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EACB comments on
BCBS Principles for the effective management and supervision of climate-related financial risks

General comments

The EACB welcomes the opportunity to comment on the Basel Committee Consultative Document on Principles for the effective management and supervision of climate-related financial risks.

We appreciate the choice to address the matter following a principle-based approach rather than with more detailed standards. The consistent integration of climate-related risks in supervision and the overall prudential domain and governance framework passes necessarily through a learning phase and it cannot disregard the experiences being matured at jurisdictional level.

We also appreciate the explicit reference that the principles are to be applied on a proportionate basis depending on the size, complexity and risk profile of the bank or banking sector, including the fact that "*Banks should manage climate-related financial risks in a manner that is proportionate to the nature, scale and complexity of their activities and the overall level of risk that each bank is willing to accept.*"

A proportionate approach is particularly necessary when looking at tools like scenario analysis and stress testing: while these can certainly help to model climate risk impacts, it should be considered that more time will be needed to learn how to translate scenarios into losses. Not being able to rely on historical series makes it difficult to set assumptions on how climate scenarios impact the results of companies. Standardised solutions could be of help particularly where banks have fewer resources to develop internal approaches.

We would also like to stress that climate risks can only be integrated in the risk management and supervision by reflecting them in the existing components of the supervisory dialogue, i.e. looking at business model and governance, and risks to capital and liquidity but as stemming from the known categories of credit, market and operational risk and not as separate risk categories.

It is also essential to ensure that the expectations for climate risks are consistent with the existing regulatory framework, and that the incentives/disincentives are properly aligned. The transition to a climate-friendly economy will be the challenge of the century and banks will play a central role to finance this massive endeavour. Therefore, institutions should not be left scrambling trying to balance the supervisory expectations for managing climate risk, its effects and the need to sustain the transition, with the need to continue providing credit to the economy also at regional level and ensuring financial inclusion (constitutive elements of co-operative banking), while fulfilling prudential requirements.

Answers to specific questions

Q1: Has the Committee appropriately captured the necessary requirements for the effective management of climate-related financial risks and the related supervision? Are there any aspects that the Committee could consider further or that would benefit from additional guidance from the Committee?

A more proportionate and differentiated approach is needed when looking at the intended outcome of the supervisory expectations. Smaller institutions, but more generally local/regional cooperative banks also of

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large size, have a retail profile and a portfolio less exposed to corporates, infrastructures and similar exposures. Such projects would instead be allocated to specific institutions or the central body in a co-operative group or network. When lending to SME and individuals a less granular or no proper climate risk assessment can be done as no disclosures or climate ratings are available. Therefore, it will probably seem that such institutions are not progressing even when in reality for retail exposures they may have done as much as other banks with a different portfolio composition. For such counterparties and asset classes lower data standards or even estimations should be considered on a best effort basis until better data are available

Such lack of coverage among tools currently available not only affects the actual results achieved but also the planning process. Banks with a large corporate portfolio will more rapidly progress on the learning curve of sustainability metrics, alignment with Paris Agreement, scenario analysis, etc. by purchasing or applying one of the current tools available, while it would be uneconomic for banks that have a mostly retail orientation to follow that same path as current tools might be or relevance for about 1% of their portfolio of loans. As a consequence, that could give the impression, both to the supervisors and the greater public, that these banks are not moving forward while the reality is that there are no tools out there to evaluate retail exposures and that benchmarking with other banks' business models would not be meaningful.

We would also like to recall that while banks are becoming aware of the relevance of climate risks and learning to understand their relevance following supervisory focus, they also naturally tend to understand and manage new risks that emerge. This can be the case for instance of outdating of technologies and of products, the change of consumer preferences, etc. Such challenges are relevant also outside the climate risk dimension and possibly even to a higher degree (e.g. due to digitalization, change of public opinion, etc.) and institutions may put in place broader risk mitigation strategies which should be taken into due account by supervisors.

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

Corporate governance

Principles 1 and 2

Looking specifically at the expectations regarding banks' corporate governance arrangements and the allocation responsibilities at the level of the management body, we strongly recommend that the Committee clarifies in an unambiguous manner that such allocation of tasks/responsibilities does not imply an individual legal liability of a member of the management body, which would be against the national legislative frameworks in various countries. In addition, some recommendations should be considered relevant only at a consolidated level in a cooperative group; a range of solutions should remain possible while keeping in mind that the objective is an integration of climate risk considerations in governance that is effective and adequate.

According to various countries' legislation, collective responsibility of the management body is indisputable starting point. This would not exclude, however, to establish clear lines of responsibility in the bank.

Management monitoring and reporting

Principle 7

With regard to IT and data aggregation expectations, the Committee should specify that these should be achieved from banks in the medium term. As long as relevant regulatory pieces remain incomplete and stress tests exercises are in exploratory mode, banks cannot develop complete databases and IT infrastructure since these require also investments and cannot be overhauled over short time horizons.

Banks also need a start-up phase to anchor the topic appropriately throughout their organization. In this context, the lack of relevant data has to be tackled. Currently banks face difficulties in executing risk assessments that fulfil the new expectations, as in practice those cannot be fulfilled, mainly in view of the current lack of clarity of what kind of data should be collected from customer/counterparties and assessed. And even if that were the case, most customers, especially SMEs, may not be in a position to generate the data required. The data requirements should not exceed the public agencies available information.

