April 28, 2023

Adrienne Harris
New York State Department of Financial Services
1 State Street
New York, NY 10025

Dear Superintendent Harris,

On behalf of Public Citizen and 24 undersigned organizations and more than 500,000 members and supporters, we welcome the opportunity to comment on the New York State Department of Financial Services' ("DFS") Proposed Guidance for New York Regulated Banking and Mortgage Organizations Relating to Management of Material Financial Risks from Climate Change. We particularly support DFS's focus on proactively mitigating the disproportionate impact of the climate crisis on low- and middle-income communities and communities of color and recognizing that climate change poses significant risks to all banks, irrespective of their size or business lines.

Specifically, DFS's proposed guidance is the strongest regulatory caution to date against climate-related decisions to disinvest or raise the costs of credit in at-risk low- and moderate-income (LMI) communities and communities of color. Additionally, DFS's guidance is the first to apply to all banks and mortgage companies, recognizing the need to take a proportionate approach to risk management based on their size and complexity. To solidify these accomplishments, DFS should strengthen its enforcement of fair lending laws and provide greater support to small financial institutions.

Along with these important steps, DFS should do even more to confront the threats that banks and communities face. Physical and transition risks are rapidly worsening. In 2022, eighteen natural disasters resulted in $165 billion in costs. Financial losses will only increase as natural disasters grow more severe and more frequent. Furthermore, the Inflation Reduction Act is rapidly transforming technological development and accelerating the adoption of renewable energy, which will only increase the risk that loans to carbon-intensive clients and similar assets will rapidly lose value.

DFS's 2021 insurance guidance included more comprehensive risk mitigation recommendations. It included reducing financed emissions, assessing customers' transition plans, requiring public disclosure of climate risk and mitigation strategies, as well as providing regulated entities with a clear timeline for implementing climate risk management.To achieve an equivalent level of protection for New York financial institutions, the final banking and mortgage organization guidance should incorporate these previous recommendations.

Climate risk mitigation must not disproportionately impact marginalized communities.

DFS emphasizes that low-and moderate-income (LMI) communities and communities of color are more exposed to climate-related disasters and environmental toxins due to a legacy of redlining and environmental racism. As a result, financial institutions mitigating their exposure to climate-related risks may inadvertently engage in “bluelining:” the reduction of investment, coverage, and lending in these at-risk areas, which exacerbates preexisting racial and economic disparities.

To address these injustices, the guidance appropriately centers equity by explicitly warning banks against divesting from climate-impacted communities as a tool for risk management. This approach is based on financial institutions’ requirement to comply with fair lending laws as well as the availability of other avenues for promoting climate resiliency in at-risk communities, such as providing credit for related projects under New York’s Community Reinvestment Act (CRA). Also important for addressing these injustices is DFS’s extension of the climate guidance to promote the continued safety and soundness of community and agricultural banks, which marginalized and rural communities rely on for essential financial services.

DFS can further promote its equity goals by providing greater clarity on how it will undertake fair lending reviews in climate-impacted areas and by advising institutions to promote diversity, equity, and inclusion in their senior leadership and board management. Lastly, DFS should encourage banks to establish policies and procedures to monitor the actions they are taking to promote climate mitigation and adaptation in at-risk communities while also documenting their progress in addressing disparate impacts.

DFS must support small financial institutions’ technological and data needs for managing climate-related risk.

DFS is the first U.S. regulator to propose including small financial institutions in its climate risk guidance. This action properly reflects that, regardless of size, financial institutions are exposed to climate risks. Community and agricultural banks are especially critical for access to banking in already underbanked LMI and rural communities. Yet, worryingly, small and mid-sized banks are already falling behind large banks in adopting climate risk strategies.

