

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

Mr. Ben McDonough
Chief Counsel
Office of the Comptroller of the Currency
400 7th Street SW
Suite 3E-218
Washington, DC 20219

Mr. James P. Sheesley
Assistant Executive Secretary
Attention: Comments/Legal OES (RIN 3064-AF29)
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

January 16, 2024

Subject: Notice of Proposed Rulemaking for Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity (Docket ID OCC-2023-0008; Docket No. R-1813, RIN 7100-AG64; and RIN 3064-AF29); and Regulatory Capital Rule: Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; Systemic Risk Report (FR Y-15) (Docket No. R-1814, RIN 7100-AG65)

Dear Ms. Misback, Mr. McDonough, and Mr. Sheesley:

The undersigned organizations are writing concerning the Board of Governors of the Federal Reserve System (Board), Federal Deposit Insurance Corporation (FDIC) and Office of the Comptroller of the Currency's (OCC's) (hereafter, the agencies) proposed Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity;¹ and the Board's notice of proposed rulemaking, Regulatory Capital Rule: Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; Systemic Risk Report (FR Y-15).²

¹ "Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity," 88 Fed. Reg. 64,028 (Sept. 18, 2023).

² "Regulatory Capital Rule: Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; Systemic Risk Report (FR Y-15)," 88 Fed. Reg. 60,385 (Sept. 1, 2023).

We fully support the agencies' work to finalize and implement bank capital rules that align with the goals of the Basel Committee on Banking Supervision (BCBS), and that incorporate lessons from the financial crisis of 2008 and, more recently, from the 2023 U.S. banking crisis. To that end, we urge you to **finalize strong rules that improve the safety and soundness of large banks and banks with significant trading activity and that strengthen financial system resiliency. It is also critically important to acknowledge and address climate-related financial risks and clarify how the agencies' Principles for Climate-Related Financial Risk Management (hereafter, the climate principles)³ apply to capital requirements.**

Climate change poses significant and growing risks to banks and to the financial system, including transition risks associated with carbon intensive assets and physical risks caused by increasingly frequent and severe climate-related disasters, chronic weather changes, and the growing property insurance protection gap. In the climate principles, the agencies confirmed that climate change is a threat to the safety and soundness of banks and the stability of the financial system. The climate principles followed publication of the BCBS principles for the effective management and supervision of climate-related financial risks.⁴ The Financial Stability Oversight Council's (FSOC) recently approved analytic framework for financial stability risks recognizes that climate-related financial risks are "potential risks to financial stability" and "developments affecting the resiliency of the financial system."⁵ Treasury Secretary Yellen has similarly acknowledged that climate change must be addressed, as it is "an existential threat" that "poses a tremendous risk to our country's financial stability."⁶ The Financial Stability Board (FSB),⁷ the European Central Bank (ECB),⁸ the European Systemic Risk Board (ESRB),⁹ the Bank of England (BOE),¹⁰ and others have similarly recognized the significant financial risks of climate change.

Capital requirements should play an important role in mitigating these risks.¹¹ As one expert has noted: "One of the most powerful tools in financial regulators' arsenal is the bank capital framework, and it should be at the heart of efforts to improve the resilience of the financial system to climate-related risks." Indeed, regulators around the world have recognized the important role that capital can play in

³ "Principles for Climate-Related Financial Risk Management," 88 Fed. Reg. 74,183 (Oct. 30, 2023).

⁴ BCBS, "Principles for the effective management and supervision of climate-related financial risks" (June 2022), <https://www.bis.org/bcbs/publ/d532.pdf>.

⁵ "Analytic Framework for Financial Stability Risk Identification, Assessment, and Response," 88 Fed. Reg. 78,026, 78,033 (Nov. 14, 2023).

⁶ Janet Yellen, "Remarks by Secretary Janet L. Yellen at the Open Session of the meeting of the Financial Stability Oversight Council (Mar. 31, 2021), <https://home.treasury.gov/news/press-releases/jy0092>.

⁷ FSB, "Supervisory and Regulatory Approaches to Climate-related Risks" (Oct. 13, 2022), <https://www.fsb.org/wp-content/uploads/P131022-1.pdf>.

⁸ ECB, "Climate change and the ECB," <https://www.ecb.europa.eu/ecb/climate/html/index.en.html>.

⁹ ECB/ESRB Project Team on Climate Risk Monitoring, "Towards macroprudential frameworks for managing climate risk" (Dec. 2023),

<https://www.esrb.europa.eu/pub/pdf/reports/esrb.report202312~d7881028b8.en.pdf>.

