February 14, 2022

VIA ELECTRONIC SUBMISSION

Chief Counsel's Office
Attention: Comment Processing
Office of the Comptroller of the Currency
400 7th Street, Suite 3E-218
Washington, DC 20219
Docket ID OCC-2021-0023

Re: Principles for Climate-Related Financial Risk Management for Large Banks

Ladies and Gentlemen:

The Financial Services Forum (the "Forum")[1] appreciates the opportunity to submit this letter to the Office of the Comptroller of the Currency (the "OCC") on its proposed guidelines (the "Proposal") on the effective management 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, for a number of reasons. 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 in fact, already have taken important steps to incorporate such risks into their comprehensive, enterprise risk management frameworks. Accordingly, the Forum supports the OCC's efforts 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 OCC's guidance in the Proposal could be recalibrated. We also

[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.

provide responses to certain questions posed by the OCC throughout our letter, as indicated. Our key observations and recommendations are as follows:

- **We welcome the guidance.** The Forum recognizes the emerging risks to banks presented by climate change and the importance of having robust capabilities to manage banks' exposures to such risks. Indeed, our member institutions already have taken steps to incorporate climate-related financial risks into their risk management frameworks. The Proposal is helpful for understanding the OCC's particular areas of focus with respect to the management of climate-related financial risks, and we welcome OCC guidance in this area as our member institutions work on strengthening and refining their climate-related financial risk management processes over time.

- **Support for scenario analysis rather than traditional stress testing.** The Forum supports the use of scenario analysis, which can provide insights into a range of tailored scenarios. Scenario analysis should focus on material exposures and incorporate plausible scenarios, particularly with respect to transition risk. We also appreciate the distinction the Proposal makes between scenario analysis and traditional stress testing, which could result in adverse regulatory consequences, as gaps in data availability and methodology make regulatory consequences inappropriate.

- **Support for principles and risk-based, flexible approach.** 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. 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 OCC 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.

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

a. Scenario analysis is the preferred method of evaluating climate-related financial risks.

The Proposal recommends scenario analysis as an "important approach for identifying, measuring, and managing climate-related risks." 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 financial conditions." 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 Federal Reserve Board ("Federal Reserve") and the Financial Stability Oversight Committee ("FSOC").

Scenario analysis is a much more suitable tool to evaluate the potential economic and financial risks posed by different climate outcomes. A key difference between stress testing and scenario analysis is that traditional stress testing may be associated with regulatory requirements,[2] with respect to which the failure to comply can result in supervisory consequences and limitations on capital distributions and discretionary bonus payments.[3] As discussed in greater detail below, banks face significant challenges in identifying and measuring climate-related financial risks, particularly around data. 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 currently available data and methodologies.

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."[4] Stress testing necessarily tends to focus on shorter time horizons[5] and would be unable to account for the fact that climate-related financial risks could "evolve over various time horizons," including "those that extend beyond the bank's typical strategic planning horizon," as noted in the Proposal's "Governance" principle. Therefore, a tool like scenario analysis, which can explore a range of potential scenarios over long-term horizons, would be better suited as a more flexible risk management tool for guarding against climate-related financial risks.

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2 *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").

3 12 C.F.R. 217.11(c)(1).

4 FSOC Report, *supra* note 2; *see also* Lael Brainard, "Financial Stability Implications of Climate Change" (Mar. 23, 2021), https://www.federalreserve.gov/newsevents/speech/brainard20210323a.htm [hereinafter, "Brainard Remarks"].

5 *See, e.g.*, FSOC Report, *supra* note 2 (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).

Lastly, the Federal Reserve has itself distinguished between scenario analysis and stress testing[6] and is currently developing a program of climate-related scenario analysis.[7] 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."[8] Governor Lael Brainard reiterated that she is not currently advocating including climate-related financial risks in traditional stress tests during her nomination hearing: "I certainly have not stated that we should do climate stress tests."[9] The FSOC Report on Climate-Related Financial Risk (the "FSOC Report") also 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 Federal Reserve's Comprehensive Capital Analysis and Review ("CCAR") program.[10]

b. Response to questions regarding scenario analysis.[11]

The OCC has asked for feedback on how banks currently use climate scenario analysis and which factors would be most salient to consider when designing these exercises in the future. We highlight some observations and challenges about climate scenario analysis based on the experience of our member institutions and recommend certain features of scenario analysis that the OCC should support in its final guidance.

i. 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-

6 *See, e.g.*, Powell Remarks, *supra* note 2; Brainard Remarks, *supra* note 4.

