14 March 2024

Basel Committee on Banking Supervision (BCBS)
Bank for International Settlements (BIS)
Centralbahnplatz 2
4051 Basel
Switzerland

Dear Sir/Madam,

Disclosure of Climate-related Financial Risks – Consultative Document (the "consultation")

MSCI ESG Research[1] ("MSCI") welcomes the opportunity to provide feedback to the Basel Committee on Banking Supervision ("BCBS") on its public consultation on introducing a Pillar 3 disclosure framework for climate-related financial risks. MSCI is a leading provider of climate data and analytics to the world's leading banks and financial institutions and has collected climate-related disclosures from thousands of companies globally for over two decades.

The BCBS is the global standard setter for the regulation and supervision of banks with a mandate and purpose to enhance the resiliency of the banking sector in the face of systemic risks such as climate change.

To support the BCBS in its consultation we put forward the following broad recommendations. We provide more detailed observations in the Annex.

1. Introduce a core set of mandatory climate-related disclosure requirements for banks based on international standards.

2. Quantitative and forward-looking metrics provide consistent, comparable and decision-useful information to assess bank resiliency.

3. Scenario-based assessments and measuring alignment with net-zero pathways can provide banks with detailed insight on their exposure to future climate risks.

We hope our feedback is helpful and welcome further engagement with the BCBS on these important topics over the coming months.

Yours Sincerely,

s/
Laura Nishikawa
Managing Director, Global Research
MSCI ESG Research LLC

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.

ANNEX

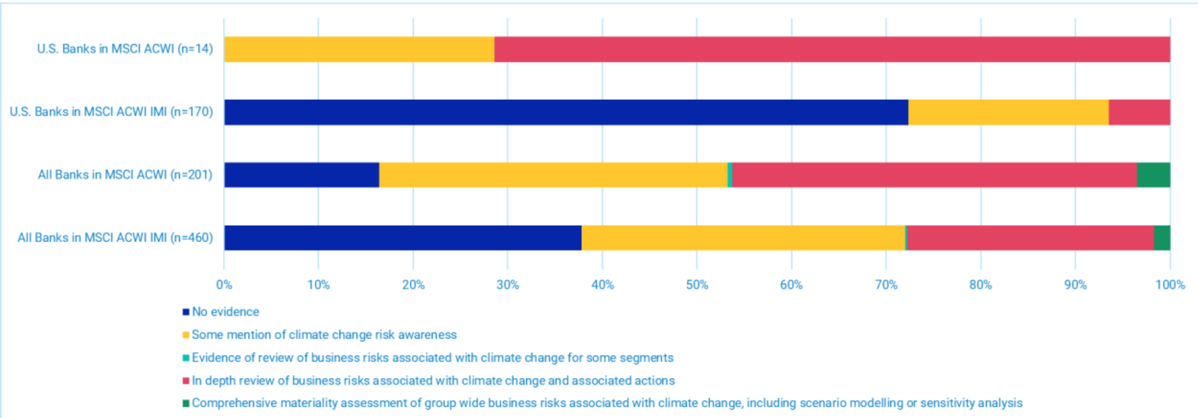
Question 1) What would be the benefits of a Pillar 3 disclosure framework for climate- related financial risks in terms of promoting comparability of banks' risk profiles within and across jurisdictions and promoting market discipline? What other benefits have been identified?

The introduction of a Pillar 3 disclosure framework for climate-related financial risks could encourage the use of consistent and comparable forward-looking climate risk analysis and help to promote transparency, accountability, and resilience in the financial sector, while also facilitating the transition to a more sustainable and climate-resilient economy.

Question 2) What are the risks of a Pillar 3 disclosure framework for climate-related financial risks not being introduced?

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 just under 40 percent of all banks in the MSCI ACWI IMI index showing no evidence on climate-related risk analysis[2]. Failure to introduce a disclosure framework might therefore lead to banks not being aware and appropriately addressing climate-related risks.

Figure 1: Banks conducting climate-related risk analysis[3]



Question 3) Would the Pillar 3 framework for climate-related financial risks help market participants understand the climate-related financial risk exposures of banks and how banks are managing these risks?