While the Committee should avoid any distortion of competition, it should be considered that banks in different jurisdictions may base their risk management on differing national climate and environmental disclosure frameworks for corporates.

It should also be considered that banks operating on several geographies face different economic environments: in some regions there are not the same levels of policy incentives for a green transition, there are fewer reporting and disclosure requirements and typically lower regulatory standards of environmental protection, etc. This might make it significantly harder for banks operating in these markets to fulfill the supervisory requirements.

Looking at the expectation that "*banks should consider actively engaging clients and counterparties*", we would like to stress the need not to shift entirely on banks the burden to stimulate an orderly transition of economic agents and their ability to provide reliable data. While customers' engagement is primal, and co-operative banks are by their very nature committed to accompany their members/customers on a long-term relationship, the engagement has its limits. Banks might be able to encourage customers, but not oblige them.

Furthermore, the engagement with customers by banks with a view to pursue public policies' objectives should not be expected to be higher than the engagement of public authorities themselves. That is, the required information on sustainability for a bank in order to approve a loan should not be more demanding than that required by public authorities in order to provide a grant, a tax deduction, etc. Finally, without well-established national or international climate and environmental (and more generally ESG) disclosure frameworks playing the role envisaged will be arduous.

Comprehensive management of credit risk

Principle 8

The Committee indicates that "*Banks should have clearly articulated credit policies and processes to address material climate-related credit risks.*" However, this expectation is difficult to grasp: banks certainly develop articulated credit policies which take into due considerations the numerous facets of credit risk. Climate-related credit risks are certainly relevant factors, but which should be included in the overall policies and not singled out, as their precise marginal contribution to the overall credit risk might be difficult to quantify.

Also, the limited climate-related risk of certain activities that could be in a bank's portfolio does not imply overall low risk. For example, financing companies that act sustainably and promote the environment but do not have adequate business management can be associated with increased risks.

In the same manner, while it is expected that "*Banks should incorporate consideration of material climate-related financial risks into the entire credit life cycle, including client due diligence as part of the onboarding process and ongoing monitoring of clients' risk profiles.*" As indicated above we also would like to stress the need to ensure that expectations do not lead to limited access to finance, particularly for retail and SME clients who would actually be in need for credit to progress on the transition path. There is a risk that segments of the market would become unbanked and turn to non-regulated credit providers.

Comprehensive management of market, liquidity, operational and other risks

Principle 10

Regarding the impact on liquidity and liquidity planning, we would like to stress that certain climate risks are being approached from a medium/long term perspective, while liquidity risk is mainly a short-term risk (even very short-term). This should be duly considered to avoid mismatches when consider integrating e.g. specific climate risks variables in the liquidity assessment.

We would also note that from a liquidity perspective the pace of changes is relevant as liquidity portfolios can (typically) be adjusted over short periods to adapt to a new situation.

Thus, while liquidity portfolios should adapt without losses to transition risks, and while physical risks might occur much more suddenly but impact in particular the value of certain assets, from a liquidity perspective these aspects remain largely manageable.

Scenario Analysis

Principle 12

The Committee indicates that "*Banks may explore the use of stress testing to assess the adequacy of their financial positions in the near term under severe yet plausible scenarios, though these capabilities are expected to mature more progressively over time as methodologies evolve.*"

While we agree that capabilities are expected to mature progressively, we would like to stress that it would be premature for supervisors to derive conclusive information as to the financial position of institutions and trigger consequences in terms of additional capital requirement decisions. Stress tests can give very different results depending on the scenarios which will be tested (smooth convergence, rapid convergence, no convergence), it is important that supervisors use results only in a qualitative manner at least until methodologies, definitions and capabilities have sufficiently matured and stabilised.

We agree with the Committee's indication under Principle 18 that "*Supervisors should take into account the level of uncertainty associated with scenarios when determining whether to disclose results. Supervisors may consider disclosing scenario analysis results at an appropriate level of aggregation and should include the appropriate level of detail on methodologies, assumptions, the level of uncertainty and key sensitivities when disclosing results.*"

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

Physical risk seems to affect especially companies and sectors with greater relationship with natural resources (land, water and ecosystems) or with the main business linked to buildings and their geographical placement. Emissions intensive sectors seem more affected by transition risk linked to climate change and circular economy (waste efficiency). Every one of these risks, physical and transitions risk should be considered when they are material for a sector; only in some cases both will have to be considered. One should also consider that environmental risks while on the one hand have negative implications, on the other they also create opportunities for business enterprises. In this respect both elements are relevant.

In this context, we would also stress that co-operative banks have particular governance features relevant in terms of alignment to the transition trends. It is the purpose of the bank to promote the economic interest of its members/clients. These are the owners of the banks and may sit in the management body. This usually implies a longstanding orientation towards close and long-term engagement with customers. Due also to the legal and statutory features, cooperative shares are not steered with a short-term income maximization perspective, but rather with a view to ensure steady and sound profit generation and to continuously enhance the capital position. A major part of the profits is usually introduced into the reserves. In this vein, cooperative banks play a fundamental role in animating and serving the economic and social life of the local communities and ensuring social cohesion, also in areas that would otherwise be unbanked. These features should be adequately considered as "natural" risk mitigants.

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