



June 2, 2022

VIA ELECTRONIC FILING

James P. Sheesley
Assistant Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

RE: FDIC Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions
Attention: Docket ID FDIC-2022-07065; RIN 3064-ZA32

To whom it may concern,

Americans for Financial Reform Education Fund (AFREF) welcomes the opportunity to comment on the Federal Deposit Insurance Corporation's (FDIC's) Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions. We support this important step toward addressing climate-related risk in the banking system, and encourage FDIC to strengthen and finalize the guidance as soon as possible.

In addition to this submission, AFREF has joined two other comments submitted to the FDIC that focus on aligning banks' climate commitments with internal strategies and governance, and fair lending, racial justice, and community development implications of the guidance. In this comment, we expand on the views of AFREF with respect to other topics and questions posed by the request for comment.

In response to Question 1: *What additional factors, for example asset size, location, and business model, should inform financial institutions' adoption of these principles?*

The FDIC draft notes that "all financial institutions, regardless of size, may have material exposures to climate-related financial risks." We agree, and encourage FDIC, in collaboration with other banking regulators, to extend and tailor their supervisory guidance to banks of all sizes, including smaller institutions which may be more vulnerable to climate risk than larger banks due to the financial needs they meet and their more limited geographic range and product offerings. It is also critical that supervisory expectations encourage enhanced operational resilience to climate risks—especially for smaller institutions that provide vital banking services to underserved communities during and following disasters and other times of acute need—and that risk mitigation strategies broadly remedy rather than exacerbate economic burdens on

lower income communities and communities of color. Tailored guidance based on location and business model should also be a component of FDIC's supervisory and examinations process.

In response to Question 3: *What challenges do financial institutions face in incorporating these principles into their risk management systems? How should the FDIC further engage with financial institutions to understand those challenges?*

In recent years, many of the largest U.S. banks have developed net zero emissions commitments¹ in recognition of the growing physical and transition risk that financed greenhouse gas (GHG) emissions pose to their businesses, including through the traditional channels of credit risk, market risk, litigation risk, and reputational risk.² [The Partnership for Carbon Accounting Financials \(PCAF\)](#)—now in use by over 200 financial institutions worldwide—offers a reliable accounting framework for banks and other financial institutions to calculate and disclose their financed emissions. Where data gaps exist, banks may still need more comprehensive, standardized information from operational firms to fully assess financed emissions and other climate risks on their balance sheets.

The Securities and Exchange Commission's climate disclosure rulemaking³ is a step in the right direction to make climate risk information more standardized, credible, decision-useful, and freely available to banks, investors, and other market participants. FDIC should work with banks to integrate this new information into their risk management processes and strategies as it becomes available.

Further, the FDIC draft notes that "climate-related financial risks can transmit to a significant number of financial institutions and raise financial stability concerns." As financed GHG emissions are a critical driver of both micro- and macroprudential climate-related risk, the FDIC should make clear that having a credible transition plan and reporting on progress is a crucial part of a bank's risk management system. The FDIC should work with banks to develop credible climate strategies and ensure that their public climate commitments are fully aligned with their internal risk management, strategy, and governance.

In response to Question 8: *What, if any, specific products, practices, and strategies—for example, insurance or derivatives contracts or other capital market instruments—do financial institutions use to hedge, transfer, or mitigate climate-related financial risks?*

The Commodity Futures Trading Commission (CFTC) Market Risk Advisory Committee recommended in 2020 that "CFTC should coordinate with other regulators to support the

¹ "Big Banks Are Making Big Climate Promises. 3 Ways to Tell Who Will Deliver," Forbes, 20 Jan 2022, <https://www.forbes.com/sites/edfenergyexchange/2022/01/20/3-climate-actions-banks-must-take-to-fast-track-net-zero-in-2022/?sh=5b1977595ff8>

² NGO Letter to US Banking Regulators, "Bank Supervision and Climate Risk," Sept 2021. <https://ourfinancialsecurity.org/wp-content/uploads/2021/09/Supervision-and-Climate-Risk-Documents.pdf>

