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June 3, 2022

The Honorable Martin J. Gruenberg
Chairman
U.S. Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Submitted Electronically via Regulations.gov

Re: Comments by the Attorneys General of West Virginia, Utah, Alabama, Alaska, Arizona, Arkansas, Georgia, Idaho, Indiana, Kansas, Kentucky, Louisiana, Mississippi, Missouri, Montana, Nebraska, Ohio, Oklahoma, South Carolina, Texas, and Wyoming on the request for comment entitled Principles for Climate-Related Financial Risk Management for Large Financial Institutions (Docket No. FDIC-2022-0020-0001)

Dear Chairman Gruenberg:

The undersigned Attorneys General submit these comments on the Federal Deposit Insurance Corporation's Principles for Climate-Related Financial Risk Management for Large Financial Institutions, 87 Fed. Reg. 19,507 (Apr. 4, 2022) ("Proposed Principles"). The States are especially interested in this rule because the FDIC is exercising its prudential regulatory power over *state*-licensed financial institutions.

These Principles track nearly word-for-word the proposed principles the Office of the Comptroller of the Currency issued in December 2021. *See* Principles for Climate-Related Financial Risk Management for Large Banks, OCC (Dec. 16, 2021), https://bit.ly/3z58kqj. Although some interagency cooperation is appropriate in certain circumstances, copying the language of another agency without explanation effectively abdicates the Corporation's independent regulatory responsibilities. *See, e.g.*, *Hoosier Env't Council v. U.S. Army Corps of Eng'rs*, 722 F.3d 1053, 1061 (7th Cir. 2013) (explaining that an agency had "an independent responsibility to enforce" a given statute and therefore could not "just rubberstamp another agency's" work). That approach is especially concerning here given that the Corporation is an independent agency. *See*, *e.g.*, Jolina C. Cuaresma, *Commissioning the Consumer Financial Protection Bureau*, 31 LOY. CONSUMER L. REV. 426, 450 n.109 (2019) (explaining how the FDIC "has long been considered independent").

In any event, the Proposed Principles are defective in at least four ways. *First*, the Proposed Principles purport to be guidance, but they are de facto legislative rules issued without adequate notice. *Second*, they are arbitrary and capricious because they single out climate-related risks even though current regulations already account for those risks. *Third*, they arbitrarily and capriciously fail to include a cost-benefit analysis. *Fourth*, they appear to be a pretextual effort to deprive disfavored industries of access to banking services. And *fifth*, they are overly vague and, in at least some cases, would arbitrarily and capriciously require financial institutions to monitor and account for immaterial risks.

BACKGROUND

The FDIC recently issued a "Request for Comment on Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions." *See Request for Comment on Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions*, FDIC (Mar. 30, 2022), https://bit.ly/3NpEe4O. The request seeks comments to help provide a "high-level framework for the safe and sound management of exposures to climate-related financial risks." *Id.* This new framework (which was published in the Federal Register a few days later) would nominally apply only to "large [state-licensed, non-member] financial institutions with over $100 billion in total consolidated assets." *Id.* But in practice, these principles would apply more broadly, as the FDIC notes that "all financial institutions … may have material exposures to climate-related financial risks." *Id.*

The Corporation highlighted four aspects of the Proposed Principles. First, the Proposed Principles address supposed "[w]eaknesses in how financial institutions identify, measure, monitor, and control" climate risks. *Request for Comment on Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions*. Second, they "provide a high-level framework for the safe and sound management" for these risks. *Id.* Third, they will purportedly "help financial institution management make progress toward addressing key questions" about how climate might affect their business. *Id.* Fourth and finally, they reflect how the "FDIC encourages financial institutions to consider" climate risks in a way that meets "the financial services needs of their communities." *Id.*

In the Proposed Principles themselves, the FDIC set out general climate-related financial risk principles on six topic areas:

1. Governance: how a company supervises and manages itself;
2. Policies, Procedures, and Limits: the rules a company sets for its own operations;
3. Strategic Planning: how a company looks to address issues and grow;
4. Risk Management: how a company handles potential risks;

5. Data, Risk Measurement, and Reporting: how a company collects data around, analyzes, and reports risks; and
6. Scenario Analysis: "exercises used to conduct a forward-looking assessment of the potential impact on an institution" of various changes or the "distribution of physical hazards resulting from climate-related risks."

