U.S. Chamber of Commerce

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

Re: Federal Deposit Insurance Corporation ("FDIC") Request for Comment on "Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions" (RIN 3064–ZA32)

Dear Mr. Sheesley:

The U.S. Chamber of Commerce ("the Chamber") appreciates the opportunity to share our views in response to the Federal Deposit Insurance Corporation ("FDIC" or "agency") request for feedback on "Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions" ("principles" or "proposal").

The Chamber has been a leader in the conversation on environmental, social, and governance ("ESG") topics for nearly a decade, and we continue to actively collaborate with our members and other stakeholders to promote practices, policies, and technology innovations across industry and government that address our shared climate challenges, particularly to reduce greenhouse gas emissions to the lowest levels possible at the pace of innovation.

Having been engaged on ESG topics across all industries, the Chamber is also a ready participant in conversations about the impacts of climate change on our financial system. While the Chamber is supportive of the overall goals of the FDIC as we move toward a low carbon economy, we also support the development of market-driven solutions to these problems. As we noted in a 2020 report, "the fundamental challenge we face today is to preserve the ability of American companies to grow, innovate, and drive prosperity under a system of free and fair capitalism. The Chamber—through its Project Growth and Opportunity or "Project GO"—is committed

to identifying practical, sustainable ways to address socio-economic challenges."[1] As a part of this effort, the Chamber, in 2019, released principles for ESG reporting that are both material and industry specific.[2]

These FDIC principles follow the actions of other regulators who are also prioritizing the development and implementation of a standardized reporting regime for climate risks. Earlier in 2021, the Office of the Comptroller of the Currency (OCC) released a request for feedback that is substantively similar to the FDIC request. Around the same time, the Basel Committee on Banking Supervision (BCBS) accepted comments on a proposal it issued on climate-related financial risk for banks. As noted in this request, the FDIC plans to issue forthcoming guidance on climate risk "that would distinguish roles and responsibilities of boards of directors (boards) and management, incorporate the feedback received on the principles, and consider lessons learned and best practices from the industry and other jurisdictions." We applaud the FDIC for its stated intention to incorporate feedback from stakeholders and urge you in any future guidance to collaborate with other regulators at home and abroad who are taking these similar steps on climate risk.

It is also critical to point out that in any forthcoming guidance on climate-related financial risk, the FDIC should not recommend moving capital away from industries or sectors that may have more environmental risk. As the federal agency standing behind consumers' deposits and tasked with resolving failed institutions, the FDIC has a keen interest in the safety and soundness of insured depository institutions. Directing capital away from politically disfavored industries can be dangerous for our entire economy. Indeed, such an approach would lead to wide swings in regulation as political Administrations change, undermining confidence in our banking system. We encourage the FDIC to limit its focus on supporting financial institutions in their assessments of climate risks only for safety and soundness purposes.

Responses to FDIC Principles and Questions

In the comments below, the Chamber addresses certain aspects of climate-related financial risk management for banks and answers specific questions posed in the guidance.

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[1] *Restarting the Growth Engine: A Plan to Reform America's Capital Markets*, U.S. Chamber of Commerce Center for Capital Markets Competitiveness (November 2020). ccmc_growthengine_final.pdf (uschamber.com)

[2] *ESG Reporting Best Practices*, U.S. Chamber of Commerce Project GO (2019). https://www.projectgo.com/esg-reporting-best-practices/

Governance

The need to understand the exposure and impact of climate-related financial risk is important, but the outline of governance in the principles is short on specific requirements and instead gives a high-level review of expectations for bank management. While the request mentions that a bank's board and management should demonstrate "appropriate understanding of climate-related financial risk exposures," it seems to be left to the FDIC's discretion to determine what is appropriate. The proposal also mentions that the board's understanding and knowledge to assess the potential impact of climate-related risks on an institution should be "adequate" but gives no detail as to what constitutes adequate knowledge. As we have mentioned, the Chamber supports market-driven solutions, and many public companies—including banks—are already demonstrating a significant understanding of these risks.[3] Institutions are also integrating climate-related policies and responsibilities throughout their organizations. Further guidance from the FDIC should take into account these efforts and the deep understanding of climate risks that banks already possess.

