Center for Climate Aligned Finance

February 14, 2022

RE: Principles for Climate-Related Financial Risk Management for Large Banks
Attention: Docket ID OCC-2021-0023
Dear Comptroller Hsu,

We are pleased to submit comments in response to the request for public feedback on the Office of the Comptroller's (OCC) recent publication of the Principles for Climate-Related Financial Risk Management for Large Banks on behalf of RMI's Center for Climate-Aligned Finance. We strongly agree with and welcome the OCC's acknowledgement of the threats that climate change poses to the safety and stability of individual banks, the banking sector, and the US financial system overall.

Background on RMI and Our Expertise

RMI is an independent nonprofit founded in 1982 that transforms global energy systems through market driven solutions to align with a 1.5°C future and secure a clean, prosperous, zero-carbon future for all. We work in the world's most critical geographies and engage businesses, policymakers, communities, and NGOs to identify and scale energy system interventions that will cut greenhouse gas emissions at least 50 percent by 2030.

In July 2020, RMI launched the Center for Climate-Aligned Finance (the Center) to help the financial sector transition the global economy toward a zero-carbon, 1.5°C future. Through deep partnerships in finance, industry, government, and civil society, the Center works to develop decarbonization agreements for high-emitting sectors and supports financial institutions to decarbonize their loan books and investment portfolios. The Center also works to shape the financial sector's operating environment by addressing barriers common to all financial institutions, including those related to financial regulation.

Beyond Risk Management to Ensure Safety and Soundness

As the OCC has noted,[1] net zero climate commitments have become commonplace across the US financial sector, including from seven of the ten largest commercial banks. This trend arrives as the price tag for climate-related damages is already sizeable[2] and growing, and there is undeniable momentum behind a global transition to net-zero. In other words, banks have publicly recognized the need for a new approach to business-as-usual to effectively address the risks presented by climate change.

In 2021, the Financial Stability Oversight Council (FSOC) acknowledged that climate change represents a systemic risk to financial stability and the health of the entire economy. Large banks, whose portfolios comprise a wide variety of interconnected exposures, are especially exposed to climate-related risks. Climate commitments from large banks are a welcome step, but making progress in implementing commitments will require sweeping changes to the way large banks approach their governance, risk assessments, and lending decisions. Banks can no longer mitigate climate-related risks through hedges or minor adjustments to their businesses or loan books. Ceres found that the cumulative exposure to the largest US banks' syndicated loan portfolios alone could be larger than $500 billion from transition

[1] https://www.occ.gov/news-issuances/speeches/2021/pub-speech-2021-116.pdf
[2] https://aon.mediaroom.com/2021-01-25-Aon-finds-climate-influenced-weather-is-key-driver-of-268B-global-damage-from-2020-natural-disasters-with-64-uninsured

risks[3] and over $250 billion from physical risks,[4] far exceeding currently disclosed estimates. In another study from Cambridge University, researchers found that approximately half of the expected losses that a typical equity investment would face in response to climate-induced economic shocks would be unhedgeable unless there is a system-wide response to climate change.[5] Accordingly, it is imperative that regulatory guidance evolve in step, if not ahead of, necessary changes to banking practices.

With that in mind, we applaud the OCC's actions to develop the Principles for Climate-Related Financial Risk Management. In addition to our support, we urge the OCC to evaluate the need for a more systemic approach to effectively monitor individual bank operations. The OCC is entrusted with ensuring the safety and soundness of individual institutions, but, in the context of climate change, the safety and soundness of individual institutions cannot be determined from individual risk exposures in isolation of broader financial system dynamics. Given that climate-related financial risks are systemic[6] and often endogenous,[7] we argue that the best defense is a good offense, and that banks themselves have a proactive role to play.

Reactive risk mitigation by individual banks fails to address the root of systemic risks. Further, the endogenous nature of climate-related risks means they are, at least in part, driven by financial institutions' own actions.[8] Rather than reacting to risks as they materialize, banks can take steps to proactively address drivers of future climate-related risks through their lending decisions. The OCC, alongside peer regulators, has an opportunity to pursue a more robust approach to ensuring banks' safety and soundness by encouraging and empowering banks to play a proactive role in facilitating a timely, inclusive transition of the real economy toward net-zero, thereby mitigating a driving source of climate-related financial risks into the future. A more proactive approach can deliver the dual benefits of reducing individual risk exposures, while contributing to the long-term reduction of systemic climate-related financial risks facing the US economy. Such an approach is central to the concept of "climate alignment"[9] and our work at the Center, where we support financial institutions in understanding, leveraging, and capitalizing on their role in the climate transition.[10]

