April 28, 2023

Submitted Via Electronic Mail

New York State Department of Financial Services
One State Street, 20th Floor
New York, NY 10004

Re: Proposed Guidance for New York State Regulated Banking and Mortgage Organizations Relating to Management of Material Financial Risks from Climate Change

Ladies and Gentlemen:

The Bank Policy Institute[1] appreciates the opportunity to comment on the proposed guidance by the New York State Department of Financial Services relating to material financial risks from climate change.[2]

BPI supports the DFS's efforts to develop and articulate principles-based guidance for climate-related financial risk management, which can be helpful to both "Regulated Organizations"[3] and supervisors as they work to promote sound practices by Regulated Organizations to identify and manage the possible manifestations of physical- and transition-related risks of climate change on their business and operations.[4] Our members are actively evaluating climate-related financial risks and their potential

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1 The Bank Policy Institute is a nonpartisan public policy, research and advocacy group, representing the nation's leading banks and their customers. Our members include universal banks, regional banks and the major foreign banks doing business in the United States. Collectively, they employ almost 2 million Americans, make nearly half of the nation's small business loans, and are an engine for financial innovation and economic growth.

2 DFS, Proposed Guidance for New York State Regulated Banking and Mortgage Organizations Relating to Management of Material Financial Risks from Climate Change (Dec. 2022), https://www.dfs.ny.gov/system/files/documents/2022/12/dfs_proposed_guidance_banking_mortgage_climate_change_202212.pdf.

3 The Proposal applies to "Regulated Organizations," which consist of New York state-regulated banking organizations, New York state-licensed branches and agencies of foreign banking organizations ("FBOs"), and New York state-regulated mortgage bankers and mortgage servicers.

4 For purposes of our comments, the terms "climate-related financial risk," "physical risk," and "transition risk" have the meanings as outlined in the Financial Stability Oversight Council's ("FSOC") Report on Climate-Related Financial Risk (Oct. 21, 2021), https://home.treasury.gov/system/files/261/FSOC-Climate-

impacts, and are devoting substantial resources to developing risk management capabilities to identify, measure, and mitigate these risks.

I. Executive Summary

Given BPI member banks' experience in this space, we believe six overarching principles should guide the DFS in finalizing its climate-related financial risk guidance. These principles and associated recommendations are summarized below:

- The principles-based nature of the Proposal appropriately reflects the diversity of climate-related financial risks to which Regulated Organizations may be exposed and the need for flexibility in the design and implementation of risk management approaches in this area.
    - The final guidance should reflect that there is significant variability of potential climate-related financial risk outcomes over longer time horizons.
    - The final guidance's Policies, Procedures, and Limits section should retain the flexible approach in the Proposal and acknowledge it would be premature at this time to require banks to establish and apply quantitative limits or thresholds for climate-related financial risk.
    - The final guidance's Corporate Governance and Data Aggregation and Reporting sections should permit appropriate flexibility in the design of reporting.
- The Proposal appropriately acknowledges that Regulated Organizations' approach to managing climate-related financial risk should be proportionate and fundamentally risk-based, such that individual Regulated Organizations may tailor their risk management programs to the risks presented and calibrate that program to the risks identified.
    - The final guidance should clarify that for purposes of the management of climate-related financial risks, individual Regulated Organizations will need to define "material" in the context of their individual circumstances and risk appetite framework.
    - The Proposal appropriately acknowledges that a Regulated Organization that is part of a group may leverage group-level policies, procedures, and processes for managing climate-related financial risks if certain conditions are met.
    - With respect to FBOs that have U.S. operations subject to the DFS's supervision, the final guidance should better reflect how FBOs operate and manage risks in the United States and acknowledge that such FBOs may be subject to home country

Report.pdf; and Basel Committee on Banking Supervision, *Climate-related risk drivers and their transmission channels* (April 2021), https://www.bis.org/bcbs/publ/d517.pdf.

requirements related to risk management and control and information sharing.

- The final guidance's Risk Management Process section should acknowledge that an appropriate, risk-based approach may lead individual Regulated Organizations to focus on different aspects of their portfolios.

- The final guidance's Scenario Analysis section should acknowledge that Regulated Organizations have the flexibility to conduct scenario analyses at appropriate, risk-based intervals.

➢ The final guidance and its underlying expectations should reflect the fact that data and tools to measure and quantify climate-related financial risk remain nascent and not fully developed.

- The final guidance should acknowledge that, in the near term, climate-related financial risk metrics and reporting may be more qualitative in nature.

- The final guidance's Risk Management Process and Data Aggregation and Reporting sections should reflect the nascent state of relevant data.

- The final guidance's Scenario Analysis section should reflect the relative immaturity of underlying data and methodologies.

➢ The final guidance should acknowledge that it may be appropriate and beneficial for Regulated Organizations to support customers through their respective low-carbon transition plans.

- The final guidance should not suggest that Regulated Organizations mitigate credit risk by establishing and managing to prescriptive lending limits.

- Although we believe that Regulated Organizations have an important role to play in addressing the impact of climate-related financial risks on financially vulnerable communities, it would be inappropriate for the DFS to impose supervisory expectations that require Regulated Organizations to minimize and affirmatively mitigate adverse impacts of climate-related financial risks on these communities without further clarification.

➢ We support the DFS's recognition of the distinction between climate scenario analysis and regulatory stress testing.

➢ We urge the DFS to coordinate with domestic regulators and international bodies to ensure consistent supervisory expectations with respect to climate-related financial risk management, including coordinating with the federal banking agencies with respect to a reasonable and consistent timeline for implementation of their respective guidance on climate-related

financial risk management.

