



May 31, 2022

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550 17th Street NW
Washington, DC 20429.

Re: RIN 3064–ZA32, *Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions*

To Whom It May Concern:

On behalf of the Center for American Progress, I write to comment on the Federal Deposit Insurance Corporation’s (FDIC) request for information titled *Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions* (RFI).¹ The Center for American Progress is an independent, nonpartisan policy institute that is dedicated to improving the lives of all Americans through bold, progressive ideas, as well as strong leadership and concerted action. We greatly appreciate the opportunity to comment on this document. The FDIC has rightly recognized that 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,” and that “[w]eaknesses in how institutions identify, measure, monitor, and control the physical and transition risks associated with a changing climate could adversely affect a financial institution’s safety and soundness, as well as the overall financial system.”²

Additionally, we are pleased to see the FDIC make clear that its focus on climate-related financial risks is about safety and soundness concerns. The FDIC articulates the position that “climate-related financial risks have the potential to impact financial institutions and the economy through both macroeconomic and microeconomic factors.”³ We agree with this assessment and appreciate the explicit focus on safety and soundness as it permits the FDIC to use the full range of its regulatory and supervisory authorities to ensure that banks, thrifts, and other FDIC-supervised institutions (collectively, “banks”) take action to protect their operations and balance sheets. The FDIC also appropriately notes that “interconnections within the financial system can accelerate the spread of a climate related financial shocks, leading to potential contagion effects if institutions

¹ Federal Deposit Insurance Corporation, “Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions,” *Federal Register* 87 (64) (2022): 19507-19512, available at <https://www.federalregister.gov/documents/2022/04/04/2022-07065/statement-of-principles-for-climate-related-financial-risk-management-for-large-financial?msclkid=47da1ec4b43711eca3d5d7211f084635>.

² *Ibid.*, p. 19509.

³ *Ibid.*, p. 19508.

experience shocks as a result of physical or transition risks.”⁴ Again, we agree with this assessment.

In addition to the above comments, below are answers to questions the RFI poses.

Question 1: What additional factors, for example asset size, location, and business model, should inform financial institutions' adoption of these principles?

Although the FDIC limits its draft principles for climate-related financial risk management to banks “with over \$100 billion in total consolidated assets,” the principles themselves are sufficiently high-level to apply to all banks, regardless of size, location, and business model.⁵ For example, the FDIC explains that “[a] financial institution’s board and management should demonstrate an appropriate understanding of climate-related financial risk exposures and their impact on risk appetite to facilitate oversight,” as well as that “[a] financial institution should employ a comprehensive process to identify emerging and material risks stemming from the institution’s business activities and associated exposures.”⁶ The FDIC notes that “all financial institutions, regardless of size, may have material exposures to climate-related financial risks,” and the principles articulated apply just as much to an institution with \$500 billion in assets as one with \$50 billion, \$5 billion, or less.⁷

While the FDIC should apply the *principles* to all institutions, it should differentiate in the *implementation* of these principles. Implementation will clearly differ based on factors the FDIC listed (i.e., asset size, location, business model) and others.

Question 2: How could future guidance assist a financial institution in developing its climate-related financial risk management practices commensurate to its size, complexity, risk profile, and scope of operations?

It is imperative that the FDIC provide institutions with the guidance they need to firmly understand and address their climate-related financial risks and explain how the FDIC intends to incorporate these risks into its examinations.

- a. *The FDIC must explain how climate risks relate to traditional financial risks and help banks understand how to manage their climate-related financial risks.*

The FDIC must continue to use guidance to describe the physical and transition risks associated with climate change and explain how those risks relate to traditional financial risks with which institutions are familiar (e.g., credit risk, market risk, liquidity risk, operational risk). As the Financial Stability Oversight Council (FSOC) recently noted, although these risks “will manifest in forms familiar to financial institutions[,] ... the nature of climate risks is less familiar.”⁸ Accordingly, the FDIC must provide in guidance

⁴ Ibid, p. 19509, *noting* Financial Stability Board, *The Implications of Climate Change for Financial Stability* (2020); Basel Committee on Banking Supervision, *Climate-related risk drivers and their transmission channels* (2021).

⁵ Federal Deposit Insurance Corporation, “Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions,” p. 19507.

⁶ Ibid, p. 19510.

⁷ Ibid, p. 19509.

⁸ Financial Stability Oversight Council, “Report on Climate-Related Financial Risk” (Washington: 2021), p. 24, available at <https://home.treasury.gov/system/files/261/FSOC-Climate-Report.pdf>.

examples of each type of risk so bankers can truly understand the risks they face.⁹ For example:

- Credit risk: Institutions may see increased real estate losses due to hurricanes, agricultural loan losses due to drought, losses from fossil fuel companies as demand for greener products increases, or losses from borrowers in communities where the economy is dependent on the fossil fuel industry.
- Market risk: Institutions may see losses due to agricultural commodity price increases due to crop damage or increased costs of capital if shareholders and bondholders withdraw financing because of a bank's climate-related risks.
- Liquidity risk: Institutions may see lower liquidity as natural disasters losses impair the value of long-term assets or disrupt short-term funding sources.
- Operational risk: Institutions may cease operating for a period of time if they lose power as a result of storms disabling the power grid.
- Reputational risk: Institutions may face increased costs of capital if potential shareholders and bondholders shift funding away from firms known to fund fossil fuel producers.

