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Climate-Related Financial Risk: Bank Regulatory and Supervisory Developments

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Introduction

- **This presentation summarizes bank regulatory and supervisory developments related to climate-related financial risks.**
- **We will update these materials periodically as warranted by further developments.**
- **There also are developments from a broad range of other bodies impacting financial markets and other sectors. These include consolidation among certain significant environmental, social and governance (“ESG”) standard-setters, steps by the International Accounting Standards Board (which administers the International Financial Reporting Standards) to establish a Sustainability Standards Board to standardize sustainability reporting and a shifting focus among various investment fund managers, activists and other stakeholders. We have additional summaries and materials regarding these broader developments and would be happy to provide those if of interest.**

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Recent Developments

- **On December 16, 2021, the Office of the Comptroller of the Currency (the “OCC”) released for public comment principles for climate-related financial risk management for large banks. The comment period ends February 14, 2022.**
 - The proposed principles would apply to OCC-regulated institutions with over \$100 billion in consolidated assets.
 - The principles cover the following topics: governance; policies, procedures and limits; strategic planning; risk management; data, risk measurement and reporting; and scenario analysis.
 - The OCC noted that adverse effects of a changing climate could include potentially disproportionate impact on the financially vulnerable, including low- to moderate-income (“LMI”) and other disadvantaged households and communities.
 - The principles address how climate-related financial risks should be incorporated into mitigating various risks, including: credit risk; liquidity risk; other financial risk; operational risk; legal/compliance risk; and other nonfinancial risk.
 - Among notable points, the proposed principles envision:
 - the board of directors having an active role in having understanding and knowledge to assess the potential impact of climate-related risks;
 - having climate-related risks incorporated into policies, procedures and limits;
 - having climate-related risks incorporated into internal control frameworks, including internal audit;
 - robust data measurement and reporting that would be used to inform decision-making across a firm; and
 - the use of scenario analysis to identify, measure and manage climate-related financial risk.
 - The OCC also noted that where banks engage in public communication of their climate-related strategies, boards and management should ensure that any public statements about their banks’ climate-related strategies and commitments are consistent with their internal strategies and risk appetite statements.
 - The OCC requested comment on a number of questions, including:
 - how banks currently consider the impacts of climate-related financial risk mitigation strategies and financial products on households and communities, including LMI and other disadvantaged communities;
 - what specific data, metrics, tools and models from borrowers and other counterparties do banks need to identify, measure, monitor and control their own climate-related financial risk; and
 - how could existing regulatory reporting requirements be augmented to better capture banks’ exposure to climate related financial risks.

- **The OCC plans to elaborate on the principles in subsequent guidance that would distinguish roles and responsibilities of boards and management, incorporate the feedback received on the principles, and consider lessons learned and best practices from the industry and other jurisdictions.**

Recent Developments (cont'd)

- On October 21, 2021, in response to President Biden's executive order titled "Climate-Related Financial Risk", the Financial Stability Oversight Council (the "FSOC") issued a report assessing climate-related risks to the financial system and the United States. Taking the first step since the report was issued, on December 17, 2021, the FSOC voted to establish the staff-level Climate-related Financial Risk Committee ("CFRC"). See slides 7-11 for information on the report's findings.
- On November 16, 2021, the Basel Committee on Banking Supervision (the "BCBS") issued a consultation on "Principles for the effective management and supervision of climate-related financial risks". The comment period closes February 16, 2022.
 - Topics covered by the consultation include: corporate governance; internal control framework; capital and liquidity adequacy; risk management process; management monitoring and reporting; comprehensive management of credit risk; comprehensive management of market, liquidity, operational and other risks; and scenario analysis.
 - The consultation also discusses principles for the supervision of climate-related financial risks.
- On November 9, 2021, the BCBS reiterated that it is exploring the use of the Pillar 3 framework to promote a common disclosure baseline for climate-related financial risks.
- On November 8, 2021, Acting Comptroller of the Currency, Michael Hsu, said that bank boards have a critical role to play in turning words into action. He then outlined the following five climate change-related questions that large bank boards of directors should ask their senior management:
 1. What is our overall exposure to climate change?
 2. Which counterparties, sectors or locales warrant our heightened attention and focus?
 3. How exposed are we to a carbon tax?
 4. How vulnerable are our data centers and other critical services to extreme weather?
 5. What can we do to position ourselves to seize opportunities from climate change?

"Time is running out...We are racing against increasing numbers of costly extreme weather events."