II. The principles-based nature of the Proposal appropriately reflects the diversity of climate-related financial risks to which Regulated Organizations may be exposed and the need for flexibility in the design and implementation of risk management approaches in this area.

We strongly support the principles-based nature of the Proposal, which appropriately reflects that climate-related financial risks may vary significantly across Regulated Organizations and that there is likely to be considerable diversity in the specific risk management tools and approaches that individual Regulated Organizations deploy, particularly as efforts to identify and measure climate-related financial risks remain relatively nascent. We also support the Proposal's acknowledgement that climate-related financial risk management processes may be incorporated into a Regulated Organization's existing risk management framework.[5]

We encourage the DFS to retain this overall approach in the final guidance, and to avoid the types of prescriptive or detailed mandates that are likely to hinder Regulated Organizations' abilities to explore, test, refine, and adapt how they manage climate-related financial risks over both the short and long term. For example, it is important that Regulated Organizations have sufficient flexibility to develop and adapt their internal risk taxonomies, to make decisions about how to incorporate climate-related financial risks organizationally within their existing risk management framework, and to determine the relative materiality of climate-related financial risk exposures to the Regulated Organization's financial condition. To that end, our comments identify a number of specific areas where maintaining this principles-based approach is particularly important to provide Regulated Organizations with appropriate flexibility.

A. The final guidance should reflect that there is significant variability of potential climate-related financial risk outcomes over longer time horizons.

First, the Proposal's Corporate Governance section notes that the board of directors should consider the relevant time horizons for materialization of climate-related financial risks and that some risks may stretch beyond the Regulated Organization's traditional capital or strategic planning horizon.[6] While this attention to longer-term time horizons is relevant in the context of climate change, it is important that the final guidance acknowledge that there is significant variability and uncertainty of potential outcomes over longer time horizons. As a result, any expectation that the board of directors develop an understanding of future impacts should take account of this variability and uncertainty. In addition, the DFS's expectations relating to longer-term strategic planning should allow for appropriate, risk-based flexibility to account for the significant variability of outcomes over multi-decade time periods. There is significant complexity and unpredictability over these longer time horizons due to, among other things, the high number of scientific, macroeconomic, financial, and other variables that can vary and must be taken into account when assessing climate-related financial risk. The DFS's supervisory expectations should be calibrated to the usefulness of strategic planning over a given time period and recognize that substantial uncertainty exists with respect to the impacts of climate-related financial risk over medium- and longer-term time horizons. In addition, while a longer strategic planning horizon may be appropriate in the context of climate-related financial risk, it is important that such expectations not be carried over to other strategic planning exercises and processes, particularly those relating to capital and liquidity, for which

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[5] Proposal, Section I, ¶7.

[6] Proposal, Section IV.A.(ii), ¶30.

typical planning horizons have been and remain effective.

Second, the Proposal's Scenario Analysis section notes that Regulated Organizations should consider using a range of climate scenarios over different time horizons in their scenario analyses.[7] Given the significant variability of outcomes over longer time horizons, supervisory expectations with respect to longer-term scenario analyses should allow for appropriate flexibility in approaches to developing and leveraging these analyses. Similarly, it would be useful for the DFS to acknowledge that relatively more resources and effort may be applied to shorter-term scenario analysis—where plausibility and degree of certainty is higher and therefore potentially more relevant for risk and business decision-making—and less to longer-term scenario analysis.

B. The final guidance's Policies, Procedures, and Limits section should retain the flexible approach in the Proposal and acknowledge it would be premature at this time to require Regulated Organizations to establish and apply quantitative limits or thresholds for climate-related financial risk.

The Proposal provides that management of material climate-related financial risks should be embedded in policies and procedures and controls across all relevant functions and business units of the Regulated Organizations, in line with the strategy and risk appetite set by the boards of directors, and that policies, procedures, and limits should be modified when necessary to reflect the distinctive nature of climate-related financial risks.[8] While this portion of the Proposal does not prescribe how Regulated Organizations should organize and implement these policies, procedures, and limits, any final guidance should be clear that the use of quantitative limits and thresholds for climate-related financial risk as a risk management tool is likely to be premature for many Regulated Organizations at this time.[9] Rather, Regulated Organizations should be permitted to initially use their directional analysis to develop and inform their risk appetite and risk management frameworks prior to assessing whether any limits and thresholds would be appropriate.[10]

C. The final guidance's Corporate Governance and Data Aggregation and Reporting sections should permit appropriate flexibility in the design of reporting.

The Proposal's Corporate Governance section states that senior management should be responsible for regularly reporting to the board of directors on the level and nature of material climate-related financial risks.[11] In addition, the Proposal's Data Aggregation and Reporting section provides that Regulated Organizations should develop risk data aggregation capabilities and risk reporting practices that

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7 Proposal, Section IV.E, ¶57.

8 Proposal, Section IV.A.(iii), ¶32.

9 In addition, requiring lending limits would not be appropriate at this time, as some Regulated Organizations already consider climate-related financial risks, particularly physical risks, in their credit underwriting processes as appropriate, and such limits could have unintended consequences on bank lending and access to credit.

10 This recognition is particularly important because Regulated Organizations may be developing their respective approaches to climate-related financial risk management in a phased manner with multiple dependencies. For example, Regulated Organizations may have established different prioritizations and timelines for data collection and standardization or scenario analysis.

11 Proposal, Section IV.A.(ii), ¶31.

are capable of monitoring material climate-related financial risk and producing timely information to facilitate board of directors and senior management decision-making.[12] This description could be interpreted to suggest that climate-related financial risk should be reported on as a standalone category of risk.

