March 14, 2024

Via Electronic Submission

Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 – Basel, Switzerland

Re: Consultative Document — Disclosure of climate-related financial risks

Ladies and Gentlemen:

The Bank Policy Institute[1] and the Financial Services Forum[2] appreciate the opportunity to comment on the Basel Committee on Banking Supervision's ("BCBS") Consultative Document seeking views from the public and market participants regarding a proposed Pillar 3 disclosure framework for climate-related financial risks (referred to herein as the "Pillar 3 climate disclosure framework").[3]

I. Executive Summary

We appreciate the BCBS's efforts to "analys[e] how a Pillar 3 disclosure framework for climate-related financial risks would further its mandate to strengthen the regulation, supervision and practices of banks worldwide with the purpose of enhancing financial stability."[4] We support the BCBS's goal of "promot[ing] comparability of banks' risk profiles and enabl[ing] market participants to access key

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1 The Bank Policy Institute is a nonpartisan public policy, research and advocacy group, representing the nation's leading banks and their customers. Our members include universal banks, regional banks and the major foreign banks doing business in the United States. Collectively, they employ almost 2 million Americans, make nearly half of the nation's small business loans, and are an engine for financial innovation and economic growth.

2 The Financial Services Forum is an economic policy and advocacy organization whose members are the chief executive officers of the eight largest and most diversified financial institutions headquartered in the United States. Forum member institutions are a leading source of lending and investment in the United States and serve millions of consumers, businesses, investors, and communities throughout the country. The Forum promotes policies that support savings and investment, financial inclusion, deep and liquid capital markets, a competitive global marketplace, and a sound financial system.

3 BCBS, Consultative document, *Disclosure of climate-related financial risks* (Nov. 29, 2023) ("Consultative Document"), https://www.bis.org/bcbs/publ/d560.pdf.

4 Consultative Document, at 1.

information relating to a bank's risk exposures in relation to climate-related financial risks."[5] Our members are actively evaluating climate-related financial risks and their potential impacts, and are devoting substantial resources to developing risk management capabilities to identify, measure and mitigate these risks. In the context of general corporate disclosures, many of our members already publish extensive climate-related information, including with respect to climate risk management. These actions are part of a trend by companies to increasingly disclose climate-related information to be responsive to requests from investors, consumers, employees and international authorities.

We agree with the objectives of Pillar 3 disclosures as currently set out: "to promote market discipline and enable market participants to access key information relating to a bank's regulatory capital and risk exposures in order to increase transparency and confidence about a bank's exposure to risk and the overall adequacy of its regulatory capital."[6] We note that the Consultative Document does not contain any discussion of intent to change the objectives of the Pillar 3 disclosure framework.

We support the BCBS's efforts to develop meaningful climate disclosure metrics consistent with the objectives of Pillar 3. However, we are deeply concerned that many aspects of the Pillar 3 climate disclosure framework contemplated by the Consultative Document are not consistent with the objectives of Pillar 3. Although we recognize the view that the BCBS should not "let the perfect be the enemy of the good," faulty metrics would inherently conflict with the stated Pillar 3 objective of promoting market discipline. In this case, the proposed requirements do not have a clear link to the risk of financial loss and are inherently flawed from the perspective of promoting the objectives of Pillar 3 disclosures. As a result, they would result in the disclosure of a large amount of nonmaterial, noncomparable and unreliable climate information that is not reflective of a bank's risk exposures and capital adequacy; would lead to onerous compliance costs and burdens for banks with little, if any, attendant benefit; and could subject banks to heightened legal and reputational risks. Moreover, by including these requirements in its Pillar 3 framework, the BCBS risks implying a meaningful link between the disclosures and a bank's risk exposures and regulatory capital adequacy, which would not be accurate and would be misleading to the market.

In addition, the proposed disclosure framework is not consistent with the approach to effective management and supervision of climate-related financial risk previously adopted by the BCBS. The BCBS has previously approached climate-related financial risks as *risk drivers* that can translate into traditional financial risk types (*e.g.*, credit risk, market risk, liquidity risk and operational risk), rather than a standalone risk type.[7] Notably, the proposed disclosure framework positions climate-related financial risk as a standalone risk type, referring to "physical risk" and "transition risk" without clarifying whether this refers to physical or transition risk as a driver of an existing financial risk type and without establishing the relevance of a particular proposed disclosure metric to market understanding of how that metric reflects a bank's risk exposure with respect to an existing financial risk type. Importantly, the Consultative Document does not contain any discussion of intent to change the BCBS's approach to treating climate-related financial risks as risk drivers, nor do we believe the BCBS should change its position that climate-related financial risks are risk drivers that can translate into traditional financial risk types.

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5 *Id.* at 4.

6 *Id.* at 3.

7 BCBS, *Principles on Effective Management and Supervision of Climate-related Financial Risk* (June 2022), at 2, https://www.bis.org/bcbs/publ/d532.pdf.

Furthermore, because the proposed disclosures would not provide meaningful information on banks' climate-related financial risks and their impact on banks' safety and soundness and regulatory capital adequacy at the individual bank level, on a macro level, such information would not inform views on the potential impact of climate risk drivers on financial stability.

To address these concerns, the BCBS should revise the proposed requirements and issue a re-proposed Pillar 3 climate disclosure framework that is more closely tailored to meeting the stated objectives of Pillar 3 disclosures. **We request that the BCBS engage with the banking industry in developing meaningful disclosure requirements that reflect banks' financial risk exposures before re-proposing a Pillar 3 climate disclosure framework. We welcome the opportunity to meet with BCBS's representatives to discuss our comments and to work with the BCBS to develop meaningful disclosure requirements for a re-proposed Pillar 3 climate disclosure framework that more effectively meets the Pillar 3 objectives.**

It is important to note that our feedback on the Consultation Document focuses on the proposed disclosures in the context of Pillar 3 disclosures and does not address the merits of climate disclosures in a corporate disclosure context. The objectives of Pillar 3 disclosures, as noted above, are distinct and more narrow than the objectives of corporate disclosures, which are not limited to key information relating to banks' safety and soundness and regulatory capital adequacy. We urge the BCBS to recognize this critical distinction between Pillar 3 climate disclosures and corporate climate disclosures when it considers public comments on the Consultation Document and its potential revisions to the proposed Pillar 3 climate disclosure framework.

We believe eight overarching principles should guide the BCBS in re-proposing a Pillar 3 disclosure framework for climate-related financial risks. These principles and related recommendations are summarized below:

- All re-proposed Pillar 3 climate disclosure requirements should be consistent with the *BCBS Principles on Effective Management and Supervision of Climate-related Financial Risk*, which appropriately recognize climate-related financial risks as drivers of traditional risk types rather than a standalone risk type.

- Any qualitative or quantitative disclosure in any re-proposed Pillar 3 climate disclosure framework must be a meaningful indicator of a bank's risk exposures and capital adequacy and reflect that climate-related financial risks are drivers of traditional risk types.

  - The proposed qualitative disclosures, such as those related to a bank's business strategy on climate and prescriptive governance requirements, would not provide a meaningful assessment of a bank's financial risk exposures and capital adequacy and should be excluded.

  - The proposed metrics related to a bank's Scope 3 emissions should not be characterized as a direct proxy for *actual* risk of financial loss and should be excluded. Absolute financed and facilitated emissions have no connection to, and financed emissions intensity might only provide a *very attenuated* connection to, a bank's ultimate financial risk exposures with respect to transition risk as a driver of traditional risk types.

    - The proposed metric on a bank's real estate exposures in the mortgage portfolio by energy efficiency level, if adopted as proposed, would not provide meaningful information about the bank's risk exposure with respect to transition risk as a driver of traditional risk types and should be excluded or modified.

    - The proposed metric on a bank's exposures subject to physical risk by geographical area, if adopted as proposed, would not provide meaningful information on the bank's financial risk exposures with respect to physical risk as a driver of traditional risk types, given challenges with aggregation of exposures and differing vulnerabilities to (and in some cases positive impacts from) various physical events, and therefore should be excluded or modified.

    - Any re-proposed Pillar 3 climate disclosure framework should exclude forecast- or target-related disclosures.

    - Certain other proposed bank-specific or exposure-related metrics, if adopted as proposed, would not result in meaningful or comparable information for Pillar 3 climate disclosure purposes due to their attenuated connection to climate-related financial risks and differences in accounting standards and practices; therefore, they should be excluded or modified.

- ➢ All re-proposed Pillar 3 climate disclosure requirements should be subject to a materiality threshold consistent with the objectives of Pillar 3 disclosures.

    - The effect of climate-related financial risks, in many cases, may be too small to merit Pillar 3 disclosures.

