February 6, 2023

Via electronic mail

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW, Washington, DC 20551

INSTITUTE OF INTERNATIONAL FINANCE

Re: IIF Public Comment on the Federal Reserve Board's Draft Principles for Climate-Related Financial Risk Management for Large Financial Institutions

Dear Secretary Misback:

The Institute of International Finance (IIF) and its members, which broadly represent the global financial services industry, appreciate the opportunity to provide public comments to the Federal Reserve Board (FRB) on its request for comment on draft "*Principles for Climate-Related Financial Risk Management for Large Financial Institutions*" (hereafter "the consultation").[1] The IIF is the global association of the financial industry, with around 400 members from over 65 countries, including commercial and investment banks, asset managers, insurance companies, ratings agencies, market infrastructure providers, and professional services firms.

IIF members appreciate the FRB's initiative to articulate a high-level framework for the safe and sound management of exposures to climate-related financial risks, and its principles-based approach to this important topic. We agree with the FRB that the way in which financial institutions identify, measure, monitor, and control for potential climate-related financial risks, and how they manage the risks associated with the transition to a lower carbon economy, could affect their safety and soundness and the overall stability of the financial system. There are several tools available for financial institutions – also engaging with their prudential supervisors – to measure, manage, and take steps to mitigate climate-related risks, including risk management practices and climate scenario analysis exercises.

Climate risk is a global issue that warrants a coordinated approach across jurisdictions, including in supervisory principles and standards with respect to climate risk management. Numerous jurisdictional authorities have already moved ahead to develop and implement regulatory responses to the climate-related risks and opportunities which face the financial sector. **It is encouraging that many authorities across the world are seeking to move swiftly on these extremely important and pressing topics; however, particularly given significant uncertainties and knowledge gaps, uncoordinated policy development could create a potentially less effective policy landscape.** Steps towards policy and supervisory coordination are particularly important with respect to risk management approaches of major cross-border financial institutions, many of which face supervisory expectations and requirements focused on aspects of climate-related risks from multiple jurisdictional authorities. IIF members therefore appreciate the steps the FRB has taken to

[1] https://www.federalregister.gov/documents/2022/12/08/2022-26648/principles-for-climate-related-financial-risk-management-for-large-financial-institutions.

contribute to greater coordination of supervisory approaches, including the alignment between the proposed principles and the Basel Committee on Banking Supervision's (BCBS) *"Principles for the effective management and supervision of climate-related financial risks"* (hereafter "the BCBS principles").[2] In February 2022, the IIF submitted a public comment letter on the consultation draft BCBS principles, which is available here. In that letter, the IIF welcomed the development of global principles to support supervisory cooperation and collaboration. The FRB may find the IIF's detailed comments on the BCBS consultative document relevant given its similarities with the FRB's consultation.

In the United States, domestic coordination and harmonization among the federal banking agencies is critical to avoid potential duplication or conflicting supervisory expectations. The IIF, therefore, commends the FRB developing the proposed guidance in consultation with the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC), and that the FRB intends to coordinate with the OCC and FDIC in issuing any final guidance.[3] Coordination both in terms of the final principles and the associated implementation timeline is also important from an industry risk management perspective, as recognized in the accompanying FRB Board memo.[4] Recognizing the many similarities between the three Agencies' proposals, the IIF encourages the FRB, FDIC and OCC to produce one common set of principles for large financial institutions which is joint across the three agencies, while accounting for pertinent institutional differences as appropriate, e.g., regarding scope of application, and reflecting feedback received through the Agencies' respective consultation processes.

Moreover, the IIF appreciates that the FRB has already incorporated some of the industry's feedback on the earlier consultations by the OCC and FDIC, including the IIF's high-level response letter to the OCC's consultation (available here) and IIF reports on supervisory and regulatory approaches to climate-related risks.[5] For example, it is very helpful that the FRB recognizes that different financial institutions will be affected by climate risk drivers in different ways, and so a diversity of responses to these risk drivers is appropriate.[6] We recognize that the FRB has taken steps to differentiate the roles of the boards and the roles of management. However, we would recommend that the FRB principles could, in addition,

---

[2] The BCBS's consultative document (November 2021) can be found here, and the finalized version (June 2022) can be found here.

[3] As noted in the consultation: *"Accordingly, after reviewing comments received on the proposed guidance, the Board intends to coordinate with the OCC and FDIC in issuing any final guidance."*

[4] Page 3: *"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."*

[5] IIF Prudential Pathways, January 2021; IIF Navigating Climate Headwinds: Reference Approaches for Scenario-based Climate Risk Measurement by Banks and Supervisors, July 2021 (hereafter referred to as "IIF Navigating Climate Headwinds, July 2021"); IIF Climate and Capital: Views from the Institute of International Finance, July 2022 (hereafter referred to as "IIF Climate and Capital, July 2022").