Climate risk is a transversal risk that may manifest in any one or more of the risk types that Regulated Organizations have traditionally managed on a dedicated basis, such as credit, market, liquidity, operational, and legal/compliance risk. The final guidance on governance and reporting therefore should be flexible and recognize that climate-driven risks may be incorporated into and addressed through a Regulated Organization's existing risk management governance program if the Regulated Organization determines that this is the most effective means of risk management. The final guidance should make clear that it does not introduce a supervisory expectation that Regulated Organizations create new, bespoke governance structures and reporting regimes for climate-related financial risk as a standalone matter, as this would limit Regulated Organizations' flexibility to integrate climate-related financial risk into existing risk management approaches and would effectively create a new risk type.

In response to the Proposal's Question 3, we also do not believe that a new type of regulatory or other external reporting specifically directed at climate-related financial risk by Regulated Organizations is appropriate or necessary at the present time. Many Regulated Organizations are already engaged in voluntary reporting efforts through the Task Force on Climate-Related Financial Disclosures, as well as other industry-led reporting frameworks.

III. The Proposal appropriately acknowledges that Regulated Organizations' approach to managing climate-related financial risk should be proportionate and fundamentally risk-based, such that individual Regulated Organizations may tailor their risk management programs to the risks presented and calibrate that program to the risks identified.

We strongly support the proportionate approach adopted by the Proposal.[13] The Proposal appropriately recognizes that each Regulated Organization should manage its material climate-related financial risks in a manner proportionate to the nature, scale, and complexity of its businesses.[14] This not only means that supervisory expectations should be tailored to the *circumstances of each institution*—including with respect to its size, business model, and client portfolio—but also that Regulated Organizations should develop and deploy various capabilities to the extent proportionate with the *risk management utility and effectiveness* of those capabilities, which may vary considerably. For example, supervisory expectations with respect to the scope and extent of data or scenario analysis capabilities should reflect the utility of those capabilities as a risk management matter, which is likely to evolve considerably over time. The final guidance should retain this proportionate, risk-based approach, as described further below.

[12] Proposal, Section IV.D, ¶54.

[13] Proposal, Section III.B.

[14] Proposal, Section IV, ¶23.

A. The final guidance should clarify that for purposes of the management of climate-related financial risks, individual Regulated Organizations will need to define "material" in the context of their individual circumstances and risk appetite framework.

The Proposal states that it is intended to address "material" financial risks related to climate change faced by Regulated Organizations in the context of risk assessment, risk management, and risk appetite setting.[15] We suggest that the DFS clarify in the final guidance that the meaning of "material" for purposes of the management of climate-related financial risks is distinct from materiality in the context of securities laws and it is for the individual Regulated Organization to determine what is material in the context of its risk appetite and framework. For example, some important components of how Regulated Organizations may assess materiality for risk management could be the plausibility and certainty of risk (i.e., there will be potential risks that will be so speculative or distant as not to be material). This may be important for the DFS to recognize, as in practice supervisors may insist on deeming remote and uncertain outcomes driven by climate change as "material" in ways they would not for more traditional outcomes.[16]

B. The Proposal appropriately acknowledges that a Regulated Organization that is part of a group may leverage group-level policies, procedures, and processes for managing climate-related financial risks if certain conditions are met.

We support the Proposal's recognition that a Regulated Organization that is part of a group of affiliated entities or a holding/parent company structure may leverage the policies, procedures, and processes developed at the group level for managing climate-related financial risks if the conditions specified in the Proposal are met.[17] It would be untenable and counterproductive for the group of which a Regulated Organization is a part to be expected to manage climate-related financial risks one way at the Regulated Organization level and another at the holding company level, or one way in the United States and another abroad. The final guidance should continue to adopt the Proposal's approach, which appropriately recognizes that effective management of climate-related financial risks is often a global, enterprise-wide endeavor that is routinely developed and coordinated at the group level.

C. With respect to FBOs that have U.S. operations subject to the DFS's supervision, the final guidance should better reflect how FBOs operate and manage risks in the United States and acknowledge that such FBOs may be subject to home country requirements related to risk management and control and information sharing.

The Proposal states that if an FBO performs risk management and control functions outside the United States, such functions, policies and procedures, and information systems should be sufficiently transparent to allow U.S. supervisors to assess their adequacy for the branch or agency in relation to the FBO's climate-related financial risks.[18] We support the DFS's recognition that a FBO may perform its risk

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15 Proposal, Section I, ¶6.

16 It will also be important for the DFS to recognize that Regulated Organizations may not be in a position to evaluate the plausibility and certainty of the risk—and therefore make materiality determinations—at this time due to underlying data challenges. Relevant data must first be generated, translated, validated, analyzed, and weighted before materiality can be determined. As discussed in Section IV.A below, Regulated Organizations generally are in the early stages of this process.

17 Proposal, Section III.B, ¶21.

18 Proposal, Section III.B, ¶22.

management and control functions at the head office level. However, it is important for the DFS to recognize, and we recommend that the final guidance acknowledge, that an FBO's head office level risk management and control functions and systems are necessarily subject to home country requirements and that an FBO may also be subject to home country requirements related to information sharing.

D. The final guidance's Risk Management Process section should acknowledge that an appropriate, risk-based approach may lead individual Regulated Organizations to focus on different aspects of their portfolios.

The final guidance should recognize that it may be appropriate for Regulated Organizations, given their individual circumstances, to focus initially on developing data capabilities and reporting on sectors, components of certain value chains, or other parts of their portfolios that they deem may be more likely to be subject to material climate-related financial risks (e.g., portfolios subject to heightened physical risks or higher emissions sectors subject to heightened transition risks).[19] Conversely, the final guidance should permit Regulated Organizations to determine that certain sectors or types of climate-related financial risks represent sufficiently *de minimis* risk that related reporting may not be useful or necessary.

