

Sustainability Blog

By PwC Deutschland | 13. Februar 2024

Navigating the Path to Standardised ESG Disclosures in Banking: Challenges, Implications, and the Road Ahead

The Basel Committee on Banking Supervision has issued a consultative document on Pillar 3 disclosure requirements for climate-related financial-risks

Unveiling the Future of Climate-Related Financial Risk Disclosure in Banking: A Comparative Analysis of Basel Committee and EU Pillar 3 Requirements. Join us as we delve into the key differences between these two regulatory frameworks, their implications for data assessments, and the roadmap for successful implementation by 2026. Discover how the banking sector is navigating the complexities of ESG disclosures, aligning with global standards, and paving the way for a more sustainable financial landscape.

As the global focus on sustainable finance intensifies, the banking sector faces the challenge of navigating the complexities of disclosure of Environmental, Social, and Governance (ESG) risks. There is a growing recognition of the importance of ESG considerations in corporate strategies and investment decisions. However, the lack of specific guidelines and standardised frameworks presents challenges for financial institutions in meeting these reporting requirements. The Basel Committee on Banking Supervision (BCBS) has responded to this need by releasing a consultation paper on climate-related risk disclosure, emphasising the importance of standardised ESG reporting practices. This aligns with the broader industry context and the global focus on sustainable finance, where ESG considerations have become integral to corporate strategies and are shaping the future of the financial industry. The alignment with global standards, such as those proposed by the BCBS, signifies a collective effort to harmonise ESG reporting practices on a global scale. This alignment goes beyond mere compliance, aiming to foster consistency in reporting methodologies and enable meaningful comparisons across diverse financial institutions. By embracing standardised reporting practices, the banking sector can contribute to a more sustainable and transparent financial landscape.

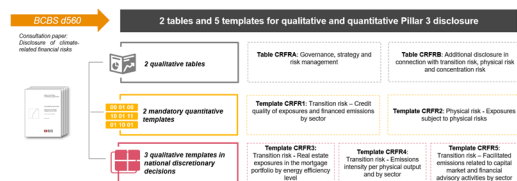
Alignment with existing disclosure requirements

EU-regulated banks face the challenge of enhancing their frameworks in line with the requirements set out in the [EBA Pillar III ESG disclosure](#)^[1]. However, new expectations are emerging, emphasising the need for an internationally oriented perspective. While the content of the disclosures proposed by the BCBS closely aligns with the EBA Pillar III ESG disclosure, there are practical limitations to a direct 1:1 adaptation.

The key reporting areas in the Basel Committee proposal, similar to the EBA Pillar III ESG disclosure, cover qualitative aspects related to governance practices, strategy, and risk management. Additionally, quantitative information is required, including exposure to physical and transition risks based on different categorizations. However, the challenge lies in the global perspective of the Basel Committee, which does not recommend using existing EU sectoral breakdown codes (NACE Codes), geographical region categorization, or energy efficiency labels (EPC Labels). This places an additional burden on banks to provide datasets for different views, adding complexity to the reporting process.

The below table summarises the main disclosure requirements of the Basel Committee proposal.

[Table 1: An overview of the BCBS d560 consultation](#)



Challenges

The challenges in reporting ESG disclosures arise from the complexity and evolving nature of ESG considerations. Financial institutions need to navigate through various challenges to ensure meaningful and accurate reporting.

1. **Absence of Specific Guidelines for Geographical Regions:** The absence of specific guidelines for determining geographical regions or locations in assessing physical risks allows national discretion, which may lead to a lack of data comparability between countries. The consultation paper does not provide clear instructions on how to handle the reporting of the required regions, including whether the template should be reported multiple times, similar to the EBA Pillar III ESG disclosure. This lack of guidance creates challenges for financial institutions in determining consistent reporting practices across different jurisdictions.
2. **New Reporting Requirements for Facilitated Emissions:** The newly introduced template focuses on disclosing facilitated emissions resulting from capital markets and financial advisory activities, with reporting responsibility determined by national jurisdictions. This decentralized approach poses challenges as financial institutions need to navigate varying reporting requirements and frameworks across different countries. The absence of guidance on the methodology for determining and estimating facilitated emissions further adds complexity to the reporting process. The proposed requirements include disclosing facilitated emissions for each type of financial market and financial advisory activity, such as underwriting, advisory, and securitization, per sector of economic activity. While disclosure is generally required for material sectors, this template mandates the disclosure of facilitated emissions for all 18 TCFD sectors, regardless of their level of significance. This broad scope of disclosure presents challenges for financial institutions in collecting and reporting data for all sectors, requiring additional data sources and internal resources for developing estimation models.
3. **Lack of Guidance on Metrics and Scenarios:** Similar to Template 3 of the EBA Pillar III ESG disclosure, BCBS requires the disclosure of alignment metrics expressed differently as emission intensity per physical output and by sector. The PiT (point in time) distance to target is calculated similarly, with both the forecast and reference year values needing to be disclosed. However, there is currently a lack of specific specifications for the metrics and scenarios to be used, such as the IEA NZE2050 scenarios. This absence of clear guidelines poses a risk of financial institutions applying different standards, leading to uncertainties about the relevance and representativeness of the calculated values for actual decarbonization. It also increases the complexity of setting specific decarbonization goals and developing alignment metrics when clear guidelines regarding the

