FINANCIAL SERVICES FORUM

February 14, 2022

VIA ELECTRONIC SUBMISSION

Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Re: Proposed Principles for the Effective Management and Supervision of Climate-Related Financial Risks

Ladies and Gentlemen:

The Financial Services Forum (the "Forum")[1] appreciates the opportunity to submit this letter to the Basel Committee on Banking Supervision (the "BCBS") on its proposed guidelines (the "Proposal") on the effective management and supervision of climate-related financial risks. The Proposal is relevant to each of our member institutions, the eight U.S. global systemically important bank holding companies ("U.S. GSIBs").

At the outset, we wish to highlight that we welcome the Proposal, subject to certain changes discussed further below. As noted in the introduction to the Proposal, the effects of climate change could have implications for the banking sector. Our member institutions recognize the need for banks to have robust capabilities to manage their exposures to climate-related financial risks, and in fact, already have taken important steps to incorporate such risks into their comprehensive, enterprise risk management frameworks. Accordingly, the Forum supports the BCBS's efforts to establish guidance for banking organizations managing climate-related financial risks and "to foster alignment in terms of supervisory expectations."

Below, we comment on the specific principles and overarching themes that we support and highlight areas where the BCBS's guidance in the Proposal could be recalibrated. Our key observations and recommendations are as follows:

[1] The Financial Services Forum is an economic policy and advocacy organization whose members are the chief executive officers of the eight largest and most diversified financial institutions headquartered in the United States. Forum member institutions are a leading source of lending and investment in the United States and serve millions of consumers, businesses, investors, and communities throughout the country. The Forum promotes policies that support savings and investment, deep and liquid capital markets, a competitive global marketplace and a sound financial system.

- **Support for scenario analysis rather than traditional stress testing.** We support the BCBS's focus on the use of scenario analysis, which can provide insights into a broader range of scenarios and permit longer-term studies. Traditional supervisory stress testing, which can result in regulatory consequences, is not an appropriate tool for assessing climate-related financial risks. We recommend that the final guidance distinguish the types of stress testing and internal capital and liquidity adequacy assessment processes discussed in the Proposal from traditional supervisory stress testing. We also suggest that the final guidance clarify that climate scenario analysis is not intended to lead to potential regulatory consequences.

- **Support for a principles- and risk-based, flexible, and phased approach.** The Forum supports principles that enable banks to have flexibility to incorporate climate-related financial risks into their existing risk management frameworks and processes where appropriate, as currently proposed. In addition, we support a risk-based approach that considers the unique characteristics of each bank and allows banks to focus on targeting material climate-related financial risks. Given the evolving nature of the risks, data and tools, we also urge the BCBS to support a "phased approach" in order to enable banks to have sufficient time to meet supervisory expectations.

1. We recommend that the final guidance clearly distinguish references to climate scenario analysis from traditional supervisory stress testing, which can lead to regulatory consequences for the tested institution.

Principles 12 and 18, as well as supporting commentaries 6, 41, 54 and 60, suggest that banks utilize scenario analysis and stress testing to help assess and manage climate-related financial risks. Principle 5 and supporting commentary 53 state that banks should incorporate climate-related financial risks into their internal capital and liquidity adequacy assessment processes. We recommend that the final guidance distinguish between climate scenario analysis and traditional supervisory stress testing and clarify that these references to stress testing and internal capital and liquidity adequacy assessment processes are not intended to evoke traditional supervisory stress testing.[2]

Quantitative assessments offer important insights into the impacts of climate risk drivers on banks. Accordingly, the Forum supports scenario analysis as a useful tool for evaluating the potential economic and financial risks posed by different climate outcomes. We also recognize the value of the type of non-traditional stress testing, referred to herein as "exploratory stress testing," discussed in the BCBS's April 2021 report on climate-related financial risk measurement and methodologies (the "BCBS Methodologies Report").[3] Notably, the BCBS

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[2] We recognize that scenario analyses may be conducted over longer time horizons, but the time horizons used in overall climate-related financial risk management frameworks should be consistent with current approaches to risk management in order to facilitate incorporating climate-related financial risks into existing practices. For example, to the extent that capital and liquidity planning for climate-related risks is implemented, we note that those should be conducted on a shorter time frame to accommodate the need for bank management to address the more immediate impacts in an effective manner consistent with risk appetite and business planning.

