

June 29, 2022

Secretariat to the Financial Stability Board (FSB)
Bank for International Settlements
Centralbahnhofplatz 2
CH-4002 Basel
Switzerland

Re: CBA comments on the FSB Interim Report – Supervisory and Regulatory Approaches to Climate-related Risks

Dear FSB Secretariat,

The Canadian Bankers Association (CBA) welcomes the opportunity to provide comments on the FSB's interim report for consultation on Supervisory and Regulatory Approaches to Climate-related Risks. We understand the objective of the report is to assist supervisory and regulatory authorities in developing their approaches to monitor, manage, and mitigate risks arising from climate change and, in particular, to promote consistent approaches across sectors and jurisdictions. We support global coordination amongst supervisory and regulatory authorities and efforts to establish common approaches in relation to climate-related risks. In this letter, we share our views on key topics and provide additional comments on the FSB's consultation questions in the attached appendix.

Transverse nature of climate-related financial risks

Given the transverse nature of climate-related financial risks and their correlation to a variety of risk categories, we support integrating governance of climate-related financial risks into existing risk management frameworks and structures, where applicable. Banks already have well-developed and effective policies, procedures, and controls for addressing traditional risk categories. We believe that regulators should consider how to leverage existing risk frameworks to address climate-related financial risks. This would avoid duplicative frameworks that would lead to inefficiencies in governance policies and procedures.

Data challenges

We agree that supervisory oversight of financial institutions' governance, processes, and controls on data is important. However, we highlight several challenges that impact the reliability of data including:

- **Lack of data granularity** – There is a critical need for geographically granular climate/weather-related data for our clients' businesses and our own in order to identify, manage, and mitigate the physical aspects of climate risk. For example, this would include data with respect to client locations, supply chain risk, and other inputs. Challenges are particularly acute for smaller companies, including non-public companies, in reporting such detailed information.
- **Interconnectedness of data** – It is difficult to measure how climate data impacts other data points (e.g., macroeconomic metrics such as GDP, employment, investment) and to determine the financial implications of the data.

- **Proliferation and comparability of data providers** – It can be challenging to review all the different data providers to determine which data is credible, relevant, and useful. Likewise, a lack of consistency across providers makes comparability of data difficult.
- **Data materiality** – It is difficult to determine which climate data is material to financial institutions financial performance. All other data used by financial institutions to predict financial performance is historical and not appropriate for predicting the effects of climate change on bank portfolios.
- **Access to reliable and validated tools** – Financial institutions will require time to onboard new data sources and tools or enhance the existing data management ecosystem to adapt climate information into decision-useful financial analysis. The application of tools may also differ depending on the activity that is subject to climate risk assessment, measurement, and reporting (e.g., insurance, project lending, debt, equity underwriting, or asset management).
- **Difficulties for Canadian financial institutions** – Canadian data is not available. Canada has generally been combined with the other OECD countries and this results in inaccurate and incomplete data on Canada and Canadian clients.

Third-party verification

While acknowledging the benefits of third-party verification, we note that requiring third-party verification where it is not otherwise required by legislation or regulation will pose a number of implementation challenges. Third-party verification requirements currently vary across climate disclosure regimes. We advocate for alignment with other standard setters – for example, the TCFD does not require independent external assurance at this time.

Pillar 2 approach

We support a Pillar 2 supervisory approach to address climate-related financial risks through the use of various tools including the internal capital and liquidity adequacy assessment processes. We would caution regulators, though, against changing the capital and liquidity adequacy frameworks to account for climate-related financial risks, until more work is done to assess the impacts. We would highlight that measurement tools with respect to climate-related financial risks are still in the early stages of development and may produce results that are incomplete or not properly validated/back-tested against empirical evidence. In addition, we note that the time horizons for capital and liquidity planning are typically 1 to 3 years while the time horizons for particular climate-related financial risks can extend over a much longer time period (e.g., 30 years), which is beyond the scope of our current internal assessments. We also believe that any changes in capital requirements should be reflected in Pillar 2 instead of Pillar 1.