¹⁰ BOE, "Climate Change," <https://www.bankofengland.co.uk/climate-change>.

¹¹ We note, however, that the safety and soundness of individual institutions and the stability of the financial system also will depend on other measures that address climate-related financial risks, such as mandatory transition plans.

these efforts.¹² While the proposal would appropriately strengthen requirements for credit, operational, and market risks, it is confusingly silent on the ways that climate-related financial risks—as identified in the agencies' recent climate principles—should be incorporated into capital requirements and capital adequacy assessments.

Given rapidly growing climate-related risks for banks, this is a significant oversight. Transition risks to large banks are growing, for example, as the US and other countries move away from fossil assets and renewable energy becomes more accessible and meets greater demand. Fossil assets are increasingly likely to become stranded as countries commit to phasing out fossil fuels, renewable energy technologies advance and become more affordable, and public demand for addressing climate change grows. Research indicates that half of the world's fossil fuel assets—\$11 trillion to \$14 trillion worth—could become worthless by 2036 under a net-zero by 2050 transition.¹³ A Federal Reserve Bank of New York study looking at fossil fuel transition risk determined “the effect of climate stress could potentially be substantial in the future if banks are not sufficiently capitalized.”¹⁴ Physical risks are growing as well, through risks to their borrowers, collateral, and investments, exacerbated by the growing insurance protection gap for residential and commercial real estate.

The prospect of increasing climate risks, and the gaps in adequate provision for them underscore both the need for the specific enhancements discussed here and for more robust capital standards in general. Because the climate principles discuss the growing prominence of climate risks and include expectations around capital plan monitoring in light of those risks, banks would benefit from the agencies clarifying how they intend these efforts to interact, both explicitly within the final rules and in future changes to the capital framework and guidance. This will ultimately improve implementation of the related regulations and in turn promote bank safety and soundness, help avoid government bailouts, and reduce threats to the financial system in the face of growing climate-related risk.

¹² See, e.g., ECB/ESRB Project Team on Climate Risk Monitoring, “Towards macroprudential frameworks for managing climate risk” (Dec. 2023),

<https://www.esrb.europa.eu/pub/pdf/reports/esrb.report202312~d7881028b8.en.pdf>; FSB, “Supervisory and Regulatory Approaches to Climate-related Risks” (Oct. 13, 2022), <https://www.fsb.org/wp-content/uploads/P131022-1.pdf>; “BCBS, “Frequently asked questions on climate-related financial risks,” (Dec. 8, 2022), <https://www.bis.org/bcbs/publ/d543.pdf>; ECB, “Walking the talk” (Nov. 2022) (noting use of Pillar 2 capital requirements).

<https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.thematicreviewcerreport112022~2eb322a79c.en.pdf?c59ddfc36c950805785e5f3112dda4cb>; ECB quotes, and any other relevant examples of regulators saying capital can help mitigate climate risk

<https://greencentralbanking.com/2022/11/08/ecb-capital-requirements-climate-thematic-review/>

¹³ Jonathan Watts, et al., “Half world's fossil fuel assets could become worthless by 2036 in net zero transition,” *The Guardian* (Nov. 4, 2021), <https://www.theguardian.com/environment/ng-interactive/2021/nov/04/fossil-fuel-assets-worthless-2036-net-zero-transition>.

¹⁴ Hyeyoon Jung, Robert Engle, and Richard Berner, “CRISK: Measuring the Climate Risk Exposure of the Financial System,” *Federal Reserve Bank of New York Staff Reports*, no. 977, at 4 (Revised Mar. 2023), https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr977.pdf?sc_lang=en.

The following sections recommend that the agencies (1) explain how the climate principles apply in the regulatory capital context and adjust the capital rules to reflect climate-related financial risks, (2) adopt a precautionary approach given the nature of climate-related financial risks, and (3) consider additional measures to address large banks' contribution to climate-related financial risks.