[3] BCBS, Climate-related financial risk—measurement methodologies (Apr. 2021), https://www.bis.org/bcbs/publ/d518.pdf [hereinafter, "BCBS Methodologies Report"].

Methodologies Report explains that, "[w]hile traditional supervisory stress testing is used by supervisors to determine the resilience of banks' capital positions to financial losses, or inform the calibration of additional capital requirements, climate scenario analysis and stress tests are typically exploratory – and not used for any such specific policy purpose at this juncture."[4]

This distinction between exploratory stress testing and traditional supervisory stress testing is critical, as traditional supervisory stress testing is not an appropriate tool for assessing climate-related financial risks. Unlike scenario analysis and exploratory stress testing, traditional supervisory stress testing may be associated with regulatory requirements,[5] with respect to which the failure to comply can result in supervisory consequences and limitations on capital distributions and discretionary bonus payments.[6] As discussed further below, we strongly oppose climate stress testing that could potentially impact banks' regulatory requirements, a perspective we believe is consistent with the recommendations in the BCBS Methodologies Report.

First, there are a number of challenges, including significant gaps, with available climate data. As the BCBS Methodologies Report notes, "the outcomes of scenario analyses and stress tests … depend crucially on assumptions and methodological choices."[7] There is significant uncertainty surrounding the assumptions as a result of the extended time horizons, complexity and non-linear nature of climate risk.[8] Therefore, it would be inappropriate for any kind of climate scenario analysis or stress testing to potentially lead to adverse regulatory consequences for banks.[9] In fact, citing the inherent uncertainty in climate scenario analyses and stress testing, the BCBS Methodologies Report suggests that these tools should be used for understanding the impacts of climate change on banks and incentivizing banks to develop appropriate practices for managing such risks, rather than for "test[ing] banks' capital adequacy against potential losses."[10]

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4 *Id*. at 30.

5 *See, e.g.*, Financial Stability Oversight Council, Report on Climate-Related Financial Risk, at 90 (Oct. 2021) [hereinafter, "FSOC Report"]; Jerome Powell Remarks, Green Swan Conference, hosted by the Bank for International Settlements (Jun. 4, 2021) [hereinafter, "Powell Remarks"] (stating that scenario analysis is "not meant to be setting up a regulatory consequence, which obviously does flow from our regulatory stress tests").

6 12 C.F.R. 217.11(c)(1).

7 BCBS Methodologies Report, *supra* note 3, at 30.

8 *See, e.g.*, FSOC Report, *supra* note 5, at 23.

9 *See, e.g.*, *id*. at 49 ("While a large amount of potentially relevant data for climate-related physical risks currently exists, more work is needed to improve access to this data and incorporate it into financial risk assessments.").

10 BCBS Methodologies Report, *supra* note 3, at 30 ("[C]limate scenario analysis and stress testing, as currently used by supervisors, serves two main objectives: first, as a tool to supplement supervisors' understanding of the impacts of climate change on their regulated banks' risk management and business strategy, rather than a test of banks' capital adequacy against potential losses; second, as part of their prudential policies, as a means to raise the awareness of the industry with respect to these risks and incentivize banks to develop appropriate risk models and governance and identify data gaps.")

Second, traditional supervisory stress testing necessarily tends to focus on shorter time horizons[11] and would be unable to account for the fact that "climate risks may materialise over a much longer time horizon," as noted in supporting commentary 10 of the Proposal. In fact, a recent staff report released by Federal Reserve Bank of New York ("NY Fed Staff Report"), which explored the effects of weather disasters over the last quarter century on U.S. banks' performance, concluded that weather disasters had "generally insignificant or small effects on bank performance and stability."[12] Our member institutions certainly are examining potential impacts of climate-related financial risks over the short-term horizon and involving some degree of stress testing in their scenario analyses. However, a tool like scenario analysis, which is forward-looking and can explore a range of potential scenarios over long-term horizons, ultimately offers greater promise as a more flexible risk management tool for guarding against climate-related financial risks.[13]