Strategic Planning

The Chamber commends the FDIC for recognizing that strategic planning for climate-related financial risk is an iterative process, and the proposal notes that climate risks evolve and mature over time. The proposal also notes that "any climate-related strategies, including any relevant corporate social responsibility objectives, should align with and support the bank's broader strategy, risk appetite, and risk management framework." Climate-related risk is one of a host of risks, and banks must institute different strategies to prepare for each type of risk in any strategic planning. The Basel Committee on Banking Supervision has even noted that there is a limited amount of research and accompanying data that explore how climate risk drivers feed into transmission channels and the financial risks faced by banks."[4] Undue emphasis on climate-related risk in strategic planning could lead banks to spend inordinate time and resources on climate risks when others are more material. We urge that in any forthcoming guidance, the FDIC not place an undue emphasis on climate-related risks over others in a bank's overall risk strategy.

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[3] See for example the Chamber's report on materiality of corporate disclosures. Essential Information: Modernizing Our Corporate Disclosure System. U.S. Chamber of Commerce Center for Capital Markets Competitiveness (2017). https://www.centerforcapitalmarkets.com/resource/essential-information-modernizing-our-corporate-disclosure-system/

[4] Basel Committee on Banking Supervision, "Climate-related risk drivers and their transmission channels (April 2021), https://www.bis.org/bcbs/publ/d517.pdf.

Management of Risk Areas

Managing climate risks presents an added layer of difficulty for banks since these risks must be incorporated into a bank's overall risk profile. Research by Federal Reserve staff recognizes these challenges:

> In principle, quantifying climate-related risks should be similar to quantifying other financial stability risks. In practice, however, climate-related risks face several challenges to measurement beyond those associated with conventional financial system vulnerabilities and potential shocks, and which will require investment to address. These climate-related features impair not only estimation and modeling at the level of the overall economy, but also the analysis of region-, sector-, asset-, institution-, and investor-level exposures. Investment in data procurement, and careful analysis of climate-related data to describe specific economic and financial risks, is critical to addressing these challenges and producing high-quality research on climate-related outcomes.[5]

The proposal also makes numerous references to physical risks of climate change like damage to property and business disruptions and notes that financial institutions are likely to be affected by these risks. However, the proposal fails to note that those risks are often negligible and very short-lived. A staff report by the Federal Reserve Bank of New York concluded that:

> FEMA disasters over the last quarter century had insignificant or small effects on U.S. banks' performance. This stability seems endogenous rather than a mere reflection of federal aid. Disasters increase loan demand, which offsets losses and actually boosts profits at larger banks. Local banks tend to avoid mortgage lending where floods are more common than official flood maps would predict, suggesting that local knowledge may also mitigate disaster impacts.[6]

[5] Board of Governors of the Federal System, Climate Change and Financial Stability, https://www.federalreserve.gov/econres/notes/feds-notes/climate-change-and-financial-stability-20210319.htm

[6] Federal Reserve Bank of New York, How Bad Are Weather Disasters for Banks? (November 2021), https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr990.pdf

In any future guidance, the FDIC should consider the challenge banks face in managing climate risk while recognizing that many banks are already doing significant work to mitigate the effects of climate-related disasters.

The proposal notes specific risk areas that bank should account for in their risk management plans:

A. Credit Risk

Credit risk is an important aspect of a bank's overall risk profile. In the context of climate-related events, staff at the Federal Reserve Bank of New York noted that climate disasters have not proven to be a significant source of risk for banks:

> Our findings suggest the disaster channel is not likely a material source of instability for banks. Even very small banks facing extreme disasters are not substantially threatened. This resilience seems inherent to some degree because disasters increase the demand for loans. Earnings on new loans helps offset losses on loans on the books. In fact, income for larger banks increases after disasters. Local banks also manage to limit exposure to high-risk areas, perhaps reflecting their greater knowledge of such risks. Those endogenous factors seem to buttress banks more than federal disaster assistance.[7]

The FDIC should consider these findings in any future guidance related to credit risk, in addition to recognizing that relying on credit risk models presents its own set of challenges: "the estimation of credit risk models needed to generate loss projections relies on a limited set of datapoints and has no near-term potential for back-testing. Furthermore, because the loss projections rely so heavily on the judgment of experts, validating the projections is nearly impossible."[8]

B. Liquidity Risk

The guidance directs banks to "assess whether climate-related financial risks could affect liquidity buffers and, if so, incorporate those risks into their liquidity risk management and liquidity buffers." Banks already incorporate these risks into their risk management profile. With already stringent liquidity requirements in place for banks, the Chamber cautions the FDIC against issuing any guidance that would unnecessarily burden banks with increased liquidity requirements, thus impairing

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[7] Federal Reserve Bank of New York at https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr990.pdf

[8] Bank Policy Institute (BPI), Challenges in Stress Testing and Climate Change (October 2020), https://bpi.com/challenges-in-stress-testing-and-climate-change/

banks' ability to meet customer needs. As noted above, banks consider all forms of risk, and climate-related risk is only one of a host of risks they must weigh.

