

Brussels, February 14, 2022.

Basel Committee on Banking Supervision

Submitted via email

**Subject: ECIIA views on the consultative document of the principles for the effective management and supervision of climate related financial risks**

We welcome the principles proposed in the consultation document. They are aligned with the existing regulations (eg ECB guidelines on climate and environmental risks, MAS guidelines for environmental risk management for banks...) and describe the role of internal auditors, based on the Three Lines Model.

Nevertheless, the principles are structured on a high level perspective and it might be difficult to measure their implementation and effectiveness.

**ECIIA general comments**

Internal auditors play an important role in climate related risks and provide independent and objective reasonable assurance and insight to the board and management, on all aspects of governance, risk management and internal control related to climate risks. We observe that climate risks are broader than financial, they include reputational risks, operational risks, compliance risks.

There is a need for a strong internal control system (efficient and effective), as part of integrated risk management (e.g. the COSO model that integrates the sustainability dimension, or the ERM model that also includes sustainability issues). Like all risks an organisation is facing, climate risk management implies risk analysis, risk appetite setting, risk responses, risk monitoring and risk reporting. An integrated approach throughout the organisation is key, and a strong governance is needed, with clear roles and responsibilities, and effective coordination to effectively execute the strategy. The level of maturity regarding climate risks management varies from one organisation to another, and we believe that there is no "one size fits all" solution.

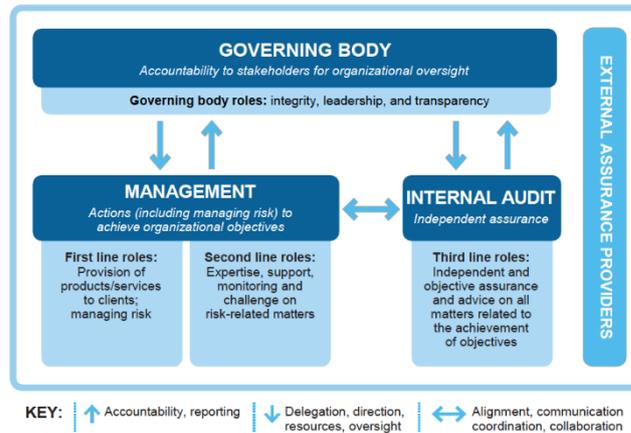
The principles include references to the "Three Lines of Defence Model" that articulates the core components of effective governance. The model has been recently updated by IIA as the [Three Lines Model](#).

The model includes the following principles:

- Accountability for the governing body to stakeholders for organisational oversight;
- Actions, including risk management, by management to achieve the objectives of the organisation through a risk based approach;
- Assurance and advice by an independent internal audit function to provide clarity and confidence, and to promote and facilitate continuous improvement.



## The IIA's Three Lines Model



Each organisation will adapt the model to its own environment, but it is important to define the accountability of each party involved to ensure the reliability, coherence and transparency of the information needed for risk based decision making. The work of internal audit should be aligned with the level of maturity of the internal control system implemented for climate risks.

In terms of reporting on climate risks, we promote clear guidelines regarding the framework to be used: Standards are needed for comparability among companies and to facilitate informed business decisions that consider climate impacts.

### ECIIA detailed comments

#### Principle 4

In Principle 4, we would suggest updating the reference to the new Three Lines Model. We also would appreciate if the highest level of independence is clearly in the third line, internal audit: " Banks should incorporate climate-related financial risks into their internal control frameworks across the three lines of the organization to ensure sound, comprehensive and effective identification, measurement, mitigation and assurance of material climate-related financial risks. [Reference principles: BCP 26, SRP 20, SRP 30]"

#### Guidelines 17

It should refer to the three lines rather

*Guideline 18* does not contain indication to expectations in understanding the climate change impact and related risks for the entity (reputation and other environment and social risks for the entities). This principle *does not mention essential elements like Climate related legislation and international commitments* as well as the entities commitments to manage climate risk, monitoring and reporting on client base climate impact and assessing climate risk in the Product Development and Review Process.

#### Guideline 19

We recommend more clarity about the second line: “The second line the risk function, should be responsible for undertaking separate climate-related risk assessment and monitoring, including challenging the initial assessment conducted by the frontline, while the compliance function should ensure adherence to applicable rules and regulations.” It is the responsibility of the third line, internal audit, to give an objective and independent assurance.

#### Guideline 20

It mentions that the third line must carry out regular reviews but does not mention how these reviews should be included in the audit universe. It is also important to mention that internal audit gives objective and independent assurance (from Management).

#### Principle 6

It seems that the risk management process is limited to climate related financial risk. It would be a missed opportunity not to make a broader assessment to e.g. include operational risk (reputation risk, environmental and social risk ...) as mentioned in Principle 11. A broad vision should be considered when assessing climate risks.

#### Principle 7

This principle is about managing monitoring and reporting but *it does not give guidance* about the baseline/standards for Sustainability Reporting metrics and targets.

*Guideline 30* It is also important to define the level of internal assurance required and the role of the 2<sup>d</sup> line and the 3<sup>rd</sup> line.

*Guideline 31* Quantitative and qualitative indicators should be considered.

#### Principle 8

*Guideline 32* A full assessment of the credit portfolio should be made, not just the new loans.

#### Principle 12

*Guideline 45* Internal auditors can play a pivot role in reviewing and challenging the various scenarios and procedures in place and make recommendations for improvements.

### About ECIIA

The European Confederation of Institutes of Internal Auditing (ECIIA) is the professional representative body of 34 national institutes of internal audit in the wider geographic area of Europe and the Mediterranean basin. We represent 48.500 internal auditors.

The mission of ECIIA is to be the consolidated voice for the profession of internal auditing in Europe by dealing with the European Union, its Parliament and Commission and any other appropriate institutions of influence. The primary objective is to further the development of corporate governance and internal audit through knowledge sharing, key relationships and regulatory environment oversight.

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