We believe that climate-related financial risks should be incorporated into ICAAPs and ILAAPs iteratively and progressively, as the methodologies and data used to analyze these risks continue to mature over time and analytical gaps continue to be addressed. This reflects the time needed to develop related tools including scenario analysis and data measurement, which are crucial to climate risk management.

Scenario analysis

Many banks already conduct climate scenario analysis. However, even among those banks that conduct such analysis, many are still in the initial stages of tailoring and refining scenarios and analysis for implementation. Supervisors should be cognizant of the early stage of development in assessing results.

We believe that consistency and alignment with international standards in areas such as scenario analysis are important. However, we believe that the local jurisdictional context should also be considered and that such initiatives should continue to be led by jurisdictional regulators to ensure consistency and alignment for sectors. We also suggest differentiating between scenario analysis and stress testing due to factors such as different time horizons and levels of maturity in terms of quantitative techniques including modelling capabilities.

Proportionality

We agree with the FSB that a key policy consideration for authorities as they evaluate their information needs and consider regular standardized reporting requirements should be proportionality, taking into account the nature, size, and risk profile of a financial institution. Another key consideration will be the capacity of each bank to invest in the necessary capabilities to effectively identify, assess, monitor, manage, and report climate-related financial risks. For small- and medium-sized banks in particular, investments in these capabilities represents a significant cost. It is important to ensure that undue burden does not undermine the competitiveness of small- and medium-sized banks. We also suggest that subsidiaries of foreign banks be permitted to adopt guidance from their parent bank as long as the risk management frameworks of their parent bank meet regulatory and supervisory expectations.

Implementation

We recommend a transition period for supervisory and regulatory approaches to climate-related risks that is sufficiently robust given the various challenges faced by banks and regulators including the constantly evolving nature of climate-related financial risks. In addition, we note that various regulatory and standard setting bodies are becoming involved in the climate risk space and there is a lack of standardized methodologies and consistency across jurisdictions. We believe that additional time would be helpful for regulators to review feedback and preliminary data from initial consultations within their jurisdictions. Additionally, alignment between regulators and standard-setting bodies is critical to inform consistency in approach going forward. Regulators will then be better positioned to determine the best path forward collectively, with our preference being a harmonized approach which provides clarity and consistency and reduces the operational burden on banks.

We note that regulators have increased their requests for information and data on banks' management of climate-related financial risks. It is important to highlight that banks are at different stages of maturity in their journey with respect to collecting data and building tools and infrastructure capabilities. Regulators should have realistic expectations on what banks can deliver in light of various factors, including a lack of available and complete data sources, data timeliness and time lags, and the absence of developed and tested models to measure the impact of climate-related financial risks.

We believe that a phased-in adoption approach with appropriate interim milestones should be considered for banks, as existing data infrastructure is not yet built to identify and report climate-related data elements. Banks will need time to update their data infrastructure, and the industry needs time to develop governance processes and standards in this area. Similarly, we believe that a phased-in approach should be taken by Supervisors with respect to the supervisory review process. As such, we support principles-based approaches such as the one proposed by the BCBS that should provide greater time for the advancement of methodologies and tools.

Thank you for considering our comments. We would be pleased to discuss any questions you may have on our response at your convenience.

Sincerely,

A handwritten signature in black ink, appearing to read "Deborah L. Crossman".

Attachment

CBA Comments on FSB Interim Report
Supervisory and Regulatory Approaches to Climate-related Risks

CBA Members' Comments and Requests for Clarification

Overall comments

We support FSB's objective to promote consistent approaches to monitor, manage and mitigate risks arising from climate change, across sectors and jurisdictions and we would further support this consistency across supervisory authorities.

We do not believe a standalone climate risk framework is needed. We believe climate-related financial risks are transverse risks and we can rely on existing risk management frameworks. However, it will take time to identify and assess the impact of climate-related financial risks across physical and transitional climate risk drivers for the various risk types (e.g., credit, market, etc.). Current risk management policies and frameworks do not fully address climate-related financial risks and banks are at different maturity levels globally. Banks should be given enough time to build the capabilities to understand the impact of climate-related risk drivers on their credit risk profiles. We support a phased-in approach given the evolving nature of climate risk management.

