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Regulation: Federal Reserve Announces Consultation on Climate Risk

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Regulation

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Earlier this month, the Federal Reserve Board of Governors, announced a public consultation on a proposed “framework for the safe and sound management of exposure to climate-related financial risks for large banking organizations.” The proposals would apply to banks with over $100 billion in total assets and would cover both physical and transition risks associated with climate change. The proposed principles cover six areas: governance; policies, procedures, and limits; strategic planning; risk management; data, risk measurement and reporting; and scenario analysis. Comments on the proposals, which according to the press release are substantially similar to proposals issued by the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation, can be submitted for 60 days following the announcement. These proposals follow a letter sent to the Federal Reserve by eight consumer advocacy and climate organizations calling for the Federal Reserve Board to issue principles for managing climate-related financial risks for large institutions under its supervision.

The proposal already has encountered resistance within the Board of Governors. Fed Governor Michelle Bowman stated that “I believe it is critical that any final principles complement the existing supervisory framework supporting the safety and soundness of financial institutions, and that the Board consider the costs and benefits of any new expectations.” Governor Christopher Waller did not support the issuance of the guidance, stating that “[c]limate change is real, but I disagree with the premise that it poses a serious risk to the safety and soundness of large banks and the financial stability of the United States. The Federal Reserve conducts regular stress tests on large banks that impose extremely severe macroeconomic shocks and they show that the banks are resilient.”

Taking The Temperature: The Federal Reserve announcement underscores the importance of climate-related risk for directors of financial institutions, but its articulation of broad-based principles is equally applicable as a matter of best practices for boards of companies in all industries. The principles also appropriately

acknowledge that a one-size-fits-all approach likely is inappropriate: "Effective risk management practices should be appropriate to the size of the financial institution and the nature, scope, and risk of its activities. 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." The Board added its recognition 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." The proposal also comments on the need to address specific risk areas, including credit, liquidity, operational, and legal and compliance risk. We will continue to monitor the accelerating development of global financial regulatory guidance in the climate area.