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FDIC Requests Comment on Proposed Framework for Managing Climate-Related Risk

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On March 30, 2022, the Federal Deposit Insurance Corporation ("FDIC") requested comment on draft principles "that would provide a high-level framework for the safe and sound management of exposures to climate-related financial risks." These draft principles, which are "targeted at the largest financial institutions" (*i.e.*, over $100 billion in total consolidated assets), "are intended to support efforts by financial institutions to focus on the key aspects of climate risk management." The principles reflect the FDIC's view that the "effects of climate change and the transition to a low carbon economy present emerging economic and financial risks that threaten the safety and soundness of financial institutions and the stability of the financial system."

In order to address these risks, which the FDIC recognizes comprise both physical risk (*i.e.*, harm to people and property from acute climate events or chronic climate changes) and transition risk (*i.e.*, challenges or opportunities associated with the transition to a low carbon economy), the FDIC seeks comment on principles (certain of which are set forth below) in the following broad areas:

- Governance: "A financial institution's board and management should demonstrate an appropriate understanding of climate-related financial risk exposures and their impact on risk appetite to facilitate oversight." The release emphasizes the board's need to have adequate understanding and knowledge to assess and address the potential impact of climate-related risks.

- Policies, Procedures and Limits: “Management should incorporate climate-related risks into policies, procedures and limits to provide detailed guidance on the institution’s approach to these risks, in line with the strategy and risk appetite set by the board.”

- Strategic Planning: “The board and management should consider material climate-related financial risk exposures when setting the institution’s overall strategy, risk appetite and financial, capital and operational plans.” Among others, the board and management should consider potential climate-related impacts on low to moderate income and other disadvantaged households and communities, stakeholders’ expectations, and the institution’s reputation.

- Risk Management: “Management should oversee the development and implementation of processes to identify, measure, monitor and control climate-related financial risk exposures.” These could include heat maps, climate risk dashboards and scenario analysis.

- Data, Risk Measurement and Reporting: The release observes that “effective risk data aggregation and reporting capabilities” are important in order for boards and management to assess and address climate-related risk, and that this area “continue[s] to evolve at a rapid pace.”

- Scenario Analysis: The release recognizes the importance of scenario analysis (*i.e.*, forward-looking assessments of the potential impacts of climate-related risks under various sets of assumptions and time horizons) for “identifying, measuring and managing climate-related risks.” The release cautions that climate-related scenario analysis “should be subject to oversight, validation, and quality control standards that would be commensurate to their risk.”

The FDIC stated that it “plans to elaborate” on these principles in subsequent guidance that “would distinguish roles and responsibilities of boards of directors (boards) and management” and incorporate “feedback received on the draft principles.”

The FDIC is just the latest financial regulator to weigh in on the obligations of regulated entities in terms of addressing climate change. Other significant statements include the Securities and Exchange Commission’s Proposed Rules to Enhance and Standardize Climate-Related Disclosures for Investors; the Financial Stability Oversight Council’s Report and Recommendations on Climate-Related Financial Risk; the Commodity Futures Trading Commission’s Managing Climate Risk in the U.S. Financial System; and the Office of the Comptroller of the Currency’s Principles for Climate-Related Financial Risk Management for Large Banks.