The FDIC must also explain to institutions how many of these risks are interconnected and that a bank may face multiple climate-related financial risks at once from the same or different counterparties (e.g., institutions may face credit risk from agricultural borrowers at the same time as they face market risk from increased agricultural commodity prices). It must also stress that transition risk may come from both governmental activities (e.g., new statutes or regulations) and from private actors (e.g., shifts in investor preferences).

Further, the FDIC must use guidance to help banks understand how best to manage their climate-related financial risks. Although the FDIC should not *mandate* particular risk-reducing activities, it should help institutions understand options for reducing, mitigating, or otherwise managing their climate-related risks. These options could include, among others, incorporating climate-related financial risk management practices in all business lines, creating procedures by which climate-related issues may be escalated to the management or board level, and assisting counterparties in developing their own climate-related risk management or transition plans.

To both highlight climate-related financial risks and help banks manage those risks, the FDIC should use existing publications and activities such as the *Quarterly Banking Profile*, periodic *Risk Reviews*, and the Community Banking Research Program to understand, identify, and articulate the seriousness of its climate concerns.

b. The FDIC must provide guidance as to how climate-related financial risks fit into the CAMELS framework.

The FDIC uses the Uniform Financial Institutions Rating System, better known as CAMELS, “for evaluating the soundness of financial institutions on a uniform basis and for

⁹ See generally Americans for Financial Reform Education Fund and others, “Recommendations for Supervisory Guidance for Bank Regulators” September 2021, p. 5, available at <https://www.nrdc.org/sites/default/files/supervision-guidance-climate-risk-202109.pdf>.

identifying those institutions requiring special supervisory attention or concern.”¹⁰ FDIC examiners assign banks a score of 1 to 5 on six components (“capital adequacy, asset quality, management capability, earnings quantity and quality, the adequacy of liquidity, and sensitivity to market risk”) and provide an overall composite score. Banks take their CAMELS ratings very seriously, and regulators use them to decide whether a bank holding company can engage in non-banking financial activities and how much to charge for insurance premiums.¹¹

The Federal Financial Institutions Examination Council (FFIEC) has provided guidance on what factors examiners should consider when evaluating banks for each component, and climate risk may be easily incorporated.¹² The FDIC should issue guidance explaining how its examiners will incorporate climate-related financial risks into its CAMELS ratings. For example, the FFIEC guidance explains that examiners should consider “balance sheet composition, including the nature and amount of intangible assets, market risk, concentration risk, and risks associated with nontraditional activities” when determining a bank’s Capital Adequacy score.¹³ Accordingly, the FDIC could explain that examiners may consider whether its assets are at risk of losing value as markets transition away from fossil fuels. Similarly, the FFIEC guidance explains that examiners should consider “the adequacy of, and conformance with, appropriate internal policies and controls addressing the operations and risks of significant activities” to determine a bank’s Management score, and examiners may consider whether the bank has sufficient policies addressing climate-related financial risk.¹⁴

c. *The FDIC must update its examination manuals to incorporate climate-related financial risks.*

The FDIC maintains several different examination manuals, including its *Risk Management Manual of Examination Policies*,¹⁵ its *Consumer Compliance Examination Manual*,¹⁶ and its *Trust Examination Manual*.¹⁷ Although these manuals are drafted to aid examiners in evaluating banks’ safety and soundness, institutions themselves rely on these manuals to understand the FDIC’s and examiners’ expectations of them. Accordingly, the FDIC should update these manuals to ensure that climate-related financial risk is referenced as appropriate and in a timely manner. Additionally, if the FDIC determines it is

¹⁰ Federal Financial Institutions Examination Council, “Uniform Financial Institutions Rating System,” *Federal Register* 61 (245) (1996): 67021-67029, available at <https://www.govinfo.gov/content/pkg/FR-1996-12-19/pdf/96-32174.pdf>.

¹¹ See Legal Information Institute, “12 U.S. Code § 1843 - Interests in nonbanking organizations,” available at <https://www.law.cornell.edu/uscode/text/12/1843> (last accessed May 2022); Legal Information Institute, “12 U.S. Code § 1841 - Definitions,” available at <https://www.law.cornell.edu/uscode/text/12/1841> (last accessed May 2022); Legal Information Institute, “12 CFR § 327.16 - Assessment pricing methods,” available at <https://www.law.cornell.edu/cfr/text/12/327.16> (last accessed May 2022).

¹² Federal Financial Institutions Examination Council, “Uniform Financial Institutions Rating System.”

¹³ *Ibid.*, p. 67026.

¹⁴ *Ibid.*, p. 67027.

¹⁵ Federal Deposit Insurance Corporation, “Risk Management Manual of Examination Policies,” available at <https://www.fdic.gov/regulations/safety/manual/> (last accessed May 2022).

¹⁶ Federal Deposit Insurance Corporation, “Consumer Compliance Examination Manual,” available at <https://www.fdic.gov/resources/supervision-and-examinations/consumer-compliance-examination-manual/index.html> (last accessed May 2022).

¹⁷ Federal Deposit Insurance Corporation, “Trust Examination Manual,” available at <https://www.fdic.gov/regulations/examinations/trustmanual/> (last accessed May 2022).

necessary to employ examiners focused on climate-related financial risks, it should consider issuing an exam manual dedicated to that topic.

d. The FDIC must tailor guidance.