We believe that market discipline alone may not be sufficient to address climate risk and acknowledge the role of supervisory review. However, we suggest that any future supervision related to climate risk be proportionate to the size of the FRFI and that a phased approach be undertaken. We also suggest focusing first on those sectors which are most material and exposed to climate-related financial risk. In terms of stress testing, the uncertainty, long-time horizon, and lack of appropriate data and related modelling capabilities limit the usefulness of climate-based projections. Scenario analysis which relies on professional judgment and is focussed on identifying potential areas of risk would be more appropriate at this time rather than use of validated models typically used in stress testing.

Supervisory and regulatory reporting and collection of climate-related data from financial institutions

1. Does the report highlight the most important climate-related data (qualitative and quantitative) for supervisors' and regulators' identification of exposures and understanding of the impacts of climate-related risks of financial institutions and across financial sectors? Please provide examples of climate-related data deemed most relevant and that should be prioritised.

- Yes, the categories of climate-related data identified in the report align to the key data types required by financial institutions to conduct climate risk assessments; however, the availability and granularity of such data is highly dependent on the sector, region, and size of the company for which such data is being collected.
- Supervisors should provide guidance on what relevant climate data elements are expected and how they interact with data for existing risk categories (e.g. credit and market risks) and also consider external data available when providing final guidance, so banks can source the data appropriately and ensure consistency.
- Furthermore, supervisors should recognize the existing data gaps and that this is an evolving space (i.e. lack of standards, methodologies, etc.).
- Where external data sources are used, supervisors should provide standards for consistency to ensure comparability across macroprudential and macroeconomic factors.

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- P.14 – We recommend removal of trading activities as part of the Financial Quantitative Metrics. The trading book is not currently defined as a focus of emission financing. We believe it is more appropriate to focus on facilitated emission activities such as investment banking underwriting activities. (PCAF is currently under development, and ISSB exposure draft requires such disclosure).
- P.14 – Financial impact (direct and indirect) of climate risk on firm's balance sheet and income statements. As indicated by the FSB, we request more examples and guidelines on how these impacts should be estimated as they are generally not directly observable.

2. Does the report draw attention to the appropriate areas to increase the reliability of climate-related data reported by financial institutions?

- See comments on data challenges and third-party verification in cover letter.
- It is not clear that such third parties will have in place processes and procedures to generate data that would meet a reasonable verification standard and it is not clear that financial institutions could require third parties to, in a timely manner, change such processes and procedures. Data that financial institutions can generate themselves will raise similar concerns and, at least in the short term, it is not clear what data standards attestation providers will accept.
- We also anticipate difficulties, at least in the short term, in selecting qualified third-party verification providers, as the current pool of qualified experts is limited, and it is expected that there will be competition for qualified verification providers.

3. Does the report appropriately identify the elements of a common high-level definition of climate-related risks (physical, transition and liability risks)?

- We agree with the common elements identified by the FSB for defining physical and transition risks and for differentiating between these two types of risk. However, we do not believe that liability risk should be separately defined. We observe that frameworks such as the TCFD divide climate-related risks into two major categories (transition and physical risks) with legal risk included in the former category¹. The Bank of England similarly identifies financial risks from climate change as arising from two primary channels (physical and transition risks) in relation to the UK banking sector².
- With various regulatory and standard setting framework proposals coalescing around the TCFD framework (e.g., SEC, ISSB) and in the interests of promoting consistency across jurisdictions and sectors, we recommend only two risk types (i.e., physical and transition risk).
- We also recommend that supervisors provide additional clarity on the definitions, and the criteria for the classification of various components of climate-related risks, such as unifying the definitions of carbon-intensive industries (i.e., TCFD vs NZBA definitions of carbon-intensive), and an acceptable list of financial products supporting decarbonization (i.e., green bonds vs. sustainability-linked bonds criteria).

