6 October 2023

Basel Committee on Banking Supervision (BCBS)
Bank for International Settlements (BIS)
CH-4002 Basel
Switzerland

Consultation on the Core Principles for Effective Banking Supervision (the "consultation")

MSCI ESG Research[1] ("MSCI") welcomes the opportunity to provide feedback to the Basel Committee on Banking Supervision ("BCBS") on its review of the *Core Principles for Effective Banking Supervision* ("Core Principles"). The Core Principles and the framework they underpin are the global standards for the sound prudential regulation and supervision of banks. We acknowledge the significance of this consultation, as the Core Principles have been revised only twice since their introduction more than 25 years ago, most recently in 2012.

We are encouraged to see the BCBS introduce changes to the Core Principles to reflect the emergence of climate-related financial risks facing the global banking sector. The rise in physical and transition risks can affect the safety and soundness of banks, and in the absence of strong risk management may ultimately lead to wider financial stability implications. By explicitly integrating climate risk considerations into the Core Principles, the BCBS is encouraging both banks and their regulatory authorities to proactively monitor, measure and manage the potential impact of their climate-related exposures.

MSCI is a leading provider of ESG data and analytics to the world's largest banks and financial institutions and has collected climate-related disclosures from thousands of companies globally for over two decades. To support the BCBS in its review of the Core Principles, we put forward the following broad recommendations. We provide more detailed observations in the Annex.

1. The Core Principles could encourage the use of consistent and comparable forward-looking climate risk analysis. They could require banks to:
    a. Use a well-established set of climate scenarios from the Network for Greening the Financial System ("NGFS").
    b. Calculate and report relevant quantitative metrics, such as climate value-at-risk indicators, which provide an assessment of a bank's exposure.

1 MSCI ESG Ratings, research and data are produced by MSCI ESG Research LLC. MSCI ESG Research (UK) Limited is a subsidiary of MSCI ESG Research LLC.

2. The Core Principles could align with international climate standards and existing banking supervisory frameworks on climate. This could include:
    a. Aligning with the disclosure framework of the International Sustainability Standards Board ("ISSB"), this will become the global baseline for sustainability-related reporting.
    b. Consideration of climate-related developments in some of the major banking jurisdictions, such as the European Banking Authority's Pillar 3 ESG risk disclosure framework, the U.S. Federal Reserve's high-level principles, and climate-risk management guidance for banks in the U.K., Singapore and Hong Kong.

3. The Core Principles could recognise the importance of measuring and managing the risks associated with banks' Scope 3 financed GHG emissions ("financed emissions"). This can be achieved by requiring banks to:
    a. Calculate and report on their financed emissions, based on the framework put forward by the Partnership for Carbon Accounting Financials ("PCAF"), which provides guidance for banks looking to measure their portfolio financed emission.

4. The revisions to the Core Principles could go beyond those currently proposed in this consultation. They should:
    a. Consider other emerging risks such as biodiversity loss and nature-related risks as the research and data on these topics advances. This will ensure the Core Principles maintain an element of flexibility and stay relevant as the risk landscape for the banking sector evolves.
    b. Climate-risk considerations should be integrated across a larger number of the Core Principles, not just those currently targeted in this consultation. This should include the Core Principles around corporate governance, disclosure and transparency.

We hope our feedback is helpful for the BCBS in its work finalising the revised Core Principles ahead of their launch in mid-2024. We welcome further engagement with the BCBS on this over the coming months.