E. The final guidance's Scenario Analysis section should acknowledge that Regulated Organizations have the flexibility to conduct scenario analyses at appropriate, risk-based intervals.

The Proposal's Scenario Analysis section notes that the development and implementation of climate scenario analysis should be commensurate with a Regulated Organization's size, complexity, business activity, and risk profile.[20] Consistent with this proposed guidance, Regulated Organizations should have the discretion to conduct scenario analysis at intervals that are appropriate to their size, business activity, and other factors, as appropriate. In addition, where the final guidance applies to Regulated Organizations that are branches, agencies or subsidiaries of FBOs, those Regulated Organizations should be given flexibility either to rely on the application of scenario analysis at the group level, or to apply the scenario analysis developed elsewhere within their groups to their relevant U.S. operations.

IV. The final guidance and its underlying expectations should reflect the fact that data and tools to measure and quantify climate-related financial risk remain nascent and not fully developed.

The DFS's final guidance should reflect the evolving nature and understanding of climate-related financial risks and the fact that existing data and tools to measure and quantify climate-related financial risk—and in particular, longer-term physical and transition risks—are only just emerging, and will need to undergo substantial exploration, refinement, and adaptation over time. Although data capabilities are improving, significant gaps in data sourcing, capture, standardization, and aggregation substantially affect the accuracy of projections and risk assessment.[21] Given these challenges, the DFS should give Regulated

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[19] The banking sector, private sector generally, and regulatory agencies are developing data capabilities as well, and the ability of individual Regulated Organizations to develop data capabilities in many ways depends on these larger efforts.

[20] Proposal, Section IV.E, ¶57.

[21] Climate-related data provided by borrowers and counterparties is often limited and not consistent or comparable. For example, while property, asset, and supply chain data are available for larger public clients,

Organizations due flexibility to develop, adopt, implement, and refine both (i) data capabilities and methodologies and (ii) quantitative risk management tools that depend on that data, such as risk limits, risk appetites, or scenario analysis. For this same reason, we also believe that it is important that any final guidance acknowledge and affirm that, in many cases, Regulated Organizations may need to rely on qualitative assessments and judgments about climate-related financial risks, particularly in the near term while more sophisticated and standardized data and measurement tools are being developed.

A. The final guidance should acknowledge that, in the near term, climate-related financial risk metrics and reporting may be more qualitative in nature.

Data gaps currently prevent Regulated Organizations from being able to develop the kind of precise metrics that are conducive to developing quantitative thresholds, limits, and KPIs and KRIs to generate, analyze, and validate the kind of data needed to support those metrics. Accordingly, it is important for the final guidance to recognize that policies, procedures, and any limits as they relate to climate-related financial risk, as well as reporting, initially may be more qualitative in nature and may rely less on standardized metrics, limits, and thresholds. The final guidance should acknowledge that the development of a comprehensive risk identification process based on quantitative metrics may appropriately pass through an extended transition state that is short of the mature approach identified in the Proposal and may be useful only for limited purposes in the short-term.

B. The final guidance's Risk Management Process and Data Aggregation and Reporting sections should reflect the nascent state of relevant data.

Given data gaps and the evolution of climate and risk transmission models, Regulated Organizations are generally in the data collection and risk identification and measurement stage and therefore it will be premature in many instances to integrate climate-related financial risk into medium- and longer-term strategic planning.[22] For example, an expectation that Regulated Organizations further incorporate climate-related financial risk into their capital and liquidity planning processes at this time would be inappropriate in light of the need for further maturation of the relevant quantitative tools.[23] At this time, given these challenges, scenario analysis should be considered an exploratory exercise that enables firms to identify key areas of the business model that could be impacted by climate risk (both transition and physical) events. As the Basel Committee on Banking Supervision recently determined, there is limited research and accompanying data that explore how climate-related financial risks feed into the traditional risks faced by banks.[24] The final guidance should establish an expectation that Regulated

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there are gaps when assessing smaller and privately held clients or those in less carbon-intensive sectors. Further, and importantly, we note that emissions data may not necessarily be indicative of risk.

[22] We also note that the integration of climate-related financial risk management into strategic planning is distinct from the integration of public commitments with respect to emissions or other environmental goals into strategic planning.

[23] Moreover, to the extent that Regulated Organizations are expected to incorporate climate-related financial risk into their capital planning process, it is critical that the capital planning framework maintains its existing parameters, especially as relates to time horizon, plausibility, and expected and unexpected losses. Regulated Organizations already incorporate short-term, evolving physical risk into capital planning, as is appropriate given the purpose and goals of capital planning.

[24] Basel Committee on Banking Supervision, Climate-related risk drivers and their transmission channels (April 2021), https://www.bis.org/bcbs/publ/d517.pdf.

Organizations integrate climate-related financial risk into strategic planning only to the extent that the underlying data and methodologies are sufficiently developed and tested, and further should acknowledge that Regulated Organizations may employ qualitative approaches in the near term while data and methodologies remain under development.

C. The final guidance's Scenario Analysis section should reflect the relative immaturity of underlying data and methodologies.

Banks are actively engaged in developing scenario analysis capabilities,[25] and any final guidance should recognize the exploratory nature of scenario analysis given the data gaps and the fact that models and methodologies are evolving. For example, even the internationally established reference scenarios have developed granularity only for a subset of sectors. The final guidance should permit Regulated Organizations to leverage the results of scenario analysis in a manner commensurate with the maturity of the underlying data and methodologies. Further, given that this work is in the early stages, Regulated Organizations should have sufficient flexibility to develop and implement scenario analysis and related data capabilities over time.