C. Legal/Compliance Risk

As with any new regulations, legal and compliance risks will increase for banks as they are required to incorporate climate risk into their overall risk profile. This will be particularly acute for banks that have instituted a massive increase in legal and compliance staff in the wake of the regulatory barrage following the implementation of the Dodd-Frank Act. In any forthcoming guidance, the FDIC should weigh the implications of future regulatory actions on banks' compliance efforts, as such compliance costs are regressive to the size of an institution. This is important to note as mid-size banks are important providers of financing for main street businesses.

The guidelines also note that any consideration of risks by banks should include "possible fair lending concerns if the bank's risk mitigation measures disproportionately affect communities or households on a prohibited basis such as race or ethnicity." The Chamber notes that banks are acutely aware of the potential impacts of their risk mitigation efforts and are committed to instituting risk measures that do not disproportionately affect any particular communities, including their obligations under the Community Reinvestment Act (CRA) and applicable fair lending laws.

Below, we address specific questions posed in the FDIC principles:

Question 1: Are there additional categories of banks (i.e., based on asset size, location, business model) to which these principles should apply?

The Chamber does not feel that these principles should apply to other categories of banks. The choice of a $100 billion threshold already encapsulates a significant number of banks and will encompass more as banks grow organically and as the industry continues to consolidate. In any event, the Chamber urges coordination with other bank regulators to ensure that these principles are applied fairly.

Question 2: How could future guidance assist a bank in developing its climate-related financial risk management practices commensurate to its size, complexity, risk profile, and scope of operations?

The Chamber applauds the FDIC for its intention to maintain a risk-based approach to supervision and to tailor future guidance based on banks' complexity of

operations and business models. In future guidance, the FDIC should recognize that banks have differing risk profiles and needs based on their size and structure. We believe that appropriate tailoring should be included in any future guidance for banks related to climate risk based on size, complexity, risk profile, and scope of operations.

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

Compliance issues are always among the biggest challenges in implementing new policies and procedures at any financial institution. Even when banks undertake these changes voluntarily, which many are doing, the transition costs and burdens are significant. As the FDIC plans to issue future guidance on climate risk, banks would likely welcome engagement with the agency. This request for feedback, along with other public interaction with banks, will provide the FDIC opportunities to better understand the challenges banks face in incorporating climate risk into their risk management systems.

Question 5: How do banks determine when climate-related financial risks are material and warrant greater than routine attention by the board and management?

Banks and other financial institutions are making investments in more climate-smart, modern, resilient infrastructure to reduce overall risks over the asset life cycle. Companies that have operations or products dependent on natural resources or are geographically at risk to climate impacts are often highlighting material implications in disclosures.

From a climate risk perspective, banks take into consideration the plausibility and certainty of a risk to determine materiality. Risks that meet these criteria will warrant greater attention by boards and management. If a bank determines that risks are speculative and distant, they generally will not consider them material or give them heightened scrutiny. Banks should be given the flexibility to determine what is material, and in future guidance, the FDIC should recognize that these determinations are evolving due to the immaturity of data.

Question 9: How do banks currently consider the impacts of climate-related financial risk mitigation strategies and financial products on households and communities, specifically LMI and other disadvantaged communities?

Banks are acutely aware that their risk mitigation strategies could impact communities and are focusing on building resilience as part of investments. A major

strategic focus of banks is compliance with CRA. Under CRA, banks are required to consider the impact of their business decisions on low-to-moderate income (LMI) and other disadvantaged communities. Allowing banks to receive CRA credit for climate risk mitigation activity in LMI communities would be an attractive way to promote responsible climate policies and transition to cleaner investments while also furthering the investment goals of the CRA.

Question 10: What, if any, specific climate-related data, metrics, tools, and models from borrowers and other counterparties do banks need to identify, measure, monitor, and control their own climate-related financial risks? How do banks currently obtain this information? What gaps and other concerns are there with respect to these data, metrics, tools, or models?