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

8 Senate Banking, Housing, and Urban Affairs Committee Nomination Hearing (Jan. 11, 2022).

9 Senate Banking, Housing, and Urban Affairs Committee Nomination Hearing (Jan. 13, 2022).

10 FSOC Report, *supra* note 2, at 90 ("Scenario analysis is similar to, but distinct from, stress testing as deployed by financial regulators, such as the supervisory Dodd-Frank Act Stress Tests of the Federal Reserve Board, OCC, and FDIC and the Comprehensive Capital Analysis and Review (CCAR) performed by the Federal Reserve Board on the largest banking organizations.").

11 This section is responsive to Questions 12 and 13 posed by the OCC, respectively: "Scenario analysis is an important component of climate risk management that requires assumptions about plausible future states of the world. How do banks use climate scenario models, analysis, or tools and what challenges do they face?" and "What factors are most salient for the OCC to consider when designing and executing scenario analysis exercises?"

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.

For example, some of our member institutions designed scenarios to examine the impacts of two short-term transition risk pathways on a sample portfolio of companies in the oil and gas value chain. One of these pathways was based on rapid electric vehicle adoption and the other was based on the adoption of a global carbon tax. Focusing on this portfolio allowed our member institutions to analyze the financial impacts of each pathway across different segments of the value chain within the oil and gas industry.

- **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. Data gaps, and 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. While climate-related data has improved in both quantity and quality over the past several years, there are still considerable gaps that frustrate attempts to accurately identify climate-related financial risks. In particular, our member institutions have highlighted data gaps regarding physical risks, such as the possibility that specific locations will experience extreme weather events and the geographic location of physical assets of companies. One of our member institutions conducted a scenario analysis to identify areas exposed to significant physical risks by mapping the bank's exposures by geography and then cross-referencing these global geographies against potential hot spots for physical climate impacts. The more reliable the geographic data, the more useful such exercises will be.

  As another 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 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. As discussed above, financial risks are generally considered over the short to medium-term horizon and are generally assessed over one to three years. Climate scenario analysis over substantially longer horizons presents two important challenges. First, risk management decisions are not generally made with respect to lengthy time horizons. Second, the uncertainty around risks of any type grow quickly with the time horizon. 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. Making such forecasts in the near-term is difficult, and understanding how the distant evolution of the climate relates to various economic indicators is all the more challenging.

ii. Recommendations.

We recommend the following for the OCC'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.

- **Materiality thresholds should be incorporated.** A risk-based approach that considers the unique characteristics of each bank and that allows banks to focus on targeting material climate-related financial risks should apply to scenario analysis as well. The OCC, for example, should permit banks to continue focusing their scenarios on the most material likely exposures that would be impacted by climate change, and subjecting only certain asset portfolios to climate scenario analysis.

- **Banks should have flexibility in designing scenarios.** Although we would appreciate high-level guidance on scenario analysis from regulators, we also recommend that the OCC give banks flexibility in the design of their scenarios. This approach will ensure that the broad frame of the scenario is articulated comprehensively while allowing individual firms to tailor the scenarios to the specific needs of their asset portfolios. For example, one of our member institution's subsidiaries applied transition and physical risk methodologies to the commercial real estate and agriculture sectors. The subsidiary chose these two

climate-vulnerable sectors because of its exposure—the two sectors together comprised nearly a quarter of the subsidiary's commercial banking lending portfolio. The flexibility to design its own scenario allowed the subsidiary to make choices based on its unique exposure that were both plausible and severe.

- **Scenarios encompassing transition risks should be plausible.** Scenarios used for scenario analysis may be severe and rigorous but should also be credible. Scenarios keyed to tail risks that are too remote may result in risk measurements that are not highly relevant. Overall, the degree of severity in any climate scenario must be appropriately balanced against its plausibility. This balance should be made explicit in a well-articulated and measurable standard that should be employed to help ensure that climate scenarios, and in particular transition risks, are empirically relevant and have the potential to result in actionable outcomes. Transition risk may be even harder to predict than physical risk because it depends on the path of government policy. Moreover, different assumptions about the specific type and trajectory of policy can lead to significantly different outcomes. As an example, a transition risk scenario that considers the rapid imposition of a large and widely applicable carbon tax would have a significantly different impact than a transition risk scenario that is focused more narrowly on policies targeting the fossil fuel industry. OCC guidance should provide clear, high-level guidance on the nature and extent of transition risk scenarios to be considered, and these scenarios should be plausible.