As the FDIC articulates new climate related principles and expectations for how institutions will implement those principles, it should consider (on a document-by-document basis) whether or how those principles or expectations may be tailored to institutions' business lines or sizes. The FDIC should also consider whether institutions with particular business lines or institutions that operate in particular locations require tailored guidance. For example, institutions with high concentrations of mortgage loans will have different risk profiles from institutions with high concentrations of agricultural loans, and institutions with high concentrations of mortgage loans in one area of the country will have different risk profiles from institutions in others. The FDIC should tailor its expectations for how institutions will mitigate their risks faced, and it would be appropriate for the FDIC to issue guidance specifying what those tailored expectations are.

e. The FDIC must tailor examiners' interactions with banks.

Just as the FDIC should tailor its written guidance, its examiners' interactions with institutions should be similarly tailored. Some of the largest institutions are keenly aware of their climate risks and began taking steps to mitigate those risks even before the FDIC issued its guidance.¹⁸ For these institutions, examiners' climate-related responsibilities should be focused on, for example, ensuring that institutions' managements have put forth policies and procedures based on the most recent science, and that staff comply with those policies and procedures. However, for smaller institutions that may not have the resources to begin adapting to the realities of climate change, examiners should have conversations with institutions' boards and management so that they understand their institutions face climate-related risks and have basic information as to the range of possible responses.

f. The FDIC must require that banks fulfill their public commitments.

We strongly support the FDIC's statement that, "where institutions engage in public communication of their climate-related strategies, boards and management should ensure that any public statements about an institution's climate related strategies and commitments are consistent with their internal strategies and risk appetite statements." Although the FDIC cannot legally mandate that institutions make specific public commitments regarding their loan portfolios, it should require that when institutions articulate measurable targets that they also take the steps necessary to adhere to those targets.

When an institution fails to adhere to its public commitments on climate change, it could face losses for both reputational and legal reasons. First, institutions that make extensive climate commitments, such as commitments to be net zero by 2050, may lose customers if they fail to make significant progress on those commitments, as individuals who choose their banks based in part on climate pledges may move their business away

¹⁸ For example, six U.S.-headquartered global systemically important banks have joined the Net-Zero Banking Alliance. See Net-Zero Banking Alliance, "Members," available at <https://www.unepfi.org/net-zero-banking/members/> (last accessed May 2022).

from institutions that fail to make progress on their commitments. Second, publicly traded institutions that make climate commitments may face litigation under the securities laws for making materially false statements if they similarly fail to make significant progress on those commitments. To help institutions avoid losses from these risks, the FDIC should make clear that institutions that make public climate commitments must develop and implement credible strategies for fulfilling those commitments.

Importantly, those strategies should not rely on carbon offsets, which are “tradable ‘rights’ or certificates linked to activities that lower the amount of carbon dioxide in the atmosphere.”¹⁹ Not only is there deep concern that many carbon offsets, as currently designed, do not work,²⁰ but regulators with jurisdiction over carbon markets may bring enforcement actions against sellers of offsets for fraud, severely limiting the supply and increasing the price of legitimate offsets.²¹ To the extent institutions wish to rely on carbon offsets to meet their commitments, the FDIC should ensure that efforts are in place to substantiate that those offsets result in the removal of carbon from the atmosphere.

Question 3: What challenges do financial institutions face in incorporating these draft principles into their risk management systems? How should the FDIC further engage with financial institutions to understand those challenges?

In our interactions with banks, the primary challenge they face is with obtaining data with which to effectively understand their climate-related financial risks. Accordingly, the FDIC should provide guidance as to what types of information may be useful in helping institutions understand their climate risks as well as how banks may obtain this information.

In order to fully understand their counterparties’ and their own operations’ climate-related financial risks, banks will need asset-specific data and metrics that are forward-looking. Banks will need information both from counterparties and from public sources to fully understand their exposure to climate-related financial risks.

When making loans, banks typically rely on information disclosed by borrowers, and banks should request climate-related information from their counterparties. The Securities and Exchange Commission’s (SEC) proposed climate disclosure rule provides good examples of the types of information that banks should be requesting from their borrowers,²² including information about how corporate borrowers’ governance policies

¹⁹ See e.g., Angelo Gurgel, “Carbon Offsets,” MIT Climate Portal, September 11, 2020, available at <https://climate.mit.edu/explainers/carbon-offsets>.

²⁰ See e.g., Lisa Song and Paula Moura, “An Even More Inconvenient Truth: Why Carbon Credits for Forest Preservation May Be Worse Than Nothing,” ProPublica, May 22, 2019, available at <https://features.propublica.org/brazil-carbon-offsets/inconvenient-truth-carbon-credits-dont-work-deforestation-redd-acre-cambodia/>.

²¹ Todd Phillips, “A Climate and Competition Agenda for the Commodity Futures Trading Commission,” American Progress, February 1, 2022, available at <https://www.americanprogress.org/article/a-climate-and-competition-agenda-for-the-commodity-futures-trading-commission/> (“The CFTC has jurisdiction over carbon offsets through its authority to address fraud and market manipulation in spot commodity markets...and it can hold offset issuers accountable if they promise carbon reductions that do not, or simply cannot, occur.”).