Finally, we note that U.S. regulators have been supportive of scenario analyses, but not traditional stress testing. For example, the FSOC Report strongly recommended that member agencies use scenario analysis, but stopped short of recommending climate stress testing akin to the Dodd-Frank Act Stress Tests or the Comprehensive Capital Analysis and Review.[14] The draft "Principles for Climate-Related Financial Risk Management for Large Banks" (the "OCC Principles"), released by the Office of the Comptroller of the Currency (the "OCC") on December 16, 2021, also encourage the use of scenario analysis and explicitly distinguish scenario analysis from "traditional stress testing."[15] The Federal Reserve has articulated a similar view[16] and is currently developing a program of climate-related scenario analysis, as

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[11] *See, e.g.*, FSOC Report, *supra* note 5, at 90 (noting that "stress tests within the remit of regulators tend to focus on a shorter time horizon in order to determine the solvency and liquidity of an institution given an 'extreme but plausible' market risk or set of macroeconomic shocks"); 12 C.F.R. 225.8(d)(16) (defining "planning horizon" for capital planning purposes to include a period of at least nine consecutive quarters); 12 C.F.R. 252.35(a)(4) (requiring liquidity stress testing to be conducted using overnight, 30-day, 90-day and one-year planning horizons).

[12] Kristian S. Blickle et. al., Federal Reserve Bank of New York, How Bad Are Weather Disasters for Banks?, at 1 (Nov. 2021) [hereinafter, "NY Fed Staff Report"].

[13] *See* BCBS, Climate-related risk drivers and their transmission channels (Apr. 2021), at 1, 13, https://www.bis.org/bcbs/publ/d517.pdf (suggesting that scenario analysis is the favored tool by researchers and supervisors to analyze transition risks due to its "forward-looking nature").

[14] *See* FSOC Report, *supra* note 5, at 118-125.

[15] Office of the Comptroller of the Currency, "Principles for Climate-Related Financial Risk Management for Large Banks" (Dec. 16, 2021), https://www.occ.gov/news-issuances/bulletins/2021/bulletin-2021-62.html [hereinafter, "OCC Principles"] ("Climate-related scenario analysis is emerging as an important approach for identifying, measuring, and managing climate-related risks. … These exercises differ from traditional stress testing exercises that typically assess the potential impacts of transitory shocks to near-term economic and financial conditions.").

[16] *See* Powell Remarks, *supra* note 5; Lael Brainard, The Role of Financial Institutions in Tackling the Challenges of Climate Change (Feb. 18, 2021), https://www.federalreserve.gov/newsevents/speech/brainard20210218a.htm (clarifying that "[t]o be clear, scenario analysis is distinct from our traditional regulatory stress tests at banks. Scenario analysis is an exploratory exercise that allows banks and supervisors to assess business model resilience to a range of long-run scenarios. … By contrast, traditional stress tests are a regulatory exercise to assess the capital adequacy of banks to specific macroeconomic scenarios and financial market shocks over the short-run.").

discussed further below.[17] In particular, Federal Reserve Chair Jerome Powell in his re-nomination hearing reiterated support for scenario analysis rather than traditional stress tests: "I think it's very likely that climate stress scenarios, as we like to call them, will be a key tool going forward. I would stress that those are very different from the regular stress tests which affect capital."[18]

2. We support the Proposal's approach of enabling banking organizations to incorporate climate-related financial risks into existing risk management frameworks.

Banks may consider climate risk to be a transverse, cross-cutting risk in some instances or in others a standalone risk. As a result, in some circumstances it may be more appropriate for banking organizations to embed climate-related financial risks into existing risk management frameworks.[19] Acknowledging that banks may do so not only would be consistent with regulatory expectations that banks' risk management frameworks encompass all material risks to the bank,[20] but also would enable banks to more expeditiously address emerging climate risks. As discussed further below, we welcome the Proposal's support for giving banks flexibility to incorporate climate-related financial risks into existing frameworks, but recommend that the final guidance more explicitly do so in certain instances.

a. *U.S. GSIBs already have in place robust risk management and governance frameworks that are designed to address material risks and that are purposefully flexible to enable the incorporation of responses to new and emerging risks.*