Support for the Principles for Climate-Related Financial Risk Management

While we believe a more proactive approach to regulation is the best way to meaningfully address climate-related financial risks, we firmly support the OCC's draft principles as a complementary first step. The Center especially supports the following elements of the proposed principles:

1. **Making internal strategies consistent with public-facing climate commitments**. We predict that 2022 will be the year for large banks with existing public climate commitments to begin

[3] https://www.ceres.org/sites/default/files/reports/2020-10/Ceres%20Bank%20Risk%20Report%202020%20FINAL.pdf
[4] https://www.ceres.org/sites/default/files/reports/2021-09/Ceres%20Financing%20a%20Net%20Zero%20Economy%20FINAL.pdf
[5] https://www.cisl.cam.ac.uk/system/files/documents/unhedgeable-risk.pdf
[6] https://home.treasury.gov/system/files/261/FSOC-Climate-Report.pdf
[7] Chenet, Ryan-Collins, van Lerven (2019) Climate-related financial policy in a world of radical uncertainty: Towards a precautionary approach. https://www.ucl.ac.uk/bartlett/public-purpose/sites/public-purpose/files/iipp-wp-2019-13-climate-related-financial-policy-in-a-world-of-radical-undertainty-web.pdf
[8] Danielsson, Song Shin, Zigrand (2009) Risk Appetite and Endogenous Risk. https://www.fmg.ac.uk/sites/default/files/2020-08/risk-apetite.pdf
[9] https://climatealignment.org/wp-content/uploads/2022/02/impact_principles_for_climate_aligned_finance_report.pdf
[10] https://climatealignment.org/

substantiating those commitments, such as through interim targets[11] and transition plans.[12] Public climate commitments and targets can send a powerful signal of intent, including internally across banks' business units. But commitments are only a first step, and the OCC is right to call for evidence on how banks organize their businesses to reflect their stated intent.

2. **Incorporating climate-related risk management throughout business units**. A pre-requisite to implementing firm-wide climate commitments is the integration of climate-aligned strategies throughout a bank's business. Effective climate-related risk management can help banks meet climate commitments, but as described above, climate risk management and climate alignment are distinct concepts. They have distinct goals and often lead to different outcomes.[13] Empowering banks to incorporate climate-related risk management at every level of their business will support banks in better understanding the myriad ways climate risks impact their firm. From here, internal strategies must go a step further to be consistent with climate alignment commitments. By proactively acting, through financial and non-financial activities, to mitigate climate risks, integrating climate alignment strategies inherently supports better integration of risk management.

   Our report, *Zeroing In: The US Financial Sector Perspective on Net-Zero Lending and Investing*,[14] is based on a series of workshops the Center held in December 2020 with nine US banks and ten institutional investors to understand the challenges they face in implementing climate alignment commitments. During these workshops, participants from US banks highlighted internal challenges as a top barrier. One participant likened the transformation necessary to meet climate commitments to "changing the DNA of an organization", requiring an evolution of all business units, functions, and operational infrastructure. To enable this holistic transformation, participants noted the need for buy-in from executive leadership and culture change throughout the institution – including by embedding climate values with portfolio managers and front-office investment teams. Regulatory clarity was cited as a key opportunity to accelerate these processes, providing the confidence necessary to reshape internal cultures.

3. **Assessing climate risks differently than other financial risks.** As the OCC recognizes, climate poses meaningful financial risks to US banks. However, because these risks are substantially different from traditional financial risks, a different approach is required to evaluate their true magnitude and scope. For one, both physical and transition risks will materialize over longer time periods than many banks' strategic planning horizons and must be analyzed accordingly over longer timelines. Further, as the OCC's guidance suggests, it is important for banks to monitor and assess physical and transition risk exposures across various segments of the economy and a bank's portfolio, including potential correlations across those risks. We echoed these positions in a recent analysis of the *FSOC Report on Climate-Related Financial Risks*:

   > *Systemic risk means that one financial actor's vulnerability (or climate risk exposure) can jeopardize the well-being of other financial actors, corporates, and households economy-wide. Like dominoes, systemic risks can be passed through "transmission channels," impacting seemingly disconnected parts of the economy. Acknowledging that climate risks are dynamic*

