

Comments on

the FSB's interim report on Supervisory and Regulatory Approaches to Climate-related Risks

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The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent approximately 1,700 banks.

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General comments

Dealing appropriately with climate-related risks, integrating them into risk management strategies and supervising financial institutions are key topics in the ongoing discussion about sustainable finance.

In Europe, the European Central Bank (ECB) and the Federal Financial Supervisory Authority (BaFin) have set out what they expect of the institutions they supervise when taking account of climate-related risks. These expectations are now being implemented by banks and corresponding solutions to meet the requirements are being developed. The first ever bottom-up climate stress test, which is to be implemented this year, is also likely to break new ground. In parallel, the European Banking Authority (EBA) has already issued regulations for originating and monitoring loans and has published a report, which accurately reflects the current status of the debate.

In dealing with climate risks, supervisory bodies, regulators and banks all find themselves in uncharted territory, which is why all the parties involved are starting out along a new learning path together. Understanding this is important because ultimately it is a matter of correctly assessing risks and drawing conclusions from the analyses, which are then used by management teams as the basis for their control mechanisms. This is why it is vital that sufficient time is allowed for further developing tailor-made methods. Compliance should not just be an exercise in ticking boxes, it should provide real knowledge gains for institutions and supervisors alike.

We see the greatest leverage in mitigating physical and transition risks not in the issue of capital adequacy, but in the strategic orientation of an institution and the anchoring of these risks in the organisation's guidelines and, especially, in the credit decision process.

We are closely following the work of the Network for Greening the Financial System (NGFS) and believe its findings to date are very valuable. In this respect, it seems entirely appropriate for supervisory authorities and banks to build on the work of the NGFS in dealing with climate-related risks. However, in doing so, account should be taken of the complexity of the NGFS scenarios and it should be ensured that their implementation in small and non-complex banks is proportional.

In conclusion, climate-related risks are without doubt a risk driver that affects known risk types, such as credit, market or operational risk. The fundamental difference between them and previous risks is primarily the long period under consideration for the risk assessment – especially for transition risks.

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Specific comments

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

We support calls by the FSB to create international convergence on definitions as well as in sustainability reporting. Global banks and businesses need international standards, not a patchwork of regulation. In this regard, the greatest possible alignment of approaches and definitions is a goal worth supporting. The German Banking Industry Committee therefore welcomes the establishment of the ISSB, whose standards will create a baseline for internationally active businesses.

With regard to the data, we support the idea of relying more on quantitative information as well as on qualitative data. However, current developments, particularly in Europe, for example with Pillar III and in EFRAG's draft standards on sustainability reporting, show that the direction of travel is clearly away from trying to achieve the goal of demanding meaningful and comparable data and avoiding an information tsunami. In the end, the core information is crucial. Identifying this is the subject of ongoing debate, but it is absolutely vital in order not to overburden businesses, banks and ultimately the supervisory bodies with reporting obligations.

In terms of the comparability of data, we believe it is important that proxies are harmonised and coordinated at the international level. At the present time, the banking industry cannot get around closing data gaps by developing proxies. There is neither a uniform understanding nor are there uniform standards, as yet. We suggest specifying harmonised high-level guidelines on the compiling and use of proxies in order to increase the comparability of the data. In order to ensure that standards are uniform and to prevent developments occurring in parallel, guidelines such as these must be formulated strictly from the top down, i.e., from the international to the national level.

Banks do not usually have the capacity to examine in detail all the climate-related data for each of their customers. We share the opinion that companies' key figures can also be checked for plausibility by third parties.

Incorporating systemic risks into supervisory and regulatory approaches

In our opinion, the effects of climate-related risks vary more at micro level than at macro level. There is, therefore, no need for industry-wide measures, but rather a bank-individual analysis, e.g., through stress tests and scenario analyses, which examine exposures, portfolios, risk management practices, business models and risk mitigation strategies. In our opinion, a blanket approach through Pillar I would not be effective.

Certainly, it is necessary to have a good understanding of the transmission channels of physical and transition risks. At the same time, however, even the first-round effects of climate-related risks are challenging to model. We, therefore, believe it is practicable to initially take account of only the first-round effects and afterwards, when more experience has been gained, include the impact of second-round effects.

Scenario analyses are currently one method of analysing climate-related risks. Banks will often base their analyses on corresponding scenarios put together by the NGFS. As valuable as scenario analyses are as

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an instrument, it is important to be aware of the limitations and assumptions of such scenarios. A scenario analysis is and remains a 'what if' analysis and represents a set of hypothetical developments, but does not generally make any claims about the probability of them occurring. The longer the observation period, the greater the degree of uncertainty. No one can make valid predictions as to how the economy will look in 10, 20 or 30 years' time. With the current crisis dynamic, making projections just two to three years into the future is challenging, if not impossible.

The results of these scenario analyses ought therefore to be used to set out (strategic) courses of action. They do not, however, indicate a concrete risk that can be mitigated with capital. In fact, calls for higher capital requirements would not only be a hindrance to the transformation of the economy, because capital is needed to achieve it, it would also be misguided since banks that are strategically badly positioned today will not be successful in the future, even with a capital buffer for climate-related risks. We, therefore, reject a capital requirement for climate-related risks in Pillar I, and in Pillar II as well due to its long-term and therefore uncertain horizon.

Early considerations on other macroprudential tools and policies

Since the effects of climate-related risk vary from bank to bank, macroprudential tools would be unsuitable for modelling these specific features with any degree of accuracy. A macroprudential buffer for the entire industry would, in fact, treat all banks equally, irrespective of whether they have portfolios in gas and oil or in wind farms; in this scenario, both banks would be subject to the same additional capital requirements.

Furthermore, a potential climate buffer would have to ensure that risks covered in other buffers were not counted twice, e.g., in a systemic risk buffer, a countercyclical buffer or higher risk weighting for certain exposures (regulators in the EU already have this option at their disposal).

Added to which, the current buffer regime is applied differently across Europe – despite the single rulebook and countries having similar economic cycles. If harmonisation on the application of the macroprudential toolkit cannot even be achieved in Europe, then it will be harder still to create a level playing field at the global level. The macroprudential approach is, therefore, unsuitable for mitigating against climate risks.