We appreciate the current principles-based approach used in the Proposal and suggest that the final guidance acknowledge and take into account the robust risk management and governance frameworks that are already in place for U.S. GSIBs. U.S. banking organizations and, in particular, U.S. GSIBs, are already subject to robust risk management standards that can accommodate climate-related financial risks. In fact, the BCBS has itself previously issued guidelines for banks to address corporate governance and risk management, which guidelines can encompass climate-related financial risks. Although we agree that supervisors and banks alike could benefit from additional guidance from the BCBS and other regulators regarding climate-related financial risk, as the Proposal acknowledges, "the *Core principles for effective*

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17 *See, e.g.*, Federal Reserve, Financial Stability Report, at 63 (Nov. 2021), https://www.federalreserve.gov/publications/files/financial-stability-report-20211108.pdf.

18 Jerome Powell, Senate Banking, Housing, and Urban Affairs Committee Hearing on the Nomination of the Honorable Jerome Powell (Jan. 11, 2022) [hereinafter, "Powell Re-Nomination Hearing"].

19 *See, e.g.*, Climate Financial Risk Forum, Risk Management Chapter, in Climate Financial Risk Forum Guide 2020, at 8 (June 2020), https://www.fca.org.uk/publication/corporate/climate-financial-risk-forum-guide-2020-risk-management-chapter.pdf (noting that good practice is to treat climate risk as a cross-cutting, or transverse, risk type that is integrated into existing risk frameworks, rather than as a principal, or standalone, risk type).

20 *See, e.g.*, OCC Guidelines Establishing Heightened Standards for Certain Large Insured National Banks, Insured Federal Savings Associations, and Insured Federal Branches; Integration of Regulations, 79 Fed. Reg. 54517 (Sept. 11, 2014) [hereinafter, "OCC Heightened Standards"].

banking supervision (BCPs) and the supervisory review process (SRP) are sufficiently broad and flexible to accommodate additional supervisory responses to climate-related financial risks."[21]

Likewise, existing risk management and corporate governance standards applicable to large U.S. banking organizations are sufficiently broad and flexible to accommodate climate-related financial risks as an integrated component. For example, under section 165 of the Dodd-Frank Act as implemented by the Federal Reserve Board (the "Federal Reserve"), the risk management framework of a large U.S. bank holding company must "be commensurate with its structure, risk profile, complexity, activities, and size," requiring subject institutions to implement broad frameworks rather than targeted responses to enumerated risks and to adjust their frameworks as risks and activities vary.[22] Capacity to identify and address new and emerging risks is a fundamental feature of the risk management frameworks expected by U.S. bank regulators.[23]

U.S. bank regulations and standards also address many of the specific risk management and internal control elements promoted in the Proposal, including without limitation for board and senior management oversight, risk appetite framework, risk data aggregation and reporting and internal controls.[24] Moreover, U.S. bank regulators also already expect banking organizations to consider their material risks in capital planning, strategy development, credit portfolio management and liquidity management, as well as the impact of material and emerging risks on other risk categories, including liquidity, credit, market and operational risk.[25]

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21 *See* BCBS, Core principles for effective banking supervision (effective Dec. 15, 2019), https://www.bis.org/basel_framework/chapter/BCP/01.htm; BCBS, Supervisory review process: Risk management (effective Dec. 15, 2019), https://www.bis.org/basel_framework/chapter/SRP/30.htm; *see also* BCBS, Guidelines: Corporate governance principles for banks (effective July 8, 2015), https://www.bis.org/bcbs/publ/d328.htm; BCBS, Principles for effective risk data aggregation and risk reporting (Jan. 9, 2013), https://www.bis.org/publ/bcbs239.htm [hereinafter, "BCBS 239"]; BCBS, Revisions to the principles for the sound management of operational risk (Mar. 31, 2021), https://www.bis.org/bcbs/publ/d515.htm.

22 Enhanced Prudential Standards for Bank Holding Companies and Foreign Banking Organizations, 79 Fed. Reg. 17239 (Mar. 27, 2014) [hereinafter, "Enhanced Prudential Standards"]; *see also* OCC Heightened Standards, *supra* note 20.