"We are at an important moment. Climate change poses significant risks to the financial system. Detailed reports have been published. Eloquent words have been spoken. **It is time to convert those words into action.**"

*Michael Hsu
Acting Comptroller of the OCC
November 8, 2021*

Recent Developments (cont'd)

- **On September 30, 2021, Federal Reserve Board (“FRB”) Chair Powell stated in his testimony to the House Financial Services Committee that the FRB’s role is to ensure that the firms it regulates are able to manage climate change risks. The central bank is developing a program requiring larger banks to produce a plan on how they would manage such risks.**
 - Scenario analysis will be a principal tool for managing climate change risks. Currently, the focus is on better understanding what such risks are, how they will develop over time and where they come from, in contrast to the FRB’s annual stress tests.
 - FRB Chair Powell did not specify whether the scenarios would be developed by individual firms or by the central bank.

- **Among the legislation that has been proposed to address climate-related risks in the financial sector, Representatives Ayana Pressley (D-MA), Mondaire Jones (D-NY) and Rashida Tlaib (D-MI) introduced a bill on September 15, 2021 that would require bank holding companies with \$50 billion or more in assets to prepare emissions reduction plans, which would require a plan for such a firm to reduce financed greenhouse gas emissions significantly over time, including by reaching zero financed greenhouse gas emissions by 2050. Somewhat similar to capital restoration plans under the prompt correction action regime, the FRB would be primarily responsible for reviewing, approving and enforcing the plans. The bill also would add non-trivial contributions to financed greenhouse gases to the factors considered by the FSOC when considering designations of nonbank financial companies.**

Financial Stability Oversight Council's Report

- **On May 20, 2021, President Biden issued an executive order titled “Climate-Related Financial Risk”, directing his administration to develop a sweeping strategy to measure, mitigate and disclose climate-related risks for public and private financial assets.**
 - Development of the President’s strategy is under the purview of Brian Deese, director of the National Economic Council, and Gina McCarthy, the National Climate Advisor, in coordination with Treasury Secretary Yellen and the Office of Management and Budget.

- **In response to the directive in the executive order, the FSOC issued a report on October 21, 2021 assessing climate-related risks to the financial system and the United States. The FSOC’s report identified climate-related financial risks as an emerging threat to U.S. financial stability of the United States. Doing so does not have any immediate regulatory or legal effect, but indicates that the FSOC will focus on climate-related financial risks as a part of its ongoing work.**

- **In this report, the FSOC made four main recommendations, listed below, and a number of sub-recommendations. See slides 8 through 11 for additional detail on the FSOC’s recommendations.**
 1. Build capacity and expand efforts to address climate-related financial risks;
 2. Fill climate-related data and methodological gaps;
 3. Enhance public climate-related disclosures; and
 4. Assess and mitigate climate-related risks that could threaten the stability of the financial system.

- **The FSOC report notes that climate-related financial risks may manifest through traditional prudential risk categories that are supervised under safety and soundness mandates and that some depository institution regulators are incorporating climate-related financial risks into their areas of focus for monitoring and assessment.**

Financial Stability Oversight Council's Report (cont'd)

▪ The FSOC's recommendations for its member agencies:

1. Building capacity and expanding efforts to address climate-related financial risks.

- The FSOC established the CFRC on December 17, 2021. The CFRC will identify priority areas for assessing and mitigating climate-related risks to the financial system and serve as a coordinating body, where appropriate, to share information, facilitate the development of common approaches and standards, and facilitate communication across the FSOC members and interested parties.
- The FSOC will form a Climate-related Financial Risk Advisory Committee ("CFRAC"). The advisory committee, reporting to the CFRC, will help the FSOC gather information on and analysis of climate-related financial risks from a broad array of stakeholders.
- Prioritize internal investments to expand their respective capacities to define, identify, measure, monitor, assess and report on climate-related financial risks and their effects on financial stability, including investments in staffing, training, expertise, data, analytic and modeling methodologies and monitoring.
- Include descriptions of their activities related to climate-related financial risks in their annual reports and consider incorporating climate-related financial risks in relevant risk reports that they publish, as appropriate.
- Make climate-related data freely available to the public, as appropriate and subject to any applicable data confidentiality requirements
- Coordinate the analyses of climate-related financial risks conducted in the supervisory and regulatory functions of their agencies and organizations with efforts to understand impacts on communities and households. The FSOC members should integrate these analyses into the public reports discussed above and use the CFRC to share information regarding these efforts.
- Federal Insurance Office ("FIO") should act expeditiously to analyze the potential for climate change to affect insurance and reinsurance coverage, in a manner consistent with Executive Order 14030.
- Consistent with applicable mandates and authorities, evaluate climate-related impacts and the impacts of proposed policy solutions on financially vulnerable populations when assessing the impact of climate change on the economy and the financial system.
- The Treasury Department should engage other members of the Financial Literacy and Education Commission ("FLEC") to analyze and understand the impact of climate change on the financial well-being of financially vulnerable populations. The FSOC members that are also FLEC members should actively participate in this analysis.

