Polish Bank Association

response to the FSB consultation on supervisory and regulatory approaches to climate-related risks

INTRODUCTION /GENERAL REMARKS

We would like to thank for the opportunity to answer the FSB consultation on supervisory and regulatory approaches to climate-related risks.

As general remarks, before answering concrete questions, we would like to express our general remarks concerning the subject on supervisory and regulatory approaches to climate-related risks.

Looking at the ESG risk management perspective, we are conscious that this document is dedicated rather to regulators and Financial Supervision Authorities than banks. Nevertheless, it is important for us to present the position of banking industry in this area which is very important for industry and the role of these factors will grow rapidly in near future.

We recommend the FSB to play the leading role in the area of worldwide coordination of the measures proposed recently in the area of climate-related risks and the supervision and disclosures of these risks. The responsibility for climate and ESG disclosure standards has now been assigned to the ISSB. In addition, banking regulation standards are being defined by the BCBS, and securities-related climate disclosures standards are defined by IOSCO. We have the draft of specific proposal of ESG risk disclosure for banks in the Pillar 3 in the European Union. These initiatives should be more coordinated in order to avoid any overregulation. The disclosure requirements coming from different sources should not be duplicated. We are very afraid that proposed requirements will be very broad and banks will concentrate their efforts to meet new commitments and leaving less time for making business. We appreciate the need of correct and complex communication with different shareholders, however we are convince that the requirements should be not duplicated and adopted to the existing possibilities nowadays. In this context, we would to highlight the importance of the FSB to leverage on the work of various regions, bring value on top of existing initiatives, and foster convergence in an already fragmented landscape.

It is also very important for us to highlight that while we welcome this opportunity to provide comments on the consultative FSB report, we are concerned with the timing of this public discussion given that there are already several regulatory and supervisory requirements in place or awaiting implementation with very specific data requirements (Pillar 3 in the EU, SEC proposed disclosures in the US, IABS proposal, stress -test in several jurisdiction, etc.). This makes the report by the FSB less useful in comparison to emerging topics that the FSB could focus on.

Given all above-mentioned initiatives on climate, we suggest that the FSB play the necessary and important role of ensuring that any forthcoming standards or guidance is flexible enough to adapt to the unique circumstances of each jurisdiction and does not create unintended consequences.

Concerning the experience of risk management departments in Polish banks we would like also to indicate some specific general issues with data regarding ESG risk assessment availability, especially when it concerns data on a company level. Polish economy is different than economy of many other European countries and this is driven by the structure of energy production in a large extent. As a result, in Poland we cannot use data aggregated on an economy branch level for the whole Europe.

Furthermore, disclosures under CSRD regulation are applicable only for small number of companies in Poland. The rest, especially micro-companies and SME's often are not able to provide data required by the banks (e.g. GHG emissions, even in scope 1, not mentioning scopes 2 & 3), thus some guidance from the regulators regarding approach to them would be appreciated. Also some support in obtaining access to country-level databases would be required (in many cases this may have to be the result of necessary amendments in the local law).

For example, there is no law regarding energy efficiency labels for buildings as well as banks in Poland do not have access to energy efficiency certificates database (and this database doesn't cover all buildings built in Poland).

It is common that banks do not possess data regarding geolocation of key assets of the corporate customers (this is important for general purpose loans) and this capability needs to be built.

External ESG ratings are backboxes. Some guidance regarding embedding external ESG ratings and / or development of internal ones would be extremely appreciated.

Imposing of new regulatory reporting obligations should be preceded by detailed due diligence regarding availability of external data sources. In other situation the positive result of better communication will be lost by the weak quality of published information.

In area of potential capital requirements for banks the industry needs the guidance regarding possible ways of embedding ESG risk factors into ICAAP process different than add-ons or buffers. This solution should be analysed and the support would be appreciated.

Questions:

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 prioritized.

Data

The most relevant issue regarding climate-related supervisory reporting is data standardization, reliability and maturity. 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. Some elements of this position we have already mentioned in our general comments.