- 1. The agencies should explain how the climate principles, as well as the BCBS climate FAQs, apply in the regulatory capital context and adjust the capital rules to reflect climate-related financial risks, as identified in the climate principles.*

The climate principles explain that all banks face climate-related financial risks—including transition and physical risks—that manifest across the traditional risk stripes (e.g., credit, market, operational, legal and compliance) and which should be incorporated into banks' risk management, governance, and strategy. The climate principles also establish that bank management “should consider climate-related financial risks as part of the underwriting and ongoing monitoring of portfolios,” and bank boards “should consider material climate-related financial risk exposures . . . when overseeing management’s implementation of capital plans.”¹⁵

Other authorities like the BCBS agree that climate risk should impact banks' capital-related policies and procedures. A BCBS climate-related frequently asked questions document (BCBS climate FAQs) clarifies how Pillar 1 standards should capture climate-related financial risks, noting, for example, that banking organizations should consider and evaluate “material climate-related financial risks” in their credit risk assessment, “when determining whether an exposure is to an investment grade company”¹⁶ and as part of “counterparty due diligence.”¹⁷

However, the agencies' proposal does not address climate-related financial risk directly, nor does it address the need for boards to consider climate-related financial exposures when overseeing implementation of bank capital plans pursuant to the climate principles. And while the proposal's “residual risk add-on” includes a modest capital enhancement to capture “exotic risks, such as weather, longevity, and natural disasters,” it fails to acknowledge that these risks are becoming much more prevalent each year as climate change accelerates.

While the climate principles make clear that certain elements of the current and proposed regulatory capital framework (e.g., requirements to maintain capital commensurate with all risks) incorporate climate-related financial risks—including by noting that such risks are “[s]imilar to other risks” and “can affect safety and soundness”—the agencies should confirm this by directly addressing climate-related financial risks. We strongly urge the agencies to confirm and clarify the applicability of the climate

¹⁵ 88 Fed. Reg. at 74,185.

¹⁶ BCBS, “Frequently asked questions on climate-related financial risk,” at 3 (Dec. 8, 2022), <https://www.bis.org/bcbs/publ/d543.pdf>.

¹⁷ *Id.* at 2.

principles and the BCBS climate FAQs, to the extent relevant to the U.S. context, to the agencies' rules, including in the following ways.

First, the final rules should indicate that management should consider climate-related risk during the credit assessment and underwriting process for all exposures with material climate risk, and capture climate explicitly in the market risk stress test and residual risk add-on capital requirements. Due diligence requires consideration of climate-related financial risk. The agencies should codify due diligence requirements that encompass climate-related financial risks for all exposures and, consistent with the current and proposed treatment of securitization exposures, impose higher risk weights for failure to meet those requirements.

The rules should note, however, that as management increases capital in response to physical risks, it should not use these increases to attempt to justify unfair and unjust limits on lending to low- and moderate-income (LMI) and other underserved communities in climate vulnerable areas. This would be inconsistent with the agencies' expectation, set forth in the preamble to the climate principles, that "financial institutions [will] manage climate-related financial risks in a manner that will allow them to continue to prudently meet the financial services needs of their communities, including LMI and other underserved consumers and communities, and to ensure compliance with fair housing and fair lending laws."¹⁸ Risk mitigation strategies that result in disparate impacts where an alternative with "less discriminatory effect" exists may violate those laws.¹⁹ As detailed below, the agencies should seek to minimize this impact and to more justly allocate risks and costs associated with physical climate risk to large banks facilitating these risks through their financing of fossil fuel activities.

Second, the final rules should indicate that bank boards of directors should consider climate-related risk in their role overseeing a banking organization's capital plan, consistent with the climate principles. The agencies should clarify that capital plans, including those required by 12 CFR 225.8 and 12 CFR 238.170, must address climate-related financial risks. The final rule or subsequent guidance also should clarify how this expectation applies to the current capital requirements, which the proposal would not change, for banking organizations to (1) maintain capital commensurate with the level and nature of all risks to which the banking organization is exposed, and (2) have a process for assessing its overall capital adequacy²⁰ in relation to its risk profile and a comprehensive strategy for maintaining an appropriate level of capital. In addition, the agencies should clarify that the operational risk management function's responsibilities include climate-related risks, consistent with the expectations set forth in the climate principles, and that climate change can cause operational loss events, such as workplace safety issues, damage to physical assets, and business disruption and systems failures.²¹

¹⁸ 88 Fed. Reg. at 74,185.

¹⁹ OCC, et al., "Interagency Fair Lending Examination Procedures," at iv (Aug. 2009), <https://www.ffiec.gov/pdf/fairlend.pdf>.

²⁰ The BCBS has adopted principles that should guide these capital assessments. BCBS, "Principles for the effective management and supervision of climate-related financial risks" (June 2022), <https://www.bis.org/bcbs/publ/d532.pdf>.

²¹ 88 Fed. Reg. at 74,188-74,189.

Third, the agencies should consider climate-related financial risks to different types of exposures as they determine risk weights in the final rule and incorporate climate-related financial risks into all stress testing requirements. Doing so would ensure the capital rules address the risks identified in the climate principles.