Financial Stability Oversight Council's Report (cont'd)

2. Filling climate-related data and methodological gaps.

- Promptly identify and take the appropriate next steps towards ensuring consistent and reliable data to assist in assessing climate-related risks through:
 - identifying the data needed to evaluate the climate-related financial risk exposures of regulated entities and financial markets;
 - performing an internal inventory of currently collected and procured data and its relevance for climate risk assessments; and
 - developing a plan for procuring necessary data through data collection, data sharing arrangements and information purchased from data providers or other sources.
- Use existing authorities to implement appropriate data- and information-sharing arrangements to facilitate the sharing of climate-related data across the FSOC members and the non-FSOC member agencies to assess climate-related financial risk.
- The FSOC should work with its members through the CFRC to coordinate efforts, as appropriate, to address data gaps, including prioritizing data sets and coordinating data acquisition, in order to avoid duplication of effort and facilitate the improvement and coordinated use of data and models across the FSOC members.
- The Office of Financial Research, in coordination with the CFRC, should provide data services—including identifying, hosting, and procuring data—and analytical tools to facilitate members' assessment of climate-related financial risks, including scenario analysis.
- Move expeditiously to develop consistent data standards, definitions and relevant metrics, where possible and appropriate, to facilitate common definitions of climate-related data terms, sharing of data, and analysis and aggregation of data.
- Continue to coordinate with their international regulatory counterparts, bilaterally and through international bodies, as they identify and fill data gaps, address data issues and develop definitions, data standards, metrics and tools.

Financial Stability Oversight Council's Report (cont'd)

3. Enhancing public climate-related disclosures.

- Review existing public disclosure requirements and consider, as appropriate, updating them to promote the consistency, comparability and decision-usefulness of information on climate-related risks and opportunities, consistent with mandates and authorities.
- Consider enhancing public reporting requirements for climate-related risks in a manner that builds on the four core elements of the Task Force on Climate-Related Financial Disclosure, to the extent consistent with the U.S. regulatory framework and the needs of U.S. regulators and market participants.
- Evaluate standardizing data formats for public climate disclosures to promote comparability, such as the use of structured data using the same or complementary protocols, where appropriate and practicable.
- The FSOC understands that information on greenhouse gas (“GHG”) emissions promotes a better understanding of the exposures of companies and financial institutions to climate-related financial risks. The FSOC recommends that its members issuing requirements for climate-related disclosures consider whether such disclosures should include disclosure of GHG emissions, as appropriate and practicable, to help determine exposure to material climate-related financial risks.
- Continue to coordinate with their international regulatory counterparts, bilaterally and through international bodies, as they assess requirements for climate-related disclosures.
- The Securities and Exchange Commission (the “SEC”) staff are developing a proposal on disclosure requirements for public issuers related to climate-related risks for the SEC’s consideration. The FSOC is encouraged by the SEC’s work on this critical issue and supports its efforts to consider enhanced climate-related disclosures to provide investors with information that is consistent, comparable and decision-useful.
- Federal banking regulators, consistent with their mandates and authorities, should continue to review banks’ public regulatory reporting requirements to assess whether enhancements are needed to provide market participants with information on institutions’ climate-related financial risks, taking into account a bank’s size, complexity and activities.
- The FSOC supports continued efforts by FIO and insurance regulators to work together to enhance the existing climate-related disclosures for the insurance sector.
- The SEC staff are evaluating requirements for registered funds and investment advisers related to ESG factors, including ESG claims and related disclosures, for the SEC’s consideration. The FSOC is encouraged by the SEC’s work on this issue and supports its efforts in this area.
- The FSOC encourages its members to review their authorities to consider how disclosure of climate-related risks related to municipal securities can be enhanced.
- The FSOC welcomes the work of the International Financial Reporting Standards Foundation Trustees in laying the foundation for the formation of an international sustainability standards board to promote the development of sustainability reporting standards focused on enterprise value creation that could lead to consistent and comparable disclosures that can be used as building blocks across jurisdictions.