¹ Final Report - Recommendation of the Task Force on Climate-related Financial Disclosures (June 2017): <https://assets.bbhub.io/company/sites/60/2020/10/FINAL-2017-TCFD-Report-11052018.pdf>

² Bank of England Prudential Regulation Authority - Transition in thinking: The impact of climate change on the UK banking sector (September 2018): <https://www.bankofengland.co.uk-/media/boe/files/prudential-regulation/report/transition-in-thinking-the-impact-of-climate-change-on-the-uk-banking-sector.pdf?la=en&hash=A0C99529978C94AC8E1C6B4CE1EECD8C05CBF40D>

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4. Do the proposed recommendations help accelerate the identification of authorities' climate-related information needs from financial institutions and work towards common regulatory reporting frameworks? Please elaborate on areas where the recommendations could be enhanced, if any.

- We agree with the recommendation to incrementally enhance the reporting of climate-related data beginning with qualitative information supplemented with available quantitative information and increasing the quantitative component as measurement methodologies improve.
- We recommend a phased-in or transition period for adopting more quantitative approaches.
- For any updates to regulatory data and reporting, we request that banks be provided sufficient time to prepare and build out their infrastructure. It should also be done on a gradual and incremental basis (i.e., agile approach) allowing flexibility for change/correction, noting that: (1) lead time to produce the returns will likely be longer than other returns and therefore expanding existing returns will be operationally challenging, (2) climate risk models and data are not yet mature and therefore are likely subject to multiple changes. We expect such changes will evolve or even replace previous iterations of reporting requirements .
- We advocate for as much alignment as possible with other standard setters.
 - For financed emissions disclosures – we strongly advocate for alignment with NZBA and PCAF.
 - For transition plan disclosures - more guidance is needed on what should be included in the disclosure of transition plans. Such guidance is being developed by GFANZ and others. We advocate for alignment to these initiatives.
- We support the proposal to establish public data repositories at the national, regional or global levels for various forms of climate-related data. This should be done in a coordinated manner as the data would be beneficial to the financial institution regardless of the host jurisdiction (i.e., a Canadian bank with business in the US can benefit from US public data repositories). Such data standardization can lead to better comparability of the calculations as well as improve cost efficiency for smaller participants. Therefore, we recommend enhancing Recommendation #5 on global coordination and cooperation to include data infrastructure building and sharing.

Incorporating systemic risks into supervisory and regulatory approaches

5. Does the report identify relevant system-wide aspects that should be considered as part of supervisory and regulatory approaches to incorporate systemic risks arising from climate change? Please elaborate on other aspects that should be considered, if any.

- Yes, we believe the report identifies relevant system-wide aspects. However, please refer to the data challenges section of our cover letter for concerns in relation to the interconnectedness of climate data and risks which complicates the assessment of systemic risks within and across financial institutions.

6. Does the report accurately reflect the extent to which current supervisory and regulatory tools and policies address climate-related risks?

- On loss modelling and capital requirements:

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- If the current prudential capital time horizon were to be extended to accommodate consideration of longer-dated climate-related risk drivers, the effect could be to widen the window over which the distribution of potential bank losses is measured/considered, and the effect would be (probably) higher capital requirements "today" i.e., potentially long before those risks may materialize.
- Extending the capital time horizon for credit risk (e.g., from 1-year unexpected losses to ~10-year unexpected losses) would imply that all drivers of credit risk (all factors affecting borrower PD and/or LGD) would need to be assessed over an entire time horizon; if only climate-related risk drivers were accounted for over a longer horizon that would be asymmetric and unduly weight climate-related factors.
- We agree with the tools used to assess climate-related risks, such as scenario analysis and stress testing.
- We suggest differentiating between scenario analysis and stress testing. These two concepts are different with scenario analysis being a relatively new tool in relation to climate-related financial risks. Supervisors are considering the impacts of transition and/or physical risks on generally static bank balance sheets under different climate scenarios that span longer time horizons (e.g., 30 years)³. However, stress testing is a more well-established process that considers the impact of broader macroeconomic shocks to the financial system over much shorter time periods (e.g., 3 – 5 years).
- We request clarity on whether the FSB is suggesting that scenario analysis results would need to be publicly disclosed if performed.