    - The requirements to disclose exposures and Scope 3 emissions with respect to each of the 18 TCFD sub-sectors, regardless of materiality, is inconsistent with, and detrimental to, the objectives of Pillar 3 disclosures and should be excluded.

    - Any re-proposed Pillar 3 climate disclosure framework should only require disclosure of climate-related financial risks if they could be reasonably expected to materially affect the overall adequacy of a bank's regulatory capital.

    - The BCBS should clarify that, consistent with the objectives of Pillar 3 disclosures, a bank's materiality assessment for purposes of Pillar 3 climate disclosures should be in the context of its risk and capital management framework, which is distinct from materiality assessment(s) conducted for other purposes (*e.g.*, compliance with securities laws).

- ➢ Any re-proposed Pillar 3 climate disclosure framework must be based on a realistic understanding of the significant limitations on data availability and quality, methodologies and modeling capabilities.

    - The reporting of Scope 3 emissions poses significant challenges, including significant use of proxies and estimates, and would not result in meaningful or comparable information for Pillar 3 purposes.

- In the absence of a comprehensive energy efficiency regime, it would not be feasible to produce reliable and comparable information on a bank's real estate exposures in the mortgage portfolio by energy efficiency level.

- Assessment of a bank's exposures subject to physical risk by geographic area would not result in meaningful or comparable information for Pillar 3 purposes.

- Inclusion of retail exposures would be operationally burdensome and would not result in meaningful or comparable information.

➢ Any re-proposed Pillar 3 climate disclosure framework should incorporate a sufficient level of flexibility and avoid overly prescriptive requirements.

- The BCBS should allow banks to have flexibility in determining the appropriate sector classification system to use.

- The BCBS should allow banks to have flexibility in determining how to categorize counterparties that operate in more than one sector and/or geographical area for purposes of sector split and/or geographical split, or provide clearer guidance on how banks should categorize such counterparties.

➢ The BCBS should only finalize a Pillar 3 climate disclosure framework if the benefits of the framework clearly outweigh the costs.

➢ All re-proposed Pillar 3 climate disclosure requirements should be subject to jurisdictional discretion, considering differences in jurisdictional regulators' respective mandates.

➢ Any re-proposed Pillar 3 climate disclosure framework should permit a banking group with bank subsidiaries in multiple jurisdictions to elect to satisfy the disclosure requirements for each bank subsidiary at either the consolidated group level or the bank subsidiary level.

Sections II through IX below provide more detail on these principles and recommendations. Section X below provides our responses to certain consultative questions.

II. All re-proposed Pillar 3 climate disclosure requirements should be consistent with the *BCBS Principles on Effective Management and Supervision of Climate-related Financial Risk*, which appropriately recognize climate-related financial risks as drivers of traditional risk types rather than a standalone risk type.

The BCBS explains it is seeking views on the introduction of a Pillar 3 climate disclosure framework because "[t]he existing Pillar 3 framework does not provide distinct or comparable information as to how climate risk drivers could impact a bank or the banking sector."[8] However, the conclusion that the existing Pillar 3 disclosures are inadequate to capture climate risk drivers is inconsistent with the BCBS's previous conclusion that traditional risk types (*e.g.*, credit risk, market risk, liquidity risk and operational risk) used

[8] Consultative Document, at 3.

by financial institutions and reflected in the Basel Framework can be used to capture climate-related financial risks.[9] Further, the broad references to "transition risk" and "physical risk" templates appear to treat climate risk as a standalone risk type, rather than climate risk drivers, which is inconsistent with the approach in the *BCBS Principles on Effective Management and Supervision of Climate-related Financial Risk*.

Given the relationship between climate-related risk drivers and traditional financial risks, the risks the BCBS is trying to capture through the proposed disclosure requirements may already be captured through the existing Pillar 3 disclosure requirements that focus on the traditional financial risks themselves. Before introducing a new Pillar 3 climate disclosure framework, the BCBS should explain, and seek feedback from market participants on, what incremental benefits this framework would bring to market participants in light of the existing Pillar 3 disclosure requirements that focus on traditional risk types, and why the BCBS is treating climate risk drivers differently from other potential risk drivers for traditional risk types. BCBS also should more clearly connect any proposed disclosure with how climate risk is a driver of traditional risk types rather than simply referring to "transition risk" or "physical risk."

III. Any qualitative or quantitative disclosure in any re-proposed Pillar 3 climate disclosure framework must be a meaningful indicator of a bank's risk exposures and capital adequacy and reflect that climate-related financial risks are drivers of traditional risk types.

The BCBS does not explain how the proposed metrics would provide meaningful and comparable information about how climate risks result in financial risks to banks or affect the safety and soundness of banks or the stability of the broader banking system. We believe the proposed metrics in the Consultative Document would not enable market participants to assess climate-related financial risks at banks, or any impacts on safety and soundness, and could, on the contrary, lead to market confusion and unintended consequences. Further, it would be faulty for the BCBS to conclude that *any* incremental disclosures by banks pursuant to the proposed metrics would necessarily benefit the market from the perspective of promoting the objectives of Pillar 3 disclosures by increasing the amount of climate-related information banks disclose, even if these proposed metrics suffer from conceptual limitations regarding their link to banks' safety and soundness and regulatory capital adequacy. Rather, metrics that give market participants a false impression of a bank's true risk exposure and regulatory capital adequacy would be contrary to the BCBS's objective of promoting market discipline through Pillar 3 disclosures.

Accordingly, we urge the BCBS to issue a re-proposed Pillar 3 climate disclosure framework that only includes disclosures that reflect a meaningful link between the disclosures and a bank's risk exposures and regulatory capital adequacy. Such re-proposal should specifically analyze and explain the incremental benefits that the framework would bring to market participants from the perspective of promoting the objectives of Pillar 3 disclosures, particularly in light of the existing Pillar 3 disclosure requirements that focus on traditional risk categories.

As noted in Section I above, because of the critical distinction between Pillar 3 climate disclosures and corporate climate disclosures, our comments below are limited to our views on the meaningfulness of the proposed metrics in the context of Pillar 3 disclosures and do not address the merits of these metrics in other contexts, such as a corporate climate disclosure context.

9 BCBS, *Climate-related risk drivers and their transmission channels* (Apr. 2021) ("BCBS Climate Risk Drivers Report"), at 2, https://www.bis.org/bcbs/publ/d517.pdf.

A. The proposed qualitative disclosures, such as those related to strategy on climate and prescriptive governance requirements, would not provide a meaningful assessment of a bank's financial risk exposures and capital adequacy and should be excluded.

The Consultative Document includes proposed disclosure requirements related to a bank's business strategy on climate, including disclosures related to transition planning and forecasts (discussed in more detail in Section III.E). Pillar 3 disclosures related to a bank's business strategy on climate should be consistent with the level of disclosure of other aspects of business strategy. The existing Pillar 3 framework focuses on the traditional risk types (*i.e.*, credit, market, liquidity and operational risk[10]) and does not require similar disclosure for business strategy and planning with respect to other topics, such as pandemics, potential recessions, or emerging markets business risk.

As it relates to governance, we caution that elements of the proposed framework are overly prescriptive and appear to go beyond disclosure to dictate the conduct of a bank's board of directors and in some cases blur the distinction between the board of director's responsibility for *oversight* of the business and affairs of the bank and management's responsibility for the *day-to-day operations* of the bank. For example, items 1(b)[11] and 1(d)[12] under Table CRFRA appear to presume the described activities as tasks of the board, and, as a result, conflate management's responsibility for day-to-day decision-making regarding a bank's business strategy with respect to climate with the board of directors' oversight responsibility.

B. The proposed metrics related to a bank's Scope 3 emissions should not be characterized as a direct proxy for *actual* risk of financial loss and should be excluded. Absolute financed and facilitated emissions have no connection to, and financed emissions intensity might only provide a *very attenuated* connection to, a bank's ultimate financial risk exposures with respect to transition risk as a driver of traditional risk types.

The Consultative Document contemplates a number of quantitative disclosure requirements regarding a bank's Scope 3 emissions[13] and related forecasts: financed emissions by sector (Template CRFR1), financed emissions intensity per physical output and by sector (Template CRFR4) and facilitated emissions related to capital markets and financial advisory activities by sector (Template CRFR5).

We recognize the importance of Scope 3 emissions disclosures to many investors, consumers, employees and the public and note that many banks are already disclosing, to the extent feasible, Scope 3

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10 The definition of operational risk excludes strategic risk. *See*, BCBS, *Basel Framework,* https://www.bis.org/baselframework/BaselFramework.pdf ("Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk, but excludes strategic and reputational risk.").

11 Item 1(b) would require banks to describe: "How the board ensures that the appropriate skills and competencies are available to oversee strategies designed to respond to climate-related financial risks."

