



Building on the foundation of the CFTC’s seminal report on managing climate risks, the NYDFS becomes the first US regulator to set forth climate-related expectations for financial firms under its supervision.

On October 29, 2020, the New York State Department of Financial Services (“NYDFS”) issued a Climate Risk Industry Guidance letter outlining the agency’s expectations for New York-regulated financial institutions integrating climate-related financial risks into their governance frameworks, risk management processes, and business strategies.¹ The NYDFS issued similar guidance last month to New York-regulated insurers as the agency continues advancing a strategy for integrating climate-related risks into its supervisory mandate.²

NYDFS efforts reflect evolving US regulatory landscape on climate-related financial risks

Until recently, climate risk has received significantly more interest from financial institutions and regulators outside the US. Last year, the NYDFS became the first US financial regulator to join the Network of Central Banks and Supervisors for Greening the Financial System (“NGFS”), an international group of central banks and regulatory agencies developing plans to manage financial risks posed by climate change.³ More recently, the NYDFS hired its first Director of Sustainability and Climate Initiatives to engage the financial industry on climate-related financial risks and foster public-private partnerships.⁴

NYDFS operationalizes CFTC’s first-of-its-kind report on managing climate risk in the US financial system

The NYDFS letter comes on the heels of a report on managing climate risk in the US financial system published in September 2020

by the Climate-Related Market Risk Subcommittee of the Commodity Futures Trading Commission (CFTC).⁵ The report called for strengthening regulators’ capabilities, expertise, and data analytics to better monitor, analyze, and quantify risks.⁶ Additionally, the report authors found that existing legislation already provides US financial regulators with “wide-ranging and flexible authorities that could be used to start addressing financial climate-related risk now.”⁷

While the CFTC provided 53 recommendations in its first-of-a-kind report,⁸ the NYDFS with its industry letter becomes the first US financial regulator to call directly for financial institutions under its supervision to start taking climate risks into their risk and governance considerations. In a press release accompanying the letter, NYDFS Superintendent Linda Lacewell said that managing the risk posed by climate change “is critical for the safety and soundness of the financial services industry.”⁹

Given these recent developments, corporate boards and senior management should continue efforts to improve and integrate their climate risk management capabilities as well as encourage innovation and raise awareness at their firms in response to increasing regulatory interest in the US and globally.

What does the NYDFS letter mean for financial institutions?

The NYDFS supervises and regulates the activities of nearly 1,500 financial institutions, ranging from large banks, insurers, agencies of foreign banking organizations, credit unions, money transmitters, and virtual currency firms.¹⁰ Given the range of financial institutions

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under its supervision, the NYDFS recognizes that not all of these organizations “have the same level of resources to manage these risks.”¹¹ Accordingly, the NYDFS encourages each organization to “take a proportionate approach that reflects its exposure to the financial risks from climate change and the nature, scale, and complexity of its business.”¹² As a result, NYDFS has outlined its expectations for “regulated organizations” (e.g., banks)¹³ and “regulated non-depositaries” (e.g., money transmitters and virtual currency firms).¹⁴

NYDFS expectations for all regulated organizations¹⁵:

- Start integrating the financial risks from climate change into governance frameworks, risk management processes, and business strategies;
- Designate a board member, a committee of the board (or an equivalent function), as well as a senior management function, as accountable for the organization’s assessment and management of the financial risks from climate change;
- Conduct an enterprise-wide risk assessment 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;
- Start developing their approach to climate-related financial risk disclosure and consider engaging with the Task Force for Climate-related Financial Disclosures framework and other established initiatives.

NYDFS expectations for all regulated non-depositaries¹⁶:

- Conduct a risk assessment of the physical and transition risks of climate change, whether directly impacting them, or indirectly due to the disruptive consequences of climate change in the communities they serve and on their customers, such as business disruptions, out-migrations, loss of income and higher default rates, supply chain disruptions, and changes in investor and consumer sentiments, and start developing strategic plans, including an outline of such risks, the impact on their balance sheets, and steps to be taken to mitigate such risks.

What are the longer-term considerations for how this will impact the financial industry?

The ongoing COVID-19 pandemic has demonstrated that “preparation is key in addressing systemic risks” and that “by the time a crisis occurs, it is simply too late.”¹⁷ It is important that financial organizations, if they have not already begun, begin to plan for managing the financial risks from climate change, and the impact on their businesses as the frequency and intensity of extreme weather events continue to increase and affect the US financial system and the broader economy.