V. The final guidance should acknowledge that it may be appropriate and beneficial for Regulated Organizations to support customers through their respective low-carbon transition plans.

It is crucial that the final guidance acknowledge and affirm that it is appropriate—and indeed, in many cases desirable—for Regulated Organizations to support and serve customer needs over the course of any climate-driven economic transition. This recognition is not only important to ensuring an effective and orderly transition to a carbon-neutral economy, but it is also to be encouraged as a matter of safety and soundness, as giving Regulated Organizations the flexibility to support customers through that transition is likely to produce better outcomes for the Regulated Organizations in both the short and long run.

A. The final guidance should not suggest that Regulated Organizations mitigate credit risk by establishing and managing to prescriptive lending limits.

The Proposal states that Regulated Organizations should consider climate-related financial risks that exist or may arise in their underwriting and ongoing portfolio monitoring practices and encourages Regulated Organizations to continue extending credit in a manner consistent with their risk management frameworks.[26] Some banks already consider climate-related financial risks, particularly physical risks such as flooding, fire, and other severe weather-related risks, in their credit underwriting processes as appropriate, and banks are continuing to explore the impact of physical and transition risks on credit decisions as analytical approaches evolve and the climate data environment expands. It should also be noted that banks may already impose limits or certain thresholds for industrial or geographic sectors based on a variety of risk factors and it is not clear that any climate-related risk for such sectors would in any way alter or replace existing risk limits or thresholds; significantly more analysis is needed to make such assessments.

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[25] For example, many banks are onboarding sophisticated acute physical risk models to quantify asset and exposure impacts under more severe physical risk scenarios (e.g., RCP8.5).

[26] Proposal, Section IV.C.(v).(a), ¶46.

As described above, however, the final guidance should clarify that the DFS does not expect Regulated Organizations to mitigate credit risk by establishing and managing to prescriptive limits on lending to certain sectors or otherwise. Such an expectation could have unintended consequences on bank lending and access to credit. The final guidance should recognize that Regulated Organizations are supporting these clients' transition to a low-carbon economy across a necessarily long-term horizon, and managing any climate-related financial risks of doing so within the construct of their internal risk appetite and management frameworks. It also would be helpful if the final guidance recognized that the integration of climate-related financial risk into the credit granting and monitoring process is nascent and will improve as climate-related financial risk measurement techniques mature.

B. Although we believe that Regulated Organizations have an important role to play in addressing the impact of climate-related financial risks on financially vulnerable communities, it would be inappropriate for the DFS to impose supervisory expectations that require Regulated Organizations to minimize and affirmatively mitigate adverse impacts of climate-related financial risks on these communities without further clarification.

We agree with the Proposal's statement that many low- and moderate-income communities and communities of color (collectively, "financially vulnerable communities") could be harmed disproportionately by climate change.[27] We believe that Regulated Organizations have an important role to play in supporting these communities in response to increased climate risks. We also believe that partnership with the government is crucial to this effort. We recommend that regulators work with the industry to analyze impacts on financially vulnerable communities and how they can be best addressed in accordance with existing banking laws and regulations. For example, the DFS's Industry Letter on CRA Consideration for Activities that Contribute to Climate Mitigation and Adaption provides helpful examples of financing activities supporting climate resiliency that may qualify for credit under the New York State Community Reinvestment Act ("CRA").[28] As climate science and climate-related financial risk management practices evolve, the DFS should consider supplementing and clarifying its guidance on which types of activities designed to improve the climate resilience of financially vulnerable communities, for both individual properties and large-scale community projects, would be eligible for CRA credit. Further, given the importance of housing to CRA plans and the complexity of risk pricing and insurance impacts that may affect long-term value and wealth preservation in impacted communities, it is essential for the DFS to consult and coordinate with federal and state housing agencies, the federal banking agencies (i.e., the Board of Governors of the Federal Reserve System ("FRB"), the Office of the Comptroller of the Currency ("OCC"), and the Federal Deposit Insurance Corporation ("FDIC")), and the Consumer Financial Protection Bureau to ensure transition externalities are addressed in a manner that balances safety, soundness, and fairness. Policy responses to the issue of climate-related financial risk could also be advanced through coordination with the federal and state housing agencies and government-sponsored enterprises to improve other relevant federal and state programs, such as flood insurance.

With that said, we note that the Proposal also states that the DFS expects Regulated Organizations to "minimize and affirmatively mitigate adverse impacts" on financially vulnerable communities while

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27 Proposal, Section III.A, ¶18.

28 *See* DFS, Industry Letter: CRA Consideration for Activities that Contribute to Climate Mitigation and Adaptation (February 9, 2021), https://www.dfs.ny.gov/industry_guidance/industry_letters/il20210209_cra_consideration.

