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OCC Seeks Public Feedback on Principles for Climate-Related Financial Risk Management for Large Banks

SUMMARY

On December 16, 2021, the Office of the Comptroller of the Currency (OCC) released draft Principles designed to provide large OCC-regulated institutions—national banks, federal savings associations and federal branches or agencies of foreign banking organizations (collectively referred to as “banks”) with over $100 billion in total consolidated assets—with a high-level framework for the safe and sound management of exposures to climate-related financial risks consistent with existing OCC rules and guidance.[1] In particular, the OCC identified the physical effects of climate change and the transition to a low-carbon economy as emerging risks to banks’ safety and soundness, as well as that of the overall financial system, with potentially disproportionate impacts on the financially vulnerable, such as low- and moderate-income and otherwise disadvantaged communities and individuals. The OCC Principles outline six key aspects of climate-related financial risk management: governance; policies, procedures and limits; strategic planning; risk management; data, risk measurement and reporting; and scenario analysis. In addition, the Principles offer risk assessment principles for incorporating climate-related financial risks in various traditional risk categories. The OCC is soliciting public feedback on the Principles to inform additional guidance on climate-related financial risks.

GENERAL PRINCIPLES

The general principles address the following six key aspects of managing climate-related financial risks—consisting of both physical risks and transition risks[2]—with a focus on the OCC’s expectations of the roles and responsibilities of bank boards and management:

- **Governance:** Board and management should have an appropriate understanding of the bank’s climate-related financial risk exposures and their impact on risk appetite to facilitate oversight.

- **Policies, Procedures and Limits:** Management should incorporate climate-related risks into bank policies, procedures and limits that align with the strategy and risk appetite established by the board.
- **Strategic Planning:** Board and management should consider material climate-related financial risk exposures as part of the bank's strategic planning, including the bank's overall business strategy, risk appetite, and financial, capital and operational plans.
- **Risk Management:** Management should oversee 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. Board and management should also incorporate climate-related risks into their internal control frameworks, including internal audit.
- **Data, Risk Measurement and Reporting:** To facilitate timely and sound decision-making across the bank, management should incorporate climate-related financial risk information into the bank's internal reporting, monitoring and escalation processes.
- **Scenario Analysis:** Management should develop and implement climate-related scenario analysis[3] frameworks in a manner commensurate with the bank's size, complexity, business activity and risk profile.

The OCC recognizes that the incorporation of climate-related financial risks into various risk management frameworks and planning processes is an iterative process and that a bank's data, risk measurement, modeling methodologies and reporting will continue to evolve over time, and suggests that management should monitor these developments and incorporate them into their climate risk management process as appropriate. The OCC plans to elaborate on these principles in subsequent guidance that will continue to distinguish roles and responsibilities of boards and management.

RISK ASSESSMENT PRINCIPLES

The Principles suggest that, as part of a sound risk governance framework, boards and management should consider and incorporate climate-related financial risks when identifying and mitigating all types of risk. The Principles describe how climate-related financial risks can be addressed in the following risk categories:

- credit risk (*e.g.*, considering climate-related financial risks as part of the underwriting and ongoing monitoring of portfolios);
- liquidity risk (*e.g.*, assessing whether climate-related financial risks could affect liquidity buffers);
- other financial risk (*e.g.*, monitoring interest rate risk and other model inputs for greater volatility or less predictability due to climate-related financial risks);
- operational risk (*e.g.*, considering how climate-related financial risks may adversely impact a bank's operations, control environment, operational resilience and business continuity);
- legal and compliance risk (*e.g.*, considering the legal and regulatory implications arising from climate-related financial risks and risk mitigation measures, including in connection with flood or disaster-related insurance and fair lending considerations); and
- other nonfinancial risk (*e.g.*, considering climate-related reputational damage, liability or litigation).

The OCC intends to elaborate on these risk assessment principles in subsequent guidance.

REQUEST FOR FEEDBACK

The OCC is seeking feedback on all aspects of the Principles, along with 13 specific questions. Key considerations for the OCC as illustrated by the questions include:

- **Applicability and Tailoring:** The OCC is seeking feedback on whether there are additional categories of banks to which the Principles should apply and how future guidance could help banks develop climate-related financial risk management practices commensurate with their circumstances.
- **Current Risk Management Practices:** The OCC is seeking feedback on banks' current climate-related financial risk management practices, including any specific tools and strategies that banks use to incorporate climate-related financial risks into their risk management frameworks; how banks determine the materiality of climate-related financial risks; any specific products, practices, and strategies banks use to hedge, transfer or mitigate climate-related financial risks; any climate-related financial products or services that banks offer to clients and the risks associated with these products and services; and how banks consider the impacts of climate-related financial risk mitigation strategies on low- to moderate-income and other disadvantaged communities.
- **Data, Disclosures and Reporting:** The OCC is seeking feedback on any specific climate-related data, metrics, tools and models that banks need from third parties (*e.g.*, customers and other counterparties) to address their own climate-related financial risks; how banks currently obtain this information and whether there are any gaps and concerns; and how regulatory reporting requirements could better capture banks' exposure to climate-related financial risks.
- **Scenario Analysis:** The OCC is seeking feedback on how banks use climate scenario models, analysis or tools, and related challenges and on the most salient factors for the OCC to consider when designing and executing scenario analysis.

NEXT STEPS

The OCC is seeking feedback on all aspects of the Principles by February 14, 2022. The specific questions included for public feedback highlight the breadth and depth of the OCC's ongoing considerations of climate-related financial risks to banks and the financial system and the complexity of the issues involved. The OCC has indicated that it will consider feedback received as well as lessons learned and best practices from the industry and other jurisdictions in connection with developing future guidance on climate-related financial risks, and that any resulting supervisory expectations would be appropriately tailored to reflect differences in banks' circumstances. In addition, Acting Comptroller of the Currency Michael J. Hsu said that "[the OCC] look[s] forward to . . . working with [its] interagency peers to develop more detailed guidance next year."[4]

It is likely that banking organizations will continue to receive additional regulatory guidance and requirements in 2022, including, for banking organizations that are public companies, disclosure requirements promulgated by the Securities and Exchange Commission.

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ENDNOTES

1 "Principles for Climate-Related Financial Risk Management for Large Banks" (Dec. 16, 2021), *available at* https://www.occ.gov/news-issuances/news-releases/2021/nr-occ-2021-138a.pdf.

2 The term "physical risks" refers to "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." The term "transition risks" refers to "stresses to certain banks or sectors arising from the shifts in policy, consumer and business sentiment, or technologies associated with the changes necessary to limit climate change." Principles, at 1.

3 In the Principles, "climate-related scenario analysis" refers to "exercises used to conduct a forward-looking assessment of the potential impact on a bank of changes in the economy, financial system, or the distribution of physical hazards resulting from climate-related risks." Principles, at 4.

4 "OCC Seeks Feedback on Principles for Climate-Related Financial Risk Management for Large Banks," OCC News Release 2021-138 (Dec. 16, 2021), *available at* https://www.occ.gov/news-issuances/news-releases/2021/nr-occ-2021-138.html.

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