12 Item 1(d) would require banks to describe: "How the board and its committees consider climate-related financial risks when overseeing the bank's strategy, its decisions on major transactions, and its risk management processes and related policies, including whether the board has considered trade-offs associated with those risks."

13 For purposes of this letter, the term "emissions" refers to greenhouse gas emissions.

emissions in their corporate disclosures. Many of our members have, as a matter of business strategy, set targets to reduce their Scope 3 emissions and currently disclose, where possible, some portion of their Scope 3 emissions in their voluntary climate reports. We also recognize that some jurisdictions have enacted or proposed sustainability- or climate-related disclosure requirements that contemplate the disclosure of emissions, including certain portions of Scope 3 emissions, consistent with the climate policy and the relevant regulators' mandates in those jurisdictions.[14]

However, a bank's Scope 3 emissions are the subject of business strategy rather than a meaningful indicator of the bank's transition risk or risk exposures in relation to transition risk; therefore, they should be excluded from any re-proposed Pillar 3 climate disclosure framework to avoid confusion and unintended consequences.

First, consider *financed emissions*. The BCBS noted that, because "[e]missions by obligors could be considered an indicator of their transition risk," disclosures of absolute financed emissions by banks "could provide market participants with an indication of banks' exposure to climate-related transition risks and related impact on their risk profiles."[15] Similarly, the BCBS noted it is exploring whether financed emission intensity metrics "could be a reasonable proxy for the transition risk that may be transmitted to banks by their counterparties."[16]

The Consultative Document suggests that financed emissions of obligors by sector, when augmented with other appropriate information, could be a meaningful indicator of a bank's transition risk. As an initial matter, it is important to note that transition risk is a driver of traditional banking risks such as market, credit, and operational risk and is not a standalone risk type in itself. Thus, the relevant question is whether disclosure of financed emissions, along with supporting context, aids the market in determining the degree of market, credit, or operational risk that a bank may incur from an obligor's financed emissions. However, the causal chain from obligor emissions to the underlying financial risks is too complex to provide meaningful information for the market to make that determination. As a result, the financed emissions metrics, as currently proposed, would in fact be misleading to the market.

To illustrate the difficulties of inferring bank risk from obligor emissions, we focus on credit risk, since, as discussed in Sections IV.A and X.A, the absolute effect of emissions on market or operational risk is likely to be immaterial. The credit risk that a bank incurs from an obligor is related to the financial characteristics of the obligor as well as the risk management tools the bank has employed, such as client credit selection, loan covenants, collateral arrangements, and workout procedures. As a driver of credit risk, a climate-related factor such as emissions will be one of many drivers impacting a bank's credit risk exposure, and it is nearly impossible to isolate that impact from the myriad of other factors. While the

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14 For instance, although the EU has incorporated emissions disclosure into Pillar 3 disclosure, the European Central Bank has a mandate to facilitate the net-zero transition. *See* European Central Bank, *Introduction*, https://www.ecb.europa.eu/mopo/intro/html/index.en.html (noting the Treaty on the Functioning of the European Union, which sets forth the European Central Bank's mandate, provides that "'without prejudice to the objective of price stability', the ECB shall also support the general economic policies in the EU with a view to contributing to the achievement of the Union's objectives as laid down in Article 3 of the Treaty on European Union," which include, among others, "a high level of protection and improvement of the quality of the environment").

15 Consultative Document, at 5.

16 *Id.* at 8.

level of emissions could affect the financial characteristics of an obligor by exposing it to revenue losses or higher costs, the actual change in default probability is a highly non-linear function of the specific details of the financial condition of the obligor. Revenue losses could result from changes in the underlying economy (*e.g.*, breakthroughs in battery technology reduce the demand for gas-powered cars). Higher costs could result from rising carbon taxes or other regulations. Revenue losses or higher costs could increase the default probability of an obligor, holding all other factors constant. However, two obligors in the same industry with exactly the same emissions could have very different sensitivities of default probability to transition risk.

Besides depending on the specific financial details of the obligor, the credit risk, as opposed to the default risk, also depends on the bank's actions. Banks differ in their risk appetites and may provide loans to obligors in the same industries with substantially different underlying default risk.

Different banks may also require different loan covenants, require different amounts of collateral, and employ different workout procedures, which can limit losses upon default. The term of the loans is also highly important in determining the resulting credit risk. For example, if a loan to a high-emissions borrower is short term, even if the borrower faces higher transition risk to its business model, the loan is more likely to mature before the borrower experiences revenue losses or higher costs, and therefore a higher-emissions borrower may not be associated with higher default risk in this case.

As a result, it is impossible to determine the amount of credit risk that results from transition risk in a portfolio of obligors by sector by looking only at the amount of absolute emissions of that portfolio. In particular, given two portfolios in the same industry, one with higher emissions and the other with lower emissions, market participants could not justifiably infer that the portfolio with the higher emissions has greater credit risk resulting from transition risk. Also, since probability of default (and loss given default) are highly non-linear functions of the underlying financial data of an obligor, even if a portfolio with substantially higher emissions did have greater credit risk, the difference in credit risk between the two portfolios could be small. Without very detailed calculations, it would be impossible to form any meaningful judgment. The addition of other information for context, such as qualitative information suggested by the Consultative Document, would not help.

Importantly, aggregate financed emissions metrics also do not take into account clients' ability to absorb the costs associated with the transition (*e.g.*, although a larger client may have higher emissions today, it is also likely to have more resources to absorb the incremental costs related to the transition to a low-carbon economy) or the extent to which different clients are investing in the transition to a low-carbon economy (*e.g.*, a client in a high-emitting sector could be in the process of phasing out its high-emitting assets). Aggregate financed emissions metrics also do not take into account banks' ability to respond to policy changes over a longer time horizon. For example, although clients may face higher costs from rising carbon taxes, it is reasonable to assume that governments will not impose exorbitant carbon taxes overnight that would cause a client to immediately default on its loan; banks have historically adjusted in response to policy changes that had impacted clients' credit risk.

For the reasons outlined above, the emissions of most borrowers would not provide insight into whether transition events or activities would diminish a borrower's credit quality or demand for financing, and aggregate portfolio-level absolute emissions would not provide insight into whether transition events or activities would diminish a portfolio's credit quality or client demand for financing. A bank's financed emissions are therefore not an accurate reflection of actual transition risk and would be misleading if used as a proxy for transition risk exposure.

Although the *emissions intensity* of a bank's lending portfolio may serve as a rough proxy for the vulnerability of those clients to a carbon tax (which is a commonly cited transition risk), emissions intensity metrics might provide only a *very attenuated* connection to a bank's ultimate financial risk exposures with respect to transition risk as a driver of traditional risk types. Scope 3 emissions have a complex and non-linear relationship to carbon pricing vulnerability and cannot be viewed as a meaningful measure of credit risk exposure. Vulnerability to a carbon tax will differ from firm to firm—the question is to what degree a firm's Scope 3 value chain emissions are a proxy for demand exposure to carbon-based products. Vulnerability to a carbon tax will also depend on the particular company's business model and to what degree their Scope 3 value chain emissions reflect their exposure to demand for carbon-based products that will be most directly impacted by the imposition of a carbon tax. As one example, the imposition of a carbon tax would likely be directly reflected in the price of gas for automotive vehicles, which would be likely to impact consumer demand. In this case, an oil and gas company's Scope 3 emissions becomes a proxy for demand exposure to a carbon tax. As another example, banks are not selling carbon-based products, and a bank's business model is not as sensitive to the imposition of carbon tax. It is also important to note that a client's decreased profitability does not necessarily result in default, and that many jurisdictions have imposed increased carbon prices without causing widespread loan defaults. In addition, vulnerability to a carbon tax does not take into account the likelihood that a carbon tax will be implemented, or that it will be implemented suddenly in a way that the market will not be able to adjust to and that will cause a material portion of a bank's loans to default.

Finally, *facilitated emissions* mainly reflect the size of the bank and its clients and the proportion of the bank's activities devoted to providing capital markets and financial advisory services, fluctuate primarily as a result of changes in macroeconomic conditions and market forces, and do not reflect a bank's exposure to credit risk or other financial risk as driven by transition risk. Underwriting a capital markets offering or advising on an M&A transaction does not present the same ongoing counterparty credit risk that a loan to a borrower does. Moreover, facilitated emissions do not necessarily reflect a bank's ability to generate fees from its capital markets and financial advisory activities. For example, a bank that underwrites multiple rounds of short-term bonds for an issuer through new issuance and refinancing transactions would likely report higher facilitated emissions while generating higher fees from these transactions than if the bank underwrites fewer rounds of longer-term bonds for the same issuer.

The Scope 3 emissions metrics would be even less meaningful as indicators of the potential impact of transition risk drivers on the safety and soundness of banks considering the significant limitations on Scope 3 data, methodologies and modeling capabilities (see Section V.A).