³ "SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors," 21 Mar 2022. <https://www.sec.gov/news/press-release/2022-46>

development of a robust ecosystem of climate-related risk management products.”⁴ Products such as catastrophe bonds, weather derivatives, carbon offsets, and water futures may well be effective for risk transfer and hedging for individual financial institutions, but we are concerned that they may contribute to, rather than ameliorate, systemic climate risk that harms the financial system, consumers, and the broader economy.⁵

In dealing with climate risk—which poses a broad and deep [emerging threat to financial stability](#) and the financial health of communities and households across the country—risk transfer cannot be a substitute for true systemic risk mitigation.⁶ Insurers regularly use catastrophe bonds and reinsurance contracts to transfer physical climate risk to investors or other institutions, all the while investing and insuring the fossil fuel expansion projects that create carbon emissions, worsen climate impacts, and raise the chances of payouts due to climate-driven disasters.⁷

In 2020, a water futures market emerged on the Chicago Mercantile Exchange based on the availability of water rights in California, where droughts have become common and are expected to worsen as climate change unfolds.⁸ A December 2021 petition called for the suspension of the market, led by Food & Water Watch, a nonprofit, and signed by an additional 138 other organizations including AFREF.⁹ The water futures market may have negative effects on the real economy, discouraging water efficiency activities, and driving up prices for water—an essential natural resource and public need. Water is an unacceptable target for financial speculation.

Carbon offsets, credits, and derivative products are commonly invoked within net zero transition plans, [but credibility problems persist](#), and reliance on these products may delay emissions reduction investments and progress that is critically needed for systemic risk mitigation. A recent report from the New Climate Institute and Carbon Market Watch analyzed corporate net zero transition plans for 25 companies and found that “Companies’ plans to offset or ‘neutralise’ their emissions are especially contentious.”¹⁰

⁴ CFTC, “Managing Climate Risk in the U.S. Financial System,” Sept 2020.

<https://www.cftc.gov/PressRoom/PressReleases/8234-20>

⁵ See E.g., “Wall Street’s Favorite Climate Solution is Mired in Disagreements,” Bloomberg, June 2021.

<https://www.bloomberg.com/news/features/2021-06-02/carbon-offsets-new-100-billion-market-faces-disputes-over-trading-rules?sref=f7rH2jWS>

⁶ Financial Stability Oversight Council, “Report on Climate-Related Financial Risk,” 2021.

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

⁷ Americans for Financial Reform Education Fund, Letter to the Federal Insurance Office on the Insurance Sector and Climate-Related Financial Risks RFI, Nov 2021.

<https://ourfinancialsecurity.org/wp-content/uploads/2021/11/11.15.21-AFREF-comment-to-Treasury-FIO-on-Insurers-and-Climate-Risk.pdf>

⁸ Yale Environment 360, “Wall Street Begins Trading Water Futures as a Commodity,” Dec 2020.

<https://e360.yale.edu/digest/wall-street-begins-trading-water-futures-as-a-commodity>

⁹ Food and Water Watch, “More than 100 Groups Call on CFTC To Shut Down Dangerous ‘Water Futures’ Market,” Dec 2021.

<https://www.foodandwaterwatch.org/2021/12/20/more-than-100-groups-call-on-cftc-to-shut-down-dangerous-water-futures-market/>

¹⁰ New Climate Institute and Carbon Market Watch, *Corporate Climate Responsibility Monitor 2022*,

https://carbonmarketwatch.org/wp-content/uploads/2022/02/CMW_CCRM2022_v08_FinalStretch2.pdf

Further, derivatives may help individual institutions hedge climate change risks in the short-term, but climate change is not a short-term challenge. Risks related to climate change will only increase over the coming decades, and banks should therefore be encouraged to adopt long-term risk mitigation strategies that don't depend on the availability of complex financial products and markets. The FDIC should research the use and impacts across all of these hedging products in collaboration with the CFTC, the other banking regulators, and the Financial Stability Oversight Council (FSOC) to better understand the potential microprudential and macroprudential implications. The FDIC should provide guidance to ensure that bank risk mitigation strategies do not contribute to untenable systemic risk or worsening of the climate crisis and the resultant exacerbated safety and soundness concerns.

