February 6, 2023

VIA ELECTRONIC SUBMISSION

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Principles for Climate-Related Financial Risk Management for Large Financial Institutions (Federal Reserve Board Docket No. OP-1793)

Ladies and Gentlemen:

The Financial Services Forum (the "Forum")[1] appreciates the opportunity to submit this letter to the Board of Governors of the Federal Reserve System (the "FRB") on its proposed principles (the "Proposal") for climate-related financial risk management for large financial institutions.[2] 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, subject to certain changes discussed further below we welcome the Proposal and the evident interagency coordination. Our members recognize the need for banks to have robust capabilities for the safe and sound management of exposures to climate-related financial risks and, as the Proposal recognizes, have already have taken important steps to incorporate such risks into their comprehensive enterprise risk management frameworks.[3] Accordingly, the Forum supports the FRB's efforts, as well as the efforts of the Office of the Comptroller of the

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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.

2 Principles for Climate-Related Financial Risk Management for Large Financial Institutions, 87 Fed. Reg. 75267 (Dec. 8, 2022).

3 87 Fed. Reg. at 75268 ("Some large financial institutions are developing the governance structures, processes, and analytical methodologies to identify, measure, monitor, and control for these risks.")

Currency (the "OCC") and the Federal Deposit Insurance Corporation (the "FDIC"), to establish guidance for banks to address climate-related financial risks.

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

- **We appreciate the Proposal's efforts to distinguish the role of a financial institution's board from that of management and the ability for banks to individually and proportionally apply the guidance, but certain expectations regarding governance are too prescriptive.** Overly prescriptive board and management requirements would impede practicable risk management during nascent stages of program development. In particular, we caution that overly prescriptive requirements for the board or management may hamper a banking organization's ability to develop and explore appropriate practices to comprehensively address climate-related financial risk and other risks without limitations of assessment. For example, we are concerned about the Proposal's statement that a banking organization's board, which would include the board of the top-tier holding company, "should consider" changes to its compensation policies based upon climate-related financial risk management practices, as well as the Proposal's statement that the board "should assure" that public statements on climate-related strategies and commitments are consistent with strategies and risk appetites.[4] Accordingly, we suggest that the FRB's expectations could better align with the current roles of the board or management on the subject of climate-related financial risk.

- **We support exploratory scenario analysis rather than traditional stress testing.** The Forum supports the use of scenario analysis, which helps banks quantify and assess the range of impacts from potential transition and physical climate-related financial risks, including under plausible scenarios that may be severe or "extreme." We note that many of our member institutions are participating in the FRB's pilot climate scenario analysis, which is "designed to enhance the ability of supervisors and firms to measure and manage climate-related financial risks."[5] We appreciate the FRB's continued emphasis on distinguishing between exploratory scenario analysis and traditional stress testing—which could result in adverse regulatory or, specifically, capital consequences—as gaps in data availability and methodology make regulatory consequences inappropriate for scenario analysis.

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4 87 Fed. Reg. at 75269.

5 *Federal Reserve Board announces that six of the nation's largest banks will participate in a pilot climate scenario analysis exercise designed to enhance the ability of supervisors and firms to measure and manage climate-related financial risks*, Federal Reserve Board (Sept. 29, 2022) ("FRB Climate Pilot Press Release"), available *here*.

- **We support high-level principles and a risk-based, flexible approach to climate-related financial risk management that focuses on *material* climate-related financial risks.** The Forum supports high-level principles that enable banks to have flexibility to incorporate climate-related financial risks into their existing risk management frameworks and processes where appropriate and to determine the appropriate time horizons for various climate-related financial risk management exercises. In addition, we support a risk-based approach that considers the "differences in financial institutions' complexity of operations and business models"[6] and allows financial institutions to focus on targeting *material* climate-related financial risks. Given the evolving nature of the risks, data and tools, we also urge the FRB to adopt a "phased approach" so that banks have sufficient time to meet supervisory expectations, in particular relating to incorporation of and reliance on quantitative metrics.