23 For example, the Enhanced Prudential Standards require risk management frameworks to include "[p]rocesses and systems for identifying and reporting risks and risk-management deficiencies, including regarding *emerging risks*, and ensuring effective and timely implementation of actions to address *emerging risks* and risk-management deficiencies for its global operations . . ." (emphasis added). 12 C.F.R. 252.33(a)(2)(ii)(A).

24 *See, e.g.*, OCC Heightened Standards, *supra* note 20; OCC, Comptroller's Handbook: Corporate and Risk Governance (July 25, 2019), https://www.occ.treas.gov/news-issuances/bulletins/2019/bulletin-2019-38.html [hereinafter, "OCC Corporate and Risk Governance Handbook"]; Enhanced Prudential Standards (risk management committee), *supra* note 22; Federal Reserve, SR 21-3 / CA 21-1: Supervisory Guidance on Board of Directors' Effectiveness (Feb. 26, 2021) [hereinafter, "Federal Reserve SR 21-3"]; Bank Holding Company Supervision Manual (risk management processes and internal controls); BCBS 239, *supra* note 21.

25 *See, e.g.*, OCC Heightened Standards, *supra* note 20; Enhanced Prudential Standards (managing liquidity risk), *supra* note 22; OCC Corporate and Risk Governance Handbook, *supra* note 24; Federal Reserve SR 21-3, *supra* note 24; 12 C.F.R. 225.8(e)(2)(ii)(A); Federal Reserve, SR 15-18: Federal Reserve Supervisory Assessment of Capital Planning and Positions for Firms Subject to Category I Standards (revised Jan. 15, 2021); Federal Reserve, SR 15-19: Federal Reserve Supervisory Assessment of Capital Planning and Positions for Firms Subject to Category II or III Standards (revised Jan. 15, 2021); Federal Reserve, SR 10-6: Interagency Policy Statement on Funding and Liquidity Risk Management (Mar. 17, 2010).

The U.S. GSIBs, therefore, already have in place robust risk management frameworks and practices that are designed to address material risks to the organization. Accordingly, the U.S. GSIBs are well positioned to integrate climate-related financial risks into their existing frameworks and, as noted above, U.S. GSIBs already have been incorporating future climate risk analysis into their risk management practices, as is the case already for environmental and any other material risk.[26]

A number of the principles in the Proposal explicitly state that the practices endorsed by the principles for effective management of climate-related financial risks can be incorporated into existing frameworks and systems. Examples of these principles are listed below:

- Principle 1, stating that banks should "incorporate these risks into their overall business strategies and risk management frameworks."

- Principle 7, stating that banks should ensure that their existing "internal reporting systems are capable of monitoring material climate-related financial risks."

We support the Proposal in such instances. This approach, which acknowledges that banks may treat climate-related financial risk as a transverse risk, is consistent with current regulatory expectations that all material risks are accounted for in banks' risk management frameworks, and enables banks to leverage existing systems and processes to address climate-related financial risks where appropriate.

b. *We recommend revising certain principles in the final guidance to clarify that the specified practices can be integrated into existing frameworks.*

Although we appreciate the Proposal's approach of allowing banks to incorporate climate-related financial risks into their existing risk management frameworks, we suggest that the final guidance make this approach more clear relative to requiring certain standalone frameworks. Specifically, we recommend the following clarifications be made for the final guidance:

- Principle 2 should make clear that climate-related responsibilities can be assigned to an existing committee (*e.g.*, risk committee) or members within an existing committee, as opposed to requiring the creation of a committee specifically focused on climate-related financial risk.

- Principle 3 should clarify that existing policies, procedures and controls can be updated to reflect climate-related financial risks, as opposed to requiring banks to adopt separate policies, procedures and controls exclusively focused on climate-related financial risks.