In response to Question 10: *How do financial institutions currently consider the impacts of climate-related financial risk mitigation strategies and financial products on households and communities, specifically LMI and other disadvantaged communities? Should the agencies modify existing regulations and guidance, such as those associated with the Community Reinvestment Act, to address the impact climate-related financial risks may have on LMI and other disadvantaged communities?*

The FDIC must carefully consider the potential impacts of climate supervisory guidance on racial, economic, environmental, and climate justice, and how these expectations will interact with fair lending principles and regulation and consumer financial protections. Prudential climate financial regulation is vital, and it must not result in additional burdens on vulnerable communities and households, the very consumers who are most at risk from climate impacts.

To this end, it is critical that the FDIC expand its climate risk guidance to all banks in a way that recognizes the important role credit and banking services should play in helping vulnerable communities in building resilience to climate disasters and benefiting economically and through collateral benefits through climate mitigation. Such guidance should include how banks can and should maintain the operational resilience of the critical services they provide. It should also encourage both large and small banks to support community investment in adaptation instead of withdrawing credit, to finance green investment, and to protect consumers from unsafe "green" financial products that lack adequate consumer protections and/or do not deliver purported climate benefits.

"19 of the 25 companies assessed already know that they will rely on offsetting for their future pledges, and only one company plans explicitly without offsets (see Figure S3). At least two-thirds of these companies rely on carbon dioxide removals from forestry and other biological-related carbon sequestration (nature-based solutions) to claim that their emissions in the future are offset, i.e. that the impact to the climate is the same as if the emissions were never released in the first place. But these approaches are unsuitable for individual offsetting claims, because biological carbon storage can be reversed (e.g. when forests are cut and burned) and because there is a global requirement to reduce emissions and increase carbon storage, not one or the other. Claims of carbon neutrality today are often misleading; we identified significant credibility problems with all of the carbon neutrality claims from the companies assessed in this report, due to a combination of limited emissions coverage, inconsistent messaging, or procurement of low-quality carbon credits."

The FDIC must also modify existing regulations and guidance associated with the Community Reinvestment Act (CRA) to address the impact climate-related financial risks have on LMI and communities of color. These supervisory principles should be harmonized with anticipated CRA revisions that expand the definition to “community development” to include climate resilience and green investments, and that penalize bank investments that exacerbate racialized climate harms.

AFREF’s full views on the fair lending, racial and economic justice, and community development implications of these supervisory guidance principles can be found in the coalition comment submitted on June 2, 2022 with 13 undersigned organizations.

In response to Question 11: *What, if any, specific climate-related data, metrics, tools, and models from borrowers and other counterparties do financial institutions need to identify, measure, monitor, and control their own climate-related financial risks? How do financial institutions currently obtain this information? What gaps and other concerns are there with respect to these data, metrics, tools, or models?*

The FDIC guidance should encourage banks to obtain additional information from their borrowers and other counterparties, including:

- Scopes 1, 2 and 3 GHG emissions data;
- Information on planned capital expenditures on sustainable products and initiatives, and their likely impact on company emissions, energy and natural resource use, as well as transition plans;
- Geolocational information of all critical borrower infrastructure;
- Borrower climate disclosures prepared using the TCFD framework (banks should encourage borrowers to disclose this information using the TCFD framework to ensure that climate-relevant data is comparable across industries and geographies); and
- Information about corporate impacts and track record on environmental justice, Indigenous rights, land use, natural resources, public health, local economies, and other community-level impacts.

In response to Question 12: *How could existing regulatory reporting requirements be augmented to better capture financial institutions’ exposure to climate-related financial risks?*

We recommend that reporting requirements should be expanded to include a series of line items to each applicable schedule about loans for fossil fuel exploration, production and fossil electricity generation, as well as securities backed by these assets and derivatives referencing them. As with real estate lending on the current call reports, these loans should be broken out by duration, with detailed information about allowances for losses on loans with terms of three or more years, which are particularly exposed to transition risk. The call reports should also add additional information about exposure of existing loan types to physical risks, such as separate line items for loans and asset-backed securities secured by real estate in flood zones or high wildfire risk areas.

