Issue 17:
December 2022

Creating a climate of change digest

Creating a climate of change digest: Climate risk regulatory developments in the financial services industry

The Federal Reserve Board (FRB) announced, through a press release on September 29, 2022, that six of the nation's largest systemically important banks will participate in a climate scenario analysis pilot in 2023.[1] This announcement followed a mention of the scenario analysis by the agency's Vice Chair of Supervision Michael S. Barr during remarks on September 7, 2022.[2] The announcement of the scenario analysis indicates the FRB's interest in the effective management of climate-related financial risks at large banking organizations despite the absence of draft guidance from the agency.

The press release communicated the FRB's intent to provide the climate scenarios consisting of "climate, economic, and financial variables" at the start of exercise.[3] In conjunction with the pilot, the subject banking organizations are expected to analyze the impact of the scenarios on specific portfolios and business strategies.

The FRB has drawn a bright line between the 2023 climate scenario analysis pilot and its supervisory capital stress tests, noting the following: (1) no firm-specific information will be published, and (2) the pilot will have no capital or supervisory implications.

Key insights gained from the pilot, especially those involving the use of scenario analysis to identify climate-related risk and promote climate-related risk management, will be published by the FRB. Other banking organizations will have access to the climate scenarios and the FRB's published insights to gauge their relative preparedness to assume climate-related risk management activities.

According to the press release, the pilot may inform future interagency guidance. The pilot may be considered a stepping-stone toward the development of a climate risk stress-testing framework.

On October 3, 2022, the Financial Stability Oversight Council (FSOC) established the Climate-related Financial Risk Advisory Committee (CFRAC)[4] in accordance with its plan to establish the CFRAC in its 2021 *Report on climate-related financial risk*.[5] The committee will report to FSOC's Climate-related Financial Risk Committee (CFRC) and will help the Council gather information on and analysis of climate-related financial risks from a broad array of stakeholders.

The recently published CFRAC charter lays down the purpose of the CFRAC as assisting the FSOC in gathering information on, conducting analysis of, and making recommendations to identify, assess, and mitigate climate-related risks to the financial system, consistent with the Council's purposes and duties under the Dodd-Frank Wall Street Reform and Consumer Protection Act.[6]

The CFRAC will consist of up to 30 members, of which the FSOC has selected and named 20 members and one government observer. The members' climate data and analytical expertise is expected to support regulators' efforts in the translation of climate-related risks into economic and financial impacts. Secretary of the Treasury Janet L. Yellen voiced that in establishing the CFRAC, the FSOC will leverage the expertise of those members outside of government and work collaboratively to improve their collective understanding of how climate change may impact the financial sector.[7]

The extended comment period for the Commodity Futures Trading Commission (CFTC) June 2, 2022, request for information (RFI) on Climate-Related Financial Risk closed on October 7, 2022.[8] As covered in a previous edition of the digest, the RFI asks 34 questions to inform the agency's supervisory and policy perspectives. As of mid-October, nearly 80 comment letters were received from a range of individuals and organizations.[9] Of note was the joint Securities Industry and Financial Markets Association (SIFMA) and Institute of International Bankers (IIB) letter[10] and the letter from the Bank Policy Institute (BPI).[11]

Both comment letters expressed support for the CFTC's work on and attention to climate-related financial risk. The letters place focus on the agency's need to coordinate policy development work with other financial regulators and ensure that requirements are consistent across regulators and more broadly across jurisdictions. The BPI letter makes specific reference to recent climate-related financial risk management developments at the FRB, Office of the Comptroller of the Currency (OCC), Federal Deposit Insurance Corporation (FDIC), and the Securities and Exchange Commission (SEC).

The letters point to interagency coordination with the expectation that it would help reduce the presence of "inconsistent and conflicting" requirements, which would be most impactful for participants subject to the oversight of multiple domestic regulators as well as those global participants. The letters also speak to the importance of eliminating duplicative requirements and reducing regulatory burden that may result from inconsistencies and lack of communication between regulators.

On October 13, 2022, the Task Force on Climate-related Financial Disclosures (TCFD) of the Financial Stability Board (FSB) published its fifth report communicating firms' progress to date in meeting outstanding TCFD disclosure recommendations.[12] Key findings for fiscal year 2021 reflect overall progress made in companies disclosing climate-related information. Approximately 80% of companies reviewed made at least one of the recommended disclosures, 40% made at least five, and 4% made all 11.[13] While the noted progress is promising, the report suggests that significant opportunities for improvement remain.

