Issue 12:
June 2022

Creating a climate of change digest

Creating a Climate of Change Digest: Climate risk regulatory developments in the financial services industry

Climate risk regulatory focus continues to show signs of acceleration as evidenced by the Federal Deposit Insurance Corporation's (FDIC) recent issuance of its Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions. The FDIC is now the second of the three prudential banking regulators to outline risk management principles focused on climate-related risk.

The FDIC's principles were issued for comment on March 30, 2022,[1] and follow the structure of the climate principles issued by the Office of the Comptroller of the Currency (OCC) in December 2021.[2]

Of note are several similarities between the two sets of principles such as their primary coverage areas and overall approach to the prudent risk management of climate-related financial risk. The principles consider the impact of both physical and transition risks on financial institutions and provide a draft framework to ensure the continuation of safe and sound operations.[3] While the principles recognize that climate-related risk exposures may be prevalent in a range of financial institutions notwithstanding asset size and sophistication, the principles are applicable to financial institutions with assets exceeding $100 billion.

The draft principles for both the FDIC and OCC address six general principles and the management of six risk areas.

The general principles are:[4]

- Governance
- Policies, procedures, and limits
- Strategic planning
- Risk management
- Data, risk measurement, and reporting
- Scenario analysis

The six risk areas covered in the principles are:

- Credit
- Liquidity
- Other financial
- Operational
- Legal/compliance
- Other nonfinancial

Below is the summary of the FDIC and OCC principles. The Principles for Climate-related Financial Risk from both the OCC and FDIC are identical, signaling that the agencies likely intend to coordinate closely throughout the development process.

OCC and FDIC themes	Principles for Climate-related Financial Risk[5]
Governance	**Responsibilities of the board** • Possessing adequate understanding and knowledge to assess the potential impact of climate-related risks on the bank and to address and oversee these risks. • Actively overseeing the bank's risk-taking activities and holding management accountable for adhering to the risk governance framework. **Responsibilities of management** • Executing the bank's overall strategic plan, which includes effectively managing all risks, including climate-related financial risks, and their effects on the bank's financial condition. • Regularly reporting to the board on the level and nature of risks to the bank, including climate-related.
Policy, procedures, and limits	**Responsibilities of management** • Incorporating 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. **Responsibilities of the board and management** • Modifying policies, procedures, and limits when necessary to reflect the distinctive characteristics of climate-related risks and changes to the bank's activities.

OCC and FDIC themes	Principles for Climate-related Financial Risk
Strategic planning	**Responsibilities of the board and management** • Considering material climate-related financial risk exposures when setting the bank's overall business strategy, risk appetite, and financial, capital, and operational plans over various time horizons. • Considering climate-related financial risk impacts on stakeholders' expectations, the bank's reputation, and low- and moderate-income (LMI) and other disadvantaged households and communities, including physical harm or access to bank products and services. • Aligning any climate-related strategies—including any relevant corporate social responsibility objectives—with and ensuring that they support the bank's broader strategy, risk appetite, and risk management framework. • Ensuring that any public statements about the bank's climate-related strategies and commitments are consistent with internal strategies and risk appetite statements.
Risk management	**Responsibilities of management** • Overseeing the development and implementation of processes to identify, measure, monitor, and control climate-related financial risk exposures within the bank's existing risk management framework. **Responsibilities of the board and management** • Obtaining input from stakeholders across the organization with relevant expertise (e.g., business units, independent risk management, and legal) for inclusion in risk identification processes. • Incorporating climate-related risks into the organization's internal control frameworks, including internal audit. • Developing processes to measure and monitor material climate-related financial risks and to inform management about the materiality of those risks.
Data, risk measurement, and reporting	**Responsibilities of management** • Deploying effective risk data aggregation and reporting capabilities 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. • Monitoring developments in climate risk measurement, and modeling and incorporating them into their climate risk management as warranted. • Incorporating climate-related financial risk information into the bank's internal reporting, monitoring, and escalation processes.
Scenario analysis	**Responsibilities of management** • Developing and implementing climate-related scenario analysis frameworks, which are commensurate to the bank's size, complexity, business, and risk profile. – The frameworks should include clearly defined objectives, which could include: – Exploring the impacts of climate-related risks on the bank's strategy and business model; – Identifying and measuring vulnerability to relevant climate-related risk factors including physical and transition risks; and, – Estimating climate-related exposures and potential losses across a range of plausible scenarios. **Responsibilities of the board and management** • Aligning the oversight, validation, and quality control standards of scenario analysis to the risk of the bank. • Communicating clearly and regularly to all relevant stakeholders within the bank.

