The FSB's Climate Roadmap—Are We on the Road to a New International Standard?

Lauren Anderson |Sept. 7, 2021

On July 7, 2021 the FSB published its much anticipated—at least amongst climate policy watchers—Climate Roadmap. The Roadmap lays out a multi-year work program for the international regulatory community across four blocks of work—disclosure, data, vulnerabilities analysis and supervisory and regulatory practices.

What is interesting about the Roadmap, is that while regulators—particularly in the US—have been cautious in their public statements about climate-related risk, noting the nascent stage of policy analysis, data and analytics, the Roadmap closely follows the tried and tested international regulatory process of developing an international standard to be included in the Compendium of Standards.[1] And once that standard is agreed upon, jurisdictions will be judged against it via periodic assessments and reviews. This may not be explicitly laid out in the roadmap and there is plenty of qualifying language around the deliverables and timelines, but the signposts are there—a significant portion of the international regulatory community is pushing for an internationally agreed-upon minimum standard on how financial institutions manage climate risk, which in practice could create frictions for cross-border banking.

Generally speaking, international standards for financial systems are a good thing. By establishing baseline global standards for supervision and regulation of financial institutions and markets, the standards support safety and soundness and global financial stability. This is a key mechanism in allowing for the efficient provision of cross-border financial services, particularly for global banking organizations. Most notably, the adherence by jurisdictions to international standards allows banking organizations to operate in a less fragmented regulatory environment through mechanisms such as regulatory equivalence decisions, deference and substituted compliance. If the FSB were to establish an international standard for climate-related risk, this new standard would likely be factored into jurisdictional assessments when evaluating whether a foreign-based financial institution is headquartered in a jurisdiction that adheres to all of the international standards. The downside to this is the more international standards that are developed the higher the bar becomes for assessing jurisdictional equivalence, and what previously served as a means for reducing cross-border frictions starts to act as a barrier.

Looking at the individual blocks of the roadmap, here are some of the key signs and possible implications of the work.

Block 1: Disclosure

The first block of the FSB Roadmap that is most explicit is disclosure. The roadmap clearly states the FSB's objective is to "establish a global minimum standard for disclosures on climate-related financial risks." While much still needs to be finalized in the context of what the international disclosure standard will look like under the newly established International Standards Setting Body overseen by the IFRS Foundation, the roadmap notes "provided

[1] The Compendium of Standards lists the various economic and financial standards—by both subject area and issuing body—that are internationally accepted as important for sound, stable and well-functioning financial systems. The Compendium is an initiative of the FSB and is a joint product with relevant international standard-setting bodies.

[the] official sector's expectations regarding the IFRS process and standards are satisfied, *sectoral standard-setting bodies [will] build on the ISSB standards through their own supervisory reporting requirements.*" (emphasis added) While the roadmap does not prejudge whether or not IOSCO—the international standard-setting body for securities-related matters—will endorse the ISSB standard, arguably that is the expectation. For if there is no endorsed international standard, it would be very difficult to execute the reporting deliverable under this block. Specifically, the roadmap notes that from 2022, the FSB, coordinating with IFRS and IOSCO, will report annually to the G20 on jurisdictions' progress in implementing disclosure requirements in line with "international standards."

Block 2: Data

The second block of the FSB Roadmap focuses on data. The objective is to establish a baseline of data metrics for both the private and official sectors to monitor and assess climate-related financial risks at both the micro and macroprudential level. In particular, the FSB is focused on the identification of climate and transition-related metrics that can be translated into financial impacts. The main output of the work on data is to develop consistent metrics for use in climate-related vulnerabilities monitoring under Block 3 of the roadmap, as this will form the key inputs for vulnerability analysis, measurement and monitoring across jurisdictions.

Block 3: Vulnerabilities Analysis

The third block of the Roadmap is about vulnerabilities analysis, or more specifically, "establish[ing] regular monitoring and assessment of climate-related financial risks and vulnerabilities." This will primarily be done through regular financial stability impact assessments and through the development of a monitoring framework. This is not all that different in terms of what the FSB established in the wake of the Great Financial Crisis in relation to "ending Too-Big-to-Fail" by establishing an assessment, monitoring and reporting process around the FSB's Key Attributes of Effective Resolution Regimes, which is one of the 16 Key Standards.

