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Basel Committee Issues Guidance on Core Principles for Effective Banking Supervision



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In April 2022, the Basel Committee on Banking Supervision (the Basel Committee) began a review of “the core principles for effective banking supervision” (Core Principles or CP). Last month, the Basel Committee published a [Consultative Document](#) on the Core Principles following its review.

The Basel Committee is the primary global standard-setter for the prudential regulation of banks and provides a forum for regular cooperation on banking supervisory matters. Its 45 members comprise central banks and bank supervisors from 28 jurisdictions. The Core Principles are an important component of the Basel Committee’s global standards, aimed at ensuring sound prudential regulation and supervision of banks worldwide and are intended to remain a “living” standard, evolving over time in response to global financial developments, emerging risks, and changes in the regulatory landscape. The current review and update includes a consideration of supervisory and regulatory developments since the last substantive update in 2012.

The current review has been informed by several themes, including climate-related financial risks and risk-management practices. The Consultative Document makes clear that climate-related financial risks can affect the safety and soundness of banks while also affecting the financial stability of banking systems as a whole.

To address these “new” risks, targeted changes have been introduced to the Core Principles to specifically address climate-related financial risks and promote a principles-based approach to supervisory practices and risk management.

Proposed revisions to the Core Principles include the following:

- amendments to CP8 *Supervisory approach* and CP10 *Supervisory reporting*: supervisors would be required to consider climate-related financial risks as part of their supervisory methodologies and processes, and banks would be required to provide information to enable regulators to assess climate-

related financial risks;

- adjustments to CP15 *Risk management process*: banks would be required to adopt comprehensive risk management policies and processes for climate-related financial risks that take into account the impact of different and varying time horizons, and implement appropriate risk management measures;
- adjustments to CP26 *Internal control and audit*: this would require the consideration of climate-related financial risks as part of a bank's internal control framework;
- amendments to CP14 *Corporate governance*: these amendments give greater emphasis to corporate culture and values and emphasize diversity and inclusion on bank boards;
- amendments to CP15 *Risk management process*: proposes the introduction of the concept of business-model sustainability, with the key components of business-model sustainability set out in CP8 *Supervisory approach*; and
- revisions to CP25 *Operational risk and operational resilience*: these reflect the importance of resilience to operational risk-related events (including pandemics and natural disasters) and include an emphasis on risk-related interconnections and interdependencies.

The Basel Committee is seeking the views of stakeholders on the revised Core Principles, and comments should be submitted by October 6, 2023.

Final Thoughts

The Basel Committee's Consultative Document proposes certain key adjustments that have been informed by climate-related financial risks. The proposal recognizes the need for different, more comprehensive risk-management policies and processes that take into account that climate-related financial risk may materialize and/or have impacts over varying time horizons, potentially beyond current capital planning. While supervisors have long emphasized the potential impact of climate-related risk on the financial stability of the banking system, the Consultative Document recommends that targeted, specific amendments and adjustments be implemented to address climate-related financial risks. We have [previously reported on](#) Basel III Pillar 3 requirements, which have as a key objective enhancing a focus on ESG-related risks within the bank prudential regulatory framework. In particular, Pillar 3 requires a variety of ESG-related disclosures, including qualitative and quantitative information on transition and physical risks, exposure to at-risk sectors and green lending. More recently, [we also have discussed](#) a European Central Bank assessment from April finding that banks, on the whole, are unprepared to comply with the European Banking Authority's ("EBA") imminent [Implementing Technical Standards \(ITS\)](#) on Basel III Pillar 3 ESG risks.

(This article originally appeared in [Cadwalader Climate](#), a twice-weekly newsletter on the ESG market.)