OCC and FDIC themes	Principles for Climate-related Financial Risk
Management of risk areas	**Responsibilities of the board and management** • Considering climate-related financial risks as part of the underwriting and ongoing monitoring of portfolios for effective credit risk management. • Monitoring climate-related credit risks through sectoral, geographic, and single-name concentration analyses, including credit risk concentrations stemming from physical and transition risks. • Assessing whether climate-related financial risks could affect liquidity buffers and, if so, incorporating those risks into their liquidity risk management and liquidity buffers. • Monitoring interest rate risk and other model inputs for greater volatility or less predictability due to climate-related financial risks. • Monitoring how climate-related financial risks affect the bank's exposure to risk related to changing prices. **Responsibilities of the board and management** • Considering how climate-related financial risk exposures may adversely impact a bank's operations, control environment, operational resilience, business continuity, and evolving legal and regulatory landscape. • Considering possible fair lending concerns and possible changes to legal requirements for, or underwriting considerations related to, flood or disaster-related insurance. • Considering the extent to which the bank's activities may increase the risk of negative financial impact from reputational damage, liability, or litigation, and implementing adequate measures to account for these risks, where material.

The FDIC is requesting feedback on 14 questions spread over six topics (applicability, tailoring, general, current risk management practices, data/disclosures/reporting, and scenario analysis). The FDIC's questions are reflective of the 13 questions that the OCC posed, except for Question 4 and Question 10.

Feedback request comparison[6]

FDIC		OCC	
Question	**Content**	**Question**	**Content**
4	Would regulations or guidelines prescribing particular risk management practices be helpful to financial institutions as they adjust to doing business in a changing climate?	N/A	**The OCC did not ask a comparable question.**
10	How do financial institutions currently consider the impacts of climate-related financial risk mitigation strategies and financial products on households and communities, specifically LMI and other disadvantaged communities? **Should the agencies modify existing regulations and guidance, such as those associated with the Community Reinvestment Act, to address the impact climate-related financial risks may have on LMI and other disadvantaged communities?**	9	How do banks currently consider the impacts of climate-related financial risk mitigation strategies and financial products on households and communities, specifically LMI and other disadvantaged communities?

Specifically, the OCC's principles did not include a question covering the need for climate-related regulations or guidelines as reflected in the FDIC's Question 4. With this question, the FDIC appears to be seeking a better understanding of the need for detailed requirements or leading practices to foster a more standardized and consistent approach to climate-related risk management practices across financial institutions. The FDIC's Question 10 partially mirrors the OCC's Question 9, adding a secondary inquiry into the need for regulatory change to address potential disproportionate impacts due to income-related disparities.

Key takeaways

- Large banks supervised by the FDIC are expected to assign dedicated resources to the implementation of the climate risk management framework and the execution of climate-related requirements.
- The FDIC will follow these principles with more detailed guidance. Banks have an opportunity to provide comments on the principles that may help to inform the final guidance.
- The Principles for Climate-related Financial Risk from both OCC and FDIC are identical. The agencies likely intend to coordinate closely throughout the development process.
- As climate-related regulatory developments are made, firms with multiple regulators will need to ensure a comprehensive understanding of each regulator's requirements aligning their respective climate-related risk management frameworks with applicable regulatory requirements.

The Executive Committee of the National Association of Insurance Commissioners (NAIC) recently approved revisions to the regulator's existing annual climate risk survey to better align with requirements outlined by the Task Force on Climate-related Financial Disclosures (TCFD). Insurers generally complete the survey annually and on a voluntary basis, where survey results provide a sense of insurers' evaluation and control of climate-related risk. Insurers are expected to provide survey responses to the extent possible and with the understanding that those responses will not be confidentially held. As of 2021, the District of Columbia and 14 states,[7] representing market coverage of approximately 80%, required certain insurers to submit the survey annually.[8] The increased level of survey participation since 2010 has enhanced the level of visibility into climate-related risk management in the insurance sector.

The survey sets out to accomplish six specific goals:[9]

1. **Enhance transparency** about how insurers manage climate-related risks and opportunities.
2. **Identify good practices and vulnerabilities.**
3. **Provide a baseline supervisory tool** to assess how climate-related risks may affect the insurance industry.
4. **Promote insurer strategic management** and encourage shared learning for continual improvement.
5. **Enable better-informed collaboration and engagement** on climate-related issues among regulators and interested parties.
6. **Align with international climate risk disclosure frameworks** to reduce redundancy in reporting requirements.