The NYDFS understands that an effective approach for managing such a complex and challenging issue will require a better understanding of the transmission channels of climate-related risks,

access to better climate data and analysis, developing climate-related scenarios and methodologies, and developing greater industry expertise.¹⁸

How should financial firms prepare themselves for what’s next?

In addition to continuing to monitor the US and global regulatory agendas, financial firms should consider immediate and tangible steps toward managing climate risk, including:

- Establishing clear governance and risk ownership, including board oversight, senior management responsibilities, and staff-level engagement.
- Incorporating climate risk into the enterprise risk management framework (e.g., risk taxonomies, training, and quantitative approaches).
- Conducting risk assessments of physical and transition risk impact and current climate risk mitigation and adaption strategies, activities, and reporting, including the role of internal audit and external assurance to enhance the quality and reliability of external disclosures.



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Closing

The NYDFS and other financial regulators understand that each financial institution is unique and will be affected by climate risks in various ways depending on its size, complexity, geographic distribution, etc. Therefore, there isn't a one size fits all approach for individual firms in addressing the complexity and challenging issues that climate changes pose. As a result, it will be important for each institution to take an approach that is in line with the "nature, scale, and complexity of its business" and reflects its exposure to climate-related financial risks.

Deloitte has been at the forefront of engaging with regulators and financial services firms on these important matters, including helping leaders think through innovative ways to strengthen data analysis

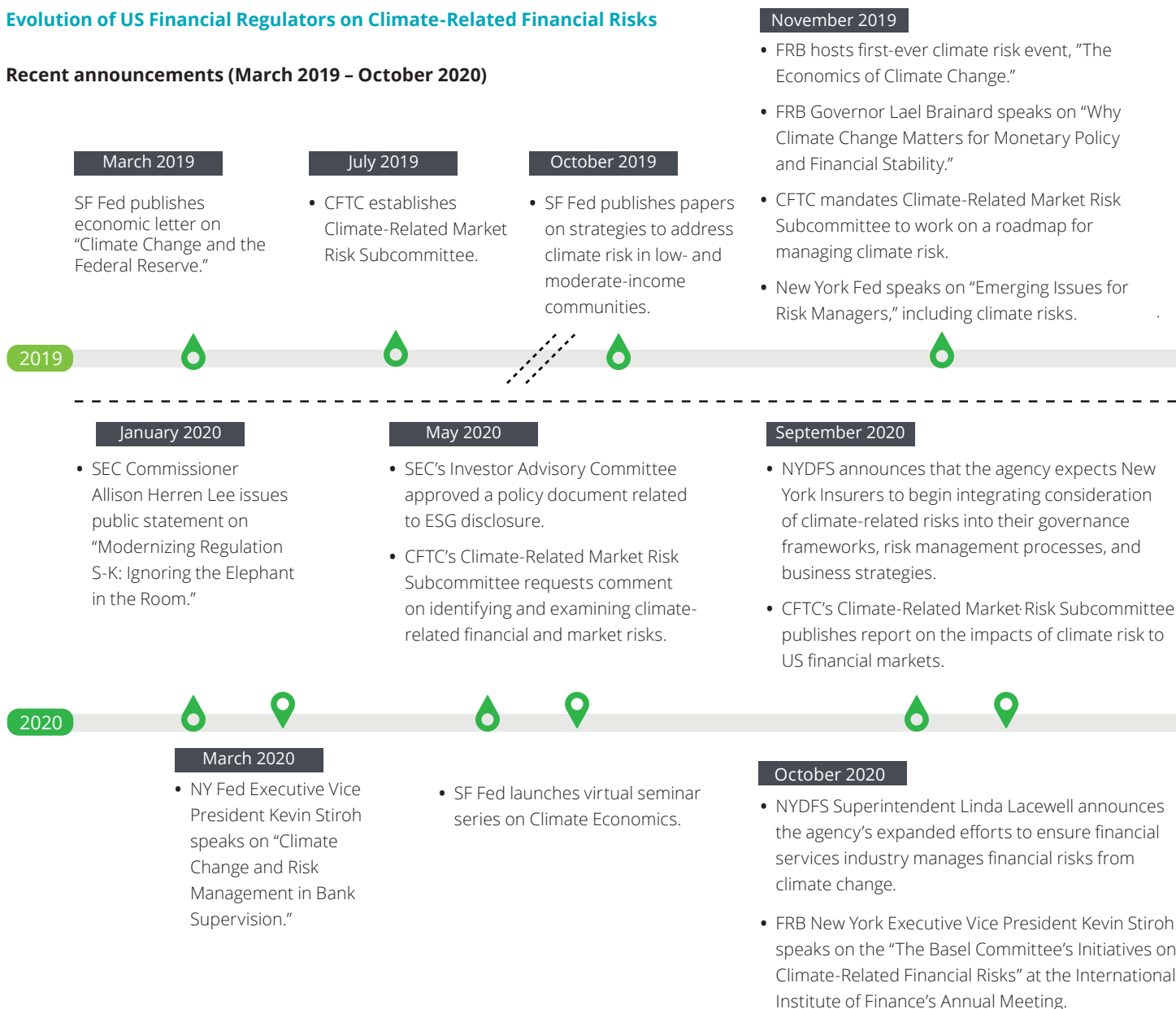
and effectively manage complex risks like those from climate risks.