Proposed Principles at 19,509-10.

Similarly, the FDIC also enumerated six climate-related risk categories. They are:

1. Credit Risk: the possibility of losses from loans not being repaid;
2. Liquidity Risk: the possibility of a lack of liquidity that leads to an institution's failure to meet its obligations;
3. Other Financial Risk: any other risks that would affect an institution's finances, including the failure of an investment or a drop in a currency's value.
4. Operational Risk: the risk of loss from internal failures;
5. Legal/Compliance Risk: the risk associated with legal actions and cost of compliance with regulations; and
6. Other Nonfinancial Risk: all other risks that do not relate to the institution's finances.

Proposed Principles at 19,510-11. The FDIC requested feedback on the Proposed Principles. *Id.* at 19,511-12. The undersigned States are taking the Corporation up on its request for feedback on these significant proposed changes.

DISCUSSION

I. The Proposed "Guidance" Appears To Be Rulemaking In Disguise.

Despite labeling its proposal a "statement of principles," the Corporation's proposed "principles" almost certainly constitute legislative rules. A legislative rule is "[a]n agency action that purports to impose legally binding obligations or prohibitions on regulated parties." *Nat'l Mining Ass'n v. McCarthy*, 758 F.3d 243, 251-52 (D.C. Cir. 2014). The Proposed Principles appear to do this very thing: They place brand new requirements on regulated parties and are not "merely interpret[ing] a prior statute or regulation." *Id.* at 252. The Proposed Principles change the FDIC's previous requirements and thus have the overwhelming appearance of legislative rules. *See Mendoza v. Perez*, 754 F.3d 1002, 1021 (D.C. Cir. 2014) (A rule that "effects a substantive change in existing law or policy" is "necessarily [a] legislative rule[].") In fact, save a fleeting reference to the FDIC's general power to issue safety-and-soundness standards, Proposed Principles at 19,509, the Corporation does not mention prior statutes or regulations at all. And the Proposed Principles repeatedly use "should" directives; that language is usually construed as mandatory. *See*, *e.g.*, *United States v. Anderson*, 798 F.2d 919, 924 (7th Cir. 1986) ("The common interpretation of the word 'should' is 'shall.'"). In short, the Proposed Principles overwhelmingly appear to be legislative rules disguised as guidance.

The Proposed Principles resemble the EPA's guidance that the D.C. Circuit deemed binding in *Natural Resources Defense Council v. EPA*, 643 F.3d 311, 321 (D.C. Cir. 2011). In that case, the court found that a rule styled as "[g]uidance" was actually a legislative rule because it bound EPA's regional directors. *Id.* at 321-22. So too here. The FDIC should reconsider the Proposed Principles to avoid this mistake. As is, the Proposed Principles *require* regulated financial institutions to consider climate-related risks above other risks; any bank that chooses to do otherwise could face serious consequences during a bank examination. It seems that the FDIC is thus planning to impose its risk-assessment preferences without regard to the institutions' own professional assessments or preferences. Because this mandate would necessarily alter the institutions' risk-management strategies, it bears the marks of a rule—not guidance.

The FDIC should thus subject the Proposed Principles to the Administrative Procedure Act's procedural requirements, lest "a reviewing court" "set aside" the Proposed Principles for "fail[ing] to observe" those requirements. *See Iowa League of Cities v. EPA*, 711 F.3d 844, 855 (8th Cir. 2013). And it should heed reviewing courts' warnings against an agency "issu[ing] or amend[ing] its real rules, i.e., its interpretative rules and policy statements, quickly and inexpensively without following any statutorily prescribed procedures." *Appalachian Power Co. v. EPA*, 208 F.3d 1015, 1020 (D.C. Cir. 2000). In short, the FDIC should not rely on "subsequent guidance" to provide the specific, discernible standards upon which regulated institutions depend. Proposed Principles at 19,509, 19,510. It should instead withdraw the proposal and reissue it with the full set of findings and analyses that ordinarily accompany a rulemaking. Further, the FDIC should do more than give conclusory judgments to explain why rulemaking is necessary in the first place.