Financial Stability Oversight Council's Report (cont'd)

4. Assessing and mitigating climate-related risks that could threaten the stability of the financial system.

- Collaborate with external experts to identify climate forecasts, scenarios and other tools necessary to better understand the exposure of regulated entities to climate-related risks and how those risks translate into economic and financial impacts.
- Continue to coordinate with international regulatory counterparts, bilaterally and through international bodies, as they assess climate-related financial stability risks.
- Use scenario analysis, where appropriate, as a tool for assessing climate-related financial risks, taking into account supervisory and regulatory mandates and the size, complexity and activities of regulated entities.
- Consider using common scenarios that build on existing work, including scenarios developed by the Network of Central Banks and Supervisors for Greening the Financial System and work at the Financial Stability Board.
- To help inform interagency assessments of the systemwide effects of climate change, the CFRC should serve as a forum for the FSOC members to share data and methodologies and leverage the expertise needed to perform scenario analysis and share results.
- Continue efforts to consider the incorporation of climate-related risks into regulatory and supervisory programs and update those programs as necessary, consistent with mandates and authorities. As part of this work, members should review regulated entities' efforts to address climate-related risks and clarify or enhance risk management requirements for regulated entities where necessary to promote appropriate consideration of climate-related financial risks.
- Review existing regulations, guidance and regulatory reporting relevant to climate-related risks, including credit risks, market risks, counterparty risks and other financial and operational risks, to assess whether updates are necessary to appropriately address climate-related financial risks.
- Evaluate whether additional regulations or guidance specific to climate-related risks are necessary to clarify expectations for regulated or supervised institutions regarding management of climate risks, taking into account an institution's size, complexity, risk profile and existing enterprise risk management processes.
- Continue to coordinate with international regulatory and supervisory counterparts, bilaterally and through international bodies, as they review their regulatory and supervisory tools to mitigate climate-related financial risks.

The Current Regulatory Landscape

- **There are currently no final and binding U.S. federal legislative or regulatory mandates on banks specific to climate change.**
 - To the extent climate-related risks are material to a publicly traded bank's business, the SEC would require disclosure of such risks.
 - ESG in general (and climate in particular) have been an earlier priority of the SEC in the Biden administration and under Chair Gary Gensler. For example, climate disclosure rule-making is in process and proposed rules are expected in early 2022, and in September 2021 the SEC issued climate-related comment letters to a number of issuers to more vigorously enforce existing climate disclosure guidance.
 - In June 2021 at the Green Swan Conference, FRB Chair Powell noted that financial institutions and policymakers would benefit from consistent disclosure standards.
 - The OCC's principles that were released for public comment are the first step in the development of federal standards in the banking industry.
- **There have been recent state-level developments, most notably by the New York State Department of Financial Services ("NY DFS").**
- **On November 3, 2021, Acting Superintendent of Financial Services Adrienne A. Harris announced the creation of a new Climate Risk Division at the NY DFS. Dr. Yue Chen, NY DFS' inaugural Director of Sustainability and Climate Initiatives, will lead the new division as Executive Deputy Superintendent.**
 - The new Climate Risk Division will integrate climate risks into its supervision of regulated entities, support the industry's growth in managing climate risks, coordinate with international, national and state regulators, develop internal capacity on climate-related financial risks, support the capacity-building of peer regulators on climate-related supervision and ensure fair access to financial services for all communities.

"As one of the most critical issues of our generation, climate change poses wide-ranging and material risks to the financial system...This new division and Nina's appointment position [NY] DFS at the forefront of climate-related financial supervision, fulfilling [NY] DFS' mandate to ensure the safety and soundness of our regulated companies as they manage the financial risks from climate change, and support the roles of our institutions in advancing the low-carbon transition and enhancing communities' resilience."

Adrienne A. Harris
Acting Superintendent of Financial Services
NY DFS
November 3, 2021

The Current Regulatory Landscape (cont'd)

- **In October 2020, the NY DFS issued guidance that banks and other firms under its supervision are expected to:**
 - Designate board and senior management-level representatives to be accountable for the assessment and management of financial risks from climate change;
 - Conduct enterprise-wide risk assessments to evaluate climate change and its impacts on risk factors, such as credit risk, market risk, liquidity risk, operational risk, reputational risk and strategy risk;
 - Integrate the financial risks from climate change into their governance frameworks, risk management processes and business strategies; and
 - Begin to develop climate-related financial risk disclosures and consider engaging with the Task Force for Climate-Related Financial Disclosures.