7. Do the proposed recommendations on incorporating systemic risks into supervisory and regulatory approaches, including the expanded use of climate scenario analysis and stress testing for macroprudential purposes, address the appropriate areas? Please elaborate if there are any other features or tools that should be considered.

- **Section 4.2.3** – We support the concept that a common set of scenarios will improve comparability and reduce the proliferation of potentially inconsistent supervisory requests, in particular for financial institutions operating across borders. This is especially true when the basic principle of climate commitments is based on a common goal of 1.5C or less with a net zero target for 2050.
- **Section 5.2** - In general, we believe the recommendations for incorporating systemic risks into supervisory and regulatory approaches address the appropriate areas, with the following comments:
 1. Supervisors should be specific on how climate-related risks will be aggregated across firms to assess the financial system. Differences in methodologies, tools and data (especially if sourced externally) across the long-time horizons of climate risk measurement and scenario analysis could result in a wide range of outcomes.
 2. Supervisors should phase in (iii) and (iv) allowing for maturity of the measurement of physical and transition risks before adding interdependencies and other spillover effects.
 3. A dynamic balance sheet for climate scenario analysis will provide a more meaningful analysis, but supervisors should provide specific guidance, assumptions, and parameters for evolving the balance sheet.
 4. As with #2, agree that risks outside of credit and market risk should be considered but that such additions should be phased in as approaches, methodologies, and capabilities mature.
 5. Agree that cooperation across supervisors and jurisdictions is beneficial for consistency across geographies, and considering that climate risk is a global risk and many financial institutions have exposures across more than their home geography.

³ For example, NGFS Technical document – Scenarios in Action – A progress report on global supervisory and central bank climate scenario exercises (October 2021) - <https://www.ngfs.net/sites/default/files/medias/documents/scenarios-in-action-a-progress-report-on-global-supervisory-and-central-bank-climate-scenario-exercises.pdf>

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6. Agree that the NGFS scenarios should be continuously refined to expand geographical and sub-regional coverage. Once refined and expanded, the scenarios should be standardized and publicized for use by supervisors and regulated institutions. In this respect, please see the comment on section 4.2.3 above regarding the generation and use of common scenarios

Other considerations:

- Supervisors/regulators should avoid duplicative subsidiary level, scenario exercises in host jurisdictions [unless under exceptional circumstances]
- We encourage greater alignment in supervisory approaches towards non-climate, (broader) environmental financial risks, but we caution against the incorporation of this larger scope (environmental risks) into climate risk principles (such as BCBS) at this point in time.

Early considerations on other macroprudential tools and policies

8. Are there other areas of work, literature or research being conducted on macroprudential tools and policies on climate-related risks that should be considered in the report?

- Supervisors should share best practices and insights they gain from other supervisors and from across the industry, including on climate-related transmission channels in relation to Credit and Counterparty Risk, Market Risk, Liquidity and Funding Risk, Insurance Risk, Operational Non-Financial Risk, Legal & Regulatory Compliance Risk, Reputation Risk, Strategic Risk, etc.
- **Section 3.1** – We agree that Supervisory and regulatory risk assessments and policies need to better incorporate an understanding of these channels and how climate-related risks to financial institutions may be transferred across sectors or borders. However, we believe such system-wide perspective should be further extended beyond financial macroeconomic considerations and be considered for other effects as well. Unintended consequences can spill over to non-financial sectors.
- One recent example is energy securities. We believe supervisors should be engaged with the underlying real economy sectors (e.g. energy regulators and policy makers) to identify the connectivity between the underlying demand/supply/transition considerations and ensure that system-wide risk are managed in a coordinated fashion between both financial and real-economy sectors.(e.g. scenario & stress testing feedback loop to the real economy as described on p. 33 – in this case it's feedback loops to energy sector impacting energy securities of the jurisdiction).

Additional considerations

9. Are there any other issues that should be considered in future work of the FSB on supervisory and regulatory approaches to climate-related risks?

No comments.