German Banking Industry Committee

Die Deutsche Kreditwirtschaft

Comments

Answers and comments to BCBS DP: The role of climate scenario analysis in strengthening the management and supervision of climate-related financial risks.

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The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks.

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The German Banking Industry (DK) would like to thank the Basel Committee on Banking Supervision (BCBS) for the opportunity to comment on the discussion paper "The role of climate scenario analysis in strengthening the management and supervision of climaterelated financial risks".

Q1. How does the role of CSA vary based on the objectives listed above, and are there other prudential objectives where CSA could be relevant?

Integration into the ICAAP is based on the risk identification process. Only relevant risk factors are integrated into the ICAAP/ILAAP. The time horizon also differs between the objectives. Short, medium and long-term time horizons are considered for risk identification. For the ICAAP, only short and medium-term scenarios are included.
Within risk identification, scenario analyses are used to assess the impact of ESG factors (as part of the risk inventory). The following questions arise here: What is the relationship to the most important sustainability reporting frameworks in the context of the outside-in materiality analysis (IFRS S2, GRI, ESRS/IG MA/VC)? What is the due diligence process for identifying relevant sustainability aspects with regard to climate change? What are relevant value chain assumptions for banks' business models as a starting point for risk assessments of these value chains? How can relevant and plausible scenarios be identified and how to deal with upside and downside risk assumptions (e.g. reaching a global 1.5 degree pathway may entail significant transition risks)?

Q2. What are the key challenges in the application of CSA and how can they be overcome?

The models on which CSAs are based are extremely complex and heavily dependent on assumptions about the future development of key influencing factors. The design of CSAs and their interpretation of results requires the development of capacity and expertise in the institutes.
Specifications for simple models would be helpful (without creating systemic risks through overly broad specifications), but not the approach of quantifying every single impact.

Another challenge is the availability of data as well as its granularity and quality. It is sometimes unclear which data is required (e.g. data from sustainability reporting), from which sources or with which methods it can be collected, which data is publicly accessible (e.g. NGFS), how high quality publicly accessible data in particular is (e.g. in terms of reliability, completeness, data history, collection / calculation methodology, etc.), which data can be determined with the ESAP.
For example, it is sometimes unclear to what extent value chains were included and which time periods were used for this. Furthermore, is a better understanding of the transmission channels also desired.

Q3. What are the key areas where CSA methodologies and capabilities need to be further developed to be useful and relevant for the different objectives listed in this paper?

In addition, sectoral and regional differentiation and the provision of short-term scenarios would be helpful.

Q4. Are the key features listed above appropriately calibrated for a range of CSA exercises, and should other features be considered?

The aspects mentioned above cover the essential features, but can be specified or expanded in some areas: For example, in terms of plausibility, it is also important to ensure that scenarios are appropriate for a bank and its customers. To promote transparency, care should also be taken to ensure that assumptions, estimates and missing values are disclosed. In terms of proportionality, the available resources of a bank and whether it has a regional, national or international business model should also be taken into account.

Q5. How does the design of CSA exercises vary depending on the objectives? Please elaborate on the main usage-specific considerations for each of the different objectives.

The design of the climate scenario analysis depends on its objectives. A high degree of standardization requires the use of uniform methods for data collection in connection with lending. Banks are required by supervisory requirements to carry out climate scenario analyses according to certain specifications. The time horizons must therefore be defined on the basis of the relevant European/national legislation (e.g. EU climate legislation). The severity of the scenarios should be based on the recommendations of the NGFS and should not consider further, more complex scenarios. Scenarios should consider plausible events. Depending on the observation horizon and objectives, it may make sense to consider events of varying severity (consideration of tail risks, particularly in the short term, appears to make sense). The most likely scenario should be used as a baseline or comparison scenario. The granularity of the CSA depends not only on the objective, but also on the institution carrying it out. For small, non-internationally oriented banks, data at sector level is normally sufficient. The balance sheet assumptions should not go beyond the current sustainability reporting obligations, as otherwise the confidentiality of business secrets could be jeopardized. With regard to the analytical framework, it can be said that publicly available frameworks are currently sufficient and new frameworks with a potentially even higher degree of complexity are not considered expedient. The principle of proportionality should continue to apply to the selection of bottom-up or top-down methodologies, so that a proportionate decision can be made that also allows for mixed forms of bottom-up and top-down methodologies. In addition, institutions should retain the freedom to choose the model used in order to be able to make an individually tailored decision and to be able to illuminate their business model and field as meaningfully as possible.

Q6. What additional usage-specific considerations are relevant for each of the different objectives of CSA listed in this paper and why?

No further comments.

Q7. Which scenario and scenario features are used for the different objectives listed above (i.e. internally developed, those from scenario builders or a combination of the two)?

No further comments.

Q8. What features and measures could be adopted in the future to enhance the utility of currently available scenarios (e.g. NGFS, IEA, IPCC)?

Some measures could be taken to increase the usefulness of the existing scenarios (e.g. NGFS, IEA, IPCC). The scenarios turn out to be quite complex and new for users, so they need support in understanding the scenarios. In addition, users would like to see exemplary procedures for use. Exemplary procedures would be particularly helpful if they take into account characteristics such as the size of a bank and illustrate adjustments to be made in the use of scenarios for different sizes of institution. An overview of the data required for application would also be helpful. The data contained in the scenarios could be better differentiated, for example by sector and region.

Q9. What alternative or novel approaches could supervisors consider for CSA and how might these be used for prudential purposes?

As an additional, emerging approach, the possibilities of big data analytics are certainly interesting for use in CSA. However, the applicability of such methods could be limited by a lack of data availability or the availability of data of varying quality. As huge amounts of data are a prerequisite for big data analytics, costs and ensuring the quality of data should be taken into account at an early stage. The same applies to the integration of machine learning. This approach can also offer advantages. However, it must be borne in mind that enormous amounts of data are also required here to train the algorithm. It is therefore important to consider whether sufficient amounts of data are available. As an expansion stage of machine learning, the question also arises as to how artificial intelligence can be used profitably in CSA. It is also important to minimize cyber security and data protection risks.

Q10. How could the effectiveness and efficiency of supervisory exercises be improved?

No further comments.