scenarios and metrics are lacking.

4. Need for Internationally Recognized Standards: As a global initiative, BCBS should specify internationally recognized standards or scenarios for calculating alignment metrics. Without such standards, comparability with other global standards and initiatives, such as the goals of the Paris Agreement, may be undermined. The disclosure of emission intensity and decarbonization goals addresses the increasing demand for transparency and sustainable banking. Clear guidelines are essential to ensure consistency, comparability, and trust among stakeholders, including investors and the public.

Addressing these challenges requires the establishment of clear and consistent guidelines, collaboration among regulators and industry stakeholders, and the development of standardised methodologies and metrics. This will enhance the reliability and comparability of ESG disclosures, fostering transparency and trust in sustainable banking practices.

The tables below summarise the main disclosure requirements of the Basel Committee proposal.

Items per BCBS	BCBS - Disclosure of climate related financial risks	Pillar 3 ESG disclosure (Art. 448a CRR)
General		
Approach	Focus on physical and transition risk categorization	Categorization of disclosures per E, S & G angle
Reporting timeline	Annual	Semi-annual
Sectoral breakdown	GICS or six- or eight-digit industry level code and 18 sectors defined by the TCFD	NACE Codes from one- to four-digit mainly to sectors that highly contribute to climate change (A-H and L)
Relevant instruments	<ul style="list-style-type: none"> Loans, debt securities, equity investments in the banking book and off-balance sheet exposures for relevant sectors Capital markets/financial advisory activities 	Loans and advances, debt securities and equity instruments, classified in the accounting portfolio in the banking book
Qualitative disclosures		
Table CFR4: Governance	Forecast risks on overall climate related financial risk, no S+G specifications and qualitative disclosure requirements	Alignment of nomination, S, social activities, labour standards, human rights, consumer protection, G – ethical conduct, transparency, independence, conflict of interest
Table CFR4: Strategy	Mitigation and transition plans only qualitative, physical vs transition risk categorization, processes to review e.g. GHG footprint, how they want to achieve forecast, impact on business model and value chain, resilience to climate risk	Objectives and targets, EU Taxonomy aligned disclosure, processes for mitigating new business related climate risks
Table CFR4: Risk Management	More general process and methodology explanations	Commitment, implementation of tools, description transmission channels
Table CFR8: Transition on physical and concentration risk	New disclosure requirements on concentration risk and detailed information on transition and physical risks	

Items per BCBS	BCBS - Disclosure of climate related financial risks	Pillar 3 ESG disclosure (Art. 448a CRR)
Transition risk		
Template CFR5: Exposures and finance emissions by sector	<ul style="list-style-type: none"> Breakdown by GICS and 18 sectors defined by the TCFD Credit quality, specifically non-performing loans and advances based on their sectoral and geographical location New data fields CRD Emission forecasts per relevant sectors CRD balance sheet requests 	<ul style="list-style-type: none"> Credit quality of assets that contribute highly to climate change or are carbon intensive risk data on non-performing loans, advances, and associated requirements Breakdown by NACE Codes Financial emissions (Scope 1, 2, and 3)
Template CFR5: Real estate exposures in the mortgage portfolio by energy efficiency level	<ul style="list-style-type: none"> Real estate exposures and collateral in the mortgage portfolio with an overall portfolio level of the energy efficiency No disclosure of EPIC Labels required 	<ul style="list-style-type: none"> Loans collateralized with immovable property (EI) and non-EI (breakdown) by energy efficiency and EPIC label
Template CFR5A: Emission intensity per physical output and by sector	<ul style="list-style-type: none"> Forecast for 18 sectors required without specifying the size of particular business such as EA NACE2020 Additional fields for the metrics of the current reporting year Qualitative balance information (related to the period under review) 	<ul style="list-style-type: none"> Estimation of alignment metrics for 8 NACE sectors including the 18 forecast and target for 3 years based on the EA NACE2020 system Adherence to BEI guideline for banks
Template CFR5B: Facilitated emissions related to capital markets and financial advisory activities by sector	<ul style="list-style-type: none"> Facilitated emissions countably (Scope 1, 2, 3), gross emissions of a particular business attributed to the relevant metrics and financial advisory services (e.g. equity underwriting, securitization etc.) including forecasts based TCFD methodology for facilitated emissions 	