managing climate-related financial risks to address safety and soundness concerns.[29] Although the Proposal does not further elaborate on this statement, we are deeply concerned by any suggestion that Regulated Organizations are subject to an affirmative obligation to minimize and mitigate the adverse impact of climate change on financially vulnerable communities, and we believe that it would be inappropriate for the DFS to impose such supervisory expectations on Regulated Organizations without further clarification. Given the vague and ambiguous nature of the statement, it is unclear whether it is intended to refer to Regulated Organizations' obligations to comply with fair lending laws and other applicable consumer protection laws, regulations, and guidance, as discussed in more detail in Section III.A., ¶19 of the Proposal, or it is intended to create a new regulatory expectation that applies more generally. While of course all banks make risk management and other business decisions with a fundamental emphasis on the impact of those decisions on their ability to meet the needs and convenience of their customers and communities, the introduction of a sweeping regulatory expectation that a Regulated Organization must discharge an affirmative obligation to minimize and mitigate the adverse impact of climate change on financially vulnerable communities while implementing its climate-related financial risk management practices could undermine safety and soundness. In practice, it could require Regulated Organizations to sacrifice the effectiveness of their own risk management for the sake of minimizing and mitigating any adverse impact that such risk management practices may have on financial vulnerable communities. For all of these reasons, we urge the DFS to strike the last sentence from Section III.A, ¶18 of the Proposal. We believe Section III.A., ¶19 of the Proposal is already sufficiently clear as to the DFS's expectations that Regulated Organizations must manage climate-related financial risks prudently while continuing to comply with their existing obligations under applicable laws, including fair lending laws and other applicable consumer protection laws, regulations, and guidance.

VI. We support the DFS's recognition of the distinction between climate scenario analysis and regulatory stress testing.

The Proposal notes that the relevant objectives, assumptions, time horizons, and possible responses of climate scenario analyses would typically be different from those applicable in traditional stress testing exercises, and that climate scenario analyses may not be well suited to assess the potential impacts of transitory shocks to near-term economic and financial conditions or to factor into an organization's regulatory capital requirements.[30] We strongly support the DFS's recognition of this distinction.[31]

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[29] *Id*.

[30] Proposal, Section IV.E, ¶56.

[31] The FSOC report on climate-related financial risk likewise distinguished scenario analysis from stress testing, noting that the former is "exploratory in nature" while the latter is linked to regulatory requirements such as loss-absorbing capital. FSOC Report on Climate-Related Financial Risk (Oct. 21, 2021), 90, https://home.treasury.gov/system/files/261/FSOC-Climate-Report.pdf. Similarly, the federal banking agencies' proposed principles for climate-related financial risk management for large financial institutions also recognize the distinction between climate scenario analysis and regulatory stress tests. *See* FRB, *Principles for Climate-Related Financial Risk Management for Large Financial Institutions*, 87 Fed. Reg. 75267 (Dec. 8, 2022); FDIC, *Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions*, 87 Fed. Reg. 19507 (Apr. 4, 2022); and OCC, *Principles for Climate-Related Financial Risk Management for Large Banks* (Dec. 16, 2021), https://www.occ.treas.gov/news-issuances/news-releases/2021/nr-occ-2021-138a.pdf.

As background, banks are investing in talent, data, and technology to build robust climate scenario modeling and analytical capabilities across all lines of business and risk types and running exercises across different parts of their portfolios to assess a range of plausible climate change outcomes. Scenario analysis frameworks are generally based on selecting discrete points along a spectrum of potential future global temperatures—leveraging output from organizations such as the International Energy Agency ("IEA"), Network for Greening the Financial System ("NGFS"), and Intergovernmental Panel on Climate Change ("IPCC")—which represent baseline, strategic, and stress scenarios. Publicly available climate scenarios do not provide banks with the appropriate sectoral and regional granularity, however, to directly translate scenario output into readily consumable inputs for internal risk modeling. For banks, the value of climate scenario analysis can only be fully realized when the science-based or macroeconomic output (e.g., global oil price or oil demand from the transportation sector) is expanded into more granular financial impacts (e.g., electric vehicle vs. internal combustion engine sales volume or lithium demand from elective vehicle battery producers) that can be applied across a diverse set of client industries and sub-sectors. There is also a limited understanding of the Integrated Assessment Models that drive these scenarios, which makes it more challenging for banks and vendors alike to expand scenario output while staying within the bounds of the model.

Given the significant work that is already underway within banks, as described above, and the extensive work that has already taken place through the IEA, NGFS, and IPCC – as well as other jurisdictions – we would recommend the DFS not develop its own bespoke scenarios for banks to use in scenario analysis at this point in time.[32] It may be helpful, however, for the DFS to provide guidance as to which of these or other external scenarios might be useful for Regulated Organizations to use as they build out their capabilities, and for the DFS to affirm that Regulated Organizations have the flexibility to make appropriate judgments on the implementation of these scenarios. It will also be important that the DFS coordinates with the federal banking agencies on any efforts being undertaken to develop climate scenarios and modeling capabilities. Notably, it is important that any expectations with regard to specific scenarios for integration into risk management frameworks focus on severe but plausible scenarios and not exaggerated scenarios that unrealistically frontload physical and transition risks.

VII. We urge the DFS to coordinate with domestic regulators and international bodies to ensure consistent supervisory expectations with respect to climate-related financial risk management, including coordinating with the federal banking agencies with respect to a reasonable and consistent timeline for implementation of their respective guidance on climate-related financial risk management.

The Proposal appropriately recognizes that the effects of climate-related financial risk drivers extend beyond individual organizations to the broader financial system and the economy and that the DFS will need to continue to coordinate with its state, federal, and international counterparts on climate-related financial supervision.[33] In particular, BPI urges the DFS to coordinate closely with the federal banking agencies, the Basel Committee on Banking Supervision, the Financial Stability Board, and other international regulatory colleagues to help ensure that supervisory expectations for the management of

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[32] As an example, the FRB did not develop its own climate scenarios but leveraged existing work conducted by the IPCC and the NGFS in prescribing specific climate scenarios used in its pilot climate scenario analysis exercise. *See* FRB, Pilot Climate Scenario Analysis Exercise, Participant Instructions (January 2023), https://www.federalreserve.gov/publications/files/csa-instructions-20230117.pdf.

