

June 3rd, 2022

RE: Principles for Climate-Related Financial Risk Management for Large Financial Institutions
Attention: RIN 3064-ZA32

Dear Chairman Gruenberg,

We are pleased to submit comments in response to the request for public feedback on the Federal Deposit Insurance Corporation's (FDIC) recent publication of the Principles for Climate-Related Financial Risk Management for Large Financial Institutions on behalf of RMI's Center for Climate-Aligned Finance. We strongly agree with and welcome the FDIC'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 FDIC has noted, climate change represents a material financial risk to both individual financial institutions and the stability of both the domestic and international financial system overall. The price tag for climate-related damages is already sizeable¹ and growing, and there is undeniable momentum behind a global transition to net-zero. This trend is especially clear within the US financial sector where net-zero climate commitments have become commonplace, including from seven of the ten largest commercial banks. This is also true among smaller and regional banks, where attention to climate-related risks is growing through initiatives such as the RMA Regional Bank Climate Risk Consortium, a consortium dedicated to preparing mid-tier lending institutions for the transition to a low-carbon economy.² In other words, banks of all sizes have publicly recognized the need for a new approach to business-as-usual to effectively address the risks presented by climate change.

¹ <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>

² <https://www.prnewswire.com/news-releases/rma-forms-new-climate-risk-consortium-for-regional-banks-301508903.html#:~:text=RMA%20promotes%20an%20enterprise%20approach,well%20as%20nonbank%20financial%20institutions>

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. Banking institutions, whose portfolios comprise a wide variety of interconnected exposures, are especially exposed to climate-related risks. Climate commitments from banks are a welcome step but implementing commitments will require sweeping changes to the way 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. Research by Ceres found that the cumulative exposure to the largest US banks' syndicated loan portfolios alone could be larger than \$500 billion from transition risks³ 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.

Relatedly, we also urge the FDIC to evaluate the need for a more systemic approach to effectively monitor individual bank operations. The FDIC 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 systemic⁶ 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 actions taken by market actors, including financial institutions and regulators.⁸ Rather than reacting to risks as they materialize, banks can take steps to proactively address drivers of future climate-related risks through their pricing strategies and lending decisions. The FDIC, 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

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-uncertainty-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/>

Climate Risks are Relevant for All Banks

While more detailed guidance from the FDIC that further elaborates on the topics discussed in these Principles will be necessary moving forward, we support the FDIC's initial approach of issuing high-level guidance to help banks begin to assess and manage climate-related risks. However, we also believe the FDIC should appropriately expand and adequately support the implementation of this guidance to all banks overseen by the agency, including regional, state, and community banks.

Climate change represents a material financial risk to banks of all sizes, and climate-related financial risks can be concentrated in regions and communities. Compared to larger, more diversified banks, regional banks may experience higher rates of failure and branch closures in the wake of natural disasters. Examples can already be seen in the financial sector. For example, consecutive record-breaking losses in 2017 and 2018 California wildfire seasons cost the state's homeowner's insurance industry two times the total amount of combined profits since 1991, pushing many smaller insurance companies to or at the brink of bankruptcy.¹¹ Analysis by Ceres has shown that over 60% of US credit unions, which similarly face highly concentrated physical and transition risks, are at physical risk due to both acute and chronic climate-related weather events and hazards while over 7% of Federally-chartered credit unions face moderate to high disruption due to membership fields aligned with carbon-intensive industries.¹²

Regional, state, and community banks overseen by the FDIC face similar climate-related risks but are often the least equipped to understand or prepare for them.¹³ This problem is compounded by the types of exposures that these banks face. In one study of all domestic FDIC-insured banks, smaller banks were shown to lend significantly more to small businesses than larger banks, and small businesses as counterparties often lack capacity to absorb climate-related shocks.¹⁴ For example, according to the Federal Emergency Management Agency (FEMA), 40% of businesses do not reopen after a disaster, and businesses that do survive may continue to suffer from a lack of access to credit and other vital financial services.¹⁵ Additionally, smaller banks often are exposed to a higher concentration of counterparties in specific industries, which can be a source of significant transition risk. For example, Zions Bancorporation, a regional bank operating in the Southwestern US, held collective commercial loan exposure to mining, quarrying, and oil and gas extraction of \$1.185 billion in 2021. This exposure represented over 19.5% of its Common Equity Tier 1 (CET1) capital, meaning that a default of some of these loans could push the bank's solvency buffer below regulatory minimums.¹⁶ This is especially relevant for the FDIC's Deposit Insurance Fund (DIF), the stability of which is dependent upon the sound risk management practices, capital adequacy, and future earnings potential of individual members, all of which could be dramatically impacted by climate change.¹⁷ For example, correlated failures among smaller banks created losses in significant excess of fund revenues during the financial crisis of 2008 and