By requiring Scope 3 emissions metrics, the BCBS would effectively be communicating to the market that higher Scope 3 emissions translate into increased financial risk and risk to banks' safety and soundness and regulatory capital adequacy, which, in turn, may lead to pressure on banks to change their business strategies and activities to reduce their Scope 3 emissions. For example, a bank may face pressure not to provide transition financing to high-emitting clients (for the purposes of helping the clients to transition to lower-emitting businesses) because the transition financing activities would increase the bank's financed emissions, even though the transition financing would not increase, but may actually decrease, the clients' transition risk, and may have no impact on the banks' credit risk given the time horizon of the financing activities.

C. The proposed metric on a bank's real estate exposures in the mortgage portfolio by energy efficiency level, if adopted as proposed, would not provide meaningful information about the bank's risk exposure with respect to transition risk as a driver of traditional risk types and should be excluded or modified.

In proposing the metric on real estate exposures in the mortgage portfolio by energy efficiency level (Template CRFR3), the BCBS notes it is exploring whether this metric could assist market participants in assessing "the extent to which the value of the underlying collateral may be negatively affected due to high emissions linked to low energy efficiency" and "if mortgage-backed borrowers may be obliged to invest in their real estate assets to make them less carbon-intensive or more energy efficient."[17]

Similar to the Scope 3 emissions metrics, this metric, if adopted as proposed, would not provide meaningful information on a bank's risk profile. The energy efficiency level of a portfolio's collateral would not necessarily affect a bank's credit risk exposures, and disclosure of this metric would not be sufficient for market participants to extrapolate meaningful insights. For example, the value of the underlying collateral may be affected by many factors, such as macroeconomic conditions, supply and demand, location, style and age. In addition, even if a mortgage-backed borrower is obliged to invest in its real estate assets to comply with jurisdictional energy efficiency regulations, such investment itself may present very little or no incremental credit risk to the bank if the borrower has ample resources to make the investment or, regardless of the borrower's ability to make the investment, if the compliance timeline in respect of the jurisdictional energy efficiency regulations is longer than the time horizon of the mortgage.

In addition, this metric may result in banks being discouraged from providing construction or renovation loans to mortgage-backed borrowers for the purposes of increasing the energy efficiency level of the underlying collateral if the energy efficiency level of the collateral is presently low, even though the lending activities would not pose any additional risk to banks' safety and soundness or regulatory capital adequacy.

Moreover, as discussed in Section V.B, significant data, methodologies and modeling issues would further reduce any possible utility of this metric. Further, requesting energy usage data for residential properties from individual bank customers may be more challenging in the United States due to privacy concerns.

D. The proposed metric on a bank's exposures subject to physical risk by geographical area, if adopted as proposed, would not provide meaningful information on the bank's financial risk exposures with respect to physical risk as a driver of traditional risk types, given challenges with aggregation of exposures and differing vulnerabilities to (and in some cases positive impacts from) various physical events, and therefore should be excluded or modified.

The BCBS notes that it is considering whether banks should disclose their exposures subject to physical risk by geographical area to "enable market participants to better understand a bank's risk profile based on the geographical split of exposure."[18] We believe this metric, as proposed, would not achieve

[17] *Id.* at 7.

[18] *Id.* at 5.

this goal and should be excluded or modified. We urge the BCBS to issue a re-proposed Pillar 3 climate disclosure framework and, if a modified physical risk-related metric is included in the re-proposal, the BCBS should explain the relationship between such proposed metric and banks' risk exposures and regulatory capital adequacy.

As discussed above with transition risk, physical risk factors are drivers of traditional banking risks and do not represent a standalone risk type. As such, proposed disclosures regarding the impacts of physical risk factors must sufficiently establish a link to existing risk types, such as credit risk. In this case, the relationship between a bank's clients' exposure to physical risk and the impact on a bank's credit risk (*i.e.*, probability of default) is not linear—*i.e.*, increasing exposure does not necessarily mean that the risk of financial loss would also increase. For example, different sectors have very different vulnerabilities to different types of physical risk. Indeed, for each sector and location, the impact of physical risk on a bank's financial risk may be positive (*e.g.*, a client's ability to grow crops in a location where it was previously impossible to do so due to chronic climatic trends may reduce a client's credit risk) or negative (*e.g.*, damage to a client's property as a result of acute weather events may increase a client's credit risk). This is particularly true when aggregating exposures to all physical risks—some clients within a region may be exposed to certain climate-related risks while others may not, and aggregating data across all clients within a region would not provide useful information about a bank's regulatory capital and risk exposures.

Moreover, a bank's exposures subject to physical risk are not necessarily reflective of the bank's financial risk because of the various other factors affecting financial risk. For example, the proposed disclosure requirements do not contemplate any mitigation factors to financial losses, such as insurance, or other relevant factors that may affect a bank's overall financial results, such as potential increasing demand for loans following natural disasters.[19] Further, as discussed in Section V.C, considering the significant limitations on physical risk data, methodologies and modeling capabilities, including, in particular, the difficulties of precisely tying physical risk to geographic areas, this proposed metric would not provide meaningful information on the effects of physical risk drivers on banks' financial risk exposures or regulatory capital adequacy for Pillar 3 purposes.

E. Any re-proposed Pillar 3 climate disclosure framework should exclude forecast- or target-related disclosures.

As an initial matter, the BCBS's proposed requirements appear to conflate "forecast" with "target." "Forecast" means "a prophecy, estimate, or prediction of a future happening or condition," whereas "target" means "a goal to be achieved."[20] For example, Sections 1(e) and 2(c) of Template CRFRA require the disclosure of "[h]ow the board oversees the *setting* of forecasts related to climate-related financial risks and *monitors progress* towards those forecasts . . ." as well as "the amount of the bank's emission forecast *to be achieved* through emission reductions within the bank's value chain and the intended use of carbon offsets *in achieving* emissions forecasts" (emphasis added).[21] In these instances, it appears the

19 *See*, *e.g.*, FRBNY Staff Report, *infra* note 28, at 15 (noting that, among other factors, banks' resilience following natural disasters "seems inherent to some degree because disasters increase the demand for loans").

20 *See* "forecast" and "target." Merriam-Webster.com. 2024. https://www.merriam-webster.com (Mar. 14, 2024).

21 Consultative Document, at 15–16.

better reading of "forecast" is that it means "target," or a goal to be achieved. However, Instruction 2(a) of Template CRFRA provides that in identifying climate-related risks that could reasonably be expected to affect a bank's prospects, the bank shall use, among other information, "information about past events, current conditions and *forecasts of future conditions*" (emphasis added).[22] In this instance, it appears the BCBS intends to use "forecasts" to mean forecasts, or estimates or predictions of future conditions.

Regardless of whether references to "forecasts" in the Consultative Document are intended to refer to "forecasts" or "targets," disclosure requirements for forecasts of, or targets for, climate metrics are not appropriate for purposes of Pillar 3 disclosures and should be excluded. A bank's climate-related targets, such as targets to achieve net-zero emissions or to reduce direct and indirect emissions in accordance with certain timelines, are aspirational and aimed at achieving certain outcomes, rather than predictions of what will happen. As discussed above, financed emissions are not measures of financial risk exposure. Therefore, climate-related targets are not appropriate measures of a bank's current or future climate-related financial risk exposures.

Banks have set Scope 3 portfolio-level decarbonization targets for business strategy purposes, not as financial risk management tools. Even genuine forecasts of the BCBS's proposed climate-related metrics would not demonstrate a bank's climate-related financial risk exposures because, as noted above, the metrics themselves do not provide meaningful and comparable key information on a bank's climate-related financial risk exposures and are subject to high degrees of uncertainty. These issues would be compounded for forecasts, which by their nature are even more uncertain. Furthermore, it can be operationally challenging to project medium- and long-term actions with certainty, particularly since a bank's strategy and approach will likely need to remain flexible to react to geopolitical and economic changes.

In addition, internally developed climate-related forecasts and targets contain proprietary business analysis and judgments that banks would not want to disclose to competitors. A requirement to disclose internal climate-related forecasts and targets if the bank has developed them could incentivize banks that have not already developed forecasts to refrain from developing them, defeating the purpose of the policy goal of banks preparing themselves for transition. Moreover, banks that have already developed forecasts or targets may pull back or fail to enhance their forecasts or targets in order to avoid disclosing them. Further, as discussed in Section X.B below, disclosure of climate-related forecasts and targets could subject banks to heightened legal risks.