2. We support the Proposal's flexibility in permitting climate-related financial risks to be incorporated into existing risk management frameworks.

a. Climate-related financial risk may be effectively addressed within existing risk management frameworks, which already sufficiently account for climate-related financial risks.[12]

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.

[12] This section is, in part, responsive to Questions 4 and 7 posed by the OCC, respectively: "What specific tools or strategies have banks used to successfully incorporate climate-related financial risks into their risk management frameworks?" and "What, if any, specific products, practices, and strategies—for example, insurance or derivatives contracts or other capital market instruments—do banks use to hedge, transfer, or mitigate climate-related financial risks?"

In the Proposal, the OCC explains that the draft principles are "consistent with the existing risk management framework described in existing OCC rules and guidance" and are intended to "help bank management make progress toward … *incorporating climate-related financial risks into banks' risk management frameworks*" (emphasis added). The "Governance" principle explicitly contemplates that "[r]esponsibility and accountability may be integrated within existing organizational structures."

As the Proposal acknowledges, the OCC's 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 OCC safety and soundness regulations require large banks to update their risk governance frameworks "at least annually, and as often as needed to address … changes in the [] bank's risk profile caused by emerging risks."[13]

OCC 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.[14] 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.[15]

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[13] 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"]; *see also* Enhanced Prudential Standards for Bank Holding Companies and Foreign Banking Organizations, 79 Fed. Reg. 17239 (Mar. 27, 2014) [hereinafter, "Enhanced Prudential Standards"] (requiring that the risk management frameworks of a large U.S. bank holding company "be commensurate with its structure, risk profile, complexity, activities, and size," and requiring subject institutions to implement broad frameworks rather than targeted responses to enumerated risks and to adjust their frameworks as risks and activities vary).

[14] *See, e.g.*, OCC Heightened Standards, *supra* note 13; 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, *supra* note 13; Federal Reserve, SR 21-3 / CA 21-1: Supervisory Guidance on Board of Directors' Effectiveness (Feb. 26, 2021) [hereinafter, "Federal Reserve SR 21-3"]; Federal Reserve Board, Bank Holding Company Supervision Manual (Nov. 2021) (risk management processes and internal controls), https://www.federalreserve.gov/publications/files/bhc.pdf.

[15] *See, e.g.*, OCC Heightened Standards, *supra* note 13; OCC Corporate and Risk Governance Handbook, *supra* note 14; Enhanced Prudential Standards (managing liquidity risk), *supra* note 13; 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).

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 would be the case for any other material risk, our member institutions already have been incorporating climate-related financial risk analysis into their risk management practices.[16]

Our member institutions have worked to incorporate oversight of climate-related financial risk into their existing governance structures by, in some instances, establishing internal committees that consist of senior executives with specific purview over climate-related financial risk management. For example, one of our member institutions has established a climate risk team that is responsible for developing the bank's internal approach to managing climate-related financial risk, with the goal of integrating climate considerations into existing risk management frameworks.

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 or high-carbon intensity. 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. Some of our member institutions are also taking into consideration the client's intended use of financing, geographic locations of operations and ability to manage potential physical risk impacts. Further, 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 and mortgages.

In addition, we do not believe that a new type of regulatory or other external reporting specifically directed at climate-related financial risk by banks is appropriate or necessary at this point in time.[17] Existing regulatory reporting, such as that required by the Securities and Exchange Commission (the "SEC"), already incorporates disclosure of material risks, and we believe that additional reporting would be duplicative and unnecessary.[18] We note that many banks are already engaged in voluntary reporting

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[16] We also note that, to some extent, banks have historically been successfully managing climate-related risks in conducting their activities. *See, e.g.*, Kristian S. Blickle et al., Federal Reserve Bank of New York, How Bad Are Weather Disasters for Banks?, at 3 (Nov. 2021) [hereinafter, "NY Fed Staff Report"] (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").

[17] This is responsive to Question 11 posed by the OCC: "How could existing regulatory reporting requirements be augmented to better capture banks' exposure to climate-related financial risks?"