²² Securities and Exchange Commission, “The Enhancement and Standardization of Climate-Related Disclosures for Investors,” *Federal Register* 87 (69) (2022): 21334-21473, available at <https://www.govinfo.gov/content/pkg/FR-2022-04-11/pdf/2022-06342.pdf>.

account for climate risks; the climate-related physical and transition risks reasonably likely to have a material impact on borrowers' current and expected assets and operations; borrowers' strategies for addressing those risks; borrowers' Scopes 1, 2, and 3 greenhouse gas emissions (excluding offsets or renewable energy credits); and any other risks that may affect borrowers' creditworthiness in the future. This requested information should relate to both physical- and transition-related risks. Banks should also request geolocation information for significant borrower infrastructure (including significant infrastructure up and down the value chain) and information about whether borrowers have applied for climate-related insurance but have been rejected.

In addition to information provided by borrowers, banks should consider using publicly available data. Useful data sources include publicly traded borrowers' climate-related securities disclosures, borrowers' competitors' climate-related securities disclosures, location-specific climate projections, and information regarding climate risks to borrowers' value chains. Importantly, banks cannot simply rely on historical data to project future trends in climate change; climate events are occurring and intensifying in a nonlinear fashion and will continue to do so into the future.²³ Finally, banks should also consider using independent consultants who have climate-related expertise and knowledge about borrowers' business sectors.

Question 4: Would regulations or guidelines prescribing particular risk management practices be helpful to financial institutions as they adjust to doing business in a changing climate?

The FDIC should consider issuing standards under section 39 of the Federal Deposit Insurance Act relating to how banks manage their climate-related financial risks.²⁴ Section 39 allows the FDIC to "prescribe standards relating to," among other things, banks' "internal controls, information systems, and internal audit systems;" "loan documentation;" credit underwriting;" and "other operational and managerial standards as the [FDIC] determines to be appropriate" to ensure banks' safety and soundness. If a bank fails to adhere to promulgated standards, the FDIC may require the bank to submit and follow a plan specifying actions it "will take to correct the deficiency."

It is important that the FDIC prescribe standards that "invoke[] some underlying purpose," rather than one that "has a definite factual trigger."²⁵ This is consistent with the existing FDIC standards promulgated under section 39, which includes among its requirements that banks have internal controls for "[e]ffective risk assessment," audit systems that provide for "[i]ndependence and objectivity," and credit underwriting standards that "[a]re appropriate to the size of the institution."²⁶ The FDIC indicated that

²³ Christian L. E. Franzke, "Nonlinear climate change," *Nature Climate Change* 4 (2014): 423-424, available at <https://www.nature.com/articles/nclimate2245>.

²⁴ Legal Information Institute, "12 U.S. Code § 1831p-1 - Standards for safety and soundness," available at <https://www.law.cornell.edu/uscode/text/12/1831p-1> (last accessed May 2022); See generally Todd Phillips, "In Support of Supervisory Guidance," September 24, 2021, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3927856.

²⁵ Bryan Lammon, "Rules, Standards, and Experimentation in Appellate Jurisdiction," *Ohio State Law Journal* 74 (423) (2013): 423-461, available at https://kb.osu.edu/bitstream/handle/1811/71589/OSLJ_V74N3_0423.pdf.

²⁶ Legal Information Institute, "12 CFR Appendix A to Part 364 - Interagency Guidelines Establishing Standards for Safety and Soundness," available at https://www.law.cornell.edu/cfr/text/12/appendix-A_to_part_364 (last accessed May 2022).

such standards allow examiners “to identify and address problems at insured depository institutions before capital becomes impaired... without dictating how institutions must be managed and operated.”²⁷

The benefit of issuing standards under section 39 are three-fold. First, doing so would help banks understand the standard by which examiners will hold them. One study found that this type of guidance “is a much-needed resource that [regulated parties] would not want to do without—and may actively demand” as it can be used to “clarify vague legislative rules” or statutes without necessitating an enforcement action.²⁸ Second, issuing section 39 standards would provide FDIC examiners a clearly legal means for requiring banks to make necessary changes with a clear mechanism for appealing such determinations.²⁹ Finally, issuing these standards under section 39 would make clear that climate-related financial risks are a safety and soundness concern. Some legislators have indicated that they believe efforts by the FDIC and other banking regulators to address climate-related financial risks are simply “advocating a certain set of social policies” such as “addressing global warming or advancing so-called racial justice,”³⁰ but courts can review actions under section 39 to ensure that they address only valid safety and soundness concerns.

Note, however, that standards issued as guidelines under section 39 are little different from other guidance documents the FDIC could issue, except that they are more vulnerable to being overturned by Congress under the Congressional Review Act. The FDIC could accomplish the same goals with other guidance not issued under section 39.³¹

Question 5: What specific tools or strategies have financial institutions used to successfully incorporate climate-related financial risks into their risk management frameworks?

No response to question 5.

Question 6: How do financial institutions determine when climate-related financial risks are material and warrant greater than routine attention by the board and management?

No response to question 6.

²⁷ Ibid.

²⁸ Nicholas R. Parrillo, “Federal Agency Guidance: An Institutional Perspective,” Administrative Conference of the United States, October 12, 2017, p. 35, available at <https://www.acus.gov/sites/default/files/documents/parrillo-agency-guidance-final-report.pdf>; See also Phillips, “In Support of Supervisory Guidance,” p. 9. (Guidance “gives banks the clarity they desire that may not be available from reviewing the text of a statute—and without their regulator having to begin an enforcement action against one institution to put the rest of the industry on notice.”)