- **We appreciate the interagency coordination evident in the Proposal.** The FRB notes that it developed the Proposal in consultation with the OCC and FDIC and "intends to coordinate with the OCC and FDIC in issuing any final guidance."[7] The coordination is helpful in promoting regulatory consistency and minimizing conflicting and inconsistent regulatory expectations. In line with the FRB's intentions,[8] we urge that the final guidance be joint and identical interagency guidance that incorporates the FRB's revisions thus far and any other changes made in response to further comment. We also encourage the FRB and other federal financial regulators to coordinate with market regulators to promote consistent expectations on topics such as communication and disclosure requirements around climate-related financial risk management.[9]

1. We support the principles and risk-based framework discussed in the Proposal and believe the FRB should further consider variations in materiality of climate-related financial risks and remove prescriptiveness with respect to governance.

In the introduction to the Proposal, the FRB explains that the draft principles are intended to provide a "*high-level framework* for the safe and sound management of exposures to climate-related financial risks" and to support banks' efforts "to focus on key aspects of climate-related financial risk management."[10] The FRB also notes that, "[i]n keeping with the [FRB]'s risk-based approach to supervision, the [FRB] anticipates that

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6 87 Fed. Reg. at 75268.

7 87 Fed. Reg. at 75268.

8 *See* Supervision and Regulation Report, Federal Reserve Board at 18 (Nov. 2022) ("the Federal Reserve Board intends to develop interagency guidance on the financial risks of climate change for large banks"), available *here*.

9 *See* Letter from Financial Services Forum to the Securities and Exchange Commission at 7–8 (June 16, 2022), available *here*.

10 87 Fed. Reg. at 75267 (emphasis added).

differences in financial institutions' complexity of operations and business models will result in different approaches to addressing climate-related financial risks."[11] The "Scenario Analysis" principle also advises that management develop and implement scenario analysis frameworks "in a manner commensurate to the financial institution's size, complexity, business activity, and risk profile."[12]

We support the use of these risk-based principles to support banks' efforts to manage and mitigate climate-related financial risks. A risk-based framework will enable firms to tailor the incorporation of climate-related financial risks into their risk management frameworks based on a particular firm's size as well as the unique nature, scale and complexity of its activities and business.

Just as the FRB acknowledges differences among financial institutions' business plans, we believe the FRB should also acknowledge that the materiality of climate-related financial risk will also vary within a banking organization, i.e., climate-related financial risk may be more material to certain subsidiaries of a bank holding company, but less material to the banking organization as whole. Accordingly, we believe the FRB should recognize that the degree of responsibility assigned to a financial institution's board (and specifically the board of the top-tier bank holding company) may vary with the materiality of climate-related financial risk to the banking organization as whole. Further, to the extent that climate-related financial risk may be material at the level of a bank subsidiary, but not material at the level of a top-tier holding company, for example, the Proposal as drafted may require a financial institution's parent company board to inappropriately devote more attention and resources to climate-related financial risks than to other risks that are more material to the institution as a whole.

High-level principles and a risk-based framework should allow each firm the flexibility 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 subsidiaries or certain financial instruments, such as certain short-dated positions, may not generate material climate-related financial risk. While our member institutions will certainly be monitoring for all categories of risks and adjusting their internal controls as appropriate, focusing on key material risks within key affected business lines will allow our member institutions to manage their exposure to climate-related financial risks in a manner that is most targeted and efficient.

In addition to our high-level comment about potentially varying degrees of materiality of climate-related financial risk within a financial institution, we provide a number of specific examples below of where we would recommend reframing the guidance to (1)

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11 87 Fed. Reg. at 75268.