With a wealth of knowledge on sustainability issues, Deloitte can advise on evolving and leading practices to turn climate risk management into a competitive advantage. Deloitte can also help with development and integration of climate risk considerations into the governance and risk management framework to more effectively identify financial and economic implications.

This is part of an ongoing series on how climate risks are shaping US financial regulatory initiatives and the impact these developments may have on the financial services industry and the broader economy.

Evolution of US Financial Regulators on Climate-Related Financial Risks

Recent announcements (March 2019 – October 2020)



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Endnotes

1. New York State Department of Financial Services (NYDFS), "Industry Letter to the Chief Executive Officers or the Equivalents of New York State Regulated Financial Institutions," assessed on October 29, 2020.
2. NYDFS, "During New York climate week, DFS Superintendent Linda A. Lacewell announces actions bolstering DFS's commitment to addressing climate-related financial risks," assessed on October 29, 2020.
3. NYDFS, "During climate week, DFS becomes first U.S. state banking regulator to join leading international coalition of bank supervisors dedicated to addressing climate change," assessed on October 29, 2020.
4. NYDFS, "Industry Letter to the Chief Executive Officers or the Equivalents of New York State Regulated Financial Institutions," assessed on October 29, 2020.
5. Commodity Futures Trading Commission (CFTC), "Managing Climate Risk in the US Financial System," assessed on September 9, 2020.
6. Ibid.
7. Ibid.
8. Deloitte, "In a first-of-its-kind report, a US financial regulator assesses the impacts of climate risk on financial markets, recognizing it as posing serious risk to the US financial system and anticipating meaningful change on the horizon," assessed on October 29, 2020.
9. NYDFS, "Superintendent Lacewell announces DFS expands efforts to ensure financial services industry manages financial risks from climate change," assessed on October 29, 2020.
10. NYDFS, "Industry Letter to the Chief Executive Officers or the Equivalents of New York State Regulated Financial Institutions," assessed on October 29, 2020.
11. Ibid.
12. Ibid.
13. Regulated Organizations includes New York regulated banking organizations, New York licensed branches, agencies of foreign banking organizations, New York regulated mortgage bankers and mortgage servicers, as well as New York regulated limited purpose trust companies (collectively, the "Regulated Organizations"). See NYDFS, "Industry Letter to the Chief Executive Officers or the Equivalents of New York State Regulated Financial Institutions," assessed on October 29, 2020.
14. Regulated Non-Depositories includes New York regulated non-depositaries (other than New York regulated mortgage bankers, mortgage servicers, and limited purpose trust companies), including New York regulated money transmitters, licensed lenders, sales finance companies, premium finance agencies, and virtual currency companies (collectively, the "Regulated Non-Depositories").
15. NYDFS, "Industry Letter to the Chief Executive Officers or the Equivalents of New York State Regulated Financial Institutions," assessed on October 29, 2020.
16. Ibid.
17. NYDFS, "Industry Letter to the Chief Executive Officers or the Equivalents of New York State Regulated Financial Institutions," assessed on October 29, 2020.
18. Ibid.



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