BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Date: November 23, 2022

To: Board of Governors

From: Staff[1]

Subject: Proposed Risk Management Guidance on Climate-Related Financial Risks for Large Financial Institutions

ACTIONS REQUESTED: Approval to publish in the Federal Register draft proposed guidance that would provide high-level principles for the safe and sound management of exposures to climate-related financial risks for large financial institutions with over $100 billion in total assets. Staff also seeks authority to make technical, non-substantive changes to the proposal prior to publication in the Federal Register.

EXECUTIVE SUMMARY:

- Climate-related financial risks, including physical and transition risks, can manifest as traditional microprudential risks, including as credit, market, liquidity, operational, and legal risks.
- In December 2021 and March 2022, the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC), respectively, proposed risk management principles to provide guidance to banking organizations they supervise with over $100 billion in total assets as they develop capabilities and deploy resources to manage climate-related financial risks.
- The proposal from staff at the Board is substantially similar to the OCC and the FDIC proposed guidance and would support the effective management of climate-related financial risks.
- Board staff developed the draft principles in consultation with the OCC and the FDIC. The proposal states that the Board would coordinate with the OCC and the FDIC in issuing any final guidance to promote consistency across supervision of large financial institutions with over $100 billion in total assets.
- The proposed principles would cover six areas: governance; policies, procedures, and limits; strategic planning; risk management; data, risk measurement and reporting; and

[1] Michael Gibson, Kevin Stiroh, Anna Lee Hewko, Morgan Lewis, Matt McQueeney, Saba Haq, Katie Budd, and Susan Ali (Division of Supervision and Regulation); Mark Van Der Weide, Charles Gray, Asad Kudiya, Matthew Suntag, Kelley O'Mara, and David Imhoff (Legal Division).

scenario analysis. The principles also describe how climate-related financial risks can be addressed in specific prudential risk areas including credit, liquidity, other financial risks, operational, legal/compliance, and other non-financial risks.

DISCUSSION:

I. Background

The financial impacts that result from the economic effects of climate change pose an emerging risk to the safety and soundness of banking organizations[2] and the financial stability of the United States. Banking organizations are likely to be affected by both the physical risks and transition risks associated with climate change.[3] The effects of climate change can manifest as traditional microprudential risks, including as credit, market, liquidity, operational, and legal risks. For example, chronic flooding or wildfires may pose a risk to the value of the collateral that a banking organization has taken as security against its loans. Technological innovations in the production, storage, and transport of energy could decrease the value of assets dependent on older technologies, resulting in mark-to-market losses on a banking organization's trading portfolios or reduced cash flow of certain borrowers.[4]

Weaknesses in how banking organizations identify, measure, monitor, and control climate-related financial risks could adversely affect a banking organization's safety and soundness. Many

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[2] In this memorandum, the term "banking organization" includes state member banks, bank holding companies, savings and loan holding companies, foreign banking organizations with respect to their U.S. operations, and non-bank systemically important financial institutions (SIFIs) supervised by the Board.

[3] Physical risks refer to the harm to people and property arising from acute, climate-related disaster events, such as hurricanes, wildfires, floods, and heatwaves, as well as longer-term chronic phenomena such as higher average temperatures, changes in precipitation patterns, sea level rise, and ocean acidification. Transition risks refer to stresses to certain institutions or sectors arising from the shifts in policy, consumer and business sentiment, or technologies associated with the changes necessary to limit climate change. FSOC, Report on Climate Related Financial Risk (2021), p. 12-13.

[4] Board, Supervision and Regulation Report (Nov. 2020), p. 26.

large banking organizations are considering these risks, and guidance in this area could promote a consistent understanding of how large banks can effectively manage climate-related financial risks as they develop capabilities and deploy resources to manage such risks.

Board staff developed the proposed guidance in consultation with staff of the OCC and the FDIC. The OCC and the FDIC separately proposed substantially similar draft principles for management of climate-related financial risks in December 2021 and March 2022, respectively. Staff at the agencies believe that a consistent approach and implementation timeline across federal banking agencies will best support the effective management of these risks. After reviewing comments, the Board intends to coordinate with the OCC and the FDIC in issuing any final guidance.

II. Risk management principles

The proposed guidance is substantially similar to the draft principles previously proposed by the OCC and the FDIC and, like those proposals, would apply only to banking organizations with over $100 billion in total consolidated assets. The proposed guidance outlines a set of general principles in six areas: governance; policies, procedures, and limits; strategic planning; risk management; data, risk measurement and reporting; and scenario analysis. In addition, the proposed guidance includes a section on “management of risk areas,” which describes how climate-related financial risks can be addressed in certain risk categories such as credit, liquidity, other financial risks, operational, legal/compliance, and other non-financial risks.

RECOMMENDATIONS:

Staff recommends that the Board approve publishing the attached draft notice of proposed guidance in the Federal Register with a 60-day comment period. Staff further recommends that the Board grant staff authority to make technical or minor changes to prepare the proposal for publication.