II. The Proposed Principles Arbitrarily And Capriciously Target Climate-Related Risk.

The Proposed Principles emphasize climate-related risks because of claimed "emerging economic and financial risks." Proposed Principles at 19,508. The Corporation is vague about what it has in mind, referencing mostly a myriad of attenuated risks like "wildfires," "droughts," and "rising … sea levels." *Id.* But the FDIC failed to adequately demonstrate how these potential events relate to its core mission of regulating certain FDIC-insured financial institutions. So the Proposed Principles are arbitrary and capricious. *See Encino Motorcars, LLC v. Navarro*, 579 U.S. 211, 221 (2016) (An agency must "give adequate reasons for its decisions."). Even assuming the FDIC could demonstrate the connection between financial soundness and environmental change, the FDIC has not adequately explained why new regulations are necessary in light of current rules that cover the same field.

Financial institutions are already required to undertake "[e]ffective risk assessment" and have "[a]dequate procedures to safeguard and manage assets." 12 C.F.R. pt. 364 II.A.2, A.4. These controls must be "appropriate to the size of the institution and the nature, scope and risk of its activities." *Id.* II.A. Thus, if climate risks are a real threat to an institution, then under current regulations they should already be part of that institution's risk assessment scheme. Likewise, regulated institutions are already subject to stringent liquidity requirements. The Proposed Principles do nothing except impose redundant regulations and burdens on financial institutions. *See* Proposed Principles at 19,508-11. "Reasoned decisionmaking … calls for an explanation for agency action." *Dep't of Com. v. New York*, 139 S. Ct. 2551, 2576 (2019). Yet the FDIC never explains why it considers this redundant regulation necessary. Without this explanation, the Proposed Principles are arbitrary and capricious. *See Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166, 179 (D.C. Cir. 2010) (vacating an SEC rule because it failed "to determine whether, under the existing regime, sufficient protections existed").

The Proposed Principles also single out climate risks—which are unrelated to the financial institution's day-to-day business—when numerous other eventualities pose equal or greater risks. Economic downturns, foreign conflicts, changing consumer tastes, non-climate-related natural disasters, and public health crises, for example, all can and have had catastrophic effects on financial institutions. Yet, the FDIC has subjected none of these issues to special regulation. The FDIC should explain why it focused its attention on climate risks as more important than numerous others. *Cf. Yick Wo v. Hopkins*, 118 U.S. 356, 373-74 (1886) ("Though the law itself be fair on its face, and impartial in appearance, yet, if it is applied and administered by public authority … so as practically to make unjust and illegal discriminations between persons in similar circumstances … the denial of equal justice is still within the prohibition of the [C]onstitution."). The Corporation's failure to explain why it proposes to treat climate-related risks with heightened scrutiny takes the Proposed Principles out of the "zone of reasonableness" and makes the action arbitrary and capricious. *FCC v. Prometheus Radio Project*, 141 S. Ct. 1150, 1158-61 (2021). Indeed, the Corporation fails to cite any empirical data establishing that climate-related risk presents *any* safety-and-soundness concern, let alone one so significant that it requires special treatment.

III. The Proposed Principles Lack A Cost-Benefit Analysis.

The Proposed Principles also do not discuss the potential costs of imposing these new requirements. This silence is telling—it means that the FDIC has failed to perform a proper cost-benefit analysis, in spite of its self-recognized obligation to do so in rulemaking. *See* FDIC OFF. OF INSPECTOR GEN., COST BENEFIT ANALYSIS PROCESS FOR RULEMAKING (2020), https://bit.ly/38FdnTQ (describing the FDIC's cost-benefit analyses and noting past failures of the FDIC to properly conduct them). Just as calling the proposal "guidance" does not change the reality that it would function as a legislative rule, it also does not erase the FDIC's duty to conduct a proper cost-benefit analysis.