- Supporting commentary 25 states that banks should regularly carry out a comprehensive assessment of climate-related financial risks and set clear definitions and thresholds for materiality, and should develop appropriate key risk indicators for effective management

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26 We also note that, to some extent, banks have historically been successfully managing climate-related risks in conducting their activities. *See*, *e.g.*, NY Fed Staff Report, *supra* note 12 (discussing that "long run sea level rise may have already been priced into coastal properties" and that "counties more exposed to sea level risk pay higher underwriting fees for bonds").

of material climate-related financial risks that align with their regular monitoring and escalation arrangements. We encourage the BCBS in its final guidance to acknowledge that, particularly in the early transition period, a bank's assessment of climate-related financial risk may be conducted as part of the bank's existing comprehensive risk management framework. The final guidance should clarify that, after a transition period, the nature and scope of risk management frameworks will be dependent on and proportional to the materiality of the climate-related financial risk, and will develop alongside evolving data and methodologies. See further our recommendation below regarding a phased approach.

Relatedly, as noted above, banks have already long accounted for non-climate-related environmental risks as part of their risk management frameworks, such as the potential impacts of floods or hurricanes. For example, to address idiosyncratic flood risk, our member institutions generally have policies in place to require flood insurance when underwriting a mortgage if the location of the property is in a flood plain. Because broader environmental risks are already so widely accounted for in current risk management practices, we do not think it is necessary for the final guidance on climate-related financial risks to be expanded to encompass broader environmental risks.[27]

3. We support the Proposal's principles- and risk-based, flexible approach to implementation of the guidelines.

In the introduction to the Proposal, the BCBS explains that the Proposal (a) "promote[s] a principles-based approach to improving risk management and supervisory practices related to climate-related financial risks," (b) seeks to "maintain[] sufficient flexibility" in implementation of the principles "given the degree of heterogeneity and evolving practices in this area" and (c) is intended to "accommodate a diverse range of banking systems and … be applied on a proportionate basis depending on the size, complexity and risk profile of the bank or banking sector for which the authority is responsible." This perspective is exemplified in Principle 1, which provides high-level guidance regarding the implementation of a "sound process for understanding and assessing the potential impact of climate-related risk drivers on [banks'] businesses and on the environments in which [banks] operate," leaving banks responsible for assessing and determining an appropriate process that reflects their specific business strategies. We agree that such a principles- and risk-based, flexible approach to risk management of climate-related financial risks is sensible.

[27] This is responsive to Question 3 posed in the Proposal: "How could the transmission of environmental risks to banks' risk profiles be taken into account when considering the potential application of these principles to broader environmental risks in the future? Which key aspects should be considered?"

a. *A principles- and risk-based, flexible approach to management of climate-related financial risks is sensible given the varied impacts of climate-related financial risks for different banks.*

Providing for flexibility will enable firms to tailor the incorporation of climate-related financial risks into their risk management frameworks based on the unique "nature, scale and complexity" of the firm's activities and business.[28]

For example, we recognize that size and complexity of banking organizations can be correlated with their potential to pose systemic risk. For this reason, U.S. GSIBs are taking climate-related financial risks very seriously and already have taken certain steps to account for such risks in their governance and risk management frameworks. That said, there may be instances in which larger banks are less vulnerable to losses resulting from climate disaster. Notably, the NY Fed Staff Report revealed that, in the case of extreme weather events over the last quarter century, "losses at larger (multi-county) banks [were] barely affected and their income increase[d] significantly with exposure," whereas local banks, which do not benefit from diversification across multiple geographies, experienced more negative stability effects from extreme disasters.[29] The NY Fed Staff Report illustrates that the climate-related financial risks that are material to certain banking organizations are not necessarily material to other banking organizations.

The flexibility that would be provided by a principles and risk-based framework would allow each firm to focus on aspects of climate-related financial risks that are material to the particular firm and avoid diverting resources to aspects that present less risk based on the unique characteristics and activities of the firm. For example, certain financial instruments may not generate material climate-related financial risk, such as short-term liquid financial instruments for which pricing and value at risk metrics already capture the risk. While our member institutions will certainly be monitoring for all categories of risks and adjusting their internal controls as appropriate, focusing on the key material risks will allow our member institutions to manage their exposure to climate-related financial risks in a manner that is most targeted and efficient.

b. *The supporting commentary for certain principles should be revised to be consistent with a "principles-based" approach.*

Certain supporting commentaries in the principles, such as commentaries 17 and 19 (for principle 4), include a level of specificity that exceeds the "principles-based" approach and balance that the Proposal seeks to achieve.[30] We support the *principles* corresponding to these supporting commentaries, but recommend that the supporting commentaries be revised to allow for greater flexibility in implementing the principles, including the time frame for doing so.

