Triodos Bank's response to the consultation on disclosure of climate-related financial risks by the Basel Committee on Banking Supervision

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Triodos Bank was founded on the conviction that banking can be a powerful force for good. Our mission is to make money work for positive cultural, environmental and social change. We finance progressive entrepreneurs and influence the banking sector to become more transparent, diverse and sustainable.

Triodos Bank

General

Q1. What would be the benefits of a Pillar 3 disclosure framework for climate-related financial risks in terms of promoting comparability of banks' risk profiles within and across jurisdictions and promoting market discipline? What other benefits have been identified?

The economy, and as such the financial system, has come in a stage where calculating and managing risks has become more and more difficult and banks as well as their clients are faced with increasing uncertainties; the wars, the climate, the political changes. In such a context, steering businesses based on flexibility and resilience is fundamental rather than steering based on financial outcomes only. Insights into exposures to climate related uncertainties, as suggested by the Basel Committee, will enhance banks' and supervisors' ability to assess banks' soundness, their flexibility and resilience, and assess their ability to withstand shocks. The climate being an obvious uncertainty for both individual banks and economies implies that comparability of vulnerabilities is crucial for a grip on stability.

Longer-term climate-related risk is in many respects of a different nature than the relatively predictable credit risk. It is a compounding risk, aggravating losses once a climate disaster materializes. This justifies longer-term prudential considerations that limit exposures to assets that cause this compounding effect. Humans' capability to assess possible damage in a forward-looking way is limited, as well as to estimate the size of the potential damage that an individual incident could lead to in the longer run. Climate related risk can be of such a devastating nature that the only way to mitigate it in a credible way is to put maximum effort into prevention by ensuring that the financial industry uses its investing capability sustainably. Facilitating banks to steer their large exposures in this compounding risk builds on the notion that some banks are more exposed than others, as such more vulnerable to shocks and no longer able to finance their local communities. Facilitating banks to steer their large exposures in climate related risk acknowledges the need to avoid potential stranded assets or a materializing risk-concentration in harmful exposures.

What the Basel Committee may want to avoid is complex calculations, transitional measures and confusing implementation dates. For an orderly and supported implementation across the globe, a simple set of requirements is called for, with simple, comparable metrics, a clear application scope and one implementation date. Although financed emissions is not an encompassing metric for harmful environmental impact, it is an important indicator of a bank's progress in dealing with climate related risk.

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

For an orderly and supported implementation of climate related risk measures across the globe and creating comparability across banks in different regions and circumstances, introducing the simplest metric thinkable is crucial. Financed emissions as a metric has been well tested since banks in PCAF started developing and using it and EBA included it in their ESG reporting template for all banks in Europe.

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

If pillar 3 is used solely to assess banks' vulnerabilities and to support supervisors' grip on financial stability, it works as the Basel agreement was intended, as a frame to guard banks' soundness and as such the financial system's soundness. It works in the spirit of the Basel agreement if financed harm in bank loan portfolios becomes visible and as such it helps steer money allocation away from exposures that might affect the banks' and the system's stability.

Unintended consequences emerge if capital benefits are considered for the sake of loans being green. Capital benefits are justified if for example DFIs cover the tails of green loan portfolios and capital benefits are given for that guarantee, but not because the loans are green.
Unintended consequences emerge if regulatory differences emerge at the expense of clients who for example cannot afford greening up their houses or activities, i.e. rising inequality from green stamps.
So, climate related risk reporting is justified for the sake of banks' risk management and guarding financial stability, which can translate into pillar 2 (SREP) assessments and capital charges for the risk management process, as well as large exposures rules and charges for concentration risk, but it's not justified for the sake of changing capital charges on individual exposures, as inequality issues would emerge that would jeopardize financial stability in their turn.

Quantitative general

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

Comparability and tracking improvements can only be done with clear quantitative metrics, also for difficult to predict kinds of uncertainties like climate related losses, but managing exposures to these uncertainties is supported by simple indicators to get an idea of progress.

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To this end, complex calculations, transitional measures and confusing implementation dates must be avoided. For an orderly and supported implementation across the globe, a simple set of requirements is called for, with simple, comparable metrics, a clear application scope and one implementation date. Although financed emissions is not an encompassing metric for harmful environmental impact, it is an important indicator of a bank's progress in dealing with climate related risk.