By mid-2022, the FSB is aiming to identify specific issues related to climate vulnerabilities at the cross-sectoral and macroprudential level, and to develop tools to carry out monitoring. Such monitoring is then scheduled to begin at the end of 2022. It is also specifically noted that the IMF and World Bank will incorporate climate-related risks into their assessments of national financial systems through the Financial Sector Assessment Program (FSAP). While there isn't an explicit mention of what elements will specifically be incorporated into the FSAP, one would think at a minimum it would be a set of principles relating to the blocks of the FSB Climate Roadmap—i.e., assessment of the disclosure regime relating to climate-related financial risks, data availability and usage within jurisdictions, and national supervisors' incorporation of vulnerabilities monitoring and assessment. Notably, there is no mention in the Roadmap of the establishment of an Assessment Methodology, which is a detailed instructional document for how to carry out assessments in relation to a Key Standard.[2] In the absence of an Assessment Methodology, one would suspect that FSAP and peer reviews on climate-related risk would be more principled and thematic.

Block 4: Supervisory and Regulatory Practices

The fourth and final block of the FSB Roadmap focuses on supervisory and regulatory practices with the objective of developing effective supervisory and regulatory practices and tools to address climate-related risks. Part of the objective is also to drive a level of cross-jurisdictional consistency, which arguably is most likely achieved through a

[2] For example, assessment methodologies have been developed for *inter alia* the Core Principles for Effective Banking Supervision, the IADI Core Principles for Effective Deposit Insurance Systems and the FSB's Key Attributes of Effective Resolution Regimes for Financial Institutions.

set of principles or guidelines laid out by the FSB.[3] Moving through the typical international regulatory sequencing for such an output, the FSB aims to put out an interim report for public consultation in October 2021 on regulatory and supervisory approaches to climate-related risk. This will be followed by a final report, potentially including "principles or recommendations" in March 2022; and a possible peer review of regulatory and supervisory practices against "FSB guidance" in October 2023. It is also noted that this work will be conducted in coordination with the Standard-Setting Bodies and international organizations, which all have specific governance processes for endorsing an FSB standard for inclusion in the Compendium of Standards.

WHY DOES THIS MATTER?

It is clear the FSB has a lengthy road ahead before it signs off on a new Key Standard. The Roadmap follows the path of previously developed international standards—stocktaking, gathering of data, interim consultation reports, final reports and recommendations, followed by assessment, monitoring and reporting by and to international bodies.

In many respects, it is comforting that the international regulatory community is not departing from the path well-trodden when it comes to developing principles, practices or guidelines for climate-related risks; but at the same time, it is unclear whether climate-related risk is ready for prime time in terms of having its own international standard even in the medium term. Given the significant amount of work that needs to be done to improve data and analytics in relation to climate-related risk and how those translate to the contexts of individual jurisdictions, the international regulatory community should proceed in a deliberative manner before moving to a set of principles, practices or guidelines that are then used in jurisdictional assessments. Such assessments have real consequences in terms of cross-border banking and the efficiency to which such services can be provided to customers globally. For example, many regulators will look to IMF FSAP results and other sectoral assessments when assessing whether firms from a particular jurisdiction should receive equivalent treatment to local institutions or some form of regulatory deference or substituted compliance. If a jurisdiction has a rating of "noncompliance" it could create additional regulatory hurdles for its institutions operating on a cross-border basis.

Maybe the Roadmap won't lead all the way to the Compendium of Standards, in which case individual jurisdictions can proceed at their own desired paces, but if an international standard is the final destination, then due care and attention should be taken to ensure that such a standard is truly risk-based, focused and does not inadvertently become a tool that hinders cross-border banking, which of course will be essential for mobilizing transition financing at a global level in the move to a low-carbon economy.

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[3] International standards can take the form of principles, practices or guidelines. Principles are fundamental tenets pertaining to a broad policy area. Principles are usually set out in a general way to suit country circumstances. **Practices** are more specific and spell out the practical application of the principles (drawing on country experiences) within a more narrowly defined context. **Guidelines** provide detailed guidance on steps to be taken or requirements to be met in a particular area.