

The Honorable Jerome H. Powell
Chair
Board of Governors of the
Federal Reserve System

The Honorable Lael Brainard
Vice Chair
Board of Governors of the
Federal Reserve System

The Honorable Michael S. Barr
Vice Chair for Supervision
Board of Governors of the
Federal Reserve System

The Honorable Christopher Waller
Governor
Board of Governors of the
Federal Reserve System

The Honorable Michelle W. Bowman
Governor
Board of Governors of the
Federal Reserve System

The Honorable Lisa D. Cook
Governor
Board of Governors of the
Federal Reserve System

The Honorable Philip N. Jefferson
Governor
Board of Governors of the
Federal Reserve System

October 11, 2022

The undersigned organizations write to urge the Board of Governors of the Federal Reserve System (the Fed) to follow the lead of the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) and issue climate-related risk management principles for the large banks under its supervision, then work with the same regulators to follow up quickly with more detailed guidance.

Climate-related financial risks to banks' safety and soundness are well-documented and accelerating. Research by the National Oceanic and Atmospheric Administration finds that the United States saw “20 separate billion-dollar weather and climate disasters” in 2021 with damages totaling about \$145 billion.¹ In addition to these physical impacts of climate change on communities, households, and businesses, transition risks also arise as society reorients toward a clean energy economy. Additionally, these risks resemble traditional ones that banks must account for in their risk management plans, including credit, market, liquidity, and operational risks. These risks are so substantial that the Financial Stability Oversight Council released a report in 2021 finding that climate risk is an “emerging threat to financial stability.” with Fed Chair Powell voting affirmatively in support.

The Fed has a responsibility to ensure banks address the climate-related financial risks they face, and this position has been repeatedly affirmed by top Fed officials. Earlier this year, Chair Powell stated of such risks, “[The Fed’s role] is to assure that the banking institutions that we regulate understand their risks and can manage them. And it's also to look after financial

¹ NOAA, “U.S. saw its 4th-warmest year on record, fueled by a record-warm December available,” at <https://www.noaa.gov/news/us-saw-its-4th-warmest-year-on-record-fueled-by-record-warm-december> (last accessed September 2022).

stability.”² The Fed has also taken the important step of announcing that six of the largest banks will participate in a climate scenario exercise in early 2023.³

In crafting climate-related risk management principles for banks with more than \$100 billion in consolidated assets, the Fed should ensure the incorporation of six central considerations:

1. Banks must take a whole-of-business approach to mitigating climate risk.

The Fed must address the physical and transition risks associated with climate change and explain how those risks relate to traditional financial risks with which institutions are familiar (e.g., credit risk, market risk, liquidity risk, operational risk). Through guidance, the Fed must help regulated institutions understand options for reducing, mitigating, or otherwise managing their climate-related risks. These options could include, among others, incorporating climate-related financial risk management practices in all business lines, creating procedures by which climate-related issues may be reported and escalated to the management or board level, and assisting counterparties in developing their own climate-related risk management or transition plans.

2. Banks must consider appropriate time horizons for assessing and addressing climate risk.

Given the nature of climate-related risks, the Fed should encourage institutions to assess such risks over time horizons that may extend beyond its typical strategic planning horizon. Supervisory exercises, such as scenario analysis, should incorporate short-, medium-, and long-term analysis windows of 3-5 years, 5-10 years, and 30 years, which should provide for a broad range of plausible outcomes with respect to global emissions, tipping points, and the speed with which the global transition to clean energy occurs.

3. Banks must conduct robust climate scenario analysis modeling and review results with bank supervisors.

Scenario analysis is an important supervisory tool that can help banks understand their susceptibility to climate change risks. In addition to the pilot scenario analysis exercise announced by the Fed, regulators must ensure that banks subject to this guidance conduct their own analyses. These analyses must rely on at least three common scenarios: (i) one that assumes climate policies are adopted early and become more stringent over time; (ii) one that assumes greater transition risks due to delayed and disorderly implementation of climate policies; and (iii) one that assumes climate policies are insufficient, resulting in escalating chronic and acute impacts such as rising sea levels, crippling heat, and extreme weather events.

² Jerome Powell, “Federal Reserve Chair Confirmation Hearing,” C-SPAN, January 11, 2022, available at <https://www.c-span.org/video/?517047-1/federal-reserve-chair-confirmation-hearing>.

³ Board of Governors of the Federal Reserve, “Federal Reserve Board announces that six of the nation’s largest banks will participate in a pilot climate scenario analysis exercise designed to enhance the ability of supervisors and firms to measure and manage climate-related financial risks,” Press release, September 29, 2022, available at <https://www.federalreserve.gov/newsevents/pressreleases/other20220929a.htm?source=email>.

Additionally, the Fed – through guidance and examinations – must ensure that banks’ models are sufficiently rigorous and reflect up to date information about climate science and the energy transition. The Fed must also ensure that banks do not over-interpret findings or underestimate risk based on inadequate modeling, and that a precautionary approach is applied to risk management. To appropriately account for varying degrees of climate-related financial risk exposure, models should be sector- and location-specific and the assumptions made by banks’ models should be clear and transparent. Models must take into consideration network effects within the financial sector as well as that banks may face runs and the banking system as a whole may experience contagion and overall instability.

4. Banks must align internal strategies with their public climate commitments, both of which should be guided by science-based metrics and targets.