The TCFD's June 2017 report detailed 11 recommendations, grouped into four categories: governance, strategy, risk management, and metrics and targets.[14] These recommendations provide a basis for firms to incorporate climate-related financial disclosures into their current financial reporting procedures. Overall progress is measured using four distinct milestones applied over five years starting in 2017:[15]

1. Gradual increases in companies disclosing climate-related information in financial filings
2. Progressive shift in the perspectives of disclosure preparers and users toward the view that climate-related matters are typical business and investment considerations
3. Increased number of companies applying disclosure recommendations, and expanded types of information included in the disclosures
4. The development of more comprehensive disclosures over time, and improved pricing accuracy of climate-related matters

The 2022 report is based on a review of more than 15,000 reports from 1,434 companies, in eight industries, where artificial intelligence was used to assess the consistency of disclosure information with the TCFD's recommendations.[16] Specifically, public companies from the banking and insurance industries totaled 248 and 118, respectively, representing a collective 25.5% of the review population.

As of the 2022 report, several industries' average disclosure levels exceed 40% with insurance companies and banks both at 41% for fiscal year 2021 reporting. The Risks and Opportunities disclosure of the Strategy recommendation calls for "climate-related risks and opportunities the organization has identified over the short, medium, and long term."[17] This was most frequently disclosed by banking (64% of companies disclosing) and insurance companies (58% of companies disclosing). Conversely, the Resilience of Strategy disclosure of the Strategy recommendation was the least disclosed by banking (19%) and insurance (25%) companies. This disclosure asks companies to "describe the resilience of the organization's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario."[18] These results suggest that while banking and insurance companies have initiated the process of identifying and disclosing climate-related risks and their potential effects over varying time horizons, they have generally not come as far in terms of disclosing the results of scenario analyses.

From a global perspective and with 60% on average, Europe is ahead of Asia Pacific (36%), North America (29%), Latin America (28%), and Middle East and Africa (25%) regarding the 11 recommended disclosures.[19] Reporting on actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning is higher than any other recommended disclosure for Latin America, Middle East and Africa, and North America. Asia Pacific and Europe saw the highest disclosure percentages for climate-related metrics. Despite increases in disclosures, the report states that "urgent progress is necessary" to hit the targets set forth in 2017.[20]

The California Department of Insurance (CDI) commissioner is ready to enforce regulation requiring wildfire mitigation pricing discounts and consumer transparency. As wildfires continue to spread to more populated areas in the West with increasing frequency, a new pricing regulation addressing wildfire mitigation by policyholders went into effect October 14, 2022, and will be enforced by the CDI.[21]

CDI Commissioner Ricardo Lara announced that a new regulation he authored will direct insurance companies to provide discounts to consumers and businesses that take action to reduce the threat of wildfire on their properties by hardening their homes against smoke and embers and making retrofits, as necessary.[22] Insurers must submit new rate filings to the CDI that utilize the new wildfire standards and make sure they issue wildfire risk determinations to policyholders within 180 days so homeowners and businesses can see the results of their risk assessments.[23] The regulation is one of several under the CDI-created "Safer from Wildfires" framework.

Commissioner Lara has been actively trying to address climate change risk from wildfires in California—and nationally—and co-chairs a key committee on the subject at the National Association of Insurance Commissioners (NAIC). Commissioner Lara heard from consumers, who were unaware of their wildfire risk scores or felt that they could not challenge or appeal those scores by being proactive, and thus developed the regulations.[24]

The Federal Insurance Office (FIO) submitted a request for the proposed collection of historical and current homeowners' insurance underwriting data including claims, premiums, and losses in order to help it analyze the sector's climate-related exposures and how they affect availability and affordability for homeowners.[25]

The FIO, with the explicit backing of Treasury Secretary Janet Yellen, issued a press release on the intent to request approval from the Office of Management and Budget on October 18, 2022. The FIO plans to assess the data it gathers to determine the potential for major disruptions of private insurance coverage in areas vulnerable to climate change effects, in concern for consumers' ability to protect their homes through the insurance market. Treasury Secretary Yellen cited Hurricane Ian in her remarks accompanying the press release, saying the impacts in Florida from the deadly storm demonstrate the "critical nature of this work and the need for an increased understanding of insurance market vulnerabilities in the United States."[26] The FIO's notice opened the door to a 60-day comment period.

Specifically, the FIO is proposing to gather five years of underwriting data, 2017 through 2021 at a ZIP code level, from national insurers writing above a premium threshold of $100 million in homeowners' insurance premiums along with any additional insurers to be considered.[27] The goal is to reach an 80% market share threshold in each of 10 states that are potentially the most vulnerable to climate-related disasters. The FIO identified and ranked the following as the top 10 "Potential Climate-Vulnerable States," citing the Federal Emergency Management Agency and its own analysis.[28]

1. Texas
2. California
3. Florida
4. Louisiana
5. North Carolina
6. New Jersey
7. Missouri
8. Illinois
9. Iowa
10. Oklahoma

Additional Deloitte US perspective on climate risks

For additional insights, please see our 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:

- ***Centering around sustainability in financial services firms: Navigating risks, finding opportunities***
- ***Climate-related financial risk in banking: The state of play on capital requirements***
- ***Addressing the business ramifications of climate risk on banks***
- ***World of insurance climate disclosure: The potential impact of regulatory change***