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28 Proposal, supporting commentary 8.

29 NY Fed Staff Report, *supra* note 12, at 1.

30 *See* Proposal, supporting commentary 5 ("The proposed principles seek to achieve a balance in improving practices related to the management of climate-related financial risks and providing a common baseline for internationally active banks and supervisors, while maintaining sufficient flexibility given the degree of heterogeneity and evolving practices in this area.").

Alternatively, we recommend that the final guidance clarify that the supporting commentaries comprise examples, rather than precise expectations, for how banks can conform their climate-related financial risk management practices to the principles, allowing banks to make their own determination as to which of the suggestions in the commentaries are best suited for each bank's particular circumstances and anticipated time frames for the principles' implementation.

4. We recommend that the final guidance acknowledge that banks will need an appropriate timeframe to incorporate certain practices into their risk management frameworks, and accordingly, provide for a "phased approach."

For reasons discussed below, we believe the process for meeting supervisory expectations regarding climate-related financial risks should be an iterative process.

First, we note that this specific guidance on climate-related financial risks is new, although it draws from existing, more general guidelines. Accordingly, an appropriate timeframe will be required for banks to fully incorporate the practices discussed in the Proposal into their risk management frameworks and systems.

Second, banks face a number of challenges in addressing climate-related financial risks, including the following:

- Limitations on data, in particular, data "connecting the science of climate change to financial risk assessments and real-world economic impacts";[31]

- Uncertainty about the time horizons over which certain risks (*e.g.*, transition risks, longer-term risks) may manifest;[32] and

- The non-linear and complex nature of the impacts of climate change, which make it difficult to forecast the frequency and intensity of severe climate events and assess the interlinkages between climate-related pathways and economic and financial variables across the financial system.[33]

These challenges, as well as the "evolving nature of climate-related risks," necessitate an ongoing process for managing such risks.[34] Indeed, in its OCC Principles, the OCC noted that "the incorporation of material climate-related financial risks into various planning processes is iterative as measurement methodologies, models, and data for analyzing these risks continue to evolve and mature over time."[35]

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[31] *See* FSOC Report, *supra* note 5, at 23. These challenges are discussed in the FSOC Report as examples of challenges that *regulators* face, but we believe they are also applicable to banks.

[32] *Id*.

[33] *Id*.

[34] Proposal, supporting commentary 27.

[35] OCC Principles, *supra* note 15.

To account for the time required for, and the challenges associated with, integrating climate-related financial risks into banks' risk management practices, we recommend that the BCBS adopt an iterative or "phased approach." This would involve the BCBS phasing in certain expectations as the data and tools become more reliable and in recognition that banks will require transition periods to address emerging climate-related financial risks. In particular, we strongly recommend that the final guidance explicitly recognize that some expectations outlined in the principles cannot be executed based on quantitative rather than qualitative metrics until banks have sufficient time to develop and mature capabilities and data and measurement tools have advanced to the degree that they can be sufficiently relied upon to serve as a basis for a number of the expectations specified in the guidelines. A phased approach that clearly sets out gradual milestones for certain expectations would best reflect the evolving nature of climate risks and support banks' efforts to manage climate-related financial risks in a manner that is effective, efficient and methodical.

5. We recommend that the expectations for boards of directors be clarified in certain places.

The expectations for boards of directors articulated in certain principles should be revised to be made more consistent with the role and structure of the board in a banking organization. Specifically, we recommend the following modifications:

- Principle 2 and supporting commentary 24 (for Principle 6) assign responsibilities to the "board and senior management," but could do more to acknowledge the separate roles of the board and management. For example, Principle 2 states that, "[t]he board and senior management should identify responsibilities for climate-related risk management throughout the organisational structure." However, the board's role is to oversee and satisfy itself through reasonable procedures that management is implementing board direction. Management implements the board's direction by identifying responsibilities throughout the organizational structure. Therefore, we recommend that Principle 2 be revised so that only management bears this responsibility, and that similar revisions be made to supporting commentary 24, which confers on the board management-level responsibilities.

