General Council for Islamic Banks And Financial Institutions

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CIBAFI

المجلس العام للبنوك والمؤسسات المالية الإسلامية

مؤسسة منتمية لمنظمة التعاون الإسلامي
تأسست بمرسوم ملكي رقم ٢٣ لسنة ٢٠٠١م

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Agustin Carstens
General Manager
Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002
Basel
Switzerland

Dear Mr. Carstens,

CIBAFI Response to the Basel Committee's Consultative Document "Principles for the effective management and supervision of climate-related financial risks"

The General Council for Islamic Banks and Financial Institutions (CIBAFI) presents its compliments to the Basel Committee on Banking Supervision (BCBS) and takes this opportunity to express its appreciation of the work that the BCBS is doing to develop the principles for the effective management and supervision of climate-related financial risks.

CIBAFI is an international body representing Islamic financial institutions globally, who offer financial services and products complying with Islamic rules and principles (Shariah). CIBAFI acts as the voice of the Islamic finance industry, and our members comprise more than 130 Islamic banks and non-bank financial institutions, both large and small, from 34 jurisdictions.

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We welcome this opportunity to offer our responses and recommendations on the BCBS's Consultative Document (CD) "Principles for the effective management and supervision of climate-related financial risks".

We should like to present the below responses to the raised questions for further enhancement and consideration of the comprehensive and generally appropriate principles contained in the CD. The responses contained in this letter represent the views of CIBAFI's Secretariat and feedback received from our members.

One underlying point that we should like to make is that the majority of our members are not internationally active banks as understood by the Committee, and many are not in the Committee's member countries. These banks may not have the resources to develop their own quantitative methodologies in climate, and indeed some other areas, and may therefore need to be offered standardised ones which they can apply. In other areas, these standardised methodologies have usually come from their regulators, but even some central banks may lack capacity in areas such as this. A very common theme in the comments was therefore the need for more guidance from the Committee.

Question 1: 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?

> **Answer/s:** The principles address the overall requirements needed to tackle the climate-related financial risks and present guidelines covering the relevant aspects.
>
> We note that the uncertainty associated with physical risk makes it difficult for banks to have advanced risk management practices for this compared to the transaction risk. While some aspects (e.g., the effect of rising sea levels on the

bank’s locations) may be relatively easy to deal with, others, such as the changes in weather patterns in a specific country, are much more uncertain. When implementing these principles, banks will need to take this into consideration and perhaps further improvements will be needed to ensure that the blind spots associated with physical risk are covered, including a clear understanding of the relationship between the important elements that determine the physical risk and improved methods to quantify the impact associated with the physical risk.

In this context, the Committee may consider including a high-level grid mapping climate-related and environmental risk drivers (physical and transition risks) to specific risks impacting the banking industry such as credit, liquidity, market, and operational risk, as well as non-Pillar 1 risks. This grid could serve as a high-level guidance for Banks and supervisors to develop robust risk management strategies to better capture the climate related and environmental risks’ impact.

Question 2: Do you have any comments on the individual principles and supporting commentary?

Answer/s:

1. It is noticed that some Principles overlap to a certain extent. In particular, Principle 5, in para 22, covers the need for assessment of the impacts of climate-related financial risks on net cash outflows or depletion of liquidity buffers and the incorporation of the assessed material risks in the internal liquidity adequacy assessment processes. Principle 10, in para 38, is also concerned with liquidity management and makes very similar points. We suggest that the two Principles could be combined. (Alternatively, Principle 5 could be confined to capital adequacy and Principle 10 to liquidity.)

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2. Under Principle 1, the CD guides Banks to take material physical and transition risk drivers into consideration when developing and implementing their business strategies. It is of course possible that some jurisdictions will have their own strategies or regulatory guidelines, in addition to these Principles, for the management of climate-related financial risks. It might be helpful to add to the supporting text a reference to the need to take into account any such strategies or guidelines.

3. In para 14, under Principle 2, the CD emphasises on capacity building of the board and senior management to ensure that they have an adequate understanding of climate-related financial risks and are equipped with the appropriate skills and experience to manage these risks. However, due consideration is not given to capacity building and up-skilling of middle and junior management which is important for coherent policy and strategy implementation. While this may be implicit in the reference to skills and expertise in para 15, it is recommended to make explicit reference somewhere to ensuring that staff at all levels of management are equipped with the appropriate skills and experience to manage climate-related financial risks.

4. In Para 31, under Principle 7, Banks are asked to develop qualitative or quantitative metrics or indicators to assess, monitor, and report climate-related financial risks. However, it is important to note that not all banks (due to their size and capacity) have resources to develop their own metrics or indicators. While we recognise that the Principles are aimed primarily at large internationally active banks, the Committee itself recognises that they may be used more widely, and we, therefore, recommend that the Principles should also encourage the adoption of pre-existing qualitative or quantitative metrics or indicators (developed by international

institutions/bodies) that can help banks to measure and report climate-related financial risks.

5. In Principle 14, Supervisors are asked to determine that Banks can adequately identify, monitor and manage all material climate-related financial risks as part of their assessments of Banks' risk appetite and risk management frameworks. It is recommended to give banks guidance on how to assess materiality in this context; while it is a well-understood concept in accounting terms, identifying those climate risks that may have material financial consequences is a new activity for many banks.

Question 3: 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?

Answer/s: The transmission of environmental risks to banks' risk profiles with regards to these Principles must consider the identification and the understanding of the environmental risks and their drivers. Many non-climate environmental risks will have smaller impacts on banks' financial risks overall, though some may have important impacts more locally (for example if pollution abatement costs materially affect industries to which the banks are exposed). The gaps in the practices by banks must also be identified and addressed.

Moreover, the potential application of these Principles to broader environmental risks requires improved coordination and cooperation among the banks, regulators, and standard-setting institutions. Environmental risks are continuously evolving and therefore sharing risk mitigation strategies, best practices and environmental data among the stakeholders can help in addressing the challenges of transmission of environmental risks to banks' risk profiles.

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Although it goes beyond the scope of the present CD, management of the impact of the banks on climate change, particularly through their involvement in greenhouse gas emissions, is an even more important problem than the banks' management of the associated financial risks. Quantification of the impacts is difficult for the financial sector, especially because so many of them are indirect, through the banks' financing activities rather than their direct operations. While significant work has been done in this area, the involvement of the Committee, particularly in developing or endorsing quantitative methodologies, would be helpful.

We also hope that the Committee may be able to consider how banks might assess and manage their environmental impacts more widely – again, a different issue from the financial impact of environmental risks on them – perhaps within the framework of the Sustainable Development Goals – and again taking into account the needs of smaller banks in countries outside the Committee's membership.

We remain at your disposal should you need any further clarifications on the above.

The General Council for Islamic Banks and Financial Institutions takes this opportunity to renew to the Basel Committee on Banking Supervision (BCBS) the assurances of its highest respect and consideration.

With kind regards and best wishes.

Yours sincerely,

Dr. Abdelilah Belatik
Secretary General

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