We recognize many banks are subject to stress testing requirements that require them to produce certain forecasts, including of regulatory capital, under various scenarios. These stress testing requirements are distinct from Pillar 3 disclosures, which are publicly available to market participants. Existing Pillar 3 disclosures do not require forecasts of *any* financial statement line item or risk metric. Requiring banks to report climate-related forecasts would represent a significant departure from historical practice. The BCBS has not provided sufficient explanation as to why such a departure is justified.

For the above reasons, we urge the BCBS to exclude forecast- or target-related disclosures from any re-proposed Pillar 3 climate disclosure framework.

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22 *Id.* at 16.

F. Certain other proposed bank-specific or exposure-related metrics, if adopted as proposed, would not result in meaningful or comparable information for Pillar 3 climate disclosure purposes due to their attenuated connection to climate-related financial risks and differences in accounting standards and practices; therefore, they should be excluded or modified.

The BCBS notes that it is exploring the introduction of bank-specific metrics that "would enable market participants to better assess the potential impact of climate-related financial risks on the safety and soundness of banks."[23] To that end, the BCBS proposes to require the disclosure of credit quality (*i.e.*, allowances and non-performing exposures) and maturity profile (see Templates CRFR1 and CRFR2). However, the BCBS does not explain how these proposed metrics would help achieve its objective. For the reasons discussed below, we recommend the proposed bank-specific metrics be excluded from any re-proposed Pillar 3 climate disclosure framework.

Banks typically do not estimate allowances on a loan-by-loan basis for all but non-performing loans. Most performing loans are estimated in pools in which climate risk drivers are likely to represent only a small factor in assessing allowances. In addition, differences in accounting standards and practices across jurisdictions with respect to credit quality metrics render them noncomparable across jurisdictions, further reducing any value these metrics may have for the purposes of Pillar 3 disclosures. For example, under IFRS 9, allowances for loans whose credit risk has not increased significantly since initial recognition are based on a 12-month probability of default; however, under U.S. GAAP, the entire lifetime expected credit loss on loans is recognized at inception. Even among banks that follow the same accounting standards, jurisdictional differences in the definition of "non-performing" and charge-off practices can lead to noncomparable information that may be confusing and would not be useful to market participants. Finally, allowances by sector (as required in Template CRFR1) are not required for any other Pillar 3 disclosures, and would potentially be competitively sensitive at this level of granularity.

Similarly, the maturity profile metric would not provide meaningful information because banks typically manage their portfolios based on "expected" maturity (for which forecasts of prepayments, which require the forecasts of interest rates, would be needed) rather than contractual maturity.

In addition, the BCBS also proposes to require the disclosure of certain exposure-related metrics—namely, gross carrying amount for on-balance sheet items as well as off-balance sheet items (see Templates CRFR1 and CRFR2). For purposes of Templates CRFR1 and CRFR2, "gross carrying amount" means "carrying amount of loans, debt securities and equity before subtracting the loss allowances, when applicable."[24] However, debt securities may be held on behalf of clients and therefore may not be indicative of banks' owned risk; in addition, exposure to equity is variable and point-in-time and would not provide meaningful or consistent information. Therefore, the definition of "gross carrying amount" should be modified to exclude debt securities and equity.

Finally, there is no discussion in the Consultative Document about the off-balance sheet exposures by sector (Template CRFR1) metric. The BCBS should exclude this metric from any re-proposed Pillar 3 climate disclosure framework or present evidence as to how this metric would provide meaningful and

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23 *Id.* at 6.

24 *Id.* at 21 & 24.

comparable information that is consistent with the objectives of Pillar 3 before requiring it in any re-proposed Pillar 3 climate disclosure framework.

IV. All re-proposed Pillar 3 climate disclosure requirements should be subject to a materiality threshold consistent with the objectives of Pillar 3 disclosures.

A. The effect of climate-related financial risks, in many cases, may be too small to merit Pillar 3 disclosures.

The objectives of Pillar 3 disclosures are focused on "increas[ing] transparency and confidence about a bank's exposure to risk and the overall adequacy of its regulatory capital."[25] Although the BCBS states that physical and transition risks "can . . . result in financial risks to banks . . . , potentially affecting the safety and soundness of banks and the stability of the broader banking system,"[26] the BCBS does not cite any evidence supporting this view in the Consultative Document. As previously acknowledged by the BCBS, "[t]here is little work that takes climate risk drivers all the way through to the impact on banks."[27]

In fact, limited existing research on this subject suggests the effect of climate-related financial risks, in many cases, may be too small to merit Pillar 3 disclosures. For example, the Institute of International Finance recently evaluated the results of supervisory climate scenario analyses and stress tests and concluded that "on a purely quantitative basis, the levels of potential exposure and stability risks posed by climate change . . . do not appear to currently indicate levels of risk over the near to medium term which would justify the use of the capital framework."[28] In addition, in a recent Staff Report co-authored by staff of the Federal Reserve Bank of New York, the authors studied how banks fared against Federal Emergency Management Agency ("FEMA")-level disasters from 1995–2018 and found such disasters generally had "insignificant or small effects on bank performance and stability."[29] In addition, based on BPI analysis, the effect of climate change on banks' operational risks is likely to be very small and not a potential safety and soundness concern for the banking system.[30]

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25 *Id.* at 3.

26 *Id.* at 2.

27 BCBS Climate Risk Drivers Report, at 1.

28 Institute of International Finance, *Climate and Capital: Views from the Institute of International Finance* (July 28, 2022), at 4, https://www.iif.com/portals/0/Files/content/32370132_climate_and_capital_-_perspectives_from_the_iif_final.pdf. *See also*, Institute of International Finance, *Navigating Climate Headwinds: Reference Approaches for Scenario-based Climate Risk Measurement by Banks and Supervisors* (July 2021), https://www.iif.com/portals/0/Files/content/Regulatory/07_15_2021_navigating_climate_headwinds.pdf.

29 Kristian S. Blickle, Sarah N. Hamerling, and Donald P. Morgan, *How Bad Are Weather Disasters for Banks*? FED. RESERVE BANK OF NEW YORK 1 (Jan. 2022) (the "FRBNY Staff Report"), at 1, https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr990.pdf.

30 Greg Hopper, *Are Banks' Operational Risks Significantly Affected by Climate Change* (Jan. 4, 2024), https://bpi.com/are-banks-operational-risks-significantly-affected-by-climate-change/#_ftnref2.

B. The requirements to disclose exposures and Scope 3 emissions with respect to each of the 18 TCFD sub-sectors, regardless of materiality, is inconsistent with, and detrimental to, the objectives of Pillar 3 disclosures and should be excluded.

The BCBS proposes to require disclosure of exposures, financed emissions and facilitated emissions by sector, according to the 18 sectors defined by the Financial Stability Board's Task Force on Climate-related Financial Disclosures ("TCFD"),[31] regardless of materiality assessment (Templates CRFR1 and CRFR5). The BCBS appears to assume that a bank's exposures and Scope 3 emissions with respect to each of the 18 TCFD sub-sectors are meaningful information for purposes of assessing the bank's climate-related financial risks and the overall adequacy of the bank's regulatory capital, and could imply to the market that these metrics are material for Pillar 3 purposes, even if not assessed as such by banks.

This prescriptive approach represents an arbitrary bright line for which the BCBS has not provided any support, and is inconsistent with, and detrimental to, the objectives of providing key information for market participants to assess a bank's safety and soundness and overall regulatory capital adequacy. Under this approach, even if a bank's exposures and Scope 3 emissions with respect to a TCFD sub-sector were not material for purposes of Pillar 3 disclosures, the proposed requirements would still require the bank to disclose the information, which would result in the disclosure of a large amount of granular data, making it more difficult for market participants to understand the key financial risks (climate-related or otherwise) that could potentially affect the bank's safety and soundness and overall regulatory capital adequacy. Accordingly, the requirement to disclose exposures and Scope 3 emissions with respect to each of the 18 TCFD sub-sectors, regardless of materiality, should be excluded.

The BCBS also proposes to require banks to undertake and disclose a materiality assessment of all other sectors outside of the 18 TCFD sectors. It is unclear how banks would undertake this materiality assessment, and the BCBS has not explained why the benefit of this undertaking would justify the resulting operational burden, as well as the compliance risk associated with conducting a materiality assessment without clear guidance on the meaning of "materiality" in this context.

C. Any re-proposed Pillar 3 climate disclosure framework should only require disclosure of climate-related financial risks if they could be reasonably expected to materially affect the overall adequacy of a bank's regulatory capital.

