



Banking agencies finalize principles for climate-related financial risk management

Initial perspectives and considerations for large banking organizations

On October 24, 2023, the federal bank regulatory agencies (the Board of Governors of the Federal Reserve System (FRB), the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC)) jointly finalized principles for climate-related financial risk management for large financial institutions. The principles are applicable for financial institutions with more than \$100 billion in total consolidated assets. This includes foreign banking organizations with combined United States operations of greater than \$100 billion, and any branch or agency of a foreign banking organization that individually has total assets of greater than \$100 billion.

5 insights you should know

Governance and management responsibilities: The final principles clarify the role of the board of directors in overseeing the financial institution’s risk-taking activities and the role of management in executing the strategic plan and risk management framework. They also accentuate the importance of incorporating physical and transition risks into their enterprise risk management (ERM) frameworks.

Risk materiality: The guidance states it is the responsibility of the board for considering material climate-related financial risk exposures when setting and monitoring the financial institution’s overall business strategy, risk appetite, and when overseeing management’s implementation of capital plans.

Scenario analysis: The principles ask that banks consider the potential changes in the economy and financial system, and the distribution of physical hazards resulting from climate-related financial risks. The results should be tailored to a bank’s size, complexity, business activity and profile, and communicated to the board and all relevant individuals.

Low-and-moderate-income (LMI) and other underserved consumers and communities: As part of strategic planning, the board is required to encourage management to consider the impact that the financial institution’s strategies to mitigate climate-related financial risks could have on LMI and other underserved communities and their access to financial products and services, consistent with the financial institution’s obligations under applicable consumer protection laws.

Data and risk measurement: Large banks should deploy effective risk data aggregation and reporting capabilities to capture and report material and emerging climate-related financial risks. Banks should also incorporate climate-related financial risk information into the bank’s internal reporting, monitoring, and escalation processes.

5 considerations to evaluate

- 1 **How should we incorporate climate into our risk governance framework?** Incorporating climate into the risk taxonomy is a good start towards risk identification, but it’s just the starting phase within the risk framework. Elements like modeling analysis and reporting need to follow. These require complex analytics, data and general understanding and ownership across the three lines of defense. This is a slow and laborious process. Changing the framework in paper is one thing, implementing will take time.
- 2 **How do we determine materiality?** Materiality is now a broad term, as companies use a double materiality framework to identify relevant sustainability topics, so the term and concept can be conflated with other priorities in internal conversations. Determining climate risk materiality can be subjective in itself, and will be linked to different timelines and scenarios the banks decide to use, and will need to be associated to corresponding physical or transition risks.
- 3 **How far can I go with my scenarios, considering climate change is a long-term issue?** Banks should incorporate a range of scenarios and analysis commensurate with their overall risk and complexity, as well as build out governance and data capabilities to regularly reevaluate existing models and incorporate new and emerging information.
- 4 **Does exposure to physical and transition risk mean divestment?** The principles suggests that a change in strategy should consider implications to disadvantaged communities. Even if it could be considered a financially sound decision, those communities may depend on the banking sector and can’t be left behind when they need it the most. This is the confluence between environmental (E) and social (S) pillars of environmental, social, and corporate governance.
- 5 **Can I implement the framework?** Creating the right taxonomy and reflecting physical and transition risk into other business risks is a good start, in theory. Does the institution have the data required to monitor risk in a credible way? That depends on the availability of that data, either now or in the future.

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¹ Board of Governors of the Federal Reserve System (FRB), Office of the Comptroller of the Currency “[Agencies issue principles for climate-related financial risk management for large financial institutions](#)”, Press Release, October 24, 2023.