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UPDATE: FDIC Issues Proposed Statement of Principles for Managing Exposure to Climate-Related Financial Risks

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On March 30, 2022, the Federal Deposit Insurance Corporation (the "FDIC") issued a notice regarding a proposed *Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions* (the "Principles"). The notice also requests comments from the public on the proposed Principles. The Principles are substantively similar to those issued by the Office of the Comptroller of the Currency on December 16, 2021. As proposed, the Principles would create a high-level framework for the safe and sound management of exposures to climate-related financial risks.

As currently proposed, the high-level framework would identify six (6) principles for ensuring banks develop an effective process for managing climate-related risks. Those six (6) principles are generally described below.

- Governance – Banks should be able to demonstrate an appropriate understanding of climate-related financial risk exposures and their impact on the bank's risk appetite. The FDIC notes that sound governance includes, among other things, reviewing information necessary to oversee the bank, allocating appropriate resources, assigning climate-related financial risk responsibilities throughout the bank (i.e., committees, reporting lines and roles), and clearly communicating to staff regarding climate-related impacts to the bank's risk profile.

- Policies, Procedures, and Limits – Banks would be expected to incorporate climate-related risks into policies, procedures and limits to provide detailed guidance on the bank's approach to these risks in line with the strategy and risk appetite set by the board.

- Strategic Planning – Banks would be expected to consider material climate-related financial risk exposures when setting the institution's overall business strategy, risk appetite, and financial, capital and operational plans. As part of forward-looking strategic planning, the board and management would be expected to address the potential impact of climate-related financial risk exposures on the bank's financial condition, operations (including geographic locations) and business objectives over various time horizons. In addition, consideration should also be given to climate-related financial risk impacts on stakeholders' expectations, the institution's reputation, and low- to moderate-income and other disadvantaged households and communities, including physical harm or access to bank products and services.

- Risk Management – Banks would be expected to oversee the development and implementation of processes to identify, measure, monitor, and control climate-related financial risk exposures within the institution's existing risk management framework. Banks should employ a comprehensive process to identify emerging and material risks stemming from the institution's business activities and associated exposures. The risk identification process should include input from stakeholders across the organization with relevant expertise (e.g., business units, independent risk management, and legal). Risk identification would include assessment of climate-related financial risks across a range of plausible scenarios and under various time horizons.

- Data, Risk Measurement and Reporting – In addition, a bank would be expected to incorporate climate-related financial risk information into the institution's internal reporting, monitoring, and escalation processes to facilitate timely and sound decision-making across the institution. Effective risk data aggregation and reporting capabilities allow management to capture and report material and emerging climate-related financial risk exposures, segmented or stratified by physical and transition risks, based upon the complexity and types of exposures. The FDIC notes that data, risk measurement, modeling methodologies, and reporting continue to evolve at a rapid pace, and that management should monitor these developments and incorporate them into their climate risk management as warranted.

- Scenario Analysis – A bank's management would also be expected to implement climate-related scenario analysis. "Climate-related scenario analysis" is defined as meaning exercises used to conduct a forward-looking assessment of the potential impact on an institution of changes in the economy, financial system or the distribution of physical hazards resulting from climate-related risks. These exercises differ from traditional stress testing exercises that typically assess the potential impacts of transitory shocks to near-term economic and financial conditions. An effective climate-related scenario analysis framework would provide a comprehensive and forward-looking perspective that banks could apply alongside existing risk management practices to evaluate the resiliency of a bank's strategy and risk management to the structural changes arising from climate-related risks.

In connection with the identification of the foregoing principles, the FDIC also indicated that banks should consider the following risk areas when evaluating their potential exposure to climate-related risks: (i) credit risk; (ii) liquidity risk; (iii) other financial risk; (iv) operational risk; (v) legal/compliance risk; and (vi) nonfinancial risk. The FDIC stated that it intends to issue additional guidance that will elaborate on these risk areas.

Although the Principles are targeted at the largest banks, i.e., those banks with over $100 billion in total consolidated assets, the FDIC notes that regardless of size, small banks may have material exposures to climate-related financial risks and banks are expected to implement effective risk management practices appropriate to the size of the bank and nature, scope and risk of its activities. The FDIC further notes that it would appropriately tailor any resulting supervisory expectations for smaller institutions to reflect the differences in such institutions' circumstances, such as complexity of operations and business models.

To read the proposed Principles, please click here.

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