¹¹ https://climatealignment.org/wp-content/uploads/2021/11/FIO_Climate_RFI.pdf

¹²

https://www.ceres.org/sites/default/files/reports/202205/561_The%20Changing%20Climate%20for%20Credit%20Unions.pdf

¹³ See "Impact on Community Banks and Credit Unions",

<https://www.ceres.org/sites/default/files/reports/202109/Ceres%20Financing%20a%20Net%20Zero%20Economy%20FINAL.pdf>

¹⁴ <https://www.sciencedirect.com/science/article/pii/S0261560620302370>

¹⁵ <https://www.newyorkfed.org/medialibrary/media/smallbusiness/2017/SBCS-Report-on-Disaster-Affected-Firms.pdf>

¹⁶ <https://www.climate-risk-review.com/p/us-regional-banks-team-up-to-tackle?s=r>

¹⁷ <https://www.fdic.gov/about/strategic-plans/performance/2022annualplan.pdf>

2009, prompting the FDIC to take emergency action to maintain fund liquidity.¹⁸ Correlated losses among smaller financial firms due to physical and transition risk events can also aggregately drive disruption and economic stress throughout the entirety of the US financial system.¹⁹

Smaller and regional financial institutions are only beginning to examine and address climate-related risks. This is especially true as many smaller, publicly traded banks prepare for compliance with other climate-related financial regulation, such as the SEC's proposal for climate-related financial disclosures. We encourage the FDIC to look to developing more tailored resources, tools, and guidance for these institutions to increase the resiliency of the US financial system against climate-related risks.

Support for the Principles for Climate-Related Financial Risk Management

While we believe a wider and more proactive approach to regulation is the best way to meaningfully address climate-related financial risks, we firmly support the FDIC'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.** Operationalizing and substantiating existing public climate commitments, such as through interim targets²⁰ and transition plans,²¹ will require a significant overhaul of how banks conduct business today, especially smaller banks. 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 FDIC 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.²² 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*,²³ 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 for meeting 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

¹⁸ <https://www.fdic.gov/bank/historical/crisis/chap5.pdf>

¹⁹ <https://crsreports.congress.gov/product/pdf/R/R47026>

²⁰ <https://rmi.org/how-the-net-zero-banking-alliance-helps-banks-set-interim-emissions-targets/>

²¹ <https://rmi.org/five-trends-to-watch-in-climate-aligned-finance-in-2022/>

²² <https://www.tandfonline.com/doi/full/10.1080/20430795.2020.1848142>

²³ <https://rmi.org/insight/zeroing-in/>

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 FDIC 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 FDIC’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 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.²⁴

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 be mitigated. 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 boards 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.²⁵ While data and disclosures are constantly improving, we

²⁴ <https://rmi.org/we-read-a-130-page-report-on-climate-regulation-so-you-dont-have-to/>

²⁵ https://climatealignment.org/wp-content/uploads/2022/02/impact_principles_for_climate_aligned_finance_report.pdf

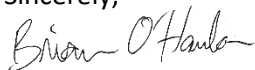
support the FDIC's guidance that banks should act now with best available resources, and then seek to integrate updated resources over time. In its 2021 report, FSOC advised that not only can tools like scenario analysis be used to assess climate risks in the absence of perfect data, but their use can support data improvements over time.²⁶ 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 FDIC, 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 FDIC'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, 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 FDIC'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 US banks of all sizes, with stark implications for the US economy, including financial markets, communities, and households nationwide. We support the FDIC'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

Whitney Mann

Alex Murray

²⁶ <https://home.treasury.gov/system/files/261/FSOC-Climate-Report.pdf>