²⁹ See Federal Deposit Insurance Corporation, “Guidelines for Appeals of Material Supervisory Determinations,” *Federal Register* 86 (14) (2021): 6880-6888, available at <https://www.fdic.gov/news/board-matters/2021/2021-01-19-notice-dis-a-fr.pdf>.

³⁰ U.S. Senator Pat Toomey, “Toomey Opening Statement at Fed Chairman Powell’s Nomination Hearing,” U.S. Senate Committee on Banking, Housing, and Urban Affairs, January 11, 2022, available at <https://www.banking.senate.gov/newsroom/minority/toomey-opening-statement-at-fed-chairman-powells-nomination-hearing>.

³¹ See Phillips, “In Support of Supervisory Guidance,” p. 17-20.

Question 7: What time horizon do financial institutions consider relevant when identifying and assessing the materiality of climate-related financial risks?

No response to question 7.

Question 8: What, if any, specific products, practices, and strategies—for example, insurance or derivatives contracts or other capital market instruments—do financial institutions use to hedge, transfer, or mitigate climate-related financial risks?

Banks can use insurance and derivatives to hedge their climate-related risks at both the loan and portfolio level. However, banks and regulators must recognize that hedging cannot not remove risk entirely from their balance sheets; any contract to transfer credit risk to another entity gives rise to counterparty risk because the counterparty may fail to fulfill their side of the contract.

Banks face different risks from hedging strategies at both the loan and portfolio level. At the loan level, banks frequently require borrowers to obtain and maintain insurance coverage for the duration of their loan—for example, residential mortgage borrowers are required to obtain homeowners insurance upon loan closure. However, as areas become more subject to the catastrophic effects of climate change, such as with changing flood maps, borrowers may be subject to increased premiums or even discontinued coverage, leaving them without insurance.³² At the portfolio level, banks can use catastrophe insurance, climate bonds, and various derivatives to hedge their climate-related financial risks.³³ However, it is easy to imagine banks entering into weather derivative contracts only to find that their counterparty's balance sheet is negatively correlated with the risk it is insuring against and could fail at just the time that the banks need protection. Such a situation does not entirely remove risk from individual banks' balance sheets but instead removes the credit risk and applies counterparty risk.

The use of insurance or derivatives to hedge risk also raises systemic risk concerns. Just as how in the leadup to the 2008 financial crisis many large financial institutions relied on credit risk protection offered by AIG,³⁴ one can imagine many large banks today relying on a single institution for climate-risk protection. If those banks all rely on one insurer and that insurer does not have a sufficiently strong balance sheet, none would be fully protected.

Accordingly, the FDIC must understand what climate-risk insurance coverage is being provided to banks, who is providing that coverage, and whether insurers' balance sheets are in any way correlated with the banks for which they are providing coverage. To the extent that many banks have counterparty risk with a single counterparty, FSOC

³² Jie Jenny Zou, "Insuring catastrophe," The Center for Public Integrity, February 25, 2020, available at <https://publicintegrity.org/environment/flood-insurance-climate-change-risk-inequality/>.

³³ See Patrick Henry, "Explainer: How catastrophe bonds help manage the risk of climate change," World Economic Forum, November 10, 2021, available at <https://www.weforum.org/agenda/2021/11/catastrophe-bond-finance-insurance-climate-change-natural-disaster/>.

³⁴ Adam Davidson, "How AIG fell apart," Reuters, September 18, 2008, available at <https://www.reuters.com/article/us-how-aig-fell-apart-idUSMAR85972720080918>.

should consider whether to designate that firm as systemically important and subject to enhanced prudential standards.

Question 9: What, if any, climate-related financial products or services—for example, “green bonds,” derivatives, dedicated investment funds, or other instruments that take climate-related considerations into account—do financial institutions offer to clients and customers? What risks, if any, do these products or services pose?

No response to question 9.

Question 10: How do financial institutions currently consider the impacts of climate-related financial risk mitigation strategies and financial products on households and communities, specifically LMI and other disadvantaged communities? Should the agencies modify existing regulations and guidance, such as those associated with the Community Reinvestment Act, to address the impact climate-related financial risks may have on LMI and other disadvantaged communities?

The FDIC’s principles note that climate change “could include potentially disproportionate impact on the financially vulnerable, including low- to moderate-income (LMI) and other disadvantaged households and communities,” and, accordingly, it is especially important that the FDIC help ensure institutions continue to provide services to these households and communities. Although there may be additional means of tackling this, the FDIC should take three specific actions.

First, the FDIC should work with the other federal banking agencies to update their Community Reinvestment Act (CRA) rules to ensure that credit flows to LMI and other disadvantaged communities to help these communities reduce their fossil fuel emissions and protect themselves from climate impacts.³⁵ Currently, banking deserts—often in central cities and rural areas—are excluded from the benefits promised by the CRA because they are not in any institution’s assessment area. The FDIC should update its CRA regulations to ensure that institutions with a nationwide presence direct investment into all underserved communities, not only those surrounding physical branches. Further, the FDIC should explore a climate resilience and environmental justice finance mandate for the CRA, which would give institutions credit for providing loans for projects such as energy efficient and climate resilient affordable housing, installation of community solar energy projects, and others.³⁶

Second, the FDIC must ensure that banks consider whether their climate risk mitigation efforts have fair lending implications and must ensure agency examiners and enforcement officials can sufficiently identify issues that may result in discrimination. A number of laws to which banks are subject—including the Equal Credit Opportunity Act,

³⁵ Federal Deposit Insurance Corporation, “Agencies Issue Joint Proposal to Strengthen and Modernize Community Reinvestment Act Regulations,” Press release, May 5, 2022, available at <https://www.fdic.gov/news/press-releases/2022/pr22039.html>.