Make no mistake: cost-benefit analysis is required. Congress empowered the Corporation to implement "appropriate" operational or managerial standards for regulated institutions. 12 U.S.C.A. § 1831p-1. The Supreme Court has held that an agency charged with determining whether a regulation is "appropriate or necessary" must consider cost as part of that determination. *Michigan v. EPA*, 576 U.S. 743, 759 (2015). This cost-benefit analysis must be performed at an early enough stage to allow interested parties time to respond. Any failure to do so would render the Proposed Principles arbitrary and capricious. *See id.*

The Corporation's failure to conduct an adequate cost-benefit analysis is especially problematic given that the Proposed Principles would have tremendous negative effects. We expect that financial institutions would have to bear huge costs in terms of both money and personnel to comply. Compliance costs like these are the "most important[] cost[s]" that an agency "must consider." *Michigan*, 576 U.S. at 759. Those costs could be especially high given the current lack of data on climate-related risk and the relative novelty of some of the methodologies that the Corporation proposes to require, such as scenario analysis. Additionally, the complexity and scope of the Proposed Principles would open up financial institutions to greater litigation risks, another obvious cost that the FDIC has not addressed.

The FDIC says this regulation will apply to only the "largest financial institutions," Proposed Principles at 19,509, but the effects will be felt more broadly. Large financial institutions will inevitably disperse their compliance costs onto others through higher interest rates and other means. Thus, it is small businesses and individuals—who cannot pass on costs further downstream—who will suffer from the increased operating costs the proposal will force onto financial institutions. And because the Proposed Principles required consideration of climate-related risks "as part of the underwriting" process, individuals who live in areas that financial institutions believe are at climate risk would likely find it harder to buy homes or start businesses, particularly if the home or business itself is alleged to contribute to the conditions that give rise to climate risk. *Id.* at 19,510. These costs are yet more in a long list that the Proposed Principles failed to consider.

IV. The Proposed Principles Appear To Constitute A Pretextual Effort To "De-Bank" Certain Industries.

The Proposed Principles would also have an unjustifiably negative effect on certain industries. For instance, the proposal directs financial institutions to consider climate-related risks concerning "the institution's reputation" and "stakeholders' expectations," so regulated institutions are likely to consider whether credit applicants are politically favored in terms of their climate efforts when deciding whether to extend credit. Proposed Principles at 19,510. Thus, industries such as mining or power generation would be particularly vulnerable. Businesses in these industries may more often have credit denied, or be offered credit on worse terms than otherwise similarly situated applicants. Limiting these businesses' financial access would likely raise the cost of everyday necessities like electricity—a concern to which the FDIC should be more attuned, not less, in the current economic environment. Similarly, customers located in geographic areas thought to be most affected by climate change (like coastal areas or sensitive agricultural regions) might find it difficult to obtain credit at all, lest the lending institution face criticism from the examiner for assuming undue risk.

The Corporation's failure to explain the supposed need for an immediate revision of the supervisory standards strongly implies that the effort is pretextual. Although "a court may not reject an agency's stated reasons for acting simply because the agency might also have had other unstated reasons," including political ones, a court may set aside agency action where the record demonstrates that "the sole stated reason" for the action is pretextual and "contrived." *New York*, 139 S. Ct. at 2573-75. The Proposed Principles—which encourage regulated institutions to target "certain companies or sectors" that the FDIC believes "may become less competitive" over time—appear ripe for such a challenge. Proposed Principles at 19,508. Indeed, the Proposed Principles go so far as to require a financial institution's board and management to adopt an "appropriate understanding" of climate-related risk—that is, a view of climate change consistent with the Corporation's. *Id.* at 19,509. At the same time, the Proposed Principles repeatedly call on regulated institutions to divert attention to "low- to moderate-income (LMI) and other disadvantaged households and communities," *see*, *e.g.*, *id.* at 19,509, further suggesting that the Corporation is pressing a deliberate reallocation of capital access.

