OPEN LETTER TO BASEL COMMITTEE on BANKING SUPERVISION

Dear members of the BCBS,

We write to you today to highlight a specific issue of concern with regards to one of the core principles relating to your recent consultation on climate-related financial disclosures[1] which risks undermining much of the good work set out by the Committee in its proposals if left unaddressed.

At present, there is insufficient clarity and guidance on the reporting of financial flows and associated scope-3 emissions within regulatory reporting. There is a risk that because of the way financial exposures are classified, some operational simplifications may distort a true and fair view of climate-related risks and impacts. In particular, classifying financial exposures by sectoral codes (whether GICS or NACE etc) enables the potential for concealment of underlying climate impact of activities by the process of financial intermediation. Without an unambiguous principle of "full transparency" (looking through the layers of finance to connect the providers of finance to the underlying economic activity) there is a growing risk that the separation could mean that climate-related risks and impacts are grossly understated. With greater scrutiny on banks' targets and commitments, this may lead to a perverse incentive to increase the level of intermediation to manage what is disclosed rather than managing the necessary underlying transition itself.

Given that, on average, the financed emissions of financial institutions are 700x larger than their operational emissions[2], it is clear that classifications of financial exposures to financial intermediaries (or chains of intermediation) run the risk of significant distortion and concealment. Disclosure regulations need to be reformed, harmonised and levelled-up, building on frameworks such as PCAF, to ensure full, true and fair disclosure on climate impacts are attained. This means coordinated mandatory rules that peel back the layers of financial exposures and connect them with all underlying sources of emissions. Failing to do so could stimulate abuse of the entire premise of climate-related financial disclosures set out by the Committee and promote a form of 'emissions laundering' via layers of financial intermediation.

There has been documented evidence[3] of financial institutions favouring financial intermediation and failing to report the underlying climate-related risks applying to those exposures[4]. This may be a consequence of structuring for fiscal efficiency or may have been motivated by the financial institutions' own climate targets. Either way, it is vital that these disclosure loopholes are closed to ensure that this activity does not proliferate and that market discipline is maintained.

In view of the recent trends towards the popularity of private credit and the potential growth in the associated layers of financial intermediation between the banking sector and the underlying activities in the real economy, we expect this to be an issue of increasing relevance and concern for financial regulators.

With global temperature increase hitting 1.5-degrees in the second half of 2023[5], we should be bracing ourselves for climate risks cascading through the financial sector. **We need an effective financial disclosures regime to account for the true impact of climate risks. This means closing the loopholes for concealment of emissions through financial intermediation, peeling back the layers and looking through to the underlying activities and their associated emissions.**

Signatories:

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Aaron Morehouse, PhD, Executive Director, **Climate Safe Lending Network**
Zak Gottlieb, Co-founder & Executive Director, **Bank.Green**
Diogo Silva, Campaign Lead, Banks and Climate, **BankTrack**
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Lauren Compere, Managing Director, **Boston Common Asset Management**
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Jesse Griffiths, CEO, **Finance Innovation Lab**
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[1] Basel Committee on Banking Supervision: Disclosure of climate-related financial risks *https://www.bis.org/bcbs/publ/d560.pdf*

[2] CDP Financial Institutions emissions (2020) *https://www.cdp.net/en/research/global-reports/financial-services-disclosure-report-2020*

[3] Banks increase allocation to private credit market https://www.bloomberg.com/news/articles/2023-09-14/banks-rush-to-gain-foothold-in-1-5-trillion-private-debt-market?leadSource=uverify%20wall

[4] How MDBs Support Fossil Gas through Financial Intermediary Investments *https://re-course.org/wp-content/uploads/2023/12/Still-Bankrolling-Climate-Change-1-1.pdf*

[5] World's first year-long breach of key 1.5C warming limit *https://www.bbc.co.uk/news/science-environment-68110310*