Establishing a common set of globally accepted disclosure requirements for banks would provide investors and other market participants with the data needed to both make informed judgments about the climate-risk profile of individual banks and also support comparative assessments between banks.

2 MSCI ESG Research, as of March 8, 2024
3 MSCI ESG Research, as of March 8, 2024

For this reason, MSCI welcomes the alignment of the proposed Pillar 3 frameworks with existing international climate standards such as those developed by the International Sustainability Standards Board (ISSB) to ensure the interoperability of uniform climate- related disclosure frameworks and help establish a global common baseline for sustainability-related reporting.

Question 4) 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?

No comment.

Question 5) Would there be any unintended consequences of a Pillar 3 framework for climate-related financial risks? If so, how could these be overcome?

Being overly prescriptive in scenario assumptions and modelling approaches may lead to a lack of ownership of banks over their climate assumption and model choices. Other unintended consequences may be potential market risk from an overreliance by all banks on similar climate assumptions due to 'group think'.

This could be overcome by not being overly prescriptive on exact scenario assumptions and models, instead providing guidance on best practice of scenario methodologies. It is critical to ensure that the climate scenario exercise is robust, challenging, considers multiple plausible scenarios and in line with the latest climate science, especially regarding physical risks. On both transition and physical risk side nonlinear impacts, networked impacts and market pricing-in dynamics should be considered.

However, in certain aspects, the Pillar 3 disclosures could be enhanced with recommendations for a more granular approach. For example, benchmark scenarios that reflect differences in decarbonization feasibility between sectors and regions, such as those from the NGFS, should be prioritized for assessing and disclosing climate-related risks. Failing that, there could be a risk that capital is withdrawn from those sectors and regions in the economy where it is most needed to help counterparties transition to low-carbon business models for example in emerging economies and hard-to-abate sectors.

Question 6) What are your views on potentially extending a Pillar 3 framework for climate-related financial risks to the trading book?

No comment.

Question 7) What are your views on the proposed methodology of allocating exposures to sectors and geographical locations subject to climate-related financial risks?

Allocating exposures to sectors and geographical regions depends on the type of climate-related risk being assessed. On the transition side, a fairly coarse regional / country / sector allocation should work well and MSCI supports GICS as well as NACE classifications.

With regard to physical risk, the exact location can be more important. For example, whether a particular corporate location or property is affected by flood risk depends on the exact location, not on whether the location is in a flood-prone region. For physical risk assessments, the use of NUTS regions has become a widespread market practice as it provides a more granular breakdown of geographic location.

Question 8) What are your views on which elements should be made subject to national discretion and which should be mandatory? Why?

To ensure consistent disclosures across all jurisdictions and to provide international investors with the same level of information across all markets, we believe that no disclosure items should be made subject to national discretion.

Question 9) What are your views on whether potential legal risks for banks could emanate from, or be mitigated by, their disclosures as proposed in this consultation, and why?

No comment.

Queston 10) Would the qualitative and quantitative requirements under consideration need to be assured in order to be meaningful? If so, what challenges are foreseen?

No comment.

Question 11) What are the benefits of the proposed qualitative Pillar 3 climate-related financial risk disclosure requirements?

MSCI is supportive of the proposed qualitative disclosure requirements being fully aligned with the ISSB standards to ensure future interoperability across geographies. In particular, qualitative disclosures around 'governance' and 'strategy' are important building blocks for an investor's understanding of how a bank may be approaching the management of climate-related risks.

However, qualitative disclosures should not become boilerplate statements and should be produced in conjunction with more meaningful, timely and objective quantitative information.

Queston 12) Should the proposed qualitative Pillar 3 climate-related financial risk disclosure requirements be on a mandatory basis to facilitate comparability across banks?

MSCI would welcome mandatory disclosure requirements for a common set of qualitative templates, aligned with the ISSB standard.

Question 13) What key challenges would exist for preparers or users of the proposed qualitative Pillar 3 climate related financial risk disclosure requirements? How could these be overcome?

No comment.