II. The agencies should assume a precautionary approach to capital for climate-related risks given the radical uncertainty and significant impact of these risks.

As the agencies finalize these rules and take future action on capital requirements, it is vital they recognize the need for a precautionary approach to the radically uncertain and significant risks posed by climate change.²²

For exposures that pose the greatest climate-related financial risks—particularly transition-related exposures given the significant uncertainty and potential downside risks associated with unabated and expanded fossil fuel use—such an approach to capital is warranted. A 150% risk weight, at a minimum, for existing fossil fuel exposures and a 1,250% risk weight, or one-for-one approach, for new fossil fuel exposures is appropriate given the riskiness and volatility of the former and the elevated risk of complete losses and broader financial instability for the latter.²³ This would account for the substantial transition risks from those exposures to individual banking organizations, as well as for macroprudential risks of climate change (detailed more below). A one-for-one approach would be consistent with the treatment of certain high-risk exposures in the current capital rule and the proposal, as well as BCBS standards for certain crypto-asset exposures.²⁴

III. The agencies should evaluate other capital standards for holding large banks accountable for their macroprudential climate-related financial risks, including factoring them into the GSIB surcharge and capital buffers.

Large banks are exacerbating risks to financial stability with financing of fossil assets that continues apace at levels grossly incompatible with maintaining a physical environment that is hospitable to stable economies and financial systems like those that exist at present.

As the National Oceanic and Atmospheric Administration and others have documented, natural catastrophe events are increasing in number and severity. Last year, scientists determined that 2015-2022

²² Hugues Chenet, Josh Ryan-Collins, Frank van Lerven, “Finance, climate-change and radical uncertainty: Towards a precautionary approach to financial policy,” *Ecological Economics*, Vol. 183 (May 2021), <https://www.sciencedirect.com/science/article/pii/S092180092100015X>.

²³ Thierry Philipponnat, Finance Watch, “Breaking the climate-finance doom loop” (June 2020), https://www.finance-watch.org/wp-content/uploads/2020/06/Breaking-the-climate-finance-doom-loop_Finance-Watch-report.pdf; Greg Ford, et al., Finance Watch, “A safer transition for fossil banking” (Oct. 2022), <https://www.finance-watch.org/wp-content/uploads/2022/10/A-safer-transition-for-fossil-banking-Finance-Watch-report.pdf>.

²⁴ BCBS, “Prudential Treatment of Cryptoasset Exposures” (Dec. 2022), <https://www.bis.org/bcbs/publ/d545.pdf>.

were the hottest on record.²⁵ Preliminary data projects that 2023 will now top the list.²⁶ Damages to property from natural disasters has led to financial losses for and failures of insurers.²⁷ In response, insurers are departing from climate vulnerable areas, raising premiums, restricting coverage, and making payments on claims more difficult to secure. Nearly a dozen smaller insurers have gone bankrupt in Florida in the last two years.²⁸ Additionally, many individuals facing serious flood risks have long lacked adequate insurance as a result of inadequate flood-related data, unavailability of flood insurance, and prohibitive costs. It is estimated, for example, that only one-third of households in flood zones have flood insurance.²⁹ Entities holding loans for underinsured homes and other property face heightened risks of borrower defaults and impaired collateral. Mortgage loans that appeared less than sound in climate vulnerable areas a year ago are now even more clearly subprime as insurance becomes less accessible. A Board staff study details how these physical climate risks could flow to other interconnected entities, including to government-sponsored enterprises, insurers, investors, and others.³⁰ As noted in a literature survey by Federal Housing Finance Agency (FHFA) staff, “While natural hazards, such as hurricanes, riverine flooding, and wildfires have historically posed risks to regional housing markets, the systemic risk that climate change may pose to housing and mortgage markets is of increasing concern.”³¹

Large U.S. banks are major contributors to these risks,³² but they are not significantly bearing the responsibility or related costs their actions are imposing on others, including homeowners, investors, other financial institutions, and the financial system. Through their financing of fossil assets that increase physical risk for the financial system and transition risk for both the banks themselves and the broader system, large banks are originating and distributing risks to the financial system in a manner not dissimilar to the origination and distribution of risks by lenders and securitizers of mortgage-backed securities during the 2008 financial crisis. Through 2022, five of the top twelve of these financiers are U.S. banks, which have provided more than \$1,516.8 trillion in financing for fossil fuels since the Paris Agreement.³³ And many impacted consumers and entities—including community banks and credit unions that

²⁵ Henry Fountain and Mira Rojanasakul, “The Last 8 Years Were the Hottest on Record,” *The New York Times* (Jan. 10, 2023), <https://www.nytimes.com/interactive/2023/climate/earth-hottest-years.html>.