12 87 Fed. Reg. at 75270.

focus on the board's responsibility for oversight, (2) eliminate over-prescriptiveness and (3) focus more explicitly on only *material* climate-related financial risk:

- The Proposal provides that "[a] financial institution's board should acquire sufficient information to understand the implications of climate-related financial risks."[13]
    - This requirement would be too prescriptive, as Federal Reserve SR 21-3, the FRB's Supervisory Guidance on Board of Directors' Effectiveness, already requires a board to "seek[] . . . information about the firm and its activities" including "emerging and ongoing risks."[14]
    - While the Proposal seeks not to conflict with Federal Reserve SR 21-3,[15] we believe that information requirements specific to climate-related financial risk are too limiting for the principles-based approached taken by both the Proposal and by Federal Reserve SR 21-3.
    - Further, a financial institution's board's responsibility should be to "seek" or "direct[] senior management to provide"[16] (rather than "acquire") information, and that responsibility should only arise to the extent the information is material to the financial institution.
- The Proposal would require that a financial institution's board and management "[a]s part of forward-looking strategic planning . . . should address the potential impact of climate-related financial risk."[17]
    - The final guidance should clarify that these requirements should be conditioned on the materiality of climate-related financial risk to the financial institution.
- The Proposal also states that a financial institution's board "should consider . . . changes to its compensation policies" with respect to climate-related financial risks.[18]
    - Federal Reserve SR 21-3 already requires a financial institution's board to develop compensation practices "consistent with the firm's strategy, risk appetite, and safety and soundness."[19]

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13 87 Fed. Reg. at 75269.

14 Federal Reserve, SR 21-3 / CA 21-1: Supervisory Guidance on Board of Directors' Effectiveness (Feb. 26, 2021) ("Federal Reserve SR 21-3"), Attachment at 3.

15 87 Fed. Reg. at 75268 n.7.

16 *See* Attachment to Federal Reserve SR 21-3, *supra* note 14, at 3.

17 87 Fed. Reg. at 75269.

18 87 Fed. Reg. at 75269.

- As noted above, the Proposal seeks not to conflict with Federal Reserve SR 21-3.[20] We believe that compensation requirements specific to climate-related financial risk are too limiting for the principles-based approach taken by both the Proposal and by Federal Reserve SR 21-3.

- The Proposal states that "*boards* and *management should assure* that any public statements about their institutions' climate-related strategies and commitments are consistent with their internal strategies and risk appetite statements."[21]

  - This proposed requirement is too prescriptive with respect to the board's responsibilities related to public statements, as it places an undue amount of responsibility on the board, when such responsibilities are better suited for key staff that have access to day-to-day information.

  - Moreover, the final guidance should recognize that banks are already subject to a variety of securities and consumer protection laws and regulations that regulate the way they disclose information and market their products, and that banks are actively engaged with the authorities enforcing these laws and regulations to ensure their public statements meet applicable requirements.

  - Accordingly, we recommend that the final guidance not assign the board or management responsibility for ensuring alignment between public communications and internal climate-related strategies.

- The Proposal would require that "[c]limate-related scenario analysis results should be clearly and regularly communicated to the board and all relevant individuals within the financial institution."[22]

  - Given the exploratory nature of scenario analysis, financial institutions should have flexibility in the use and communication of any scenario analysis outputs. Accordingly, in light of potential non-materiality, data limitations and the uncertainty of the outputs, we believe it would be appropriate for the final guidance to suggest that only *material* scenario analysis results ought to be shared with a financial institution's board.

- The final guidance should focus on material and measurable climate-related financial risks.

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19 Attachment to Federal Reserve SR 21-3, *supra* note 14, at 5.
20 87 Fed. Reg. at 75268 n.7.
21 87 Fed. Reg. at 75269 (emphasis added).
22 87 Fed. Reg. at 75270.

- For example, the Proposal contains a list of potential sources of physical risk, "such as hurricanes, wildfires, floods, and heatwaves, and chronic shifts in climate, including higher average temperatures, changes in precipitation patterns, sea level rise, and ocean acidification."[23]

  - While we agree the sources of climate-related physical risks may be varied, we caution the FRB against requiring banks to protect against vaguely defined, unmeasurable or immaterial physical risks. The FRB should acknowledge that certain physical risks may be more material and acute, such as flooding as opposed to ocean acidification and changes in precipitation patterns. Accordingly, the final guidance should allow banks to apply judgment in determining the risks most relevant to their portfolios and devote more resources to the management of material and measurable risks than to more remote or immaterial physical risks that cannot currently be measured.