[18] *See* SEC, Commission Guidance Regarding Disclosure Related to Climate Change (Feb. 8, 2010), https://www.sec.gov/rules/interp/2010/33-9106.pdf (explaining how items of Regulation S-K can capture a number of climate-related financial risks).

efforts through the Taskforce on Climate-Related Financial Disclosures ("TCFD") as well as other industry-led reporting frameworks.[19]

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 and reporting. This 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-related financial risks.

b. Time horizons should be consistent with how banks currently assess and mitigate risk.[21]

The specific time horizon considered relevant for climate-related financial risks depends on the specific use for which the analysis is employed. A bank's risk management and stress testing time horizons generally are relatively short-term (e.g., less than three years and often far shorter), in order to facilitate meaningful and realistic risk appetite and business strategy planning. The Basel Committee on Banking Supervision ("BCBS") explains that traditional financial risk scenario analysis and stress testing use shorter time frames because the uncertainty of the results increases with the timespan, as more assumptions are required.[22]

As the Proposal's Governance principle states, climate-related financial risks could "evolve over various time horizons," including "those that extend beyond the bank's typical strategic planning horizon." Although we agree climate change is a long-term phenomenon, 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 the more immediate impacts in an effective manner consistent with risk appetite and business planning. For example, a 30-year time horizon would be inconsistent with the risk management frameworks used by our member institutions.

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19 *See* TCFD, Core Recommendations, https://www.fsb-tcfd.org/recommendations/#core-recommendations; Carbon Disclosure Project, Climate Change 2021 Questionnaire (Jan. 2021), https://guidance.cdp.net/en/guidance?cid=18&ctype=theme&idtype=ThemeID&incchild=1&microsite=0&otype=Questionnaire&tags=TAG-13071%2CTAG-605%2CTAG-600.

20 *See, e.g.*, OCC Heightened Standards, *supra* note 13.

21 This section is, in part, responsive to Question 6 posed by the OCC: "What time horizons do banks consider relevant when identifying and assessing the materiality of climate-related financial risks?"

22 *See* Basel Committee on Banking Supervision, Climate-Related Financial Risks – Measurement Methodologies (Apr. 2021), at 20–21, https://www.bis.org/bcbs/publ/d518.pdf; Federal Reserve, The Supervisory Capital Assessment Program: Design and Implementation (Apr. 24, 2009), at 3, https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20090424a1.pdf.

We recognize that scenario analyses may be conducted over longer time horizons, as discussed above, 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. Accordingly, we recommend that the final guidance give banks flexibility to determine the appropriate time horizon depending on the purpose of the analysis.

3. We support the principles and risk-based framework discussed in the Proposal and believe the final guidance should reflect this framework and allow banks to focus on climate-related financial risks that are material to them.

In the introduction to the Proposal, the OCC 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 risk management" (emphasis added). The OCC also notes that, "[i]n keeping with the OCC's risk-based approach to supervision, the OCC intends to appropriately tailor any resulting supervisory expectations to reflect differences in banks' circumstances such as complexity of operations and business models." The "Scenario Analysis" principle also advises that management develop and implement scenario analysis frameworks "in a manner commensurate to the bank's size, complexity, business activity, and risk profile."

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.

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, a recent staff report released by Federal Reserve Bank of New York economists ("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.[23]

[23] NY Fed Staff Report, *supra* note 16, at 1.

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 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.

It is important that Forum member institutions be allowed to leverage existing risk management practices and capabilities in assessing the materiality of an asset portfolio in relation to climate-related risk management. For example, our member institutions have identified a variety of material climate-related financial risks based on their distinct portfolios and exposures.[24] Our member institutions generally have developed a process to determine whether a risk is material that consists of: (1) identifying and assessing the potential impacts of a risk, (2) ranking the likelihood of the occurrence of the particular risk, (3) assessing and measuring the risk and (4) then making decisions based on that assessment. The material risks identified through this process inform the bank's scenario design and analysis, risk appetite and strategic planning.

Another example of a materiality determination is identifying portfolio sensitivity to climate-related financial risks through both qualitative and quantitative analyses to gauge the materiality of an asset portfolio's sensitivity to climate change, such as rising sea levels and increased incidences of extreme weather events, like wild fires and hurricanes. This process often makes use of highly granular data, including the precise location of an asset and its relation to relevant geographic features, such as proximity to a floodplain or wildfire prone areas. These analyses are then used to build an overall assessment of a portfolio's sensitivity to climate-related financial risks, which is then used to determine if more intensive and granular scenario analysis would be warranted from a risk measurement and management perspective.

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

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

[24] This paragraph is, in part, responsive to Question 5 posed by the OCC: "How do banks determine when climate-related financial risks are material and warrant greater than routine attention by the board and management?"

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";[25]

- 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;[26] 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.[27]

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."[28]

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 "[t]he OCC recognizes 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."[29] Guidance

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25 FSOC Report, *supra* note 2, 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.

26 *Id*.

27 *Id*.

28 *Id.* at 47.

29 Proposal, "Strategic Planning" principle.

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 OCC adopt an iterative or "phased approach." This would involve the OCC 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.