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Question 14) What additional qualitative Pillar 3 climate-related financial risk disclosure requirements should the Committee consider?

We would like to highlight the importance of a climate scenario exercise that is robust, challenging, considers multiple plausible scenarios and is based on the latest climate science, especially regarding physical risks. On both transition and physical risk side, nonlinear impacts, networked impacts and market pricing-in dynamics should be considered.

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, with more than half of the world's economic output being either highly or moderately dependent on nature and biodiversity. The ISSB has already highlighted biodiversity as one of the three priority sustainability areas.

The Taskforce on Nature-related Financial Disclosures ("TNFD") published its final recommendations in September 2023.[4] 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.

Question 15) How could the proposed qualitative Pillar 3 climate-related financial risk disclosure requirements be enhanced or modified to provide more meaningful and comparable information?

See response to Question 14.

Question 16) What are your views on the relevance of the proposed qualitative Pillar 3 climate-related financial risk disclosure requirements to understand climate-related financial risks to which banks are exposed?

See response to Question 11.

Question 17) What are the benefits of the proposed quantitative Pillar 3 climate-related financial risk disclosure requirements?

MSCI sees value in the introduction of a common set of quantitative Pillar 3 metrics to ensure greater comparability of climate-related risks among banks. By having access to a core list of quantitative data, investors and other market participants will be able to build a more accurate and detailed assessment of a bank's climate-related risk exposure profile.

Furthermore, employing forward-looking disclosure templates such as the distance to net-zero pathways and alignment metrics, similar to those proposed by the European Banking Authority ("EBA")[5], provide market participants with a more comprehensive assessment of the future resilience, or lack thereof, of banks.

4 *Final Recommendations*, TNFD, September 2023
5 *Pillar 3 Disclosures on ESG Risks*, EBA, January 2022

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Question 18) Should the proposed quantitative Pillar 3 climate-related financial risk disclosure requirements be on a mandatory basis to facilitate comparability across banks?

Yes. To ensure the comparability of climate-related disclosures, MSCI would welcome that the disclosure requirements be made mandatory.

Question 19) What key challenges would exist for preparers or users of the proposed quantitative Pillar 3 climate related financial risk disclosure requirements? How could these be overcome?

As a user and provider of climate-related data to banks, MSCI supports greater standardization on disclosure requirements. In our engagement with banks and financial institutions, we have identified the following challenges relating to the collection and disclosure of climate-related risk data:

- There is a lack of understanding of the data quality, for example reported emissions data by counterparties.
- There is a lack of transparency regarding underlying complexities; particularly assumptions with regard to Scope 3 reporting which may not be comparable from counterparty to counterparty.
- There is a lack of clarity on material upstream and downstream Scope 3 categories in any one sector.
- For some sectors, there is a lack of clarity on the most suitable emissions units (i.e. Oil & Gas sector — is it MtCO2e per kWh because we assume transitioning to renewable energy or MtCO2e per EJ because we assume that operational emissions in the O&G sector need to decline).
- There is a lack of guidance for forecasting emissions and assessing the credibility of companies stated emissions reduction targets.
- There is a lack of clarity on selecting an appropriate time horizon that appropriately captures the alignment of counterparties.
- There is a lack of clarity on capturing climate solutions appropriately, for example, the amount of avoided emissions they help to address.
- There is a lack of clarity on an appropriate framework to use for transition plans.

Question 20) What additional quantitative Pillar 3 climate-related financial risk disclosure requirements should the Committee consider?

When addressing climate-related financial risks, it is in our view important for banks to take a forward-looking perspective. For example, taking into account and assessing the climate-related commitments of counterparties would be critical. They could be assessed by considering counterparty-related KPIs such as low-carbon capital expenditure, the inclusion of material emission scopes, the validation of commitments by a third party, and whether short, medium and long-term components have been included that are underpinned by a robust net-zero transition plan.

Based on these forward-looking plans, MSCI also encourages the disclosure of an alignment metric to understand the distance of the current bank's book from a net-zero pathway.