  - Further, because the list of sources of physical risk may be changing, the final guidance should clarify that in using the wording "such as," the sources of physical risk listed are just examples that may or may not actually be material.

  - Finally, the FRB should coordinate with other functional and prudential regulators to arrive at a common definition of "physical risk," which will help achieve the FRB's goal of "promot[ing] a consistent understanding of how climate-related financial risks can be effectively identified."[24]

- Further, the final guidance should remain primarily focused on material climate-related *financial* risks as opposed to focusing on non-financial risks—such as operational or legal/compliance risks—that financial institutions already address through their comprehensive risk management frameworks.

- The Proposal acknowledges the need for the "the availability of timely, accurate, consistent, complete, and relevant data."[25]

  - We emphasize that such data itself must be materially accurate to be useful for scenario analysis and other climate-related financial risk management practices. Financial institutions should not be required to

[23] 87 Fed. Reg. at 75267.
[24] 87 Fed. Reg. at 75267.
[25] 87 Fed. Reg. at 75270.

consider climate-related data in their risk management practices unless that data is material to the institution's risk profile. Moreover, as mentioned below, given gaps in the availability and reliability of data, the final guidance should clarify that financial institutions may rely on data so long as it is materially accurate.

- The Proposal states that "[w]eaknesses in how financial institutions identify, measure, monitor, and control potential climate-related financial risks could adversely affect financial institutions' safety and soundness."[26]

    - We note that while financial institutions can measure, monitor and manage climate-related financial risk, they cannot *control* it. Accordingly, the final guidance should limit a financial institution's responsibilities to managing or mitigating climate-related financial risk, not "controlling" it.

- The Proposal states that financial institutions' "board and management should consider material climate-related financial risk exposures when setting the financial institution's . . . capital plan."[27] Further, the Proposal states "[m]anagement should monitor interest rate risk and other model inputs . . . due to climate-related financial risks."[28]

    - In light of the still developing nature of quantitative tools surrounding climate-related financial risk management, we believe it is premature to require financial institutions to specifically consider climate-related financial risk in the context of heavily quantitative exercises such as capital planning and interest rate modeling.[29] Moreover, the FRB's existing requirements should adequately capture climate considerations if material and appropriate to include.

2. We support the Proposal's endorsement of *exploratory* scenario analysis, rather than regulatory stress testing, to assess and manage climate-related financial risks.

The Proposal recommends scenario analysis as an "important approach for identifying, measuring, and managing climate-related financial risks."[30] In doing so, the Proposal explicitly distinguishes scenario analysis from "traditional stress testing exercises that typically assess the potential impacts of transitory shocks to near-term economic and

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26 87 Fed. Reg. at 75267.
27 87 Fed. Reg. at 75269.
28 87 Fed. Reg. at 75270.
29 *See, e.g.,* 12 CFR 225.8(e)(2)(i)(A) (mandating capital plans include specified quantitative projections).
30 87 Fed. Reg. at 75270.

financial conditions."[31] We agree that scenario analysis is more appropriate than traditional stress testing, and this approach is consistent with the approaches supported by other U.S. regulators, including the OCC, the FDIC and the Financial Stability Oversight Committee ("FSOC"). Further, many of our member institutions are participating in the FRB's pilot climate scenario analysis. We agree with the approach to scenario analysis taken in the pilot program, which is "exploratory in nature and does not have capital consequences."[32]

Scenario analysis is a much more suitable tool to evaluate the potential economic and financial risks posed by different climate outcomes. As the FRB recognizes, a key difference between scenario analysis and stress testing is that climate scenario analysis aims to "assist firms and supervisors in understanding how climate-related financial risks may manifest and differ from historical experience," unlike stress tests, which are "designed to assess whether large banks have enough capital to continue lending to households and businesses during a severe recession."[33] Moreover, as discussed in greater detail below, banks face significant challenges in identifying and measuring climate-related financial risks as climate models and forecasting tools remain nascent and data availability limitations persist. Given the gaps in currently available data, models and methods used to assess climate-related financial risks, it would be inappropriate for banks to experience adverse regulatory consequences as a result of quantitative assessments that rely on limited data and methodologies currently available.