³⁶ See generally Michela Zonta and Caius Willingham, “A CRA To Meet the Challenge of Climate Change,” American Progress, December 17, 2020, available at <https://www.americanprogress.org/article/cra-meet-challenge-climate-change/>.

the Fair Housing Act, Community Reinvestment Act, and regulations thereunder—prohibit discrimination based on several protected characteristics.³⁷

Discrimination may be demonstrated through not only “[o]vert evidence of disparate treatment,” but also “[e]vidence of disparate impact.”³⁸ Disparate treatment occurs “when a lender openly discriminates on a prohibited basis,” whereas disparate impact occurs when “a lender applies a racially or otherwise neutral policy or practice equally to all credit applicants, but the policy or practice disproportionately excludes or burdens certain persons on a prohibited basis.”³⁹

It is particularly important for banks to ensure that climate risk mitigation efforts do not discriminate against the borrowers who are already disproportionately impacted by climate change. Unfortunately, impacts from climate change pose one such risk, as climate-induced or -exacerbated natural disasters and sea level rise has been found to disproportionately affect low-income communities and communities of color.⁴⁰ A literature review conducted by staff of the Federal Reserve Bank of New York found “that regions of the United States that are home to above-average shares of low-income and minority groups are likely to suffer the greatest meteorological effects of climate change.”⁴¹ Even more, it found “that low-income and minority Americans are limited in how they may adapt to climate change because they have less access to insurance and are less likely to have access to credit when needed.”⁴²

Accordingly, the FDIC should consider providing guidance to explain how banks could inadvertently engage in discriminatory practices when addressing climate-related financial risks in order to ensure continued access to credit for climate-affected communities. The FDIC should also instruct agency examiners and enforcement officials to recognize that discrimination can occur as banks begin taking steps to address climate risks.

Finally, the FDIC should issue guidance detailing how institutions may continue extending credit to vulnerable communities in a safe and sound manner. The FDIC should

³⁷ See Equal Credit Opportunity Act, Public Law 93, Sec. 495, Title V, 93rd Cong., 2nd sess. (October 28, 1974), available at <https://www.congress.gov/bill/93rd-congress/house-bill/11221/text>; Fair Housing Act, Public Law 90, Sec. 284, 90th Cong., 2nd sess. (April 11, 1968), available at <https://www.congress.gov/bill/90th-congress/house-bill/2516/text>; Community Reinvestment Act, Public Law 95, Sec. 128, 95th Cong., 1st sess. (October 12, 1977), available at <https://www.congress.gov/bill/95th-congress/house-bill/6655/text>

³⁸ Fair Housing Act, Public Law 90, Sec. 284.

³⁹ Federal Deposit Insurance Corporation, “FDIC Consumer Compliance Examination Manual: IV. Fair Lending” (Washington: 2021), p. 3, available at <https://www.fdic.gov/resources/supervision-and-examinations/consumer-compliance-examination-manual/documents/4/iv-1-1.pdf>.

⁴⁰ See, e.g., Maya Buchanan and others, “Sea Level Rise and Coastal Flooding Threaten Affordable Housing,” *Environmental Research Letters* 15 (12) (2020), available at <https://iopscience.iop.org/article/10.1088/1748-9326/abb266>; Jesse Keenan and Elizabeth Mattiuzzi, “Climate Adaptation Investment and the Community Reinvestment Act,” Community Development Research Brief, June 16, 2019, available at <https://www.frbsf.org/community-development/publications/community-development-research-briefs/2019/june/climate-adaptation-investment-and-the-community-reinvestment-act/>; NYU Furman Center, “Population in the U.S. Floodplain” (New York: 2017), available at [https://furmancenter.org/files/Floodplain PopulationBrief 12DEC2017.pdf](https://furmancenter.org/files/Floodplain%20PopulationBrief%2012DEC2017.pdf).

⁴¹ Ruchi Avtar and others, “Understanding the linkages between climate change and inequality in the United States,” Federal Reserve Bank of New York, November 2021, p. 5, available at <https://www.econstor.eu/bitstream/10419/247914/1/sr991.pdf>.

⁴² Ibid.

particularly focus on how institutions may safely lend for the purchase and installation of residential solar panels, which are the types of high-dollar, long-term, uncollateralized loans that institutions are traditionally reticent to make.

Question 11: What, if any, specific climate-related data, metrics, tools and models from borrowers and other counterparties do financial institutions need to identify, measure, monitor, and control their own climate-related financial risks? How do financial institutions currently obtain this information? What gaps and other concerns are there with respect to these data, metrics, tools or models?