Yours sincerely,

s/
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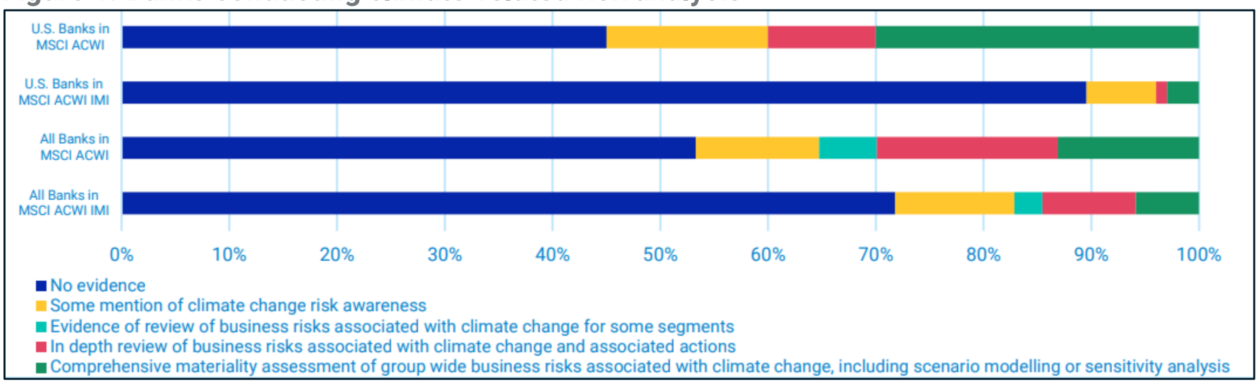
ANNEX

1.1. In the proposed review of Core Principles outlined in this consultation, the addition of climate risk considerations is most prominent in Core Principle 15 (*Risk Management)*, where the BCBS has provided new guidance for banking regulators to introduce climate scenario analysis and stress tests. We are encouraged to see Core Principle 15 *(Risk Management)* be enhanced with the requirement for banks to ensure that their scenario analysis and stress testing exercises incorporate climate-related financial risks.

1.2. As shown in Figure 1, only a small percentage of banks are currently taking into account the impact of climate change into their risk analysis, with more than 70% of banks in the MSCI ACWI IMI[2] index showing no evidence on climate-related risk analysis.[3]

Figure 1: Banks conducting climate-related risk analysis[4]



1.3. **Banks should look to use climate scenarios across multiple time-horizons as part of their risk management, including long-term models:**

The newly revised Core Principle 15 will now require banks to have comprehensive risk management policies and recognize that climate-related risks could materialize over a time horizon that goes beyond the traditional capital planning horizon of a bank. Considering that climate-risks have longer time horizons than other traditional risks that banks may face, we believe it is appropriate for banks to consider multiple short-, mid- and long-term climate scenarios when assessing their risk exposure.

1.4. The Network for Greening the Financial System ("NGFS") climate scenarios have been developed to provide a common starting point for analyzing climate risks to the economy and financial system. Regulators around the world are adopting scenarios developed by the NGFS and requiring banks and financial institutions to align their climate stress tests accordingly (e.g., Bank of England, European Central Bank, Hong Kong Monetary Authority).

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2 MSCI All Country World Index (ACWI) Investible Market Index (IMI).

3 MSCI ESG Research, as of January 31, 2022.

4 Source: MSCI ESG Research, as of January 31, 2022.

1.5. **Banking supervisors could encourage the use of NGFS-aligned climate scenarios:**

Scenario analysis provides a powerful tool for banks to understand the implications of climate change for their portfolios. However, one of the major challenges is the use of varied scenarios and tools by banks, which means that results may not be comparable. This makes it particularly difficult for both supervisors and, if disclosed, investors seeking to fully understand the balance sheet exposures to climate-related risks of banks and the broader sector.

1.6. We believe that Core Principle 15 *(Risk Management)* can be further enhanced by encouraging supervisors to mandate the use of NGFS-aligned climate scenarios, as these have become globally accepted and allow for consistent and comparative analysis of banks' risks. This can be reflected by new text added either in the Essential Criteria or in the Footnotes section.

1.7. **Climate value-at-risk metrics can help banks identify future risks:**

Forward-looking quantitative risk metrics can provide banks with more decision-useful information when conducting their risk management assessments. We note that there are a range of tools and models currently available to assist banks with assessing their material climate risks and conducting forward-looking scenario analysis.

1.8. The climate value-at-risk metric is a well-established risk indicator which can help banks identify and understand their future exposures by calculating the financial risks from climate change per security and per scenario. They can then take the necessary action for effective risk management for regulatory reporting purposes.

1.9. We would encourage Core Principle 15 *(Risk Management)* to reference indicators such as the climate value-at-risk metric. This can be reflected by new text added either in the Essential Criteria or in the Footnotes section.

2.1. Effective climate-risk management by banks can be further enhanced if it is accompanied by reporting obligations to their respective banking supervisors. We are encouraged to see the BCBS acknowledge this in its proposed enhancement of Core Principle 10 *(Supervisory Reporting)*.

