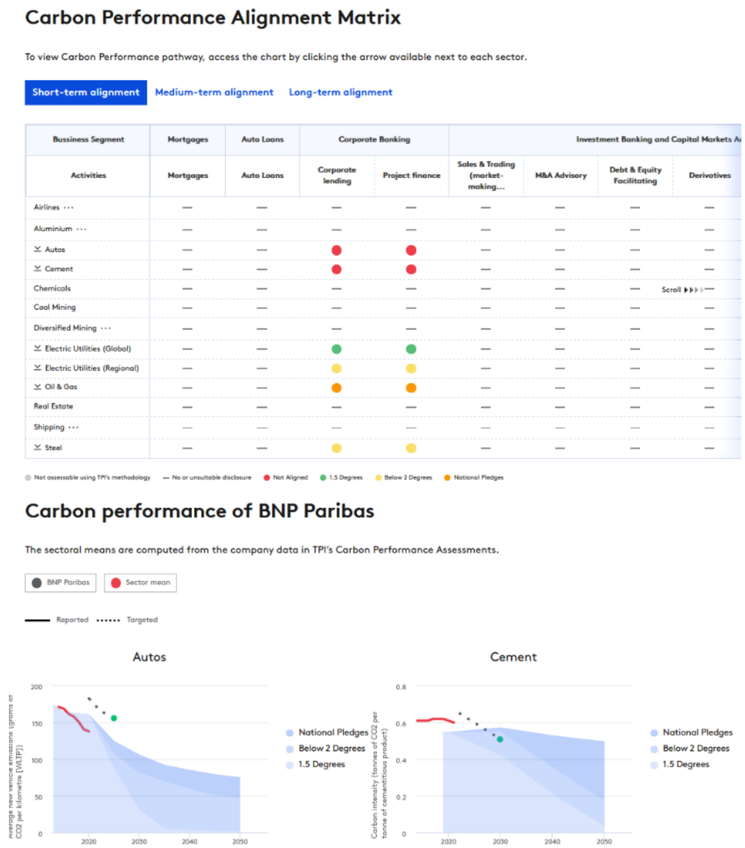

Figure 1: TPI Centre's alignment matrix (showing BNP Paribas for illustrative purpose). For more details, please visit [the TPI Centre's website]()

Q54. What are your views on the Committee exploring disclosure requirements for the impacts of climate-related financial risks on deposits/funding and liabilities?

While the literature on climate-related financial risks is still emerging, TPI believes that liquidity risk can have a material adverse impact on banks' deposits and funding costs and should therefore be included in Pillar III disclosure.

More specifically, [Lang et al. (2023)]() identify a link between climate change and bank liquidity. They posit that both physical risks (e.g. weather-driven deposit withdrawals) and transition risks (e.g. increasingly stringent climate regulations) can constrain banks' ability to create liquidity. Their findings suggest a positive correlation between a country's climate risk exposure and the pressure placed on banks' liquidity. On a broader scale, climate-related risks can negatively influence economic activities (e.g. increased business expenses due to the Carbon Border Adjustment Mechanism (CBAM) in the European Union, and supply chain disruptions) and therefore decrease consumer spending, which might, in turn, translate into below-anticipated liquidity creation for banks. Concerning climate risk sensitivity, [Lee et al. (2022)]() deduce that the influence of climate-related risks on liquidity creation appears to be more pronounced for larger banks with the following characteristics: i) lower capital, ii) banks in lower-GDP and developing countries, and iii) those in Asian countries.

Finally, Choi et al. (2022) explore how non-financial signals of banks' environmental reputation might impact their deposits and credit provisions and find that "banks with a poor environmental reputation are more likely to experience declining branch-level deposits the following year in counties exposed to severe climate change risks".

With regard to current practices, HSBC (p.224 of the FY2023 annual report) and Barclays (p.275 of the FY2023 annual report) have both mentioned that climate-related liquidity risks are incorporated into their ILAAP (Internal Liquidity Adequacy Assessment Process) and plan to develop their assessment further. Rabobank (p.139 of the FY2022 Pillar III report) also concluded that climate scenarios have a significant liquidity impact. They also note that "...The liquidity risks which were impacted most by the climate risk scenarios, were already assessed as material (e.g. facility drawings and retail deposits outflow). Hence, the overall assessment did not uncover new risk drivers for liquidity risk and therefore did not change the materiality for liquidity risk."

Consequently, TPI believes that banks should report on how climate-related liquidity risk considerations are incorporated into their climate stress tests and disclose the assumptions and methodologies they have developed for measuring these risks.

If you would like to engage with us further on our response to this consultation, please contact the Banking Team (gri.banking@lse.ac.uk) at the TPI Centre.

Yours sincerely,
Nelson Diaz, Policy Officer
Ákos Hajagos-Tóth, Policy Officer
Valentin Jahn, Research Lead

Appendix 1 – Additional proposed improvement for qualitative and Pillar 3 climate-related financial risk disclosure requirements

Table	Section	Suggestion	Priority
CRFRA	Governance	Item 1(b): Banks should disclose how they have assessed board members' competence to oversee climate risks and disclose the results of this assessment. In addition, banks should have an action plan in place to ensure that their board members acquire sufficient climate-related risk competencies, e.g. through training.	Low
	Strategy	Climate policy engagement (additional item): TPI's assessment suggests that while banks have endorsed the goals of the Paris Agreement and have begun to develop decarbonisation strategies, this is not reflected in their policy engagement and lobbying practices. Given the influence and importance of banks in driving climate action, TPI believes that banks should be required to disclose whether they have a position statement on 1.5ºC-aligned lobbying within the trade associations of which they are a member and to publish a review of their trade associations' climate positions.	Low
	Risk Management	Point 3(a): The item "whether and how the bank prioritises climate-related financial risks relative to other types of risks" may be confusing to the general reader, as it signals that climate-related financial risks should be prioritised above all other risk drivers. While climate-related financial risks can undoubtedly have a material impact on the performance of financial institutions, a balanced approach to risk assessment is recommended. Perhaps the sentence could be reworded as "whether the bank assesses climate-related financial risks based on their materiality and evaluates the linkages between climate-related financial risks and other risk drivers, such as credit risk".	Low