5. Certain of the principles should be clarified in the final guidance.

We recommend that certain of the principles be clarified further in the final guidance.

a. Governance.

For the "Governance" principle, the OCC should distinguish the roles and responsibilities of bank boards and management with respect to risk management. We believe the final guidance should explicitly align with other OCC guidance on bank boards' responsibilities, including the OCC's Director's Book, which explains that the "board's role in the governance of the bank is clearly distinct from management's role. The board is responsible for the overall direction and oversight of the bank—but is not responsible for managing the bank day-to-day. The board should oversee and hold management accountable for meeting strategic objectives within the bank's risk appetite."[30]

The Proposal states: "The board should actively oversee the bank's risk-taking activities and hold management accountable for adhering to the risk governance framework." This expectation appears in the OCC's Heightened Standards, which state that boards can fulfill their responsibility to oversee risk-taking activities by "relying on assessments and

[30] OCC, Director's Book: Role of Directors for National Banks and Federal Savings Associations (Nov. 2020), at 14–15, https://www.occ.gov/publications-and-resources/publications/banker-education/files/directors-book.html.

reports prepared by independent risk management and internal audit."[31] The final guidance should clarify that it does not augment the board's responsibility to oversee management under existing guidance. We recommend that, to align the expectation more closely with the Heightened Standards, the "Governance" principle clarify that a board should actively oversee a bank's risk taking activities, including by "relying on assessments and reports prepared by independent risk management and internal audit."[32]

b. Public communication.

For the "Strategic Planning" principle, the OCC should clarify the language regarding public communication of climate-related strategies. The Proposal calls for banks to "ensure that any public statements about their banks' climate-related strategies and commitments are consistent with their internal strategies and risk appetite statements."[33] Specifically, we believe it would be more appropriate for each bank to ensure that public communication of its climate-related strategies is consistent with *the actions the bank is actually taking*. This focus on accuracy aligns with the U.S. securities disclosure regime, which requires accuracy in public statements. We believe the current wording of this expectation would benefit from clarification by stating that the OCC's focus in this area is having banks avoid making materially inaccurate or untrue public statements regarding climate-related financial risk plans, strategies or actions.

We also believe the responsibilities of the board and management with respect to public communications regarding climate-related strategies could benefit from clarification. The Proposal calls for both boards and management to "ensure" consistency between public communications and internal strategies regarding climate-related strategies. As boards do not review a bank's public communications except in extraordinary circumstances, we recommend that the final guidance not assign the board responsibility for ensuring alignment between public communications and internal climate-related strategies. We believe this modification would align the final guidance more closely with the roles of the board and management contemplated in OCC supervisory guidance, which, as discussed above, emphasizes that boards are not responsible for managing the day-to-day affairs of banks, but rather are responsible for overseeing and holding management accountable for operating the bank in a safe and sound manner.[34]

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31 *See* OCC Heightened Standards, *supra* note 13, at 54537.

32 *Id.*

33 Proposal, "Strategic Planning" principle.

34 *See* OCC Heightened Standards, *supra* note 13, at 54537.

6. Regulatory agencies should cooperate so that there is one consistent set of high-level standards applicable across an entire banking organization.

Banking organizations benefit from a consistent set of guidelines from banking regulators. We also reiterate our support for guidance, like the Proposal, that is principles-based and high-level. In the press release announcing the Proposal, Acting Comptroller of the Currency Michael J. Hsu indicated plans to "work[] with [the OCC's] interagency peers" to develop future guidance.[35] The Federal Reserve also stated that it will review the comments submitted in response to the Proposal as part of interagency coordination relating to climate-related risk, noting that "[a] consistent approach across bank regulatory agencies will best support the effective management of these risks."[36] The Federal Deposit Insurance Corporation has said it will prioritize addressing financial risks posed by climate change in 2022, which will include seeking comment on forthcoming guidance.[37] We agree that the federal banking agencies should take a consistent and coordinated approach to high-level guidance relating to risk management frameworks for climate-related financial risk.

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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,

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The Financial Services Forum

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35 OCC, News Release 2021-138: OCC Seeks Feedback on Principles for Climate-Related Financial Risk Management for Large Banks (Dec. 16, 2021), https://occ.treas.gov/news-issuances/news-releases/2021/nr-occ-2021-138.html.

36 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.

37 *See* Federal Deposit Insurance Corporation, Acting Chairman Martin J. Gruenberg Announces FDIC Priorities for 2022 (Feb. 7, 2022), https://www.fdic.gov/news/press-releases/2022/pr22015.html.