Contacts

Kristen Sullivan
Audit & Assurance partner | Sustainability and ESG Services Leader
Deloitte & Touche LLP
ksullivan@deloitte.com

Ricardo Martinez
Principal | Deloitte Risk & Financial Advisory
Deloitte & Touche LLP
rimartinez@deloitte.com

David Sherwood
Managing director | Deloitte Risk & Financial Advisory
Deloitte & Touche LLP
dsherwood@deloitte.com

Ashley Renee Wells
Advisory analyst | Deloitte Risk & Financial Advisory
Deloitte & Touche LLP
aswells@deloitte.com

Deloitte Center for Regulatory Strategy

Irena Gecas-McCarthy
FSI director, Deloitte Center for Regulatory Strategy, Americas
Principal | Deloitte Risk & Financial Advisory
Deloitte & Touche LLP
igecasmccarthy@deloitte.com

Michele Jones
Senior manager | Deloitte Risk & Financial Advisory
Deloitte & Touche LLP
michelejones@deloitte.com

Meghan Burns
Manager | Deloitte Risk & Financial Advisory
Deloitte & Touche LLP
megburns@deloitte.com

Kyle Cooke
Senior regulatory analyst | Deloitte Risk & Financial Advisory
Deloitte & Touche LLP
kycooke@deloitte.com

Liz Festa
Senior regulatory analyst | Deloitte Risk & Financial Advisory
Deloitte & Touche LLP
lfesta@deloitte.com

Additional contributors

Sandhya Narayan
Solution manager | Deloitte Risk & Financial Advisory
Deloitte & Touche LLP
sanarayan@deloitte.com

Trupthi Gorur
Senior solution advisor | Deloitte Risk & Financial Advisory
Deloitte & Touche LLP
tgorur@deloitte.com

Priyanka Arora
Senior solution advisor | Deloitte Risk & Financial Advisory
Deloitte & Touche LLP
priyarora@deloitte.com

Shubhra Jain
Lead solution advisor | Deloitte Risk & Financial Advisory
Deloitte & Touche LLP
shubhrajain@deloitte.com

Endnotes

1. Board of Governors of the Federal Reserve System (FRB), "Federal Reserve Board announces that six of the nation's largest banks will participate in a pilot climate scenario analysis exercise designed to enhance the ability of supervisors and firms to measure and manage climate-related financial risks," press release, September 29, 2022.
2. FRB, Speech by Vice Chair for Supervision Michael S. Barr on making the financial system safer and fairer, September 7, 2022.
3. FRB, "Federal Reserve Board announces that six of the nation's largest banks will participate in a pilot climate scenario analysis exercise."
4. US Department of the Treasury (Treasury), "Financial Stability Oversight Council establishes new Climate-related Financial Risk Advisory Committee," press release, October 3, 2022.
5. Financial Stability Oversight Council (FSOC), *Report on climate-related financial risk 2021*, 2021.
6. FSOC, "Charter of the Climate-related Financial Risk Advisory Committee of the Financial Stability Oversight Council," October 3, 2022.
7. Treasury, "Financial Stability Oversight Council establishes new Climate-related Financial Risk Advisory Committee."
8. Commodity Futures Trading Commission (CFTC), "CFTC releases Request for Information on climate-related financial risk," press release, June 2, 2022; CFTC, "CFTC extends public comment period on Request for Information on climate-related financial risk," press release, July 18, 2022.
9. CFTC, Comments for Orders and Other Announcements 87 FR 34856 database, accessed October 14, 2022.
10. Securities Industry and Financial Markets Association (SIFMA), "Climate-Related Financial Risk," comment letter, October 7, 2022.
11. Bank Policy Institute (BPI), "CFTC comment," October 7, 2022.
12. Financial Stability Board (FSB), *Task Force on Climate-related Financial Disclosures: 2022 status report*, October 2022.
13. Ibid.
14. FSB, *Recommendations of the Task Force on Climate-related Financial Disclosures*, June 2017.
15. FSB, *2022 TCFD status report*.
16. Ibid.
17. Ibid.
18. Ibid.
19. Ibid.
20. Ibid.
21. State of California Office of Administrative Law, "Title 10, California Code of Regulations," notice of approval of regulatory action, October 14, 2022.
22. California Department of Insurance (CDI), "Commissioner Lara enforces nation's first wildfire safety regulation to help drive down cost of insurance," press release, October 17, 2022.
23. Ibid.
24. CDI, "Virtual homeowners' insurance investigatory hearing," accessed October 19, 2022.
25. Treasury, "Treasury's Federal Insurance Office takes important step to assess climate-related financial risk – seeks comment on proposed data call," press release, October 18, 2022.
26. Ibid.
27. Treasury, "Proposed Collection and Comment Request: Federal Insurance Office Climate-Related Financial Risk Data Collection," October 18, 2022.
28. Federal Emergency Management Agency, "National Risk Index," accessed October 18, 2022.

Deloitte.

CENTER *for* REGULATORY STRATEGY AMERICAS