[6] *"In keeping with the Board's risk-based approach to supervision, the Board anticipates that differences in financial institutions' complexity of operations and business models will result in different approaches to addressing climate-related financial risks. Some large financial institutions are developing the governance structures, processes, and analytical methodologies to identify, measure, monitor, and control for these risks. The Board understands that expertise in climate risk and the incorporation of climate-related financial risks into risk management frameworks remains under development in many financial institutions and will continue to evolve over time."* (Page 75268 of the Federal Register.)

better reflect how board and senior management principles would be applied with respect to foreign banking organizations (see further comments on this below, on page 5).

The IIF appreciates the FRB's "risk-based" approach to supervision and the application of this approach to climate risk management (page 75268 of the Federal Register). When the final principles are being applied in future, it is important that they are referenced by supervisors in a proportionate way, recognizing institutions' different starting positions, business models and geographical footprints as well as general risk profiles, which may affect the materiality of certain climate risk drivers as sources of microprudential risk. Such an approach should be accommodating enough to recognize that a variety of practices can be appropriate to manage risk and that firms' current risk management frameworks, which vary, can be leveraged to do so. To this point, we note that certain provisions in the consultation could be interpreted as suggesting that financial institutions may need to adopt new lending limits related to climate-related financial risk regardless of materiality,[7] which could be inconsistent with the general expectation that a financial institution's climate risk management framework include all material risk considerations to the financial institution. As an alternative, the FRB could clarify, for example, that *"[c]onsistent with the financial institution's risk appetite statement, management should determine credit risk tolerances and lending limits related to these risks**<u>, as appropriate</u>**"* (suggested added text shown in bold/underlined text).

IIF members welcome the FRB's appropriate assessment that climate-related scenario analysis exercises differ from traditional stress testing exercises, which the BCBS has also recognized in its global principles.[8] We also agree that climate scenario analysis can "*assist management in identifying data and methodological limitations and uncertainty in climate-related financial risk management and informing the adequacy of the institution's climate-related financial risk management framework*" (page 75270 of the Federal Register). Climate scenario analysis as a discipline is at a nascent stage, and there are currently significant limitations in terms of data and methodologies, and necessary simplifying assumptions employed to feasibly undertake exercises under these conditions. Since the foundations are not yet fully developed with respect to technical knowledge, conceptual basis, data, and modelling, **climate scenario analysis should be viewed as an exploratory tool that could be useful to understand climate risks**.[9] **Furthermore, climate scenario analysis exercises pursue fundamentally different objectives than prudential stress testing exercises** – where the latter are designed to test resilience against a historically large, short-term shock, use different methodologies, and measure specific impacts based on different indicators and timeframes.

Accordingly, firm-conducted (and supervisor-conducted) climate scenario analysis exercises should continue to be differentiated from other prudential activities and should not have regulatory capital implications. As such, IIF members welcome the clear

---

[7] e.g. *"Management should incorporate climate-related financial risks into policies, procedures, and limits to provide detailed guidance on the financial institution's approach to these risks in line with the strategy and risk appetite set by the board"* (page 75269 of the Federal Register); and *"[c]onsistent with the financial institution's risk appetite statement, management should determine credit risk tolerances and lending limits related to these risks"* (page 75270).

[8] See BCBS Principles for the effective management and supervision of climate-related financial risks (June 2022), footnotes 6 and 10.

[9] IIF Navigating Climate Headwinds, July 2021, IIF Climate and Capital, July 2022.

distinction the FRB has made in the press release about its 2023 pilot climate scenario analysis: *"Climate scenario analysis is distinct and separate from bank stress tests. The Board's stress tests are designed to assess whether large banks have enough capital to continue lending to households and businesses during a severe recession. The climate scenario analysis exercise, on the other hand, is exploratory in nature and does not have capital consequences."* Based on the same considerations, **it is not appropriate at this stage to incorporate climate-related risks into any capital or liquidity adequacy assessments.** We appreciate the generally cautious approach the FRB appears to be taking on these topics in the draft principles, although the references to assessing liquidity position are premature given current capabilities.

More broadly, in the interest of achieving global alignment, the IIF has recommended – and noted above – that individual jurisdictions should refrain from making any national adjustments to their capital framework while global standard-setting bodies (with input from market participants) are analyzing whether there is a conceptual and data-driven basis for any adjustments.

Recognizing the exploratory nature of climate scenario analysis, the suggested governance arrangements related to scenario analysis outlined in the proposal (page 75270) may be premature. The proposal states that exercises *"should be subject to oversight, validation, and quality control standards"* and that *"results should be clearly communicated to the board and all relevant individuals within the financial institution"*, which could be at odds with allowing them to be used in an exploratory manner. Instead, we believe it would be more appropriate to instead adopt paragraph 48 of the BCBS principles,[10] which acknowledges that the field of scenario analysis is highly dynamic and rapidly evolving, and therefore recommends subjecting models, frameworks, and results to regular challenge and review.

Furthermore, it would be helpful for the FRB to provide more clarity regarding the application of the draft principles to the U.S. operations of foreign banking organizations (FBOs). Based on footnotes 1[11], 4[12] and 8[13], it is unclear how the principles may apply to FBOs. The FRB should therefore clarify that the principles apply to FBOs in a consistent manner based on the size of their combined U.S. operations. This would account for U.S. branches, among other operations.