Regarding data, the Chamber commends the FDIC for its acknowledgment that "data, risk measurement, modeling methodologies, and reporting continue to evolve at a rapid pace." A major point of concern for Chamber members is the fact that, while data is foundational, it is currently very immature. Since collection of climate data is in its early stages, banks are still trying to determine what data needs to be collected and do not have a complete understanding of what is useful. Data will improve over time, but the Chamber requests that the FDIC explicitly appreciate that current data collection practices are not at their end state. Banks have a strong desire to comply with supervisory expectations and requirements, but there is a need for phasing or an iterative process in the early stages as each bank determines what is useful. Long lead times should be permitted, and the Chamber asks that regulators provide banks latitude in any forthcoming guidance regarding data collection.

Another major concern banks have regarding data, disclosures, and reporting is the audience for the data. Banks would want to know if the information they provide will be private and only for regulators' use, or if it will be made public.

The FDIC should also make use of any data that is collected and reported to international bodies. Coordination by these agencies is key to reducing burdens on banks to provide redundant information. This will streamline requirements for banks and help avoid duplicative, time-consuming efforts to comply with the demands of multiple regulators.

Question 12: Scenario analysis is an important component of climate risk management that requires assumptions about plausible future states of the world. How do banks use climate scenario models, analysis, or tools and what challenges do they face?

Banks engage in "scenario analysis," but banks define the term in a variety of ways, and this request does not attempt to bring clarity by defining the term. In any

forthcoming guidance, the Chamber requests that the FDIC clarify what is meant by "scenario analysis," as it is an ambiguous term that could encompass many different types of planning. Additionally, the Chamber asks the FDIC to clarify who will be responsible for conducting scenario analysis: will the FDIC be conducting the analysis, or will the responsibility fall to banks or third parties?

The Chamber does not believe that scenario analysis should be tied to capital or liquidity requirements. Scenario analysis should only be used to help understand potential risks to a bank's balance sheet and inform its overall risk management strategy.

It is important to note that the SEC is also exploring scenario analysis requirements. The SEC Chair has made reference to requiring "scenario analysis" on how a business might adapt to the range of possible physical, legal, market, and economic changes that the company could contend with in the future related to climate. As with all other aspects of this guidance, in any attempts by the FDIC to implement scenario analysis, the FDIC should coordinate with regulators who are pursuing similar goals to avoid duplicative regulatory requirements for banks.

Question 13: What factors are most salient for the FDIC to consider when designing and executing scenario analysis exercises?

It is important to recognize the distinction between traditional stress testing exercises and climate scenario analysis:

> Stress testing for climate change is starkly different from existing macro stress testing and given data and methodology challenges likely to be less reliable. First, the lack of historical data creates important challenges in modeling the interactions between climate, the macroeconomy, and the financial sector, which are necessary requirements in designing plausible and coherent scenarios. Second, climate stress testing attempts to measure outcomes over a much longer time horizon—30 to 50 years rather than nine quarters for macroeconomic stress testing. Third, models that generally relate credit losses to climate risk scenarios require large amounts of information about future counterparty behavior over a long time horizon. Fourth, climate stress tests generally assume that banks take no actions to hedge or reduce exposures to climate risks over that horizon. While macroeconomic stress testing has a similar assumption regarding hedging, and therefore may produce

> some error over a nine-quarter horizon, this assumption, however, becomes deeply counterfactual over a period of decades."[9]

The proposal also recognizes this difference, and we encourage the FDIC to continue to account for this difference in any forthcoming proposals. Additionally, for any future design or execution of scenario analysis, the FDIC should follow the appropriate notice-and-comment requirements of the Administrative Procedure Act ("APA"). New policies related to climate-related financial risk should be made only after weighing the costs and benefits of the chosen course, with justification for new policies being made clear to affected parties and the public. Public notice and comment are a vital component of rulemaking and should guide all regulatory efforts. Clear communication with banks is important, and banks should have fair and advanced notice of their disclosure and compliance obligations. We encourage the FDIC to provide fair notice, expressly communicate its expectations, and adhere to the APA.

Conclusion

As the FDIC reviews the current landscape of climate-related risk for banks, and considers possible new guidance, it must recognize the remarkable progress that has already been achieved through market-based approaches and practices and increased communication between banks and their customers. The business community has made building climate-smart, modern, resilient infrastructure among our top priorities. Any proposals related to climate risk for banks should afford banks the flexibility to adequately adopt disclosures that are appropriate, considering a bank's particular business, operations, and financial performance.

The Chamber appreciates the opportunity to comment and stands ready to constructively work with you on these issues going forward

Sincerely,

Tom Quaadman
Executive vice president
Center for Capital Markets Competitiveness
U.S. Chamber of Commerce

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[9] BPI paper at https://bpi.com/challenges-in-stress-testing-and-climate-change/