[11] https://rmi.org/how-the-net-zero-banking-alliance-helps-banks-set-interim-emissions-targets/
[12] https://rmi.org/five-trends-to-watch-in-climate-aligned-finance-in-2022/
[13] https://www.tandfonline.com/doi/full/10.1080/20430795.2020.1848142
[14] 36 https://rmi.org/insight/zeroing-in/

and interconnected directly challenges traditional approaches to assessing materiality and risk on an individual asset basis. Instead, systemic risks such as these must be assessed across an entire portfolio or the financial system as a whole.[15]

For instance, while the physical risks facing loans to coastal properties may be predictable through first-order impacts, the complex transmission pathways for climate-related risk factors across entire economies and lending portfolios require a broader scope and further scrutiny.

4. **Developing clear definitions of possible climate-related risk exposures and metrics for setting limits to those exposures**. Despite potential data or methodological uncertainties, starting the process of measuring banks' exposures to climate-related financial risks can help spur the operationalization of climate strategies to reduce those exposures. This includes identifying essential data needs, engaging counterparties to develop and implement transition plans, and prioritizing actions based on where attention and resources are needed most, first. Climate risks do not necessarily require divestment to mitigate. Clear and consistent metrics can help banks identify and work to proactively reduce their climate-related exposures, such as by working with counterparties to develop and implement transition plans. Metrics can also help banks make meaningful progress on integrating organization-wide climate risk assessments and monitoring capabilities. Finally, we support the inclusion of escalation procedures to encourage attention to climate-related exposures by board and management.

5. **Iteratively utilizing measurement methodologies, models, and data for analyzing climate-related financial risks as they evolve and mature**. To steer portfolios to align with their climate goals, banks will require data and metrics that are granular (i.e., asset-specific), forward-looking, and address the most significant drivers of emissions.[16] While data and disclosures are constantly improving, we support the OCC's guidance that banks should act now with best available resources, and then seek to integrate updated resources over time. In its 2021 report, FSOC advised that not only can tools like scenario analysis be used to assess climate risks in the absence of perfect data, but their use can support data improvements over time.[17] Where data gaps persist, we encourage that banks actively seek data directly with corporates and/or through collaborative partnerships with peers, data providers, and regulators to drive improved data accuracy and availability. To reinforce these efforts, we encourage the OCC, in line with FSOC's recommendations, to work with the banking sector and other financial regulators to improve the availability and quality of climate-related models and data.

6. **Managing fair lending concerns for low- to moderate-income (LMI) communities**. We strongly support the OCC's disparate impact standard in examining banks' responses to climate exposures, and we agree that banks would benefit from additional guidance on this matter. A focus on LMI communities aligns with FSOC's acknowledgement that low-income and historically disadvantaged communities are not only disproportionately impacted by climate change but also the least equipped to cope with climate shocks. This dynamic exacerbates existing inequalities and amplifies risks to the financial sector overall when shocks occur. Improving the availability and accessibility of financial products and services is essential for enabling an inclusive, economy-wide transition,

[15] https://rmi.org/we-read-a-130-page-report-on-climate-regulation-so-you-dont-have-to/
[16] https://climatealignment.org/wp-content/uploads/2022/02/impact_principles_for_climate_aligned_finance_report.pdf
[17] https://home.treasury.gov/system/files/261/FSOC-Climate-Report.pdf

Center for Climate Aligned Finance

thereby reducing one driver of systemic risks. This will require a dedicated, tailored approach by financial institutions to meet the unique needs of these communities. Further, regional and community banks, which play an outsized role in LMI and rural communities, are under-resourced to address climate risks. We understand OCC's initial focus on developing principles for large banks. However, moving forward, providing tailored guidance and support to regional and community banks, including ensuring their access to quality data, tools, and services, will be especially important.

In conclusion, climate-related physical and transition risks are widely accepted to be prevalent and material to large US banks, with stark implications for the US economy, including financial markets, communities, and households nationwide. We support the OCC's efforts to revisit and update guidance for the safe and sound management of climate-related financial risks in this unprecedented and evolving operating environment to proactively mitigate their most severe impacts.

Thank you very much for your consideration of our comments herein. If there are questions on the points highlighted here, or if you would like further information, please reach out to Whitney Mann at WMann@rmi.org and Alex Murray at AMurray@rmi.org.

Sincerely,

Brian O'Hanlon
Executive Director
Center for Climate-Aligned Finance

Kaitlin Crouch-Hess
Jessamine Fitzpatrick
Whitney Mann
Alex Murray