Most of the proposed disclosure requirements are not subject to any explicit materiality threshold. Where the BCBS does explicitly refer to a "materiality" threshold—for example, the BCBS proposes to require qualitative disclosure of the effects of "material climate-related financial risks on [a bank's] strategy and decision-making" (Template CRFRA) and quantitative disclosure of a bank's exposures, financed emissions and facilitated emissions by "material sectors" based on the bank's sectoral materiality assessment (other than the 18 TCFD sub-sectors, where disclosures are required regardless of materiality)

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31 The 18 TCFD sub-sectors are categorized into four groups: (1) Energy (oil and gas, coal, and electric utilities), (2) Transportation (air freight, passenger air transportation, maritime transportation, rail transportation, trucking services, and automobiles and components), (3) materials and buildings (metals and mining, chemicals, construction materials, capital goods, and real estate management and development), and (4) agriculture, food, and forest products (beverages, agriculture, packaged foods and meats, and paper and forest products). TCFD, Final Report, *Recommendations of the Task Force on Climate-related Financial Disclosures* (June 2017), at p. 16, https://assets.bbhub.io/company/sites/60/2021/10/FINAL-2017-TCFD-Report.pdf.

(Templates CRFR1 and CRFR5)—the BCBS does not explain what "materiality" means for purposes of the Pillar 3 climate disclosure framework.

To achieve the objectives of Pillar 3 disclosures, any re-proposed Pillar 3 climate disclosure framework should only require disclosure of climate-related financial risks if they could be reasonably expected to materially affect the overall adequacy of a bank's regulatory capital. As noted above, the effect of climate-related financial risks, in many cases, may be very small. Without a materiality threshold consistent with the objectives of Pillar 3 disclosures, banks would be required to disclose the impact of climate-related financial risks that may not have any material impact on banks' safety and soundness or regulatory capital adequacy. This would result in the disclosure of a large amount of nonmaterial and (particularly after taking into consideration the significant data, methodology and modeling issues discussed in Section V) unreliable information that could overwhelm and confuse market participants.

D. The BCBS should clarify that, consistent with the objectives of Pillar 3 disclosures, a bank's materiality assessment for purposes of Pillar 3 climate disclosures should be in the context of its risk and capital management framework, which is distinct from materiality assessment(s) conducted in other contexts (*e.g.*, compliance with securities laws).

The BCBS should clarify that, for purposes of Pillar 3 climate disclosures, a bank should conduct its materiality assessment in the context of its risk and capital management framework consistent with the objectives of Pillar 3 disclosures. For example, some important components of how banks may assess materiality for Pillar 3 purposes could be the plausibility and certainty of risk (*e.g.*, there will be potential risks that will be so speculative or distant as not to be material for Pillar 3 purposes).[32] This is important for the BCBS to recognize, because, without this clarification, supervisors in practice may insist on deeming remote and uncertain outcomes driven by climate change as "material" in ways they would not for more traditional risk categories.

For further clarity, we suggest the BCBS expressly state in any re-proposed Pillar 3 climate disclosure framework that the meaning of "material" for purposes of the framework is distinct from the meaning of "material" in other contexts, such as in corporate disclosures for the purposes of complying with applicable securities laws or other climate disclosure requirements (*e.g.*, the Corporate Sustainability Reporting Directive ("CSRD") in the EU and the U.S. Securities and Exchange Commission's ("SEC") climate disclosure rules in the United States).

V. Any re-proposed Pillar 3 climate disclosure framework must be based on a realistic understanding of the significant limitations on data availability and quality, methodologies and modeling capabilities.

Many of the proposed disclosure requirements assume a level of precision in climate-related data that does not yet exist. In addition, the methodologies and models needed to produce the proposed disclosures are based on significant subjective assumptions, estimates and judgments, are not mature, and are rapidly evolving. As a result, the proposed disclosure requirements are unlikely to provide meaningful

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32 It will also be important for the BCBS to recognize that, under certain circumstances, banks may not be in a position to evaluate the plausibility and certainty of the risk—and, therefore, make materiality determinations—at this time due to underlying data, methodology and modeling challenges (as further discussed in Section V).

and comparable information for users of Pillar 3 disclosures. Any re-proposed Pillar 3 climate disclosure requirements must be based on a realistic understanding of the significant limitations on data availability and quality, methodologies and modeling capabilities.

A. The reporting of Scope 3 emissions poses significant challenges, including significant use of proxies and estimates, and would not result in meaningful or comparable information for Pillar 3 purposes.

The proposed Scope 3 emissions disclosure requirements (Templates CRFR1, CRFR2 and CRFR5) would not result in meaningful, comparable or reliable disclosures because of the many significant practical challenges in Scope 3 emissions reporting at this stage.

First, although there has been progress in banks' ability to collect Scope 3 emissions data, Scope 3 emissions data continue to be highly challenging to obtain, calculate, and confirm, with very significant data quality concerns and error margins. A bank's ability to disclose its Scope 3 emissions depends, in large part, on the availability of Scope 1, 2 and 3 emissions data published by third-party suppliers and clients. However, not all third parties currently disclose even Scope 1 and 2 emissions—it would be infeasible for banks to obtain emissions data from their natural person clients, and it could be very challenging for banks to obtain emissions data from third parties in a bank's value chain that are not public companies (*e.g.*, small businesses) or that are businesses in jurisdictions where emissions reporting is less advanced (*e.g.*, certain emerging markets and developing economies). In addition, the reporting of Scope 3 emissions data at the subsidiary level is complicated by the fact that data may only be available at the consolidated level of a counterparty, leading to the use of further assumptions and proxies to interpolate results. Moreover, there is currently a lack of emissions data related to emerging decarbonization technologies, such as hydrogen, biofuels and carbon capture, use and storage, which play a key role in helping banks' clients decarbonize.

Second, even where the third-party data necessary to calculate Scope 3 emissions can be obtained, Scope 3 data from some emissions sources may be available only on a longer time lag. For example, Scope 3 emissions data for automotive manufacturing data obtained from publicly available regulatory reporting are disclosed on a two- to three-year lag.

Third, calculation of Scope 3 emissions is highly dependent on estimation and calculation methodologies, which are not mature and still evolving. Although calculation and reporting methodologies are available for certain types of Scope 3 emissions and asset classes, significant methodologies issues remain, including the lack of Scope 3 emissions calculation methodologies for some sectors and asset classes. For example, the Partnership for Carbon Accounting Financials ("PCAF"), an industry-led initiative to develop emissions accounting and reporting standards for the financial industry, just published its first version of the calculation method for facilitated emissions in respect of capital markets activities in December 2023[33]— there is no market consensus on its use and there is not enough experience on its use to form an understanding of how well it works; indeed, facilitated emissions are not included in existing climate standards (*e.g.*, International Sustainability Standards Board ("ISSB"), European Sustainability Reporting Standard (ESRS), and European Banking Authority Pillar 3 disclosures on ESG risks (EBA P3).

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[33] PCAF, *The Global GHG Accounting and Reporting Standard Part B: Facilitated Emissions* (Dec. 2023), https://carbonaccountingfinancials.com/files/PCAF-PartB-Facilitated-Emissions-Standard-Dec2023.pdf.

PCAF is also continually developing and broadening the scope of its emissions accounting and reporting standards, including selecting new assets and products to develop and refine its standards.[34]

Finally, many other issues could present challenges to, and significantly affect the utility and comparability of, aggregated Scope 3 emissions reporting, including those relating to double, triple or multiple counting. For example, because banks lend and provide other financial services across value chains, the same emissions could be counted multiple times as part of a bank's Scope 3 emissions.

Because of these significant challenges to Scope 3 emissions reporting, requiring broad Scope 3 emissions disclosures at this stage would not result in meaningful or comparable information for market participants. On the contrary, the proposed requirements would result in banks producing a large amount of information that would not be useful for market participants to interpret for Pillar 3 purposes, especially across banks and over time.

B. In the absence of a comprehensive energy efficiency regime, it would not be feasible to produce reliable and comparable information on a bank's real estate exposures in the mortgage portfolio by energy efficiency level.

In the absence of a comprehensive energy efficiency regime, at the mortgage level, the information on energy efficiency level of the underlying collateral is sparse, and there is not a reliable or comprehensive source for this information. This is true particularly for residential mortgages. Although estimation of energy efficiency levels is permitted, most banks do not have the expertise to produce these estimates reliably. In addition, because the relevant data are not widely available and banks are expected to produce estimates using their own methodologies, the disclosure would be subject to significant uncertainty and would not be comparable across banks.

C. Assessment of a bank's exposures subject to physical risk by geographic area would not result in meaningful or comparable information for Pillar 3 purposes.

As discussed in more detail in a recent BPI blog post, banks (and their regulators) face significant challenges in assessing a bank's exposures subject to physical risk by geographic area.[35] First, physical risk is inherently interdisciplinary, requiring an understanding of physics, economics, hydrology, meteorology, fire science, industrial health and biometeorology, among other disciplines; banks and their regulators are understandably not familiar with all these areas and are not well positioned to make the assessment. Second, as previously recognized by the BCBS, "climate-related events and risks are uncertain" and "may be subject to non-linearities," and while some aspects of physical risks can be predicable, "there is increasing uncertainty as to the location, frequency and severity of these events."[36] Third, there are still

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34 See, *e.g.*, PCAF, *PCAF announces areas for standard development in 2024* (Jan. 16, 2024), https://carbonaccountingfinancials.com/en/newsitem/pcaf-announces-areas-for-standard-development-in-2024#newsitemtext.