We are convinced that there are still many data quality issues, access to data which may generate a big gap between the regulatory expectation (obligations) and physical possibility to collect the data and later develop them to the shareholders. We have to manage how to fill or dimmish this gap.

A good example is related to the lack of information. We have to remember that corporates (and only the large or listed ones) have only recently started disclosing their relevant data concerning the climate matter.

To date, the authorities have not provided 'any guidance as to how to fill data gaps, for example by using proxies and estimates. The use of common methodology is crucial for efficiency and usability of reporting information. We will not may compare the situation amongst entities without using common approach.

We would also like to highlight that the taxonomy for ESG purpose is changing. It is the challenge how we can build the history of data in that situation. The data concerning the following years will be incomparable.

We should concentrate at start point our attention on basic information collected and delivered in area of climate-related risks. The scale of needed information should be developed step by step and the disclosure requirements for bank clients will grow. For instance, if climate data are becoming more available, it is rare nowadays to find data on other topics such as biodiversity, water consumption and specific social impacts (such as financial inclusion). Therefore, we believe that a sequenced, yet holistic, approach with the end in mind, should always be considered in area concerning the ESG topics.

We agree with the FSB 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. 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.

In general, there is a need to allow transition time for integration and improvement in data availability, access, and quality from a range of sources. Authorities should consider expanding reporting and analysis over time across key agreed sectors, rather than creating the final system-wide model at the moment. This approach would allow regulated entities to build capacity how they can gather data across sectors, aggregate them, disclosure and manage the risk.

Impact

It is premature to expect banks or their supervisors to recognize fully the impacts of climate related changes. We repeat the access to data is crucial and the possibility to use it the practice is the second step to understand the impact. We need also the temporary solution. We can not stop completely the access to credit for some branches in one moment. It is a lot to do and it can be done with one move. We need intelligent approach which will deliver good incentives how to shift to more climate-oriented economy.

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

We believe that the FSB identified the topics correctly.

We can repeat our above-mentioned suggestion to support the establishment of public data repositories at national, regional or global levels for various forms of climate-related data to increase the efficiency and quality of data collection and risk management by financial institutions.

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. Concerning liability risk, we do not believe it should be separately defined and we are afraid to banks can not verify (rely on ESG data providers) the level of this risk. In this area some estimates or proxies should be acceptable.

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.**

Supervisors and regulators could work towards more consistency by providing guidelines on use of proxies and estimates as financial institutions need more clarity from regulators and supervisors on what reference / benchmark / baseline assumptions, scenarios and forecasts they should be using when it comes to measurement.

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**.

It is correct idea to look at the ESG risk in system-wide perspective. Regulators should incorporate in right way the channels for how climate-related risks to financial institutions may be transferred across sectors and borders. This goal needs the international coordination and the establishment of a common approach at worldwide level.

Answering the question on identification of system-wide perspective, we have to repeat the part described in the FSB report that the development of policy approach is at the early stage. This is the reason why it is difficult to express opinion that that channels are well identified. The question is preemptive in that situation.

We would like to remind that risks arising from climate change start outside the financial system. It is therefore necessary to look beyond the financial system to fully understand how climate related risks flow through and impact the financial system and economy. As currently drafted, the FSB frames climate related risk as starting with the funding provided by financial intermediaries. It is necessary that the report provides for a clear understanding of the drivers of a financial institution's climate-related risk that fall outside of the financial system.

Looking at the proposal of the dynamic approach in order to better capture the second-round effects, we have to stress that it is solution which is far away from us. We have to understand better and measure the direct impact of the ESG risks thanks to better data collection and proxies. The second round effect analyzes will come later. We are afraid the regulators are trying to do too much in short time and this approach is completely impossible to implement. We have earlier to recognize the loop in the data collection and understanding the channels of ESG risk spillover and at later stage we can analyze the second-round effects and their implementation in the bank obligations.