2.2. **Align banks' supervisory reporting obligations with the International Sustainability Standards Board ("ISSB"):**

2.3. The ISSB reporting standards were finalised in June 2023, and will become the global baseline for climate and sustainability-related reporting in more than 100 jurisdictions around the world. We support the efforts of the ISSB to standardize climate disclosures that aim to capture issues that could be material.

2.4. **Consideration of climate-related developments in some of the major banking jurisdictions:**

When looking to integrate climate-related risk considerations into Core Principle 10 *(Supervisory Reporting)*, the BCBS should reflect the work that has already been done in some of the major markets:

- In the E.U., the European Banking Authority ("EBA") has put in place Pillar 3 ESG reporting requirements for banks, which include the need to calculate and disclose a list of quantitative information and metrics.[5]
- In the U.K.[6], Hong Kong[7] and Singapore[8], the respective central banks have published climate-related financial risk guidance for their local banking sectors. They require banks to report on their risks to the supervisory authorities.
- In the United States, all three federal banking authorities, the Federal Reserve ("Fed"), the Office of the Comptroller of the Currency ("OCC") and the Federal Deposit Insurance Corporation ("FDIC"), have put forward high-level principles on managing climate-related risks for U.S. banks to follow.[9]

3.1. **Data on a bank's Scope 3 financed emissions gives a more complete picture of risk exposure:**

The banking sector's main source of greenhouse gas emissions comes from their financed emissions, which captures the activities they finance including their loans and investment portfolios.

3.2. As shown in Figure 2, for global systemically important banks, MSCI research found that financed emissions accounted for almost 80 percent of their total carbon footprint.[10] However, only a minority of banks reported their financed emissions in any meaningful way and for those that did report some of these emissions, the loan portfolio coverage varied significantly.

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5 European Banking Authority, *Pillar 3 disclosures on ESG risks*, *available at* https://www.eba.europa.eu/eba-publishes-binding-standards-pillar-3-disclosures-esg-risks .

6 Prudential Regulatory Authority, *available at* https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/letter/2022/october/managing-climate-related-financial-risks.pdf?la=en&hash=D0D7E6F305C448D503EA385E20E0683E734696A0 .

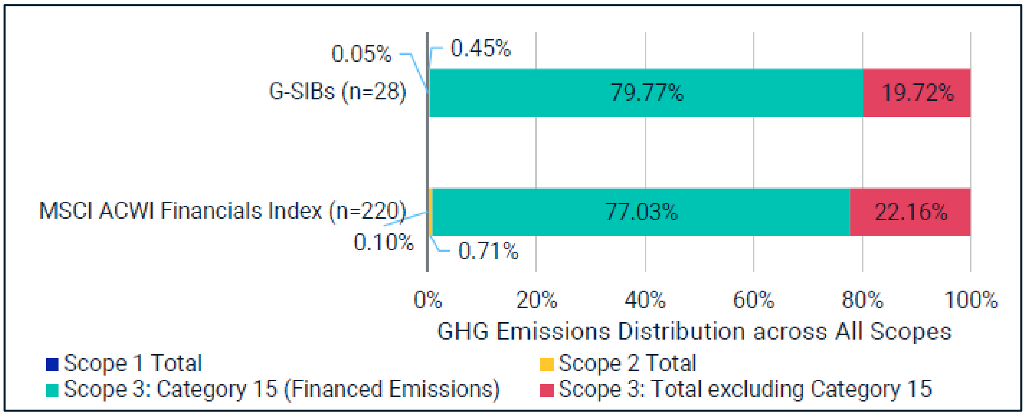
7 Hong Kong Monetary Authority, *Climate Risk Management*, *available at* https://www.hkma.gov.hk/media/chi/doc/key-functions/banking-stability/supervisory-policy-manual/GS-1.pdf .

8 Monetary Authority of Singapore, *Guidelines on Environmental Risk Management for Banks*, *available at* https://www.mas.gov.sg/regulation/guidelines/guidelines-on-environmental-risk-management .

9 U.S. Federal Reserve, *Principles for Climate-related Financial Risk Management*, *available at* https://www.federalreserve.gov/newsevents/pressreleases/other20221202b.htm .