When making loans, banks typically rely on information disclosed by borrowers, and banks should request climate-related information from their counterparties. The Securities and Exchange Commission's (SEC) proposed climate disclosure rule provides good examples of the types of information that banks should be requesting from their borrowers,⁴³ including information about how corporate borrowers' governance policies account for climate risks; the climate-related physical and transition risks reasonably likely to have a material impact on borrowers' current and expected assets and operations; borrowers' strategies for addressing those risks; borrowers' Scopes 1, 2, and 3 greenhouse gas emissions (excluding offsets or renewable energy credits); and any other risks that may affect borrowers' creditworthiness in the future. This requested information should relate to both physical- and transition-related risks. Banks should also request geolocation information for significant borrower infrastructure (including significant infrastructure up and down the value chain) and information about whether borrowers have applied for climate-related insurance but have been rejected.

Question 12: How could existing regulatory reporting requirements be augmented to better capture financial institutions' exposure to climate-related financial risks?

Public disclosure is an important facet of bank regulation to ensure safety and soundness. The Basel Committee on Bank Supervision explains that disclosure "seek[s] to provide market participants with sufficient information to assess an ... active bank's material risks and capital adequacy," and the FSOC notes that "[p]ublic, high-quality climate-related disclosures by companies that ... are regulated as a financial institution ... will better inform investors and market participants about the climate-related risks to those entities."⁴⁴ Providing disclosure of climate-related risks can help investors make better capital allocation decisions and can enable them to assist bank managements managers in instituting improved risk management practices. It can also help regulators and investors understand where the banking industry as a whole is making loans.

The FSOC notes that "[g]aps in disclosure ... exist with respect to banks," as "[b]ank and savings and loan holding companies not subject to SEC filing requirements represent 3,855 entities with about \$3.1 trillion in total assets," and "the majority of banks that are not part of a holding company are exempt from SEC-related disclosures," and that bank

⁴³ Securities and Exchange Commission, "The Enhancement and Standardization of Climate-Related Disclosures for Investors."

⁴⁴ Bank for International Settlements, "Pillar 3 framework - Executive Summary," June 27, 2019, available at https://www.bis.org/fsi/fsisummaries/pillar3_framework.htm; Financial Stability Oversight Council, "Report on Climate-Related Financial Risk," p. 67.

Consolidated Reports of Condition and Income (call reports) “could benefit from further enhancement and integration with other data sources.”⁴⁵

The FDIC should work with the Office of the Comptroller of the Currency (OCC) and Federal Reserve Board to amend their call reports and any other required reports to include relevant fields related to banks’ climate-related financial risks. At minimum, line items should be added to each applicable schedule that detail banks’ loans for or securities backing fossil fuel exploration, extraction, and electricity generation; for or backing assets subject to physical risk (broken out by type of weather event); and for or backing assets subject to transition risk.

In addition to these particular line items, the FDIC should also consider providing methods or standards by which banks can account for their greenhouse gas emissions. The Partnership for Carbon Accounting Financials (PCAF), for example, has developed standards by which banks and other financial institutions can calculate their financed emissions. While we do not necessarily recommend that the FDIC adopt the PCAF standards outright—we believe that having regulators write standards themselves “avoid[s] the potential legal, policy, and administrative risks of delegating that authority to a third party” while still relying on “[p]rivate standard-setters [to] help advance the techniques and science behind standards and develop best practices”⁴⁶—we do think that some standards should be articulated to ensure reliable, consistent, and comparable disclosures between institutions.

Questions 13 and 14: How do financial institutions use climate scenario models, analysis, or tools and what challenges do they face? What factors are most salient for the FDIC to consider when designing and executing scenario analysis exercises?

We appreciate the FDIC’s commitment to ensuring the largest banks conduct some form of climate scenario analysis. Scenario analysis, which the FDIC describes as an “exercise[] used to conduct a forward-looking assessment of the potential impact on an institution of changes in the economy, financial system, or the distribution of physical hazards resulting from climate-related risks,” is important in that it can help banks understand their susceptibility to climate change risks.

In addition to institutions with assets above \$100 billion, mid-size, regional banks should be required to undertake climate-related scenario analyses as well. Regional banks, with portfolios that may not be as diversified as those of larger institutions, may experience higher rates of failure and branch closures as a consequence of natural disasters that affect only one geographic area. Accordingly, safety and soundness concerns necessitate climate scenario analyses for mid-size institutions, though those analyses may not need to be as rigorous as the ones for larger banks so long as they help institutions gain a better understanding of the climate risks they face.

⁴⁵ Financial Stability Oversight Council, “Report on Climate-Related Financial Risk,” p. 63, 86.

⁴⁶ Dylan Bruce and others, “The SEC Should Write Its Own Environmental, Social, and Governance Rules,” Center for American Progress, December 13, 2021, available at <https://www.americanprogress.org/article/the-sec-should-write-its-own-environmental-social-and-governance-rules/>.

When developing climate scenario analysis guidance, we encourage the FDIC to keep in mind several key points.

- a. *The FDIC must begin conducting scenario analyses quickly, and the first scenarios may be somewhat simplistic.*

It is important for institutions to begin conducting their analyses quickly in order to learn from them and take action as soon as possible. To that end, it is not necessary that the FDIC's initial scenarios be perfect. Just as with the Dodd-Frank Act Stress Tests and the Federal Reserve's Comprehensive Capital Analysis and Review, scenario analysis is an evolving effort that will improve after each iteration. We expect the first scenarios provided by the FDIC to be somewhat simplistic and to become more comprehensive as the FDIC and banks learn from prior years' analyses and as climate scientists gather additional information.