35 *See*, *e.g.*, Greg Hopper, *A Primer on Climate Physical Risk* (Feb. 28, 2024) ("A Primer on Climate Physical Risk"), https://bpi.com/a-primer-on-climate-physical-risk/.

36 BCBS Climate Risk Drivers Report, at 2. *See also*, A Primer on Climate Physical Risk (reviewing relevant research literature on the effects of climate change on hurricanes, observing that "there is limited consensus on the effects of climate change on hurricane tracks and genesis points," and discussing the difficulties of precisely tying any potential changes to hurricane risk that are projected to materialize over the long run to

crucial outstanding questions in the academic literature in many areas that must be resolved before physical risk management can be mature.

The BCBS does not explain in the Consultative Document how, considering these significant challenges, this proposed metric would enable market participants to better understand the effects of physical risk on banks' regulatory capital and financial risk exposures. Allowing jurisdictional supervisors to determine geographical areas subject to physical risk would not overcome these challenges because, as explained above, regulators themselves are not well positioned to assess physical risk by geographical areas.

For the reasons outlined above, we believe any assessment of the effects of physical risk by geographic area on banks' regulatory capital and financial risk exposures would necessarily be subject to significant assumptions, estimates and judgment, which would lead to significant uncertainty and would not result in meaningful or comparable information for market participants specifically for purposes of assessing banks' risk profiles or regulatory capital adequacy. Accordingly, any re-proposed Pillar 3 climate disclosure framework should not require this metric and, if a modified physical risk-related metric is included, the BCBS should explain the relationship between such proposed metric and banks' risk exposures and regulatory capital adequacy.

D. Inclusion of retail exposures would be operationally burdensome and would not result in meaningful or comparable information.

For purposes of disclosing banks' exposures and financed emissions by sector (Template CRFR1), exposures subject to physical risk (Template CRFR2), emissions intensity per physical output and by sector (Template CRFR 4) and facilitated emissions related to capital markets and financial advisory activities by sector (Template CRFR5), the BCBS proposes retail exposures to small- and medium-sized enterprises (SMEs) be included. However, banks do not have the required information at the customer level for most SMEs. Accordingly, to the extent any re-proposed Pillar 3 climate disclosure framework requires disclosure of any of the above metrics, we recommend these requirements be modified to exclude retail exposures.

VI. Any re-proposed Pillar 3 climate disclosure framework should incorporate a sufficient level of flexibility and avoid overly prescriptive requirements.

We agree with the BCBS's view that "the development of a meaningful and robust Pillar 3 framework for climate-related financial risks is likely to be an iterative process."[37] Pursuing an iterative approach to the development of a Pillar 3 framework in this area is essential given the continuous development and evolvement of data, methodologies and modeling capabilities and considering that banks and their regulators remain at an early stage of translating climate-related risks into robustly quantifiable financial risk. Consistent with this iterative approach, any re-proposed Pillar 3 climate disclosure framework should incorporate a sufficient level of flexibility and avoid overly prescriptive requirements.

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specific geographic areas).

[37] Consultative Document, at 1.

A. The BCBS should allow banks to have flexibility in determining the appropriate sector classification system to use.

The BCBS proposes that sectorial split be based on Global Industry Classification Standard (GICS) at six- or eight-digit industry-level code for classifying counterparties.[38] However, this proposed sector split approach is not necessarily consistent with the sector classification system already used by a bank in managing its portfolios or in its voluntarily reporting of certain climate metrics in select sectors. For example, banks in the United States may use the North American Industry Classification System (NAICS), whereas banks in the EU may use the Statistical Classification of Economic Activities in the European Community (NACE).

We acknowledge that allowing banks to choose different sector classification systems may limit comparability of the sector-based disclosures across banks. However, in light of the significant challenges already associated with producing climate information discussed in Section V, and to avoid duplication of efforts and costs associated with adopting a new sector classification solely for the purposes of complying with Pillar 3 climate disclosure requirements, we urge the BCBS to allow banks to have flexibility in determining the appropriate sector classification system to use for any re-proposed Pillar 3 climate disclosure requirements that require sector split. If the use of GICS for sectoral splits is required, the BCBS should provide a thorough mapping system tying GICS to other commonly used classification systems, as it is crucial to have a homogenous way to classify counterparties.

B. The BCBS should allow banks to have flexibility in determining how to categorize counterparties that operate in more than one sector and/or geographical area for purposes of sector split and/or geographical split, or provide clearer guidance on how banks should categorize such counterparties.

The BCBS proposes that sectoral split and geographical split be based on the principal activity of a counterparty and, when the counterparty is a holding company, banks consider the sector and the geographical area of the specific obligor under the holding company (if different than the holding company itself) receiving the funding.[39] However, banks may have counterparties that operate in more than one sector or geographical area that may not necessarily have one principal activity, or the principal activity may not be conducted only in one geographical area. In any re-proposed Pillar 3 climate disclosure framework, the BCBS should clarify that banks should have flexibility in determining how to categorize counterparties that operate in more than one sector and/or geographical area for purposes of sector split and/or geographical split. Alternatively, the BCBS should provide clearer guidance on how banks should categorize such counterparties.

VII. The BCBS should only finalize a Pillar 3 climate disclosure framework if the benefits of the framework clearly outweigh the costs.

Although we support the objectives of Pillar 3 disclosures, the BCBS should only finalize a Pillar 3 climate disclosure framework if the benefits of the framework clearly outweigh the costs. In this case, the benefits of the proposed Pillar 3 climate disclosure framework are clearly swamped by the costs.

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38 *Id.* at 14.

39 *Id.*

Accordingly, we request that the BCBS assess the costs and benefits associated with the disclosure requirements in any re-proposal it considers.

The BCBS should carefully consider what, if any, benefits any proposed requirements would provide to market participants in the context of Pillar 3 objectives, considering that these requirements would result in a large amount of nonmaterial, noncomparable and unreliable climate information that would be misleading to the market if positioned as reflecting a bank's financial risk exposure or capital adequacy. If banks are required to include in their Pillar 3 disclosures granular climate information that has little or no impact on banks' safety and soundness or regulatory capital adequacy, banks' resulting Pillar 3 disclosures could be confusing and overwhelming to market participants and potentially misleading, including by giving the false impression that the climate information presented is capable of being accurately and consistently measured at such granular level or by making it more difficult for market participants to understand other key risks faced by banks that may actually affect banks' safety and soundness and regulatory capital adequacy.

By contrast, the costs associated with the proposed disclosure requirements are expected to be significant. Banks are expected to incur significant compliance burdens and costs, including those associated with collecting granular and nonmaterial data and enhancing their modeling capabilities, to produce the information required (assuming compliance is feasible at all).

In addition to the direct compliance costs, as discussed in Section X.B below, banks may also be exposed to heightened legal and reputation risks as a result of their disclosure of a large amount of granular climate information subject to significant assumptions, estimates and judgment, which are inherently uncertain and may prove to be inaccurate.

VIII. All re-proposed Pillar 3 climate disclosure requirements should be subject to jurisdictional discretion, considering differences in jurisdictional regulators' respective mandates.

Jurisdictional discretion is particularly appropriate in the context of a Pillar 3 climate disclosure framework because, among other reasons, climate risks, industrial and climate policies, and prudential regulators' roles in climate change vary by jurisdictions. For example, in the United States, the federal banking regulators' statutory mandates are limited to safety and soundness, and they do not have a mandate to execute or participate in climate policy.[40] In contrast, prudential regulators in other jurisdictions, such as the European Central Bank and the Bank of England, may have broader mandates that include combating climate change.[41]

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40 *See*, *e.g.*, Jerome H. Powell, *Statement by Chair Jerome H. Powell on Principles for Climate-Related Financial Risk Management for Large Financial Institutions* (Oct. 24, 2023), https://www.federalreserve.gov/newsevents/pressreleases/powell-statement-20231024b.htm (noting the Principles are "squarely focused on prudent and appropriate risk management" and that the "Federal Reserve is not and will not be a 'climate policymaker'"); Michael J. Hsu, Acting Comptroller of the Currency, Michael J. Hsu Statement in Support of the Finalization of Interagency Principles on Climate-Related Financial Risk Management for Large Banks (Oct. 24, 2023), https://occ.gov/news-issuances/news-releases/2023/nr-occ-2023-119b.pdf (noting "these Principles recognize and respect that industrial policy and climate policy are outside the scope of bank safety and soundness").