International Activity

▪ **Basel Committee on Banking Supervision (BCBS)**

- The BCBS is the primary global standard-setter for the regulation of banks and provides a forum for regular cooperation on banking supervisory matters among its 45 members across 28 jurisdictions. U.S. membership includes the FRB, the Federal Reserve Bank of New York, the OCC and Federal Deposit Insurance Corporation.
- In February 2020, the BCBS established its Task Force on Climate-related Financial Risks, which is charged with contributing to the BCBS' mandate of enhancing global financial stability by identifying effective supervisory practices to mitigate climate-related financial risks.
- On November 16, 2021, the BCBS issued a consultation on "Principles for the effective management and supervision of climate-related financial risks". The comment period closes February 16, 2022.
 - Topics covered by the consultation include: corporate governance; internal control framework; capital and liquidity adequacy; risk management process; management monitoring and reporting; comprehensive management of credit risk; comprehensive management of market, liquidity, operational and other risks; and scenario analysis.
 - The consultation also discusses principles for the supervision of climate-related financial risks.

▪ **International Financial Reporting Standards (IFRS)**

- In November 2021, the IFRS announced the establishment of its International Sustainability Standards Board ("ISSB") to develop global standards to improve the consistency, comparability and reliability of sustainability reporting.
- The BCBS supports the ISSB and, in parallel with the ISSB's work, will explore using Pillar 3 of the Basel Framework (regulatory disclosure requirements) to promote such common disclosure baseline for climate-related financial risk across internationally active banks.

▪ **International Organization of Securities Commissions (IOSCO)**

- The IOSCO serves as the international standard-setting body for securities and futures market regulators and includes the SEC and the Commodity Futures Trading Commission as U.S. members.
- The IOSCO established a Sustainable Finance Task Force ("STF") in 2020 with a mandate to address transparency and promote investor protection in relation to sustainability issues. In particular, the STF has been focused on improving sustainability-related disclosures by issuers and asset managers and providing decision-useful information for investors.

International Activity (cont'd)

- **International Monetary Fund (IMF)**

- The IMF is working to include climate change in its macroeconomic and financial sector surveillance and to help members address the challenges of climate change. The IMF also publishes research on the economic and financial implications of climate change and provides policy guidance to members on mitigation, adaptation and the transition to a low-carbon economy.

- **Network of Central Banks and Supervisors for Greening the Financial System (NGFS)**

- The NGFS is a group of 95 member authorities from approximately 75 jurisdictions that, on a voluntary basis, exchange experiences, share best practices, contribute to the development of environment and climate risk management practices in the financial sector, and help mobilize mainstream finance to support the transition toward a sustainable economy. U.S. members are the FRB, OCC and NY DFS. The NGFS currently comprises five workstreams: Microprudential/Supervision, Macrofinancial, Scaling Up Green Finance, Bridging the Data Gaps and Research.

Other View Points

- **In a March 18, 2021 letter to FRB Chair Powell, Senator Patrick Toomey (R), along with several other Republican U.S. Senators, questioned the purpose and efficacy of climate-related banking regulation and scenario analysis, noting that the FRB “lacks jurisdiction over and expertise in environmental matters”.**
 - Furthermore, the Senators claimed that assessing banks against predictions of what the climate may look like decades in the future raises serious questions about the relative costs and benefits of climate-related banking regulation and that “this effort is not grounded in science or economics, but is instead a self-fulfilling prophecy: claim there are financial risks with energy exploration and other disfavored investments then use the levers of government—via the unelected bureaucracy—to ban or limit those activities”.

- **In a March 29, 2021 letter to the Federal Reserve Bank of San Francisco (FRB SF), Senator Toomey expressed concern about the FRB SF’s engagement in “politically-charged research” on ESG topics, including climate change, noting that “the Federal Reserve may pursue mission creep or welcome itself to political capture. But such activities are inconsistent with its statutory responsibilities”.**

- **On June 3, 2021 in a letter sent to the SEC, House Financial Services Committee Republicans claimed that in the context of climate change disclosures, the SEC was on “a course that will take it far afield of its statutory mission to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation” and concluded that the SEC’s willingness to engage in social debates such as climate change, “risks the credibility and independence that has made the SEC such an effective regulator since its creation”.**

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