Question 21) How could the proposed quantitative Pillar 3 climate-related financial risk disclosure requirements be enhanced or modified to provide more meaningful and comparable information?

In '*CRFR1: Financed Emissions*', the disclosure of financed emissions could be enhanced by segmenting the loan portfolio according to exposures to climate critical sectors and transition finance activities.

Question 22) What are your views on the relevance of the proposed quantitative Pillar 3 climate-related financial risk disclosure requirements to understand climate-related financial risks to which banks are exposed?

See response to Question 17.

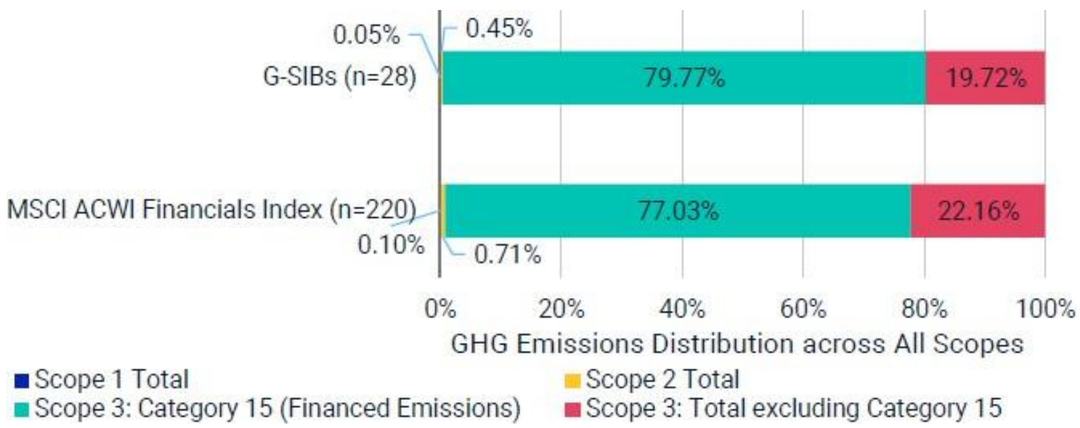
Question 23) What are your views on the calculations required to disclose the proposed quantitative Pillar 3 climate-related financial risk disclosure requirements?

No comment.

Question 24) Would exposures and financed emissions by sector be a useful metric for assessing banks' exposure to transition risk?

MSCI supports the measurement of a bank's financed emissions as a useful metric for assessing banks' exposures to transition risks. As shown in Figure 2, for global systemically important banks, MSCI research found that financed emissions, which captures the activities banks finance including their loans and investment portfolios, accounted for almost 80 percent of their total carbon footprint. 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.

Figure 2: Global Systemically Important Banks GHG Emissions by Scope[6]



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

'CRFR1: Financed Emissions' should set out Scopes 1, 2 and 3 emissions separately for both the current and forecasted financed emissions. Forecasts should also be included for physical risk and real estate. The grouping should be consistent for all templates by sector and asset class and geography.

However, financed emissions are backward-looking and do not provide a complete picture of the future transition potential of lending activities financed counterparties to a low carbon economy. For this reason, MSCI also encourages the use of forward-looking indicators.

Question 25) What are your views on the availability and quality of data required for these metrics, including by sector, activity, region or obligor?

According to MSCI's most recent analysis of the ECB's Pillar 3 banking disclosures[7] we have found that only 2 out of 8 G-SIBs reported financed emissions for a sub-set of climate critical sectors, an indication that banks may face challenges obtaining emissions disclosures directly from non-listed counterparties, illustrating the need for GHG emissions proxies while the banking sector gets ready for climate-related disclosures.

Question 26) What key challenges would exist for preparers to disclose these metrics, including by sector, activity, region, or obligor? How could these be overcome?

See response to Question 19.

Question 27) What additional transition risk disclosure requirements should the Committee consider?

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.

To establish potential future sources of transition risks, banks should consider the Climate Value-at-Risk of counterparties under a range of climate scenarios and across multiple time-horizons. Climate Value-at-Risk quantifies forward-looking and return-based valuation assessment of transition and physical risks and helps financial practitioners to model financial loss over short-, medium and long-term horizons leveraging a range of climate scenarios, for example from the NGFS and IEA.