In contrast, scenario analysis does not necessarily result in direct regulatory consequences and "may contemplate much longer time horizons in order to assess medium- and long-term business model resilience against the changes in climate-related risks that may materialize over such longer horizons."[34] Stress testing necessarily tends to focus on shorter time horizons[35] and would be unable to account for the fact that climate-related financial risks "extend beyond the institution's typical strategic planning horizon," as noted in the Proposal's "Governance" principle.[36] Therefore, a tool like scenario analysis, which can explore a range of potential scenarios over long-term horizons, would

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31 87 Fed. Reg. at 75270.

32 FRB Climate Pilot Press Release, *supra* note 5.

33 FRB Climate Pilot Press Release, *supra* note 5.

34 Financial Stability Oversight Council, Report on Climate-Related Financial Risk, at 90 (Oct. 2021) ("FSOC Report"); *see also* Lael Brainard, "Financial Stability Implications of Climate Change" (Mar. 23, 2021), https://www.federalreserve.gov/newsevents/speech/brainard20210323a.htm.

35 *See*, *e.g.*, FSOC Report, *supra* note 34 (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).

36 87 Fed. Reg. at 75269.

be better suited as a more flexible risk management tool for guarding against climate-related financial risks.

Based on the experiences of our member institutions, we highlight below observations, challenges and recommendations related to climate-related scenario analysis that the FRB and other agencies should recognize in the final guidance.

2.A. Observations and challenges.

- **Forum member institution practices.** Forum member institutions already engage in climate scenario analysis as part of their broader risk management program to measure, monitor and assess their exposure to climate-related financial risks. These analyses are focused on identifying and sizing climate-related financial risks in their asset portfolios so that these risks can be monitored and managed on an ongoing basis. In formulating climate scenarios, our member institutions focus their scenarios on the most prominent likely exposures that would be impacted by climate change, subjecting certain asset portfolios to climate scenario analysis rather than conducting enterprise-wide scenario analysis.

- **Gaps in data and modeling.** As discussed in greater detail below, existing data and tools to measure and quantify climate-related financial risk—and in particular longer-term transition and physical risks—are only just emerging, and will need to undergo substantial exploration, refinement and adaptation over time. While Forum member institutions are working to improve the depth and breadth of their climate data and technology infrastructure, the lack of historical data related to climate-related financial risk management—in contrast with other areas of risk, such as credit risk or market risk, with decades of historical observations—makes it difficult to back-test models used for scenario analysis and requires a wide array of assumptions. These data gaps, and the uncertainty given the unprecedented nature of climate change, present a significant challenge for banks because the reliability of the scenario analysis results depends on the reliability of the underlying data. In particular, our member institutions have highlighted data gaps regarding physical risks, such as the possibility that specific locations will experience extreme weather events, quantifying correlation of hazards and sourcing the geographic location of physical assets of companies.

  For example, publicly available climate scenarios do not provide banks with the appropriate sectoral and regional granularity to directly translate scenario output into readily consumable inputs for internal risk modeling. For banks, the value of climate scenario analysis can only be fully realized when the science-based or macroeconomic output is expanded into more granular financial impacts that can be applied across a diverse set of client industries and sub-sectors. There is also a limited understanding of the climate atmospheric relationships among the climate

scientists and experts who design Integrated Assessment Models that drive these scenarios, which makes it more challenging for banks and vendors alike to expand scenario output while staying within the bounds of the model.

- **Time horizons.** The long-term nature of climate change poses significant challenges for modeling climate-related financial risks, but striking the right balance between accounting for long-term climate change and doing so within an actionable framework is critical. Financial risks are generally considered over the short- to medium-term horizon and are generally assessed over one to three years. As the Proposal recognizes, climate-related financial risks are "distinctive" in that they may manifest over a "potentially longer time horizon" and are more "forward-looking" relative to other types of risk.[37] Risk management decisions are not generally made with respect to lengthy time horizons. Long time horizons lead to a wide range of uncertainty about the evolution of climate-related financial risks that make interpreting any findings difficult. Relatedly, it is necessary to make assumptions about how the evolution of the climate will impact economic variables, such as trade, employment and the relative performance of different economic sectors.