10 MSCI, *G-SIB's Financed Emissions,* February 2022.

Figure 2: Global Systemically Important Banks GHG Emissions by Scope[11]



3.3. The Greenhouse Gas Protocol provides the main principles required to compute financial institutions' financed GHG emissions (Scope 3, category 15 emissions). The Partnership for Carbon Accounting Financials (PCAF) has built on the Greenhouse Gas Protocol framework to develop detailed guidelines for financial institutions to disclose their emissions. The PCAF guidance provides direction for financial institutions looking to measure their portfolio financed emissions for key asset classes.

3.4. We would recommend the BCBS to enhance the Core Principles by encouraging banking supervisors and the banks they regulate to recognise the importance of disclosing PCAF-aligned Scope 3 finance emissions. The 2021 TCFD Implementing Guidance[12] also recommended banks calculate GHG emissions for their lending and other financial intermediary business activities using the PCAF Standard.

4.1. We agree with the proposed enhancement included in Core Principle 9 (*Supervisory Approach)*. This will require banking supervisors to take into account climate-related risks when undertaking a comprehensive and forward-looking assessment of the financial stability of the banking sector and wider economy. As mentioned previously in the response[13], climate risks have a longer-term time horizon compared to other risks.

4.2. In assessing climate risks, supervisors should also look to reflect other emerging risks which are closely tied to climate change. This includes natured-related concerns and biodiversity loss.

4.3. **Banking supervisors should also consider biodiversity loss and nature-related risks alongside climate change:**

With more than half of the world's economic output being either highly or moderately dependent on nature and biodiversity, we would encourage the Core Principles to include nature-related risks in the supervisory framework for banking regulators.

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11 Source: MSCI, *G-SIB's Financed Emissions,* February 2022.
12 TCFD, 2021, *available at* https://www.fsb-tcfd.org/publications/ .
13 Paragraph 1.3. of this response.

The International Sustainability Standards Board ("ISSB") has already highlighted biodiversity as one of the three priority sustainability areas.

4.4. The Taskforce on Nature-related Financial Disclosures ("TNFD") published its final recommendations in September 2023.[14] The TNFD framework is a key milestone in the relationship between nature, business and financial capital, positioning nature risk alongside climate risk. The TNFD recommendations are structured around four pillars, consistent with the Task Force on Climate-related Financial Disclosures ("TCFD") and the ISSB.

4.5. **To better support effective climate-risk management, it should be integrated across many more Core Principles, including Corporate Governance (CP14) and Disclosure (CP28).**

Climate-risk considerations should be integrated across a larger number of the Core Principles, not just those currently targeted in this consultation. This should include the Core Principles around corporate governance, disclosure and transparency.

4.6. For example, Core Principle 14 (*Corporate Governance*) can be enhanced with the requirement for climate-related financial risk exposures to be more clearly defined, aligned with the bank's risk appetite, and supported by appropriate quantitative metrics. Materiality assessments should be conducted by the banks regularly to reflect the speed at which the understanding of climate risks grows and also the increasing frequency and scale of the risks themselves.

4.7. The BCBS already recognises the role of climate in corporate governance in its *Principles for the effective management and supervision of climate-related financial risks*,[15] published in June 2022. The supervisor also determines that the board and senior management review and approve the bank's risk data aggregation and risk reporting framework, and that they ensure that adequate resources are deployed to support these efforts.

4.8. Core Principle 28 *(Disclosure and Transparency*) can also be further enhanced in the BCBS review. MSCI supports a framework that supplements quantitative disclosures with a qualitative overlay of a banks' views on its climate risks and opportunities. However, "boilerplate statements" should be discouraged in favor of meaningful disclosure that explains how these risks and opportunities are being managed and how they might be expected to impact the company in the foreseeable future. MSCI supports alignment of public disclosures that align with the TCFD and ISSB recommendations, particularly as they pertain to quantitative and forward-looking metrics and targets.

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14 Taskforce on Nature-related Financial Disclosures, September 2023, *available at* https://tnfd.global/ .

15 BCBS, *Principles for the effective management and supervision of climate-related financial risks,* June 2022, *available at* https://www.bis.org/bcbs/publ/d532.pdf .