[33] Proposal, Section I, ¶10.

climate-related financial risk, including with respect to scenario analysis, are consistent within the United States and coordinated internationally. Such consistency and coordination will be crucial to avoid the potential for duplicative or conflicting requirements imposed on Regulated Organizations, which would not only be burdensome, but would also likely undermine rather than support Regulated Organizations' abilities to manage climate-related financial risk.

In response to the Proposal's Question 1, we urge the DFS to coordinate with the federal banking agencies to establish a reasonable and consistent timeline for implementation of their respective guidance on climate-related financial risk management.

VIII. Other Comments on the Proposal

A. The final guidance's Corporate Governance section should affirm that the board of directors' role in climate-related financial risk management is effective oversight of senior management's implementation of risk management.

The Proposal notes that an effective risk governance framework is essential to a Regulated Organization's safe and sound operation and outlines key responsibilities of the board of directors and management with respect to climate risk.[34] Although the Proposal generally appropriately acknowledges that the board should "oversee" the Regulated Organization's risk-taking activities, while senior management should be responsible for "executing the organization's overall strategic plan, managing material climate-related financial risks, and reporting to the board regularly on the level and nature of such risks,"[35] we are concerned that the Proposal appears to conflate the roles and responsibilities of the board and management in several ways that are incompatible with the board's role to oversee management. First, the Proposal states that management *and* the board should "assess climate-related financial risks and their impact on the overall risk appetite of the organization."[36] It is important for the final guidance to clarify that it is the proper role of management to assess risks, including climate-related financial risks, and that the board may reasonably rely on management's risk assessment and seek to understand the nature and level of material risks and the Regulated Organization's overall risk profile consistent with its oversight responsibilities. Second, the Proposal states that management *and* the board "should establish and implement plans to mitigate and manage [the] organization's exposures to material climate-related financial risks and should review and assess the effectiveness of mitigation plans regularly."[37] Management – not the board – should be responsible for establishing and implementing plans, though it may be appropriate for the board to approve and oversee the implementation of certain material plans. Third, the Proposal states that management *and* the board should "integrate climate-related financial risks into the organization's risk appetite framework."[38] The board should be required only to review and approve a Regulated Organization's risk appetite framework. Fourth, the Proposal inappropriately states that the board should "*ensure* that credit management . . . is fully capable of and will be held accountable for implementing the organization's business strategies and adhering to the risk governance framework that

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[34] Proposal, Section IV.A.(ii), ¶¶28–31.

[35] Proposal, Section IV.A.(ii), ¶31.

[36] Proposal, Section IV.A.(ii), ¶28.

[37] Proposal, Section IV.C.(iv), ¶42.

[38] Proposal, Section IV.A.(ii), ¶29.

integrates climate-related financial risks" (emphasis added).[39] The board should be required to oversee credit management and hold management accountable but should not be required to "ensure" any performance result of credit management.

It is important that the final guidance follow clear and longstanding legal and safety and soundness principles that clearly distinguish the roles and responsibilities of the board of directors and management, respectively, and not conflate the two. As discussed in an industry report issued by BPI,[40] a central tenet of effective corporate governance is the distinction between, and complementary nature of, the board of directors' responsibility for *oversight* of the business and affairs of the bank, and management's responsibility for the *day-to-day operations* of the organization. Any blurring of this distinction would detract from effective governance by potentially reducing the board of directors' ability to perform its oversight role objectively and creating uncertainty as to roles and responsibilities.

While the approaches taken by individual boards of directors will appropriately vary, we note the following relating to the core role of boards of directors and board committees: (i) directors should ask informed, probing questions of management, including with respect to the resources being dedicated to climate-related financial risk management; (ii) reporting to the board of directors by senior leaders with responsibility for climate-related financial risk oversight should generally relate to *material* risks, developments, policies, and/or other issues, consistent with the board of directors' role in guiding the strategic direction of the organization and providing effective and objective oversight of management's performance; and (iii) the performance of core board of directors functions, such as oversight of risk management and control frameworks, at the various levels of the banking organization may be coordinated at the top-tier parent holding company level, taking into account the independent legal and governance responsibilities of subsidiary boards. In view of the foregoing, flexibility should be maintained to permit delegation to management on such matters as (i) organization of internal climate-related roles, responsibilities, and governance structures and/or (ii) review of any public statements to ensure consistency with internal strategies and risk appetites.

Finally, as discussed in further detail in Section VIII.B below, we recommend the final guidance to clarify how board and senior management responsibilities should be applied with respect to FBOs that have U.S. operations subject to the DFS's supervision, and to do so in manner that leverages established U.S. risk governance frameworks for FBOs (including through U.S. risk committees or other relevant committees or functions).

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39 Proposal, Section IV.A.(ii), ¶31.

40 *See generally* Bank Policy Institute, *Guiding Principles for Enhancing U.S. Banking Organization Corporate Governance* (Jan. 12, 2021 Exposure Draft Edition), https://bpi.com/wp-content/uploads/2021/01/BPI-Guiding-Principles-on-Enhancing-Banking-Organization-Corporate-Governance.pdf. *See also* The Clearing House, *The Role of the Board of Directors in Promoting Effective Governance and Safety and Soundness for Large U.S. Banking Organizations* (May 2016), https://bpi.com/wp-content/uploads/2021/03/58463da32970443bb9e2ab796a0dc699.pdf.

B. The final guidance's Corporate Governance section should clarify that the board of directors (or equivalent function) may determine the oversight approach with respect to climate-related financial risks that is most appropriate in view of a Regulated Organization's overall governance structure and avoid any requirement to designate climate-related financial risk management responsibilities to a board member.