Items per BCBS	BCBS - Disclosure of climate related financial risks	Pillar 3 ESG disclosure (Art. 448a CRR)
Physical risk		
Template CFR6: Exposures subject to physical risks	<ul style="list-style-type: none"> Geographical breakdown by GICS and 18 TCFD sectors Geographical region or location is to be determined by relevant jurisdictions New information on geographical regions not subject to physical risks and where the bank is unable to determine the physical risks 	<ul style="list-style-type: none"> Sectoral breakdown per NACE Code Acute, chronic and acute & chronic physical risks differentiations Multiple submissions of the template depending on the selected regions
Mitigating actions		
Template 6-R: GARR		Taxonomy related KPIs
Template 9: STAR	No quantitative data requirements for mitigating actions	<ul style="list-style-type: none"> CR related to taxonomy eligible and taxonomy aligned exposures for non-NFIE/CSRD companies
Template 10: Other mitigating actions		Other mitigating action that are not taxonomy aligned according to EU/2020/852 and not reported in template 7 or 8

Data availability and reliability

Accurately measuring ESG risks and ensuring reliable data is an ongoing challenge in the disclosure process. The proposed framework aligns with the objectives of the Paris Climate Agreement, with a focus on measuring greenhouse gas emissions. However, the Basel Committee has introduced additional requirements that expand on the existing EU Pillar 3 disclosure. One significant challenge for banks is forecasting the greenhouse gas emissions of their counterparties, which drives exposure to transition risk. Additionally, banks are expected to disclose facilitated emissions resulting from capital markets and financial

advisory activities, categorised by sector. This breakdown of emissions by financial activity and sector poses concerns for risk management and reporting teams. To ensure accurate disclosure of facilitated emissions, financial institutions must undertake data collection, integration, and identification of necessary data points and subsystems. This involves gathering data from various sources, seamlessly integrating it, and pinpointing specific data points essential for precise disclosure. Developing or refining estimation models specifically designed for determining facilitated emissions is also crucial to enhance precision and reliability in estimating emissions associated with financial activities. Expanding or developing estimation models and ensuring transparency and clarity in disclosed information are important qualitative requirements. Comprehensive analysis of risk assessments and governance practices related to facilitated emissions provides a holistic perspective, enabling financial institutions to make informed decisions and address potential risks effectively.

Timeline

The timeline for implementing the BCBS requirements remains uncertain, as the Basel Committee is currently seeking opinions and views from stakeholders until February 29, 2024. The potential effective date for these requirements is set for January 1, 2026. The relationship between these requirements and the existing EBA ITS on Pillar III ESG disclosure is yet to be determined from the perspective of EU regulations.

Conclusion

Standardised ESG disclosures have far-reaching implications for the banking sector. They enhance transparency, enabling stakeholders to make informed decisions and assess the sustainability performance of financial institutions. Standardisation also facilitates benchmarking and comparison, allowing investors to allocate capital more effectively and incentivizing responsible banking practices.

The road to standardised ESG disclosures in banking requires collaboration among regulators, financial institutions, and industry stakeholders. It involves establishing clear guidelines, harmonising reporting frameworks, and leveraging technology to streamline data collection and reporting processes. The development of internationally recognized standards and metrics is crucial to ensure comparability and consistency across jurisdictions.

Financial institutions need to address the challenges posed by the absence of specific guidelines for determining geographical regions, the decentralised reporting responsibility for facilitated emissions, and the lack of clear guidance on metrics and scenarios. This requires proactive efforts to establish market practices, enhance data management capabilities, and engage in industry-wide discussions to shape the future of ESG reporting in banking.

Do you have questions about BCBS, ESG, Pillar III, or need support with the implementation of ESG disclosure requirements? Our team is here to help! Feel free to reach out to us at any time for guidance and assistance. Together, we can navigate the complexities of ESG disclosures and ensure your organization is on the path to standardized reporting practices.

^[1] Commission Implementing Regulation (CIR) (EU) 2022/2453

Also interesting:

- [PwC ESG Pillar III Disclosure Study](#)
- [Between transparency and sustainability: The ESG Pillar III Disclosure Study](#)
- [How transparent are European Banks? Highlights from the ECB's Assessment of European Banks' ESG Disclosures](#)
- [ECB review of disclosures on ESG risks \(April 2023\)](#)
- [Sustainable Finance](#)
- [Sustainability consulting](#)

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