DATE: March 14, 2022

MEMORANDUM TO: Board of Directors

FROM: Doreen R. Eberley, Director
Division of Risk Management Supervision

SUBJECT: Request for Comment on the Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions

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Summary: In response to the emerging economic and financial risks posed by the effects of climate change and the transition to a low carbon economy, staff is presenting for the approval of the Federal Deposit Insurance Corporation ("FDIC") Board of Directors ("FDIC Board") the attached Request for Comment on the Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions (Request for Comment). The Request for Comment seeks industry feedback on draft principles that would provide a high-level framework for the safe and sound management of exposures to climate-related financial risks. Although all financial institutions, regardless of size, may have material exposures to climate-related financial risks, these draft principles are targeted at the largest financial institutions, those with over $100 billion in total consolidated assets. The draft principles are intended to support efforts by large financial institutions to focus on key aspects of climate-related financial risk management.

Concur:

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Harrel M. Pettway
General Counsel

Recommendation: Staff requests that the FDIC Board approve the Request for Comment and authorize its publication in the *Federal Register* with a comment period ending 60 days after publication.

Principles for the effective management of climate-related financial risks

The effects of climate change and the transition to a low carbon economy present emerging economic and financial risks that threaten the safety and soundness of financial institutions and the stability of the financial system [1, 2] Financial institutions are likely to be affected by both the physical risks and transition risks associated with climate change (together, climate-related financial risks). Physical risks refer to the harm to people and property arising from acute, climate-related events, such as hurricanes, wildfires, floods, and heatwaves, and chronic shifts in climate, including higher average temperatures, changes in precipitation patterns, sea level rise, and ocean acidification. Transition risks refer to stresses to certain financial institutions or sectors arising from the shifts in policy, consumer and business sentiment, or technologies associated with the changes necessary to limit climate change.

Climate-related financial risks pose a clear and significant risk to the U.S. financial system and, if unmitigated, may pose a near-term threat to safe and sound banking and financial stability. Weaknesses in how financial institutions identify, measure, monitor, and control the potential physical and transition risks associated with a changing climate could adversely affect a

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[1] The term "financial institution" refers to insured state nonmember banks, state-licensed insured branches of foreign banks that are subject to the provisions of section 39 of the Federal Deposit Insurance Act, and state savings associations.

[2] For additional background, *see* generally "Report on Climate-Related Financial Risk" Financial Stability Oversight Council (Oct. 21, 2021) (FSOC Climate Report), https://home.treasury.gov/system/files/261/FSOC-Climate-Report.pdf. Further, *see* "The Implications of Climate Change for Financial Stability", Financial Stability Board, (November 23, 2020), https://www.fsb.org/2020/11/the-implications-of-climate-change-for-financial-stability/.

financial institution's safety and soundness, as well as the overall financial system. Adverse effects could also include potentially disproportionate impacts on the financially vulnerable, including low-to moderate-income (LMI) and other disadvantaged households and communities.[3] Further, staff believes the manner in which financial institutions manage climate-related financial risks to address safety and soundness concerns should also seek to reduce or mitigate the impact that management of these risks may have on broader aspects of the economy, including the disproportionate impact of risk on LMI and other disadvantaged communities.

Staff recognizes the need for comprehensive risk management guidelines that can be implemented consistently, and believes the draft principles would provide a high-level framework for the safe and sound management of exposures to climate-related financial risks, consistent with the existing risk management framework described in existing FDIC rules and guidance.[4] The draft principles are intended to support efforts by financial institutions to focus on key aspects of climate-related financial risk management. Additionally, the draft principles are intended to support the use of scenario analysis as an emerging and important approach for identifying, measuring, and managing climate-related financial risks, as well as risk assessment processes related to credit, liquidity, operational, legal and compliance, and other financial and nonfinancial risks. Some financial institutions, including many large financial institutions, are considering climate-related risks and would benefit from additional guidance as they develop

[3] For further information, *see* Staff Reports, Federal Reserve Bank of New York, Understanding the Linkages between Climate Change and Inequality in the United States, No. 991 (November 2021), https://www.newyorkfed.org/research/staff_reports/sr991.html

[4] The FDIC has established standards for safety and soundness, as required by section 39 of the Federal Deposit Insurance Act, in Part 364 of FDIC Rules and Regulations.

capabilities, deploy resources, and make necessary investments to address climate-related financial risks.

Although all financial institutions, regardless of size, may have material exposures to climate-related financial risks, the draft principles would be applicable to large financial institutions with over $100 billion in total consolidated assets.[5] Staff believes the draft principles are an initial step to promote a consistent understanding of the effective management of climate-related financial risks, and, if approved, plans to elaborate on these principles in subsequent guidance that would distinguish roles and responsibilities of boards of directors and management, incorporate the feedback received on the principles, and consider lessons learned and best practices from the industry and other jurisdictions. Any resulting supervisory expectations would be appropriately tailored to reflect differences in financial institutions' circumstances, such as complexity of operations and business models. Through this and any subsequent climate-related financial risk guidance, staff will continue to underscore the FDIC's position of encouraging financial institutions to prudently meet the financial services needs of their communities.

Conclusion

Staff requests that the FDIC Board approve the Request for Comment and authorize its publication in the *Federal Register* with a comment period ending 60 days after publication.

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[5] Generally, effective risk management practices should be appropriate to the size of the institution and the nature, scope, and risk of its activities. See, e.g., Appendix A to Part 364. For purposes of these draft principles, the FDIC generally believes that these standards are particularly salient for the largest financial institutions, those with over $100 billion in total consolidated assets.

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