The survey comprises both long- and short-answer questions spanning four thematic areas of interest outlined by the TCFD: governance, strategy, risk management, and metrics and targets. Insurers are encouraged to provide responses for those long-answer questions tied directly to the TCFD framework and consider including information for the short-answer supplemental questions. The TCFD's core elements of recommended climate-related financial disclosures include:[10]

- **Governance**
  - Disclose governance around climate-related risks and opportunities including the board's oversight and management's role in assessing and managing the climate-related risks and opportunities.
- **Strategy**
  - Disclose the actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning, when material.
  - Describe the climate-related risks and opportunities and the impact of them on the organization's businesses, strategy, and financial planning, and the resilience of the strategy considering different climate-related scenarios.
- **Risk management**
  - Consider the disclosure of the metrics and targets used to assess and manage relevant, material climate-related risks and opportunities.
- **Metrics and targets**
  - Disclose the metrics used in line with strategy and risk management processes.
  - Disclose Scope 1, Scope 2, and if appropriate Scope 3 greenhouse gas (GHG) emissions and related risks.
  - Describe targets used by the insurer and performance against targets.

The TCFD recommends an insurer provide climate-related financial disclosures in their public annual financial filings. For strategy and metrics and targets recommendation disclosures, the TCFD recommends providing the information in annual filings when the information is material. Applicable materiality standards are set forth in the *NAIC Financial Condition Examiners Handbook* or the *U.S. Securities and Exchange Commissioner Accounting Bulletin: No. 99.*[11] Disclosures related to governance and risk management reporting must be disclosed regardless of materiality.

Submission deadlines for the 2022 and 2023 reporting years are November 30 and August 31, respectively, with the possibility to request an extension. Those insurers filing their initial survey will follow deadlines for the 2023 reporting year. While the more complex, quantitative disclosure expectations may not have a set deadline at this time, insurers are encouraged to begin implementing all expectations as soon as possible.

Key takeaways

- Although previously voluntary, most insurers are now required to complete the annual NAIC climate risk disclosure survey by November 30, 2022.
- An insurer licensed but not domiciled in one of the 15 states/jurisdictions must also complete the survey by November 30, 2022. However, the survey deadline in years after 2022 is August 31.
- The goal of the NAIC enacting the survey is to have a broad and unified approach to protecting consumers and promoting transparency in the insurance industry.

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***
- ***Building a more sustainable insurance industry***

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

Austin Tuell
Sustainability & ESG manager | Deloitte Risk & Financial Advisory
Deloitte & Touche LLP
atuell@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

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

Endnotes

1. Federal Deposit Insurance Corporation (FDIC), "FDIC Issues Request for Comment on Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions," press release, March 30, 2022.
2. Office of the Comptroller of the Currency (OCC), "Risk Management: Principles for Climate-Related Financial Risk Management for Large Banks; Request for Feedback," OCC Bulletin 2021-62, December 16, 2021.
3. The FDIC's principles defined physical risks as, "the harm to people and property arising from acute, climate-related events, such as hurricanes, wildfires, floods, and heatwaves, and chronic shifts in climate, including higher average temperatures, changes in precipitation patterns, sea level rise, and ocean acidification." Transition risks are defined as, "stresses to certain financial institutions or sectors arising from the shifts in policy, consumer and business sentiment, or technologies associated with the changes necessary to limit climate change." Federal Register, vol. 87, no. 64, April 4, 2022.
4. FDIC, "FDIC Issues Request for Comment on Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions," press release, March 30, 2022; OCC, "Risk Management: Principles for Climate-Related Financial Risk Management for Large Banks; Request for Feedback," OCC Bulletin 2021-62, December 16, 2021.
5. Ibid.
6. Ibid.
7. Participating states include California, Connecticut, Delaware, District of Columbia, Maine, Maryland, Massachusetts, Minnesota, New Mexico, New York, Oregon, Pennsylvania, Rhode Island, Vermont, and Washington. National Association of Insurance Commissioners (NAIC), *2022 Spring National Meeting Materials, Kansas City, Missouri*, April 6, 2022.
8. This market coverage estimate is based on direct premium written. NAIC, *2022 Spring National Meeting Materials,* Kansas City, Missouri, April 6, 2022.
9. NAIC, *2022 Spring National Meeting Materials,* Kansas City, Missouri, April 6, 2022.
10. Ibid.
11. Ibid.

CENTER *for*
REGULATORY
STRATEGY
AMERICAS