Key Takeaways from the Financial Services Forum's Responses to the OCC on Climate Risk Principles

FINANCIAL SERVICES FORUM

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The Forum commented on a proposal from the Office of the Comptroller of the Currency (OCC) to establish guidance for banking organizations to manage climate-related financial risks. As part of those comments, the Forum provided responses to specific questions posed by the OCC, including:

What specific tools or strategies have banks used to successfully incorporate climate-related financial risks into their 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. Our member institutions are also taking into consideration the client's intended use of financing, geographic locations of operations and ability to manage potential environmental impacts. Further, 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 to the required SEC disclosures, our member institutions disclose information related to climate-related financial risks on a voluntary basis through the Taskforce on Climate Related Financial Disclosures (TCFD). The TCFD reporting principles cover governance, metrics and reporting, strategy and risk management. Our member institutions release TCFD-specific reports or address these principles in other reports.

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?

- 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.

- Data gaps 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.

- The long-term nature of climate change poses significant challenges for modeling climate-related financial risks. It is therefore critical to account for long-term climate change within an actionable framework. Firms make risk management decisions using short to medium-term horizons, generally one to three years. Scenario analysis over substantially longer time horizons becomes increasingly uncertain, harder to interpret, and less actionable.

What time horizons do banks consider relevant when identifying and assessing the materiality of climate-related financial risks?

- A bank's risk management and stress testing time horizons generally are relatively short-term 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.

- Although 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.

- 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.

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?

- 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.

- Our member institutions are also taking into consideration the client's intended use of financing, geographic locations of operations and ability to manage potential environmental impacts.

- Further, 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.

How could existing regulatory reporting requirements be augmented to better capture banks' exposure to climate-related financial risks?

- We believe climate-related financial risk can be integrated into existing regulatory reporting without the need for augmentation. Because existing regulatory reporting, such as that required by the Securities and Exchange Commission (SEC) and recommended by the TCFD, should pick up climate-related impacts, we believe that additional reporting would be duplicative and unnecessary.

What factors are most salient for the OCC to consider when designing and executing scenario analysis exercises?

- **Phased approach.** There are still significant data and modeling gaps that affect the reliability of scenario analysis results. Accordingly, 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.** We 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.

- **Scenarios encompassing transition risks should be plausible.** 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. 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.