41 *See*, *supra* note 13 (discussing the European Central Bank's mandate); *See also*, Letter from the Chancellor of

Accordingly, all re-proposed Pillar 3 climate disclosure requirements should be subject to jurisdictional discretion, considering these differences. For example, home jurisdiction prudential regulators should determine whether and when they would request specific climate information as part of their supervisory processes or require specific climate information to be posted for public consumption, consistent with their respective mandates and, where appropriate, in light of the industrial and climate policies in their respective jurisdictions.

IX. Any re-proposed Pillar 3 climate disclosure framework should permit a banking group with bank subsidiaries in multiple jurisdictions to elect to satisfy the disclosure requirements for each bank subsidiary at either the consolidated group level or the bank subsidiary level.

To avoid the application of potentially duplicative and conflicting Pillar 3 climate disclosure requirements to banking groups that may operate in multiple jurisdictions, any re-proposed Pillar 3 climate disclosure framework should permit a banking group with bank subsidiaries in multiple jurisdictions to elect to satisfy the disclosure requirements for each bank subsidiary by reporting Pillar 3 climate disclosures at either (i) the consolidated group level only under the Pillar 3 climate disclosure requirements promulgated by the banking group's group-level home regulator or (ii) the level of the bank subsidiary pursuant to the Pillar 3 climate disclosure requirements promulgated by such bank subsidiary's home regulator.

X. Other Comments

A. The BCBS should not extend the climate-related disclosure requirements to the trading book.

In response to Consultative Question 6, we believe the BCBS should not extend the climate-related disclosure requirements to the trading book. Trading book exposures have short time horizons. In contrast, climate risks are generally expected to materialize over the medium to long term. Because of this time horizon mismatch, the relationship between climate risk drivers on the trading book is likely to be attenuated and not meaningful, and any impact of climate risk drivers on the trading book is likely to be immaterial. In addition, due to the short-term nature of assets held for trading, requiring disclosure of climate information with respect to the trading book based on counterparty data is expected to be significantly more challenging and even less meaningful (considering the point-in-time nature of the information), and would result in significant compliance costs and burdens for banks (if compliance is feasible at all) without any corresponding benefits for market participants. Because of these issues, extending the climate-related disclosure requirements to the trading book should be avoided.

B. Banks may be exposed to heightened legal risks as a result of the proposed disclosures.

In response to Consultative Question 9, we are very concerned that banks may be exposed to heightened legal risks as a result of the proposed disclosures. In the United States, such heightened legal risks may arise from potential liability under U.S. federal securities laws as well as state securities and

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the Exchequer to the Governor of the Bank of England, *Remit for the Monetary Policy Committee* (Mar. 2021), https://www.bankofengland.co.uk/-/media/boe/files/letter/2021/march/2021-mpc-remit-letter.pdf (updating the Monetary Policy Committee's remit to reflect the U.K. government's economic strategy for achieving strong, sustainable and balanced growth that is also environmentally sustainable and consistent with the transition to a net zero economy).

consumer protection laws. For example, banks that have securities listed on the New York Stock Exchange or NASDAQ may face heightened legal risks under Section 10(b) of the Securities Exchange Act of 1934, as amended, and Rule 10b-5 promulgated thereunder, for material misstatements or omissions if they were required to provide the proposed climate disclosures.

The risks of heightened legal liability are particularly acute for the types of climate disclosures contemplated by the Consultative Document. First, as discussed in Section V above, there are significant limitations on data availability and quality, methodologies and modeling capabilities; accordingly, climate disclosures are subject to significant uncertainty and may frequently prove, especially with the benefit of hindsight, incorrect. Second, what is disclosed may change over time as the disclosure regime and understanding of climate risk evolve, and as data availability and quality, methodologies and modeling capabilities improve. Third, banks are necessarily reliant on third-party data from their customers to be able to generate certain climate disclosures, and have no practical ability to audit data being provided by potentially thousands or tens of thousands of counterparties. Thus, a misstatement by a counterparty could trigger liability for any bank to which the counterparty reported the underlying data.

Even if banks have strong defenses to liability, given the litigation environment in the United States, banks would likely face a heightened risk of opportunistic lawsuits if they were required to make the proposed climate disclosures.

Accordingly, in any re-proposal of a Pillar 3 climate disclosure framework the BCBS considers, we urge the BCBS to, at a minimum, strongly encourage the relevant authorities in the BCBS's member jurisdictions to provide safe harbors from liability for Pillar 3 climate disclosures under the relevant liability regimes in their respective jurisdictions.

C. The BCBS should not require assurance for any Pillar 3 climate disclosures.

In response to Consultative Question 10, we urge the BCBS not to require assurance for any Pillar 3 climate disclosures. In light of the significant data, methodology and modeling limitations discussed above, the nascent stage of climate assurance, and the practical questions about whether there is a deep enough talent pool to provide such assurance, requiring assurance at this stage would be unduly burdensome for banks without providing commensurate benefits to market participants.

D. The BCBS should not rush to finalize and implement the framework by the proposed January 1, 2026 implementation date.

In Consultative Question 54, the BCBS seeks views on the feasibility of a potential implementation date of January 1, 2026, which is one year after the effective date proposed by the ISSB and after the expiration of the ISSB's proposed transitional arrangements.[42] However, the ISSB implementation timeline and transitional arrangements should not determine or guide the implementation timeline of any re-proposed Pillar 3 climate disclosure framework or its transitional arrangements, as not all jurisdictions have or will adopt, and not all banks will comply with, the ISSB standards.

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[42] Consultative Document, at 9.

As acknowledged by the BCBS, the development of a meaningful and robust Pillar 3 climate disclosure framework "is likely to be an iterative process."[43] Considering that the Consultative Document is the first time the BCBS is seeking views on the introduction of a Pillar 3 climate disclosure framework, the BCBS should not rush to finalize and implement the framework by the proposed January 1, 2026 implementation date; instead, the BCBS should afford the banking industry ample opportunities to engage with the BCBS in order to develop meaningful disclosure requirements that reflect banks' financial risk exposures and then re-propose a Pillar 3 climate disclosure framework that is more closely tailored to meeting the stated objectives of Pillar 3 disclosures.

E. The BCBS should not require disclosure of the impacts of climate-related financial risks on deposits/funding and liabilities.

In response to Consultative Question 54, we believe the BCBS should not require disclosure of the impacts of climate-related financial risks on deposits/funding and liabilities. The BCBS notes that it is exploring "whether the disclosure of sectoral distribution of deposits/funding and liabilities would help market participants to understand potential liquidity risks posed to banks during times when providers of such deposits/funding . . . are impacted by climate-related financial risks and may require drawdown of their deposits/funding to assist their recovery."[44] In the Consultative Document, the BCBS does not cite any research supporting that a bank's liquidity could be affected due to clients' demands for liquidity during times when the clients are themselves impacted by climate-related financial risks. In a previous report, the BCBS reviews limited existing studies on the impact of physical risks to banks' counterparties on banks' liquidity, which have opposite findings—one study finds that banks faced deposit withdrawals following a hurricane in the Caribbean, while another study finds an increase of deposits following natural disasters in the United States; the BCBS further notes that while there are studies analyzing the effects of transition risks on the liquidity and funding of corporates, the subsequent effect on bank liquidity has not been studied.[45] In another report, the BCBS acknowledged that efforts by both banks and supervisors on methodologies for measuring climate-related financial risks have "mainly focused on credit risk," and "to some extent on market risk," "with a much lesser focus on liquidity and operational risk."[46]

It would be premature for BCBS to require the disclosure of sectoral distribution of deposits/funding and liabilities before there is a better understanding of how climate risk drivers translate into liquidity risk through clients' demand for liquidity. Requiring this disclosure would not provide market participants with meaningful information for purposes of Pillar 3 disclosures and could lead to confusion.

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43 *Id.* at 1.

44 *Id.* at 13.

45 BCBS Climate Risk Drivers Report, at 18-19.

46 BCBS, *Climate-related financial risks – measurement methodologies* (Apr. 2021), at 43, https://www.bis.org/bcbs/publ/d518.pdf.

The Bank Policy Institute and the Financial Services Forum appreciate the opportunity to comment on the Consultative Document. We will be pleased to provide our assistance as the BCBS considers comments on the Consultative Document and works to develop meaningful disclosure requirements for a Pillar 3 climate disclosure framework that more effectively meets the Pillar 3 objectives. If you have any questions, please contact Sam Riley, Senior Associate General Counsel and Senior Associate Vice President, Bank Policy Institute, by phone at (202) 589-2406 or by email at sam.riley@bpi.com.

Respectfully submitted,

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