2.B. Recommendations.

We recommend the following for the FRB's final guidance regarding scenario analysis:

- **Phased approach.** As noted above, there are still significant data and modeling gaps that affect the reliability of scenario analysis results. Accordingly, as discussed further below, we support a phased approach to climate risk management, including for climate scenario analysis, while data becomes more reliable, available and consistent.

- **Approach to scenario analysis should be risk-based.** The FRB recognizes that financial institutions should, consistent with a risk-based approach "develop and implement climate-related scenario analysis frameworks in a manner commensurate to the financial institution's size, complexity, business activity, and risk profile."[38] Accordingly, the FRB should permit banks to continue tailoring their scenarios and prioritizing the most material likely exposures to that individual firm that would be impacted by climate change, and subjecting only certain asset portfolios to climate scenario analysis.

- **Banks should have flexibility in designing scenarios and in determining how to use and integrate the outcomes of scenario analysis.** Although we would appreciate high-level guidance on scenario analysis from regulators, we also

37 87 Fed. Reg. at 75269.
38 87 Fed. Reg. at 75270.

recommend that the FRB give banks flexibility in the design of their scenarios. Different assumptions about the trajectory of climate-related variables in the scenario design process can lead to significantly different outcomes. Financial institutions can use scenarios based on these varied assumptions to tailor the scenarios to the specific needs of their asset portfolios. However, given the inherent uncertainty over the path of climate change and the exploratory nature of scenario analysis, combined with limitations on climate-related financial data and methodologies, financial institutions should be given flexibility over how results of scenario analysis should be integrated or otherwise used, if at all. For example, it may not be appropriate to use outputs from long-term scenarios to inform short-term business planning decisions.

3. We support the Proposal's flexibility in permitting climate-related financial risks to be incorporated into existing risk management frameworks, though the Proposal in some instances is too prescriptive.

3.A. Climate-related financial risk may be effectively addressed within existing risk-management frameworks.

Climate-related financial risk may be considered a transverse, cross-cutting risk in some instances or a standalone risk in others. As a result, in some circumstances, it may be more appropriate for banks to embed climate-related financial risks into existing risk management frameworks and in others to create new, standalone frameworks. The Proposal appears to permit the approach of incorporating climate-related financial risks into existing frameworks and systems where appropriate, and we believe the final guidance should retain this flexible perspective.

As the FRB notes in the Proposal, the draft principles are "consistent with the risk management framework described in the [FRB's] existing rules and guidance" and are intended to "help financial institutions' boards of directors and management make progress toward *incorporating climate-related financial risks into financial institutions' risk management frameworks.*"[39] The "Governance" principle contemplates that the financial institution's board may "assign accountability for climate-related financial risks within existing organizational structures."[40]

As the Proposal acknowledges, 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, the FRB's Enhanced Prudential Standards require large banking organizations to have a risk management framework that includes "processes and systems for identifying and reporting risks, including emerging risks," and requires a banking

[39] 87 Fed. Reg. at 75268 (emphasis added).
[40] 87 Fed. Reg. at 75269.

organization's risk committee to "approve and periodically review the enterprise-wide risk-management policies of the company."[41] FRB 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.[42] Large U.S. banks are already expected 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, strategic, operational and model risk.[43]

U.S. GSIBs, therefore, already have in place robust risk management frameworks and practices that are designed to address material risks and are purposefully flexible to enable the incorporation of responses to new and emerging risks. In fact, as the Proposal recognizes,[44] our member institutions already have been incorporating the initial approaches of climate-related financial risk analysis into their risk management practices and performing ongoing monitoring of climate-related financial risks to the extent they are material.[45]

Forum member institutions employ a variety of effective strategies to mitigate climate-related financial risks and already generally prioritize risk management of assets and clients in industries considered to be higher risk. For example, to address idiosyncratic flood risk, our member institutions generally have policies in place to require flood insurance when underwriting a mortgage based on the property's location. Some of our member institutions are considering their clients' intended use of financing, geographic locations of operations and ability to manage potential physical risk impacts. Further,

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41 Enhanced Prudential Standards for Bank Holding Companies and Foreign Banking Organizations, 79 Fed. Reg. 17240, 17247–48, 17251 (Mar. 27, 2014) ("Enhanced Prudential Standards").