²⁶ Lauren Sommer, “2023 will be the hottest year on record. Is this how it's going to be now?” *NPR* (Dec. 28, 2023), <https://www.npr.org/2023/12/28/1221827923/2023-hottest-year-record-climate-change>.

²⁷ Benjamin Keys, “Your Homeowners’ Insurance Bill Is the Canary in the Climate Coal Mine,” *The New York Times* (May 7, 2023), <https://www.nytimes.com/2023/05/07/opinion/climate-change-homeowners-insurance-housing-market.html>.

²⁸ *Id.*

²⁹ Milliman, Inc., Society of Actuaries, “Residential Flood Risk in the United States: Quantifying Flood Losses, Mortgage Risk and Sea Level Rise,” (May 2020), <https://www.soa.org/globalassets/assets/files/resources/research-report/2020/soa-flood-report.pdf>.

³⁰ Benjamin N. Dennis, “Household, Bank, and Insurer Exposure to Miami Hurricanes: a flow-of-risk analysis,” Finance and Economics Discussion Series 2023-013, Board (Feb. 7, 2023), <https://www.federalreserve.gov/econres/feds/files/2023013pap.pdf>.

³¹ Justin Contat, et al. “When Climate Meets Real Estate: A Survey of the Literature,” FHFA Staff Working Paper 23-05 (Aug. 2023), <https://www.fhfa.gov/PolicyProgramsResearch/Research/PaperDocuments/wp2305.pdf>.

³² Rainforest Action Network, et al. “Banking on Climate Chaos,” <https://www.bankingonclimatechaos.org/>.

³³ *Id.*

disproportionately serve LMI communities—are in the most vulnerable positions as a result of discriminatory practices, and lack the capacity to avoid and address these risks.

The GSIB surcharge proposal recognizes large bank contributions to systemic risk, but the agencies—in this rule or future proposals—should acknowledge and address bank financing of fossil assets as a contributor to this risk. As explained by one expert:

“Regulators have a responsibility to mitigate financial risks created by financial institutions, not only the risks to which financial institutions themselves are exposed. Accordingly, regulators should implement a macroprudential climate risk contribution capital surcharge to bolster big banks’ resilience to the systemic risks they are creating and to require them to bear the future costs their carbon financing activities are placing on the financial system as a whole. The capital surcharge should be calibrated based on the total GHG emissions financed by the institution.”³⁴

Options for a similar climate systemic risk buffer, as well as measures such as concentration thresholds, are being explored by the ECB and ESRB.³⁵ Capital measures based on the percentage of existing fossil fuel exposures that must remain in the ground to mitigate macroprudential climate-related financial risks are another option.³⁶

Thank you for the opportunity to comment. The final rules should align with the goals of the BCBS and incorporate lessons from the financial crisis of 2008 and, more recently, the financial crisis of 2023. **We urge you to finalize strong rules that improve large bank safety and soundness and strengthen financial system resiliency, especially in light of the significant risks posed by climate change.**

Sincerely,

Americans for Financial Reform
Carrizo/Comecrudo Tribal Nation of Texas
Centre for Citizens Conserving Environment & Management (CECIC)
Climate Action Rhode Island-350
Earth Ethics, Inc.
E3G
Friends of the Earth U.S.

³⁴ Gregg Gelzinis, Center for American Progress, “Addressing Climate-Related Financial Risk Through Bank Capital Requirements,” at 16 (May 2021), <https://www.americanprogress.org/wp-content/uploads/sites/2/2021/05/Addressing-Climate-Financial-Risk.pdf>.

³⁵ ECB/ESRB Project Team on Climate Risk Monitoring, “Towards macroprudential frameworks for managing climate risk” (Dec. 2023), <https://www.esrb.europa.eu/pub/pdf/reports/esrb.report202312~d788102818.en.pdf>.

³⁶ Thierry Philipponnat, Finance Watch, “Finance in a hot house world” (Oct. 2023), <https://www.finance-watch.org/wp-content/uploads/2023/10/report-finance-in-a-hot-house-world.pdf>.

Indigenous Environmental Network
1000 Grandmothers for Future Generations
Public Citizen
Revolving Door Project
Sierra Club
The Phoenix Group
The Sunrise Project
350 Chicago
350 Eastside
350 Silicon Valley
350 Wisconsin
350 Yakima Climate Action