- We request that the BCBS not use the term "ensure" in describing the board's responsibility, such as in supporting commentary 24. Consistent with its role to provide oversight, the board does not have sufficient involvement in the day-to-day affairs of a banking organization to "ensure" outcomes. Rather, the board directs management to take certain actions and holds management accountable for execution. The Proposal's recommendations that the board "ensure" certain results could be interpreted as suggesting a greater involvement by the board in the banking organization's day-to-day affairs, which not only would be inconsistent with the board's critical oversight function, but also could interfere with the board's ability to perform this function effectively.[36]

[36] *See, e.g.*, Group of Thirty, A New Paradigm: Financial Institution Boards and Supervisors (Oct. 2013), at 28, https://group30.org/images/uploads/publications/G30_NewParadigm.pdf ("Guidance [on governance] needs to respect the role of the board as separate from management. For example, it should avoid the use of the words 'the board ensure,' in recognition of the role of the board, which is overseeing and satisfying itself through

- To more accurately reflect how responsibilities are typically assigned to the board, Principle 2 and supporting commentary 13 should be revised to state that climate-related responsibilities should be assigned to committees or subcommittees, rather than to individual members.

We further recommend that the Proposal include an acknowledgment that there are differences among jurisdictions in the duties and responsibilities required of board of directors. As such, implementation of certain of the expectations for boards and senior management may vary across jurisdictions.

6. Regulatory agencies should cooperate so that there is consistency in the standards applicable across an entire banking organization to the extent possible in light of differing mandates across jurisdictions.

We recommend that in its final guidance the BCBS recognize the benefits of regulatory agencies taking a consistent and coordinated approach to guidance relating to risk management frameworks for climate risk. However, we further recommend that the BCBS acknowledge that, in doing so, agencies must account for the different mandates granted to central banks and banking regulators in different jurisdictions to address climate change.

In the United States, as noted above, on December 16, 2021, the OCC released the OCC Principles, which provide a brief, high-level supervisory framework regarding banks' management of exposures to climate-related financial risks. While the Federal Reserve has not publicly announced a timeline for similar potential supervisory guidance, the Federal Reserve has reportedly begun working with banks to develop scenario analysis models, the results of which could be publicly released in 2023.[37] In addition, the Federal Reserve released a statement indicating that it will review the comments submitted in response to the OCC Principles as part of interagency coordination relating to climate-related risk, highlighting that "[a] consistent approach across bank regulatory agencies will best support the effective management of these risks."[38] Banking organizations would benefit from consistency in the principles released by the BCBS, the U.S. regulators and globally.

However, while aiming for consistency, our member institutions appreciate and recommend that the BCBS simultaneously acknowledge that banking regulators in different jurisdictions have different mandates to address climate change in the industry. For example, in the United States, as Chair Jerome Powell has explained, the Federal Reserve does not have a new mandate on

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reasonable procedures that management is implementing board direction. 'Ensure' is too high a bar to judge effectiveness and misunderstands the role of the board.").

37 Pete Schroeder, Wall Street Sees First Fed Climate Change Review in 2023, Reuters (Nov. 17, 2021), https://www.reuters.com/business/cop/wall-street-sees-first-fed-climate-change-review-2023-2021-11-17/.

38 Rachel Koning Beals and Greg Robb, OCC takes step toward pressure on large banks to reveal climate-change risks, Marketwatch (Dec. 16, 2021), https://www.marketwatch.com/story/occ-takes-step-toward-pressure-on-large-banks-to-reveal-climate-change-risks-11639688971.

climate change but rather its mandate is to ensure safety and soundness and financial stability.[39] Accordingly, we recommend that the BCBS encourage consistent high-level principles across jurisdictions subject to the understanding that different jurisdictions may have different regulatory authorities and directives to address climate change.

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Thank you for considering these comments. Please feel free to contact the undersigned (KFromer@fsforum.com) with any questions.

Respectfully submitted,

Kevin Fromer
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39 Powell Re-Nomination Hearing, *supra* note 18 ("We don't have a new mandate on climate change. It is really the simple mandate -- the central mandate of supervising and regulating financial institutions to make sure that they're aware of and able to manage all of their risks.").