[7] MSCI ESG Research, as of March 07, 2024

Queston 28) What are your views on the appropriateness of classifying sectors according to the Global Industry Classification Standard (GICS) with a six- or eight-digit industry-level code?

MSCI supports the use of GICS and NACE classification.

Question 29) Would it be useful to require disclosure of the specific methodology (such as Partnership for Carbon Accounting Financials (PCAF)) used in calculating financed emissions?

MSCI supports the use of the PCAF accounting standard.

Question 30) Would exposures subject to climate change physical risks be a useful metric for assessing banks' exposure to physical risk?

In assessing exposure to physical climate risks, we would like to highlight the importance of discerning between present and future exposures across various climate scenarios. This distinction allows for a comprehensive understanding of how current medium-term risks may intensify considerably in the coming decades. Such analysis aids banks in cultivating expertise and comprehending the potential impacts of climate change on future risks faced by the institution.

Question 31) Would there be any limitations in terms of comparability of information if national supervisors at a jurisdictional level determined the geographical region or location subject to climate change physical risk? How could those be overcome?

No comment.

Question 32) What alternative classification approaches could the Committee introduce for the classification of geographical region or location subject to climate change physical risk to reduce variability and enhance comparability amongst banks?

For physical risk assessments, the use of NUTS regions has become a widespread market practice as it provides a more granular breakdown of geographic location.

Question 33) What additional physical risk disclosure requirements should the Committee consider?

Exploring physical climate-related risks under a range of climate scenarios is essential to recognize the difference of potential outcomes under different scenarios. It is particularly important to include the period from 2050 to 2100, as during this time frame, the outcomes of physical risks are expected to diverge the most. It is also advisable to do this exploration for different time horizons (short-term, medium-term, long-term) and ideally standardize those.

Physical risk disclosures should differentiate between chronic and acute hazards. Acute hazards act as shocks, causing immediate impacts like infrastructure damage and supply chain disruptions. Chronic hazards are of a less immediate nature, yet the associated financial risks can be of the same magnitude as those associated with acute hazards.

Furthermore, assessments of acute physical risk impacts such as hurricanes, floods and wildfires would require location-specific input while using country-specific or regional data to assess chronic impacts such as heat risk would be more appropriate.

Finally, grouping the corporate segment further by sector/industry (i.e. GICS) could provide additional insights.

Question 34) What are your views on the prudential value and meaningfulness of the disclosure of the proposed bank-specific metrics on (i) asset quality (non-performing exposures and total allowances); and (ii) maturity analysis?

Disclosures relating to (i) *asset quality* can be enhanced by adding stage 2 exposures, as is required under the EBA Pillar 3 requirements.

Disclosures relating to (ii) *maturity analysis* can be enhanced by aggregating maturity buckets into 10 > 20 years and > 20 years to simplify disclosures and allow for meaningful analysis of the data.

Question 35) What challenges would exist for preparers or users of these disclosures? How could these be overcome?

No comment.

Question 36) What additional bank-specific disclosure requirements in respect of banks' exposure to climate-related financial risks should the Committee consider?

No comment.

Question 37) What are your views on the proposed inclusion of forecast information in the Pillar 3 climate-related financial risk disclosure requirements in instances where banks have established such forecasts?

MSCI believes that it would be important for the banks to consider forward looking models & metrics to measure, manage and disclose physical and transition climate-related risks. Furthermore, banks should use a range of climate scenarios across the short, medium and long-term time horizon when doing this.

We agree with recent NGFS guidance[8]:

> "Scenario users should seek to tailor their analyses to suit their needs and to determine which additional risk assessment tools and scenario calibrations may be required. The main areas where users may need to adapt the intensity of the

8 *NGFS Scenarios: An Explanatory Note*, NGFS, January 2024

scenarios include tipping points, physical impacts that are not captured at present, societal impacts such as migration influenced by climate change, compound risks, the calibration of physical damages, technology assumptions, government policy changes and financial sector dynamics. Consistent with best practice, scenario users should provide a narrative or qualitative explanation of what their exercise is designed to achieve and how their scenario adaptation fulfils these objectives".