- b. *The FDIC must provide multiple scenarios to banks describing orderly and disorderly transitions.*

The FDIC must provide at least three common scenarios to banks:

- (1) One that provides for an orderly transition that "assume[s] climate policies are introduced early and become gradually more stringent" and "[b]oth physical and transition risks are relatively subdued;"
- (2) One that provides for a disorderly transition that assumes "higher transition risk due to policies being delayed or divergent across countries and sectors;" and
- (3) One that provides a hot-house scenario that "[a]ssume[s] that some climate policies are implemented in some jurisdictions, but global efforts are insufficient to halt significant global warming," and "[c]ritical temperature thresholds are exceeded leading to severe physical risks and irreversible impacts like sea-level rise."⁴⁷

These scenarios should provide for a broad range of plausible outcomes with respect to global emissions, tipping points, and the speed with which the global transition to clean energy, and should set short-, medium-, and long-term analysis windows of 3-5 years, 5-10 years, and 30 years.

The FDIC's scenarios must account for the correlated nature of physical and transition risks. These risks can manifest themselves not just as discrete events, but also as events occurring in series and in parallel. For example, natural disasters can cause physical damage that consequently result in productivity losses, and technological innovations that reduce dependency on fossil fuels can beget further innovations.

Lastly, the FDIC should also look to other jurisdictions and U.S. regulatory agencies for input on its scenarios, though it need not harmonize with those other jurisdictions. We recommend the FDIC utilize the scenarios for the National Climate Assessment as a basis

⁴⁷ NGFS, "Scenarios Portal," available at <https://www.ngfs.net/ngfs-scenarios-portal/> (last accessed May 2022).

for its initial scenarios,⁴⁸ as well as resources developed by other federal agencies, such as the Environmental Protection Agency’s summaries of research investigating the sectoral impacts of climate change.⁴⁹ The FDIC can also base its initial scenarios off the work of the Network for Greening the Financial System and other jurisdictions that have begun conducting their own climate scenario analyses, including the European Central Bank,⁵⁰ the Bank of England,⁵¹ the Bank of Canada,⁵² the Hong Kong Monetary Authority,⁵³ and others.

c. The FDIC must ensure banks’ models are sufficiently rigorous and avoid obvious pitfalls.

The FDIC—through the use of guidance and examinations—must ensure that banks’ models are sufficiently rigorous so as to be useful. There are several key points that the FDIC must ensure banks consider. First, banks should not be allowed to “model shop.” The climate scenario analysis process is about helping banks understand their climate-related financial risks—not about optimizing capital, penalizing institutions, or appeasing regulators. To that end, the process of creating or identifying a model is itself just as important as the outcome, and model shopping to attain the “optimal” outcome should be discouraged. Additionally, models should be sector- and location-specific and that the assumptions made by banks’ models should be clear and transparent. Some sectors will be less susceptible to climate-related financial risks than others even if they are in the same location, and data sources that aggregate information can mask important variations in data.⁵⁴ Similarly, it is imperative that banks understand any assumptions that are baked into the models they use so bankers and the FDIC understand where models’ blind spots may be. Finally, models must take into consideration network effects within the financial sector, as institutions may face rapid asset repricing that affects not only asset owners but holders of those owners’ securities or debt. Additionally, banks may face runs and the banking system as a whole may experience contagion and overall instability. Models must take these considerations into account.

⁴⁸ U.S. Global Change Research Program, “Scenarios for the National Climate Assessment,” available at <https://scenarios.globalchange.gov/> (last accessed May 2022).

⁴⁹ U.S. Environmental Protection Agency, “Technical Documentation on The Framework for Evaluating Damages and Impacts (FrEDI)” (Washington: 2021), p. 15-16, available at https://www.epa.gov/system/files/documents/2021-10/technical-documentation-on-the-framework-for-evaluating-damages-and-impacts_maintext.pdf.

⁵⁰ Spyros Alogoskoufis and others, “ECB Economy-Wide Climate Stress Test” (Frankfurt: European Central Bank, 2021), available at <https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op281~05a7735b1c.en.pdf>.

⁵¹ Bank of England, “Guidance for participants of the 2021 Biennial Exploratory Scenario: Financial risks from climate change” (London: 2021), available at <https://www.bankofengland.co.uk/-/media/boe/files/stress-testing/2021/the-2021-biennial-exploratory-scenario-on-the-financial-risks-from-climate-change.pdf>.

⁵² Bank of Canada, “Using Scenario Analysis to Assess Climate Transition Risk” (Ottawa: 2021), available at <https://www.bankofcanada.ca/wp-content/uploads/2021/11/BoC-OSFI-Using-Scenario-Analysis-to-Assess-Climate-Transition-Risk.pdf>.

⁵³ Hong Kong Monetary Authority, “Pilot Banking Sector Climate Risk Stress Test” (Hong Kong: 2021), available at https://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/Pilot_banking_sector_climate_risk_stress_test.pdf.

⁵⁴ Task Force on Climate-Related Financial Disclosures, “The Use of Scenario Analysis in Disclosure of Climate-related Risks and Opportunities,” available at <https://www.tcfdfhub.org/scenario-analysis/> (last accessed May 2022).

Thank you again for the opportunity to comment on the RFI.

Sincerely,

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