The Corporation should be intimately familiar with the consequences of policies targeting disfavored industries after it pursued similar policies as part of its regulatory misadventure known as Operation Chokepoint. There, as here, the FDIC sought to deny banking services to certain industries that the then-current President's administration did not favor. *See* Letter from Stephen E. Boyd, Assistant Att'y Gen., to the Honorable Bob Goodlatte, Chairman, Comm. on the Judiciary, U.S. House of Representatives (Aug. 16, 2017), *available at* https://bit.ly/3MzydCF (describing the FDIC's "misguided" "Operation Chokepoint" and reaffirming the Department of Justice's view that "law abiding businesses should not be targeted simply for operating in an industry that a particular administration might disfavor"). Yet given that this "guidance" comes one year after President Biden directed members of the Financial Stability Oversight Council to evaluate climate-related risk, it would appear that the Corporation is poised to make the same mistake again. *See* Exec. Order No. 14,030, 87 Fed. Reg. 27,967 (May 20, 2021).

V. The Proposed Principles Are Arbitrarily And Capriciously Vague And May Require Monitoring And Reporting Of Immaterial Risks.

Despite their stated purpose of providing a "framework for the safe and sound management of exposures to climate-related risk," Proposed Principles at 19,509, the Proposed Principles do little to explain the actual nature and scope of that risk to financial institutions. This vagueness leaves unclear how institutions are supposed to operate in this realm, opening them to litigation or additional audit risk from failure to comply with vague requirements. By not laying out the facts supporting the proposal or explaining how exactly institutions should respond, the FDIC has failed to provide a "rational connection between the facts found and the choice made." *Little Sisters of the Poor Saints Peter & Paul Home v. Pennsylvania*, 140 S. Ct. 2367, 2383 (2020).

Predictions about the physical risks of climate change vary greatly and include a massive number of potential consequences. The FDIC itself lists "flooding, hurricanes, wildfires, and droughts" as examples. Proposed Principles at 19,508 n.3. But empirical data from the Federal Reserve Board show that severe weather events have little effect on bank performance. *See* Kristian S. Blickle, et al., *How Bad Are Weather Disasters for Banks?*, 990 FED. RESERVE BANK OF N.Y. STAFF REP. 1, 1 (2022 revision), *available at* https://nyfed.org/3wHA42U ("When we consider all FEMA disasters, we find generally insignificant or small effects on bank performance and stability."). In any event, with such an array of eventualities, financial institutions face a monumental task in discerning which they must prepare for and how. Not even the largest institutions can make accurate predictions. Yet the proposal fails to offer concrete guidance for financial institutions to help them decide what specific problems to consider and how to address them. In arbitrary-and-capricious review, courts look for a clear enough explanation that an agency's "path may reasonably be discerned." *Bowman Transp., Inc. v. Ark.-Best Freight Sys., Inc.*, 419 U.S. 281, 286 (1974). The FDIC's current path is impossible even to recognize, let alone follow.

Additionally, the Proposed Principles' vagueness expands their scope and will force banks to consider immaterial risks. For example, banks are specifically instructed to consider "physical risks" such as "flooding, hurricanes, wildfires, and droughts." Proposed Principles at 19,508 n.3. This natural-disaster-related mandate is imposed without any qualification or explanation as to when banks must consider these risks. Does a bank in Montana have to explicitly consider and evaluate its hurricane risk? In their current state, the Proposed Principles say yes.

The Proposed Principles also require financial institutions to consider outright impossible concerns such as the climate's effect on "the evolving legal and regulatory landscape." Proposed Principles at 19,511. The future of legislation and regulation is notoriously difficult to predict, so institutions will be forced to rely on extremely speculative guesses about what might happen. The Proposed Principles offer no meaningful guidance as to what the FDIC expects from them. Guessing games like this legislative look-ahead are harmful and inappropriate for financial institutions upon which so many peoples' livelihoods depend. Yet, the Proposed Principles actually encourage banks to limit access to capital based on unfounded fears and guesses, saying that institutions should "include corresponding measures of conservatism in their risk measurements and controls" when considering climate risks. *Id.* at 19,511. Banks should not be limiting access to capital based on unsupported supposition and political preferences.

CONCLUSION

The FDIC should not adopt the Proposed Principles. If adopted as written, they would constitute a procedurally improper and arbitrary and capricious legislative rule. We urge the FDIC to reconsider its proposal.

Sincerely,

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