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

No. We believe the report is missing some essential topics on the role of environmental risks in the prudential framework,. In particular, in relation to potential double-counting the report does not mention anything on the extent to which these risks are already considered or mitigated in the prudential framework (credit risk, market risk, operational risk), for example in internal models or in external ratings, and would therefore have an overall neutral impact.

The report should focus more on the time horizon mismatch. The current prudential capital time horizon is shorter than needed and expected for climate-related risks and potential losses generated by these kinds of risks. The regulators should analyze the prudential consequences of application of extended time horizon for ESG risks and its coordination with other, traditional kinds of risk in the financial institutions.

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?

In our opinion the answer has to be negative. Before the regulators come to the incorporating the supervisory and regulatory approaches, including the use of climate scenario analyses and stress testing the regulators have to develop reliable methodologies for assessing climate risks. It is difficult to prepare the stress test as we do not completely how work the channels of spillover of the climate-related risks.

In order to measure the consequences of the stress test application we have to understand the channels of ESG risk transfer and the scale of losses which can diminish own capitals of financial institutions.

The FSB affirms these risks exist but says nothing about the need for supervisors to know how to identify and measure them in a harmonized way. In the past supervisors invented the internal models that they imposed on banks in Basel II. We expect that once the work of supervisors progresses, they will be in the position to come up with robust and convergent methodologies for measuring climate risk.

Please elaborate if there are any other features or tools that should be considered.

The other feature that should be considered is that the prudential framework should be based on risks, not on political considerations. It would be useful for the FSB to ensure that basic risk principles are respected at the international level, to avoid prudential divergences based on other than risk considerations. Prudential requirements must reflect risk exposures and should be risk- based. Risk assessments must be based on objective and observable data.

Climate- Stress Tests

The recent climate stress tests exercises remains is a big challenge as it differs from traditional stress tests, with data and modeling capabilities (like projections for the following 30 years) under construction. The integration into the Supervisory Review and Evaluation Process (SREP) of the climate Stress Test exercises and the potential capital impact via Pillar 2 is premature. Particular caution should be given to the interpretation of the results and the comparability of the exercise among entities or regions given that methodologies have not converged yet. We are still at a learning stage.

Not every systemic risk requires a macroprudential solution. We do not believe that macroprudential intervention is necessary as long as climate-related risks are appropriately covered by the microprudential policy and there should not be a double counting of risks. Some ESG risks are already analysed in the supervisory review process (SREP) and they might be covered, if necessary, though Pillar 2 add-ons and some are part of the operational risk framework.

It would be very premature to include these risks in the macroprudential framework, at least until it is clear how microprudential supervisors include them in their supervisory process. Otherwise, there is the risk of overlapping requirements to cover the same risks. An additional buffer introduced as part of the EU macroprudential framework would be counterproductive as it would both dis-incentivize banks to invest in their own risk management capabilities, and “freeze” capital resources that are much-needed for such investments. There is however need to avoid overlapping and double counting among the efficient approaches.

Before presenting any proposal, regulators should assess and prove that the use of macroprudential tools is the most adequate and efficient way to address ESG risks. Macroprudential approach should play a part once it is proven the microprudential one does not fit for purpose and the risks and related uncertainties are not sufficiently covered.

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?

We would like to recommend the cooperative approach to this new kind of risk in the prudential and disclosure regulations. The climate-related risks are very important and we should implement the best regulatory solution as quickly as possible. However, we should avoid the promotion of solution which are fragmented, not verified and will need many amendments in the near future. The climate-related risks are very important for humanity and they should be implemented in order to minimize the costs, also the cost for environment and in order not to make in such way that the shareholders will treat them as artificial, not clear for providers and receivers.

We would also appreciate if supervisors share best practices with industry and between themselves. It will create better understanding of problems, transmission channels and needed prudential solutions.

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?

We do not have other issues at this stage. The FSB report is complex concerning the main aspects. Now it is necessary to cover all topics indicated in the report.

On behalf of Polish Bank Association

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