FBOs should be given the flexibility to satisfy some or all of the final FRB principles through reliance on group frameworks and build upon established FRB U.S. risk

[10] *"The field of climate scenario analysis is highly dynamic, and practices are expected to evolve rapidly, especially as climate science advances. Climate scenario models, frameworks and results should be subject to challenge and regular review by a range of internal and/or external experts and independent functions."*

[11] *"In this issuance, the term "financial institution" or "institution" 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."*

[12] *"In this issuance, 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 (SIFIs) supervised by the Board."*

[13] *"The Board will consider the total consolidated assets of a branch or agency itself for branches and agencies of foreign banking organizations subject to Board supervision."*

expectations and U.S. risk governance frameworks for FBOs. Due to the nature of the risk drivers, climate-related financial risk management is often an enterprise-wide effort which is developed and coordinated at group level. FBOs should be able to leverage their group-level programs, policies, models, and procedures. To reduce balance sheet and operational fragmentation, it is helpful for supervisors to have a clear understanding of the consolidated group strategy and the home authority's supervisory judgement of that strategy -- especially since climate risk will likely be managed on a global basis. For example, it can be efficient for global financial institutions to undertake climate scenario analysis exercises for the global group, and leverage the relevant findings across the group for local consideration. Indeed, in the case of supervisory climate scenario exercises, those may be conducted at group-level by home supervisory authorities and shared with host supervisors via supervisory colleges.[14]

In terms of **governance expectations for FBOs**, boards of global financial institutions should be able to rely on designated U.S. committees (e.g., a U.S. risk committee, or other relevant committee or entity) for oversight of climate-related financial risks in the United States. And FBOs should also be able to rely on U.S.-based management for relevant U.S. climate-related financial risk expectations for senior management. The IIF would be happy to convene a discussion between the FRB and our FBO members if helpful to further discuss these important topics.

Lastly, the proposed FRB principles – as well as similar principles that have been issued by other jurisdictions and by the BCBS – in some respects reflect a set of 'end-point' expectations in terms of financial institutions' practices. However, it is important that near-term supervisory expectations recognize that **financial institutions are working to overcome several challenges at present which influence the maturity of their approaches with respect to climate-related risk drivers[15] – many of which the FRB acknowledges in their draft principles.** These include: securing relevant and high-quality data; choosing and developing appropriate methodologies and metrics; and integrating and mainstreaming new data and metrics into decision-making. It should be clear that, at this stage, initial tools and metrics which are being developed are key to driving capacity building and raising awareness within financial institutions, but that there are challenges to making them decision-useful for the reasons just stated. Working within the constraints of these challenges, and working to overcome them, will require a multi-year effort as financial institutions try to identify and assess climate-related risks and build a better understanding of how they relate to financial impacts across different risk stripes (credit, market, liquidity, etc.).

It would therefore be helpful and reasonable for supervisors to take an explicitly proportionate, phased, and incremental approach to the introduction of supervisory expectations with respect to climate-related risks. In this regard, we appreciate that the FRB "*recognizes that the incorporation of material climate-related financial risks into various planning processes will be iterative, as measurement methodologies, models, and data for analyzing these risks continue to mature*" (pages 75268-75269 of the Federal Register). Further

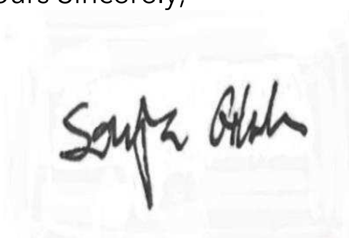
[14] This point is further discussed in IIF Navigating Climate Headwinds, July 2021.

[15] The financial industry responses to some of these challenges are discussed in recent IIF reports, "Financing the Net-Zero Transition: From Planning to Practice" (developed with McKinsey) and "The Road to Net-Zero: How Financial Firms are Approaching— and Accelerating—the Transition to a Low-Carbon Future" (developed with Deloitte) (both January 2023).

recognition of the developing nature of this area and the current technical challenges to certain aspects of risk management could be embedded in the FRB's final principles. For example, recognizing that financial institutions may start with a more qualitative approach to risk assessment until they have better data and more experience with key risk indicators and metrics, before taking steps to fully integrate risk quantification. It would be helpful for the FRB to engage with supervised financial institutions in the coming years to assess developments in terms of industry practice and technical capabilities, and review whether the supervisory expectations are set appropriately.

Thank you for your consideration of these comments. On behalf of the IIF membership, we hope that these global industry perspectives will contribute constructively to your efforts. We would be very happy to discuss any of our comments further or to assist in any way, including providing perspectives on approaches taken in other jurisdictions. We invite you to contact Sonja Gibbs (sgibbs@iif.com) or Andrés Portilla (aportilla@iif.com) should you have questions or comments.

Yours Sincerely,



Sonja Gibbs
Managing Director and
Head of Sustainable Finance,
Institute of International Finance

Andrés Portilla
Managing Director and
Head of Regulatory Affairs,
Institute of International Finance