42 *See, e.g.*, Enhanced Prudential Standards, *supra* note 41; Federal Reserve SR 21-3, *supra* note 14; Federal Reserve Board, Bank Holding Company Supervision Manual (Nov. 2021) (risk management processes and internal controls), available *here*.

43 *See, e.g.*, Enhanced Prudential Standards (managing liquidity risk), *supra* note 41; Federal Reserve SR 21-3, *supra* note 14; 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).

44 87 Fed. Reg. at 75268.

45 We also note that, to some extent, large banks have historically been successfully managing climate-related risks in conducting their activities. Notably, a staff report released by Federal Reserve Bank of New York economists 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. Kristian S. Blickle et al., Federal Reserve Bank of New York, How Bad Are Weather Disasters for Banks?, at 1, 3 (Nov. 2021) ("NY Fed Staff Report").

some of our member institutions incorporate climate-related financial risks into overall credit assessment and underwriting processes for certain industries and loans, like commercial real estate, mortgages and select corporate loans.

The Proposal includes provisions that could be interpreted as requiring banks to adopt lending limits related to climate-related financial risk regardless of materiality. For example, the Proposal suggests that "[m]anagement should incorporate climate-related financial risks into policies, procedures, and limits to provide detailed guidance on the financial institution's approach to these risks in line with the strategy and risk appetite set by the board."[46] The Proposal also suggests a new requirement for credit risk: "[m]anagement should consider climate-related financial risks as part of the underwriting and ongoing monitoring of portfolios."[47] It also states that "[c]onsistent with the financial institution's risk appetite statement, management should determine credit risk tolerances and lending limits related to these risks."[48] Mandating new lending limits specific to climate-related financial risk would be inconsistent with the regulatory expectation that banks' risk management frameworks include all material risk considerations to banks and already capture top and emerging risks through risk identification.

In line with existing risk identification processes, banks are appropriately considering impacts of climate-related financial risks on the overall risk appetite of the firm. We do not think guidance should be so prescriptive as to require changes to existing, or creation of new, credit risk tolerances and lending limits as a result of climate-related financial risk considerations. As mentioned above, Forum member institutions incorporate climate-related financial risks in their existing risk-management programs, including credit assessments, and the final guidance should not mandate that banks establish prescriptive risk tolerances or lending limits. As an alternative, FRB could clarify that "[e]ffective credit risk management practices could include monitoring climate-related credit risks through sectoral, geographic, and single-name concentration analyses, including credit risk concentrations stemming from physical and transition risks, ***as appropriate***," and that "[c]onsistent with the financial institution's risk appetite statement, management should determine credit risk tolerances and lending limits related to these risks ***if deemed material***."[49]

In short, the final guidance should retain the Proposal's approach of allowing banks the flexibility to treat climate-related financial risk as a risk that may be integrated into banks' existing risk management frameworks. This not only would be consistent with regulatory expectations that banks' risk management frameworks encompass all material

46 87 Fed. Reg. at 75269.
47 87 Fed. Reg. at 75270.
48 87 Fed. Reg. at 75270.
49 87 Fed. Reg. at 75270 (italicized and underlined language indicates the Forum's proposed revision).

risks to the bank,[50] but also would enable banks to more expeditiously address emerging climate-related financial risks.

3.B. Time horizons should be consistent with how banking organizations currently assess and mitigate risk.