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

Given the threat of climate related risk to the stability of the financial system as a whole and as such to each and every single bank in particular, the pillar 3 requirements should not only become obligatory to enhance comparability, but to enhance banks' ability to withstand shocks.

Quantitative Transition risk: exposures and financed emissions by sector

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

Yes, this may be the most important steering metric of the set. Banks and their supervisors want to know the hot spots of their risk profile. Although financed emissions are not an encompassing metric on environmental impact, they tell a lot about harmful exposures that may jeopardize economic and financial stability and as such banks' soundness. Financed emissions are tracked by so many banks across the globe now, including hot spot analyses of their portfolios, that the Basel principles should acknowledge that best practice. Also, an analysis of financed emissions per sector will lead to the hot spots that require more intense supervision and risk management, the most vulnerable sectors such as agriculture, transport, fossil fuel extraction and steel. Transition plans must give priority to these most vulnerable sectors, as transition risk is highest in those sectors. Exposures and financed emissions by sector would enable banks' risk managers and supervisors to allocate their attention effectively.

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

The experience of banks involved in PCAF learns that starting the measurement and monitoring of financed emissions matters a lot for improved risk management and managing vulnerabilities, also if data quality is still poor. Cooperation within regions both between financial actors themselves and between the financial actors and public bodies enables the improvement of data. Pillar 3 reporting should not await better data, better and better data will come with the imposed pillar 3 reporting.

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

We highly recommend those banks that didn't join PCAF yet, to do so, and ask their fellow banks in their respective regions how they overcame their data challenges. Sharing experience within regions across the globe appears to work. The Basel Committee can recommend national and regional public bodies to make climate related data available for financial institutions.

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

For now, in our view the Committee must focus on climate related risk and require the reporting of financed emissions per sector only.

In a next stage, the Committee could investigate other uncertainties that jeopardize financial stability, such as biodiversity loss, wars and inequality. To that end, banks across the globe are tracking data on exposures to activities that are defined as harmful by the OECD: hazardous substances on land-use, deforestation, controversial weapons, tobacco and human rights.

Physical risk: exposures subject to climate change physical risks

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

Climate related risk will materialize in among other physical risk and as such into credit risk. However, the management of this risk would be most effective if the cause of the risk, the climate impact, is confined, not if exposures are taken out of certain areas. Although it's worthwhile to know the vulnerabilities of the financial system in terms of physical risk, the management of what causes climate related risk would be more effective to prevent the materialization of physical risks.

Although obligatory reporting of physical risk is useful in terms of knowing where vulnerabilities may materialize into losses, we fear it might lead to less access to finance for the more vulnerable areas. This could lead to more inequality between areas, with their own jeopardizing effect on financial stability. Reporting physical risk should serve the steering of financed emissions reductions in general, and assess financial stability. Therefore, we propose not to disclose exposures by geographical region, and, for example disclose exposures to low, medium or high physical climate-risk.

Concentration risk

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

Longer-term climate-related risk is in many respects of a different nature than the relatively predictable credit risk. It is a compounding risk, aggravating losses once a climate disaster materializes. This justifies longer-term prudential considerations that limit exposures to assets that cause this compounding effect. Humans' capability to assess possible damage in a forward-looking way is limited, as well as to estimate the size of the potential damage that an individual incident could lead to in the longer run. Climate related risk can be of such a devastating nature that the only way to mitigate it in a credible way is to put maximum effort into prevention by ensuring that the financial industry uses its investing capability sustainably.

A large exposure limit builds on the notion that concentrations in climate related risks are increasing and that some banks are more exposed than others, as such more vulnerable to shocks and no longer able to finance their local communities. A large exposure limit acknowledges the need to avoid potential stranded assets or a risk-concentration in harmful exposures.

The large exposures limit could be defined as simple as possible, for example: financed emissions this year must be lower than financed emissions last year, or lower than the "budget" of financed emissions given the globally applicable trajectory to zero in 2050, which must be part of banks' transition plans (per (high emitting) sector). The surplus would be subject to the large-exposure-capital-charge.

National discretion

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

The relevant data on emissions and other relevant climate related data will be different in every jurisdiction. Therefore, adapting climate related exposures reporting to national circumstances makes sense. Given the serious implications of climate related risk to financial stability, a discretion to apply or not should be avoided at all times.

Effective date

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

Given the number of banks that already measure and monitor their financed emissions using PCAF, there appears to be no need to postpone this best practice for other banks.

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

No.