Regulated Organizations have different governance structures and assign responsibilities in different ways. There is no "one-size-fits-all" in the context of board governance. In order to ensure that climate-related financial risks are appropriately incorporated across a Regulated Organization's board governance structure, the final guidance must be flexible enough to allow various structures. We recommend the final guidance to clarify that the board of directors (or equivalent function) may determine the oversight approach with respect to climate-related financial risks that is most appropriate in view of a Regulated Organization's overall governance structure, taking into consideration the size of the board and the expertise, diversity and tenure of board members. For example, as a general governance matter, the board of directors of a Regulated Organization may determine that elements of risk oversight relating to climate are best housed within a committee (or an equivalent function) that focuses on climate. At the same time, the board of directors of another Regulated Organization may determine that it is most appropriate, consistent with the overall board structure, for oversight of this risk to be housed within the risk committee. Other institutions may adopt a different approach.

In addition, we recommend the final guidance to clarify how board and senior management responsibilities should be applied with respect to FBOs that have U.S. operations subject to the DFS's supervision, and to do so in a manner that leverages established U.S. risk governance frameworks for FBOs. Specifically, the final guidance should expressly permit FBOs to utilize designated committees and existing U.S. risk governance (e.g., a U.S. risk committee, or other relevant committee or function) to carry out the oversight of climate-related financial risks at the Regulated Organization (i.e., as part of the FBO's U.S. operations). FBOs should also be able to rely on U.S.-based management to discharge the relevant U.S. climate-related financial risk obligations of senior management. This arrangement would be more consistent with the current U.S. risk governance framework and supervisory expectations for FBOs (including those from the FRB).

Consistent with the flexible approach recommended above, we urge the DFS to remove the statement from the Proposal stating that sound governance "may include designating a board member . . . to be responsible for the oversight of assessment and management of climate related financial risks with clear and specific allocation of roles and responsibilities."[41] While BPI agrees that climate-related risk requires appropriate board oversight, we believe a proposed designated director on climate issues – even if only by way of an example – is problematic. Such an example may turn into a de facto requirement in practice because examiners may view it as "best practice" for sound governance. Boards are, by design, deliberative bodies tasked with oversight of numerous traditional and emerging risks, of which climate risk is only one. A de facto requirement of a designated board member for climate-related financial risks could suggest that boards without such a designated member are somehow deficient. Furthermore, appointment of a designated board member for climate-related financial risks comes with a significant risk that such a director would assume outsized responsibility and authority with respect to a critical risk that is the responsibility of the collective board to oversee.

[41] Proposal, Section IV.A.(ii), ¶28.

In addition, such a de facto requirement, which necessarily emphasizes climate expertise, would also come at a significant cost to Regulated Organizations' ability to appoint directors with attributes they believe are appropriate for the overall oversight of the company, including oversight over other, and perhaps more immediate or significant, risks they face. Technical climate experts may not have other critical experience or capabilities complementing skill needs for the board on a collective basis. Supervisory expectations on Regulated Organizations to have a designated director with climate expertise could result in lower-quality directors, especially given that such an expectation would exacerbate an already high demand for climate expertise. In general, we believe that flexibility in board governance is particularly important in the banking sector.

C. The final guidance's Internal Control Framework section should clarify that the compliance function or other independent risk management unit that may be assigned to oversee and support the Regulated Organization's climate-related financial risk management efforts is responsible for assessing adherence to climate-related rules and regulations rather than ensuring adherence to climate-related rules and regulations.

The Proposal inappropriately suggests that the compliance function, as part of the second line of defense, should "*ensure* adherence to relevant climate-related rules and regulations and *ensure* that internal policies and procedures are compliant with climate-related standards, directives, charters, or codes of conduct to which the Regulated Organization is subject, as well as applicable consumer protection laws, regulations, and guidance, including fair lending considerations" (emphasis added).[42] This portion of the Proposal overstates the scope of the compliance function's responsibilities. The final guidance should clarify that the compliance function (or another appropriate control unit) should *assess* (rather than ensure) adherence to relevant climate-related rules and regulations and whether the internal policies and procedures are reasonably designed to be compliant with climate-related standards, directives, charters, or codes of conduct to which the Regulated Organization is subject, as well as applicable consumer protection laws, regulations, and guidance, including fair lending considerations.

D. The final guidance should establish realistic expectations with respect to public statements.

The Proposal states that the board of directors and management should ensure that any public statements about their climate-related strategies and commitments are consistent with internal strategies and risk appetite statements.[43] The final guidance with respect to public communications should recognize the aspirational nature of external commitments and the fact that these commitments and plans will need to adapt over time as data and methodologies improve and external circumstances change. In addition, the final guidance should recognize that Regulated Organizations are already subject to a variety of securities and/or consumer protection laws and regulations that regulate the manner in which they disclose information and market their products, and that Regulated Organizations are actively engaged with the authorities enforcing these laws and regulations to ensure their public statements meet applicable requirements. Therefore, the DFS should calibrate its expectations as to the granularity between external statements and internal risk appetite statements accordingly.

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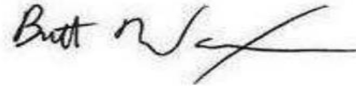
[42] Proposal, Section IV.B, ¶35.

[43] Proposal, Section IV.A.(i), ¶27.

The Bank Policy Institute appreciates the opportunity to comment on the Proposal. If you have any questions, please contact the undersigned by phone at (347) 237-7368 or by email at *Brett.Waxman@bpi.com.*

Respectfully submitted,



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