Because small banks are less diversified and geographically concentrated, they can have greater exposure to acute climate disasters and a rapid transition away from carbon-intensive industries. Whatever a bank's history with managing severe weather events, its experience does not guarantee sound management of newly emerging risks. Climate change will increase the severity and frequency of climate disasters, as well as other potential economic shocks, many of which may be connected or correlated in complex ways. Small banks need new risk management tools to understand these interconnected climate risks. Without regulatory guidance and support, they may not move quickly enough or have the capability to address these new threats.

DFS has the opportunity to set a gold standard for supporting small banks in integrating climate-related financial risk management. It can do so in part by developing in-house climate risk analysis and collecting climate risk data in coordination with federal regulators. DFS asks banks to take a proportional approach to their size and complexity. This means helping small financial institutions develop approaches to understanding their climate risks that do not rely on excessively technical modeling. Additionally, small banks can use tools and scenarios publicly available through the United Nations Principles for Responsible Investment (PRI) or Network for Greening the Financial System (NGFS) that can be incorporated into their existing in-house risk management.

DFS should apply key climate risk mitigation measures outlined in its insurance guidance to banks and mortgage organizations.

1. Reduce financed emissions to mitigate transition risk.

Globally, regulators are recognizing the value of an orderly transition to bolster individual bank safety and soundness. Reducing financing greenhouse gas emissions is a straightforward approach to mitigating a bank's own transition risk. This approach is already endorsed in DFS's insurance guidance, which states, "Reducing financed and underwritten greenhouse gas emissions in line with science-based targets is also a way to mitigate the financial and consumer risks that climate change poses to insurance markets." Bank financing of greenhouse gas emissions poses similar risks to credit markets and can benefit from the same approach. DFS should continue to recognize that reducing financed emissions is a fundamental part of the prudential oversight of climate-related financial risk.

2. Consider clients' transition plans in climate risk evaluations.

Ultimately, a financial institution's transition risk is a function of the way the transition will affect its current and future clients. A prudent approach to managing risk means taking into account potential clients' exposure to transition risk before making investments. DFS should adopt the expectations set forth in its insurance guidance and tell banks to ask clients about their low-carbon transition plans, engage with them on plans to develop sustainable business models, and urge them to develop transition plans in line with science-based targets.

3. Require public disclosures of material climate-related risks.

DFS should echo its insurance guidance and set an expectation that financial institutions publicly disclose their climate-related risk and how they integrate climate risk management into their corporate governance and business strategies. This disclosure should provide transparency on how financial institutions determine the materiality of their climate risks. In addition, public disclosures should include how banks' existing loans are exposed to physical and transition risks. Publicly available information will facilitate greater engagement with customers and companies on climate risk. As noted in DFS's insurance guidance, these disclosures can be qualitative initially, until banks quantify risks into key metrics and risk thresholds. Since financial institutions already have this information as a part of their risk mitigation strategies, it should not create a significant additional burden.

4. Provide a clear implementation timeline.

The climate crisis is worsening, and transition risk is rising in unpredictable ways. An urgent implementation timeline from DFS will give financial institutions a framework to meet regulatory expectations as soon as possible. Recognizing this, the European Central Bank has set a deadline of 2024 for banks to fully incorporate climate change into their risk management frameworks. DFS should outline when it expects banks to incorporate climate risk management into board governance, internal controls, scenario analysis, and other frameworks. This will allow DFS to assess institutions' progress in meeting its expectations. Importantly, while resource-constrained financial institutions may need greater support, climate impacts will not wait. DFS should not delay its guidance, but rather should find ways to help smaller banks understand and implement it.

Conclusion

The proposed guidance is a crucial step on managing climate related risk, and DFS should expand on this foundation. DFS is in a unique position as the first supervisor of climate risk for small institutions that provide critical financial support to local communities. Because of this, DFS can serve as a model for U.S. regulators on how to effectively address climate-related financial risks at smaller financial institutions. We look forward to working with you on these next steps.

For questions, please contact Mekedas Belayneh at mbelayneh@citizen.org.

Sincerely,
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