

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Date: September 25, 2023
To: Board of Governors
From: Staff¹
Subject: Interagency Principles for Climate-Related Financial Risk Management for Large Financial Institutions

ACTIONS REQUESTED: Approval of the attached final interagency *Principles for Climate-Related Financial Risk Management for Large Financial Institutions* for publication in the Federal Register that would provide a high-level framework for the safe and sound management of exposures to climate-related financial risks for large financial institutions with over \$100 billion in total consolidated assets. Staff also seeks authority to make technical, non-substantive changes to the guidance prior to publication in the Federal Register.

EXECUTIVE SUMMARY:

- Climate-related financial risks, including physical and transition risks, can manifest as traditional micro-prudential risks, including as credit, market, liquidity, operational, and legal risks.
- In December 2021, April 2022, and December 2022, the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and the Board, respectively, proposed substantially similar guidance on risk management principles to support the effective management of climate-related financial risks for the financial institutions they supervise with over \$100 billion in total consolidated assets.
- The final guidance is substantially similar to the guidance previously proposed by the agencies, with targeted changes in response to comments. The targeted changes include clarification on the applicability to large foreign banking organizations, clarification on the role of boards of directors and management, and removal of a reference to compensation practices.
- The guidance contains high-level principles covering six areas: governance; policies, procedures, and limits; strategic planning; risk management; data, risk measurement, and reporting; and scenario analysis. The guidance also describes how climate-related financial risks can be addressed in specific prudential risk areas including credit,

¹ Michael Gibson, Kevin Stiroh, Anna Lee Hewko, Morgan Lewis, Matt McQueeney, Saba Haq, and Susan Ali (Division of Supervision and Regulation); Mark Van Der Weide, Charles Gray, Asad Kudiya, Flora Ahn, Matt Suntag, Katherine Di Lucido, and David Imhoff (Legal Division).

liquidity, other financial risks, operational, legal and compliance, and other non-financial risks.

DISCUSSION:

I. Background

The financial impacts that result from the economic effects of climate change and the transition to a lower carbon economy pose an emerging risk to the safety and soundness of financial institutions² and the financial stability of the United States. Financial institutions are likely to be affected by both the physical risks and transition risks associated with climate change (collectively, climate-related financial risks). Weaknesses in how financial institutions identify, measure, monitor, and control climate-related financial risks could adversely affect financial institutions' safety and soundness.

The agencies separately proposed substantially similar guidance on risk management principles to support the effective management of climate-related financial risks for the financial institutions they supervise with over \$100 billion in total consolidated assets.³ The proposed guidance outlined 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 included a section on "management of risk areas," which described how climate-related financial risks can be addressed in certain risk categories

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

³ The OCC published proposed guidance on December 16, 2021; the FDIC published on April 4, 2022; and the Board published on December 2, 2022.

such as credit, liquidity, other financial risks, operational, legal and compliance, and other non-financial risks.

II. Discussion of Guidance

To promote consistency in the agencies' approach to climate-related financial risks, agency staffs' considered comments submitted on each agency's proposal and drafted the final guidance on an interagency basis. Commenters included financial services trade groups, individual banks, environmental groups, public interest and advocacy groups, data and risk model providers, governmental organizations, community groups, and individuals, among other respondents. Many comments offered suggestions for changes to the guidance or requested additional guidance or clarification in specific areas.

The final guidance is substantially similar to the guidance previously proposed by the agencies, with some targeted changes in response to comments. For example, the final guidance clarifies that the guidance is applicable to foreign banking organizations with combined U.S. operations of greater than \$100 billion. In addition, the final guidance further clarifies appropriate roles of boards and management to better align with existing interagency guidance on board effectiveness and governance. The final guidance excludes discussion of compensation practices, which was referenced in the Board's proposed guidance, because the agencies believe the issue is covered in existing interagency guidance. The final guidance does not incorporate comments that extend beyond the agencies' statutory mandates relating to safety and soundness.

RECOMMENDATIONS:

Staff recommends that the Board approve the attached draft interagency guidance for publication in the Federal Register. Staff further recommends that the Board grant staff authority to make technical or minor changes to prepare the guidance for publication.