Question 38) Would the proposed forecast information be a useful metric for assessing banks' exposure to climate-related financial risks?

Yes, such forward-looking disclosures would be helpful. However, banks should also make clear any assumptions being made in their forecasting methods.

Question 39) What type of forecasts would be most useful for assessing banks' exposure to climate-related financial risks?

'Real-world' decision useful scenarios are needed to avoid group think and encourage proper risk management practices, owning modelling choices and assumptions. Relevant guidance by the regulator would be helpful, e.g. setting time-horizons, what types of risks to include, guidelines on what constitutes a decision-useful scenario etc.

Question 40) What challenges would exist for preparers or users of Pillar 3 disclosures in relation to potential forecast information? How could these be overcome?

An unintended consequence could be 'group think' and associated market disruption as a possible result of applying one-size-fits-all forecasts. Therefore, understanding the models and climate assumptions is key with an emphasis on understanding the importance of a bank's 'own' assumptions. Some scenarios may be a better fit for one bank versus the other.

Question 41) Where forecast information is not available, what alternative information might be useful to assess banks' exposure to climate-related financial risks on a forward- looking basis?

No comment.

Question 42) 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?

We agree with the BCBS that climate-related financial risks may come about as a result of over concentration of a bank's exposure to particular industries, economic sectors and geographical regions that are subject to either transition or physical risks.

Question 43) What are your views on complementing quantitative disclosure of risk concentrations with qualitative disclosure of contextual and forward-looking information on the bank's strategies and risk management framework, including risk mitigation, to manage climate-related concentration risk?

No comment.

Question 44) What challenges would exist for preparers or users of disclosures in relation to quantitative and qualitative information on climate-related risk concentrations? How could these be overcome?

No comment.

Question 45) In relation to the disclosure of exposures subject to physical risk, would it be meaningful for assessing banks' climate-related concentration risk if these exposures were divided into six or seven broadly defined hazards, eg heat stress, floods, droughts, storms, wildfires etc?

No comment.

Question 46) What additional bank-specific disclosure elements on climate-related concentration risk should the Committee consider?

No comment.

Question 47) What are your views on the structure and design of the proposed templates in relation to helping market participants understand the climate-related financial risks to which banks are exposed?

'CRFR1: Financed Emissions' should set out Scopes 1, 2 and 3 emissions separately for both the current and forecasted financed emissions. Forecasts should also be included for physical risk and real estate. The grouping should be consistent for all templates by sector and asset class and geography.

Question 48) Would the potential structure and design of the templates pose any challenges for preparers or users of Pillar 3 climate-related financial risk disclosure requirements? How could those be overcome?

No comment.

Question 49) What are the benefits of the proposed quantitative Pillar 3 climate-related financial risk disclosure requirements subject to jurisdictional discretion?

Assessing the energy efficiency of buildings as outlined in template *CRFR3* provides valuable insights into its energy consumption. For example, buildings with effective insulation tend to consume less energy. However, assessing energy consumption alone does not provide any information about the building's actual emissions profile. While energy consumption will likely stabilize in well-insulated buildings, further reducing emissions remains the most important goal to reach net-zero emissions. Therefore, understanding the emissions intensity of buildings requires insight into the energy sources used, including the use of fossil fuels in heating systems.

Question 50) What key challenges would exist for preparers or users of the proposed quantitative Pillar 3 climate related financial risk disclosure requirements subject to jurisdictional discretion? How could these be overcome?

See answer to Question 19.

Question 51) What are your views on the feasibility, meaningfulness and practicality of banks' disclosure of facilitated emissions?

No comment.

Question 52) What are your views on the feasibility of the potential effective date of the Pillar 3 climate-related disclosure requirements?

No comment.

Question 53) Would any transitional arrangements be required? If so, for which elements and why?

No comment.

Question 54) What are your views on the Committee exploring disclosure requirements for the impacts of climate-related financial risks on deposits/funding and liabilities?

No comment.