In recent years, many of the largest banks have made public commitments to align their loan portfolios to net-zero emissions targets.⁴ Failing to adhere to public commitments on climate change could reveal more serious issues with climate risk management and general management oversight, and may expose firms to direct reputational and liability risk. The Fed must engage with banks to assess whether discrepancies exist and take steps to require institutions that set climate-related targets to implement policies that allow them to actually meet those goals.

The Fed should also understand and make clear to supervised institutions that continued financing of greenhouse gas emissions by banks is worsening climate-related financial risk by directly increasing transition risk and contributing to physical risk, both of which threaten their own stability and that of the financial system as a whole.

5. Banks must develop and implement due diligence policies to ensure respect for the rights of Indigenous and tribal peoples.

Biodiversity preservation and climate stability are best ensured when Indigenous and tribal people’s rights, especially land rights, are respected.⁵

Indigenous rights are a well-established norm in international human rights law, based on the fundamental rights to self-determination and sovereignty. A global standard for ensuring respect for those rights is Free, Prior, and Informed Consultation, in which a government or company consults with impacts Indigenous nations or tribes to determine whether they consent, or not, to a

⁴ For example, six U.S.-headquartered global systemically important banks have joined the Net-Zero Banking Alliance. See Net-Zero Banking Alliance, “Members,” available at <https://www.unepfi.org/net-zero-banking/members/> (last accessed May 2022).

⁵ Forest Governance by Indigenous and Tribal Peoples. An Opportunity for Climate Action in Latin America and the Caribbean. Food and Agriculture Organization of the United Nations, 2021, available at <https://doi.org/10.4060/cb2953en>; Asyl Undeland. “Indigenous Land Rights -- a Critical Pillar of Climate Action Strengthening Communal Land and Forest Tenure for Climate Action.” Blog. World Bank, November 19, 2021.

project.⁶ Furthermore, recent research shows that companies - and their financiers - stand to lose sizable investments when they fail to respect Indigenous people's right to self-determination.⁷

The Fed should provide guidance to help banks ensure they adopt strong, binding policies to respect Indigenous peoples' right to sovereignty and self-determination, which must include guidelines making clear that impacted Indigenous communities must be consulted before any proposed corporate activity on their lands, and that if a community opposes an industrial activity on their territory, that project cannot go forward without violating their rights.

6. Banks must recognize where and how risk-management measures could have adverse effects on low-income and marginalized households and communities, and take steps to understand and fully mitigate these risks.

It is particularly important for banks to ensure that climate risk mitigation efforts do not discriminate against the borrowers who are already most vulnerable to the effects of climate change. Low-income and communities of color are disproportionately affected by climate-induced or -exacerbated natural disasters and sea level rise,⁸ which in turn is resulting in further financial impairment with respect to access to home mortgages and flood insurance at affordable rates.⁹ The Fed should provide guidance on how banks can prevent engaging in discriminatory practices when addressing climate-related financial risks and direct them to ensure continued access to affordable credit for climate-affected communities.

⁶ Marcus Colchester. "Free, Prior and Informed Consent: Making FPIC Work for Forests and Peoples." The Forests Dialogue. Yale University School of Forestry and Environmental Studies, July 2010, available at <https://theforestsdialogue.org/publication/free-prior-and-informed-consent-making-fpic-work-forests-and-peoples>. *Note: Most human rights, such as those in the Universal Declaration of Human Rights, are inalienable and thus cannot be given up or diminished by consent.*

⁷ See, e.g., Moira Birss and Kate Finn. "The Business Case for Indigenous Rights (SSIR)." *Stanford Social Innovation Review*, May 30, 2022.

⁸ See, e.g., Maya Buchanan and others, "Sea Level Rise and Coastal Flooding Threaten Affordable Housing," *Environmental Research Letters* 15 (12) (2020), available at <https://iopscience.iop.org/article/10.1088/1748-9326/abb266>; Jesse Keenan and Elizabeth Mattiuzzi, "Climate Adaptation Investment and the Community Reinvestment Act," Community Development Research Brief, June 16, 2019, available at <https://www.frbsf.org/community-development/publications/community-development-research-briefs/2019/june/climate-adaptation-investment-and-the-community-reinvestment-act/>; NYU Furman Center, "Population in the U.S. Floodplain" (New York: 2017), available at https://furmancenter.org/files/Floodplain_PopulationBrief_12DEC2017.pdf.

⁹ See, e.g., David Sherfinski, "U.S. overhauls flood insurance to meet rising climate change risks," Reuters, October 15, 2021, available at <https://www.reuters.com/legal/litigation/us-overhauls-flood-insurance-meet-rising-climate-change-risks-2021-10-15>; Parinitha Sastry, "Who Bears Flood Risk? Evidence from Mortgage Markets in Florida," MIT Sloan School of Management, November 18, 2021, available at https://psastry89.github.io/website/psastry_JMP.pdf.

Conclusion

It is imperative that the Fed provide institutions with the guidance they need to firmly understand and address their climate-related financial risks and explain how the Fed intends to incorporate these risks into its examinations. In addition to joining the OCC and FDIC in publishing supervisory principles, the Fed should work with them to follow up soon with more detailed guidance.

Signed,

Amazon Watch

Americans for Financial Reform

Center for American Progress

E3G

The Greenlining Institute

Positive Money US

Public Citizen

Sierra Club

U.S. PIRG

350.org

cc: Kevin Stiroh, Chair of Supervision Climate Committee