The Proposal's Governance principle states that climate-related financial risks "may include those that extend beyond the institution's typical strategic planning horizon."[51] We agree that climate change is a long-term phenomenon and recognize that scenario analyses may be conducted over longer time horizons, as discussed above. However, 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. Moreover, expectations around climate-related financial risk management should seek a balance between the uncertain long-term effects of climate change and the need for bank management to address its more immediate impacts in an effective manner, consistent with risk appetite and business planning. Accordingly, we recommend that the final guidance give banks flexibility to determine the appropriate time horizon depending on the purpose of various climate-related financial risk management exercises.

4. The final guidance should adopt a phased approach to requiring banks to incorporate certain practices into their risk management frameworks.

The Forum appreciates that the FRB recognizes incorporating climate-related financial risk management practices "will be iterative."[52] As such, we believe the process for meeting supervisory expectations regarding climate-related financial risks should similarly be an iterative process.

First, we note that this specific guidance on climate-related financial risks is new, although it is similar to guidance proposed by the OCC and FDIC. 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;"[53]

50 *See, e.g.*, Enhanced Prudential Standards, *supra* note 41.
51 87 Fed. Reg. at 75269.
52 87 Fed. Reg. at 75269.
53 FSOC Report, *supra* note 34, 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.

- The relatively new and evolving nature of models and methods employed for climate scenario analysis relative to those used in traditional financial stress testing, which may not currently be suitable for rigorously assessing granular climate-related financial risks;

- Uncertainty about the time horizons over which certain risks (*e.g.*, transition risks, longer-term risks) may manifest;[54] 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.[55]

The FSOC Report included a lengthy discussion of the challenges associated with identifying and mitigating climate-related financial risks, particularly around data. The FSOC Report stated that "enhancing the availability of and access to relevant, comprehensive data and developing methods and metrics to effectively utilize climate-related data and financial data" are "[n]ecessary steps for measuring and assessing climate-related financial risk."[56] FSOC's recent Fact Sheet, reporting on FSOC members' progress since the release of the FSOC Report, continues to recognize that "[m]easurement of climate-related financial risk requires additional data and methodologies" and that "there may be gaps in available data."[57] Federal Reserve staff have also acknowledged there are "several challenges to measurement [of climate-related risks] beyond those associated with conventional financial system vulnerabilities and potential shocks," and that "[t]hese climate-related features impair not only estimation and modeling at the level of the overall economy, but also the analysis of region-, sector-, asset-, institution-, and investor-level exposures."[58]

Forum member institutions' experience with scenario analysis similarly suggests the availability and reliability of materially accurate climate-related financial data remains a salient limitation on the reliability of scenario analysis and other climate-related financial risk management exercises.

These challenges, as well as the evolving nature of climate-related financial risks, necessitate an ongoing process for managing such risks. The Proposal in fact states that the FRB "recognizes that the incorporation of material climate-related financial risks into

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54 FSOC Report, *supra* note 34, at 23.
55 FSOC Report, *supra* note 34, at 23.
56 FSOC Report, *supra* note 34, at 47.
57 Financial Stability Oversight Council, Fact Sheet: The Financial Stability Oversight Council and Progress in Addressing Climate-Related Financial Risk, at 4 (July 2022).
58 Celso Brunetti, et al., *Climate Change and Financial Stability*, FEDS Note, Federal Reserve Board (Mar. 19, 2021), available *here*.

various planning processes will be iterative, as measurement methodologies, models, and data for analyzing these risks continue to mature."[59] Guidance should take into account the limitations around currently available data and metrics when setting expectations for banks.

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 FRB adopt an iterative or "phased approach." This would involve the FRB 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 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. For example, it would not currently be appropriate to incorporate climate-related financial risks into capital and liquidity planning processes. It is important that there be sufficient flexibility in climate modeling standards so that learning and innovation can occur on an ongoing basis. A phased approach that clearly sets out gradual milestones for certain expectations would best reflect the evolving nature of climate-related financial risks and support banks' efforts to manage climate-related financial risks in a manner that is effective, accurate and methodical.

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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
President and CEO
The Financial Services Forum

[59] 87 Fed. Reg. at 75268–69.