In response to Questions 12 and 13: *Scenario analysis is an important component of climate risk management that requires assumptions about plausible future states of the world. How do financial institutions use climate scenario models, analysis, or tools and what challenges do they face? What factors are most salient for the FDIC to consider when designing and executing scenario analysis exercises?*

It's critical that the FDIC develop climate scenarios—in coordination with the other banking regulators and the FSOC—and conduct system-wide scenario analysis exercises to assess the breadth and depth of climate risk within the banking system, identify areas of risk concentration, and inform risk management strategies for individual financial institutions and for microprudential and macroprudential regulatory interventions. These scenarios should include ambitious energy transition scenarios like the International Energy Agency's Net Zero by 2050 scenario,¹¹ incorporate best practices as developed by the Network for Greening the Financial System (NGFS) and rigorous central bank exercises,¹² and include orderly and disorderly transitions coinciding with a broad range of *extreme but plausible* outcomes with respect to global emissions, climate sensitivity, tipping points, and speed of the energy transition. These exercises should be used to determine breaking points for bank solvency, so models should be analytical, not discrete, to allow for robust assessment of the risk landscape across many parameters and for a full range of extreme but plausible circumstances.

The FDIC should publish climate scenario models and tools and work with supervised banks to run their own scenario analysis exercises and stress tests, and to identify risks and mitigate them in a safe and orderly manner before physical impacts and transition shocks become unmanageable.

In developing climate scenarios and guidelines for scenario analysis exercises and stress testing, FDIC should keep the following principles in mind.

- 1) **Banks cannot rely on historical data** to measure forward looking physical risk from climate change. Over the past four decades, the intensity, frequency and economic impacts of many types of climate disasters have increased nonlinearly,¹³ and these effects are expected to continue.¹⁴ Using historical data—even *looking at the most severe events of the past*—does not capture the severity of future storms, which will likely be far more severe and costly.

¹¹ IEA, "Net Zero by 2050: A Roadmap for the Global Energy Sector," May 2021.

<https://www.iea.org/reports/net-zero-by-2050>

¹² ECB, "ECB economy-wide climate stress test: Methodology and results," Sept 2021.

https://www.ecb.europa.eu/pub/pdf/scpops/ecb_op281~05a7735b1c.en.pdf

¹³ NOAA, "United States Billion-Dollar Disaster Events 1980-2021 (CPI-Adjusted),"

<https://www.ncdc.noaa.gov/billions/time-series>

¹⁴ Swiss Re Institute, "World economy set to lose up to 18% GDP from climate change if no action taken, reveals Swiss Re Institute's stress-test analysis," 22 Apr 2021.

<https://www.swissre.com/media/news-releases/nr-20210422-economics-of-climate-change-risks.html>

- 2) **Physical and transition losses will likely be correlated and scenario analysis needs to incorporate shocks in series and in parallel, not as discrete events.** Acute physical damages from climate disasters, chronic losses of productivity due to physical changes, transition shocks, and chronic transition losses and gradual write-offs of stranded assets will occur in parallel, in series, and interdependently. The increased frequency of climate disasters will likely deteriorate the financial resilience of banks and the communities they serve, and whether households and businesses will be able to continually absorb consistently increasing climate-related losses and remain solvent must be carefully investigated.

- 3) **Scenario analysis must explore network effects within the financial sector.** The financial sector's response to climate disasters or transition shocks may include contagion, bank runs, rapid asset repricing, credit deterioration, and other network effects that lead to further financial instability. Modeling that doesn't include network effects will likely underestimate the threat of climate change to financial stability.

We thank the FDIC for moving forward with supervisory guidance to better understand and mitigate climate risk within the banking system, and we encourage you to finalize these principles and begin incorporating them into the examinations process promptly. For more information please contact Alex Martin (alex@ourfinancialsecurity.org).

Sincerely,

Americans for Financial Reform Education Fund