February 16, 2022

Submitted electronically

Basel Committee on Banking Supervision
Centralbahnplatz 2, 4051
Basel, Switzerland

Re: Principles for the Effective Management and Supervision of Climate Related Financial Risks

Dear Sir or Madam:

The World Council of Credit Unions (World Council) appreciates the opportunity to comment on the European Commission’s Consultative Document on Principles for the effective management and supervision of climate related financial risks.1 Credit unions are cooperative depository institutions and World Council is the leading trade association and development organization for the international credit union movement. Worldwide, there are over 85,000 credit unions in 118 countries with USD 2.1 trillion in total assets serving 274 million physical person members.2

World Council supports the Basel Committee’s objective to provide for the effective management of climate-related financial risks and to provide guidance for prudential supervisors, however clear guidance on a proportional and risk-based approach is necessary not only to prevent overburdensome regulation on smaller financial institutions, but to advance the Commission’s objective to bolster financial inclusion. We further ask the Commission to define risk thresholds, establish a process for addressing climate-related financial risks once they have been identified, and to consider the effects that implementing the process has on smaller community-based financial institutions such as credit unions and other cooperative financial institutions.

Response to Questions on the proposed principles:

Q1. Has the Committee appropriately captured the necessary requirements for the effective management of climate-related financial risks and the related supervision? Are there any aspects that the Committee could consider further or that would benefit from additional guidance from the Committee?

The Consultative Document highlights different scenarios of climate-related financial risks

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1 The European Commission’s Consultative Document on, Principles for the effective management and supervision of climate related financial risks, available at: https://www.bis.org/bcbs/publ/d530.pdf.
calling for a wide range of foreseeability and analysis, however, a more prescriptive conclusion will be necessary for institutions to understand how to specifically address and manage the risk once it has been classified. While the document outlines supervisory expectations for addressing these risks, upon closer inspection, these expectations give rise to additional questions and concerns regarding the aftermath and how those expectations become solutions.

A principal-based approach to improving risk management and supervisory practices typically outline principles that specify the intention of regulation, and in this instance, guidance on effective management and for prudential supervisors. We understand that the benefit of a principle-based approach gives a financial institution the flexibility necessary to make supervisory decisions based on each scenario and its unique facts, however, this may give national-level regulators too much room to implement overburdensome and unnecessary requirements, which will be particularly taxing on small financial institutions.

The Consultative Document states that, “Banks are potentially exposed to climate-related financial risks regardless of their size, complexity or business model… Banks should manage climate-related financial risks in a manner that is proportionate to the nature, scale and complexity of their activities and the overall level of risk that each bank is willing to accept.” World Council is in full support of a proportional approach to climate-related financial risks, but we urge the Commission to recommend clear guidance that not only a proportional approach is necessary, but to identify specific direction as to what steps are necessary to achieve proportionality including capital requirements, exemptions, thresholds and other necessary steps necessary to address the identified risks once scenario analysis is complete.

Further, we are concerned that the amount of analysis necessary and the granularity that may be required from a prudential regulator may quickly outweigh the benefit derived from the results of the analysis. In short, the principles provide an incomplete picture of the consequences of this approach, i.e., how will the analysis affect capital requirements. It is imperative that the regulatory burdens that arise from these efforts do not disproportionately and unduly burden smaller financial institutions with limited resources.

Q2. Do you have any comments on the individual principles and supporting commentary?

Principle 1 suggests “a sound process for understanding and assessing the potential impact of climate-related risk drivers on their businesses and on the environments in which they operate… and “take material physical and transition risk drivers into consideration when developing and implementing their business strategies.” This presents the question of what is the threshold for, or what indicator rises to the level of “impact”; or what is the definition of or the threshold for a “material” risk driver? Materiality, if not properly defined with measurable standards can be left to the discretion of an examiner or regulator and can quickly vary with a wide-ranging set of parameters based upon interpretation. We would urge the Commission to include expectations that are clearly defined by supervisory authorities when implementing this principle.

Principle 2 places responsibility on the board and senior management to assign climate-related responsibilities to members and committees and exercise effective oversight of climate-related
financial risks; as well as identify climate-related risk management responsibilities within the organizational structure. This principle further proposes that the board and senior management engage in internal workshops and training, or external collaboration with expert organizations where needed; and that relevant business units have “adequate resources”. Additional training and resources, and even application of Principle 4, may seem like a simple concept when implementing new requirements within an institution, but for many credit unions, this is a significant objective. Oftentimes, the capital and resources necessary to train, and even hire essential staff to implement necessary oversight can be financially detrimental to a credit union, and adequate resources may not be available. We request that the Commission provide proportional guidance with respect to corporate governance and regarding managing climate-related financial risks.

Much like Principle 2, Principle 4 can in practice, be extremely costly and burdensome. Updating client onboarding, credit applications and credit review processes is exceedingly demanding on credit union resources. Without defined proportional guidance, national-level regulators are left free to impose strict, arduous requirements that may be impossible for credit unions to comply with. Again, we ask the Commission for clear proportional guidance as to how to implement climate-related risk management within internal frameworks.

Principle 5 suggests the identification and quantification of climate-related financial risks followed by the incorporation of “those assessed as material over relevant time horizons into their internal capital and liquidity adequacy assessment processes.” We ask for a definition and threshold for what the Commission considers material in this instance. Further, assessing causes for net cash outflows or depletion of liquidity buffers, in addition to assessing material risks that may impair liquidity position in the internal liquidity adequacy assessment process (ILAAP), is a broad recommendation which needs specificity. We understand that the Consultative Document leans on a principle-based approach, but without clear-cut capital requirements, credit unions are at risk of submitting to severe regulations meant for G-SIBs.

We hold similar proportionality and specificity concerns for Principles 7-15; and again, request proportional guidance regarding adequate resources and capacity to assess climate-related risk suggested in Principle 17.

Q3. How could the transmission of environmental risks to banks’ risk profiles be taken into account when considering the potential application of these principles to broader environmental risks in the future? Which key aspects should be considered?

Credit unions often provide services to individuals and businesses that are a boon to environmental concerns by providing a line of credit supporting sustainable enterprises, agricultural loans, and consumers who provide little impact to the environmental footprint. It is important that proportionality is included within the climate-related financial risk guidance in order to support institutions that contribute to the betterment of the environment.

World Council appreciates the opportunity to comment on the Basel Committee’s Consultative Document on Principles for the effective management and supervision of climate related financial risks. Please do not hesitate to contact me should you have any questions regarding
our comments.

Sincerely,

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