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Chief Counsel's Office
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429
Via: Email to comments@fdic.gov.

Principles for Climate-Related Financial Risk Management for Large Financial Institutions / RIN 3064- ZA32

Dear Acting Chair Gruenberg,

On behalf of Public Citizen, a national public interest advocacy group, and more than 500,000 members and supporters, we welcome the opportunity to comment on the Federal Deposit Insurance Corporation's (FDIC's) Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions (the Principles). Providing supervisory expectations for financial institutions is a critical first step to advancing financial institution efforts to assess and address these risks, and we appreciate the similar OCC and FDIC efforts to date to define these expectations.

These Principles, similar to the earlier OCC Principles, provide a strong foundation for protecting large financial institution safety and soundness. They identify unique characteristics of climate-related risks while also insisting that financial institutions incorporate climate risk into their existing risk management plans. Building on the OCC Principles, the FDIC Principles more clearly acknowledge that climate-related financial risks pose clear and significant risks to the U.S. financial system and a near-term threat to safe and sound banking and financial stability.

We appreciate that the Principles recognize how climate risk management decisions have implications for a financial institution's broader community impacts. First, the Principles highlight how a financial institution's decisions to manage climate risk by increasing credit costs or decreasing credit availability have the potential to disparately harm communities of color and low-income communities. Second, they draw connections between a financial institution's publicly stated climate commitments, its internal management strategies, and its safety and soundness. In both of these areas, financial institutions are already acting in ways that raise concerns.

The Principles could be strengthened, however, by (1) acknowledging and addressing risks to community banks and savings associations; (2) providing additional guidance on how financial institutions should account for the unique aspects of climate-related financial risks, and additional detail on how to integrate those risks into broader risk management structures; (3) indicating ways to ensure that financial institutions' internal strategies align with their public commitments; and (4) ensuring fair access to financial services.

The Principles should be a first step in a broader regulatory program of protecting financial institutions and the financial system from climate-related risks. The Principles should be followed by interagency guidance from all federal banking regulators detailing and addressing risks posed to community banks, savings associations, and credit unions. This guidance should also explore additional ways to make the banking system more resilient to the risks of climate change, including through developing robust scenarios for scenario analysis at the insured depository level, and incorporating climate-related risks into risk-weighted capital requirements for large financial institutions. Interagency guidance should also consider measures to address the financial stability implications highlighted in the Principles, such as a climate risk capital surcharge for the largest financial institutions, concentration and portfolio limits for the riskiest assets, and transition plans to reduce contribution to climate risk via emissions financing.

To protect both financial institution safety and soundness and the communities those financial institutions are supposed to serve, we encourage you to quickly finalize these Principles as guidelines for safety and soundness under 12 U.S.C. § 1831p-1. Once finalized, these guidelines should serve as a basis for the additional, detailed guidance.

I. Smaller financial institutions need US regulator attention to their safety and soundness.

The FDIC is the primary regulator for only a handful of large financial institutions targeted by these Principles. The FDIC must also ensure the safety and soundness of approximately 4000 community banks and savings associations in the US, many of which are critically important for low and moderate income communities.¹ One in five counties exclusively depends on local financial institutions like these for access to a physical bank branch.

The Principles' focus on climate risk-related exposures of large financial institutions—financial institution entities with over \$100 billion in total consolidated assets—only tangentially addresses the immediate and longer-term threats to the safety and soundness of these smaller financial institutions, and, in turn, to fair access by marginalized communities to financial services these smaller institutions provide.

¹ FDIC, [FDIC Community Banking Study](#), (December 2020).

Climate change is directly, increasingly, repeatedly, simultaneously, and often permanently impacting homeowners, businesses, and infrastructure within certain geographies, causing escalating economic and financial losses. As borrowers and taxpayers struggle or fail to pay their bills, community banks and savings associations tied to those geographies face heightened safety and soundness concerns not faced by larger, geographically diversified financial institutions.

As explained in a report by nonprofit Ceres:

Based on their local expertise, community banks tend to focus on a few key sectors, such as residential mortgages, commercial real estate (CRE), small business financing, and agricultural sector loans. Given this focus, community bank loan portfolios are more exposed to the physical risks of climate change considering the vulnerability of these sectors to acute weather events in the near term and transition risks in the medium to long term.²

The report observes there “are already examples of climate-related disasters that have fundamentally impacted the safety and soundness of community banks and credit unions.”³ Hibernia Bank in Louisiana, for example, experienced \$175 million in losses from Hurricane Katrina. A more recent analysis targeting credit unions reflects the same concerns.⁴

A 2020 report by the Climate-Related Market Risk Subcommittee of the U.S. Commodity Futures Trading Commission (CFTC report), describes such repeated ‘sub-systemic’ shocks as initiating “*a systemic crisis in slow motion* (emphasis).”⁵

Threats to the safety and soundness of community banks and savings associations raise novel challenges for developing effective risk management measures. Unlike large financial institutions, community banks and savings associations cannot easily move or significantly shift portfolios; they exist primarily to serve local community needs. And even where they can, taking such measures would only further disadvantage the local communities that rely on them. The FDIC cannot simply ignore these risks.

Nor does it have to. The Principles recognize that part of the FDIC’s mandate is to consider and address the impact of financial institution activities on the economy. The FDIC states, “the manner in which financial institutions manage climate-related financial risks to address safety and soundness concerns should also seek to reduce or mitigate the impact that *management of these risks*

² *Id.*

³ Ceres, [Financing a Net Zero Economy: The Consequences of Physical Climate Risk for Banks](#), (Sept. 8, 2021).

⁴ Ceres, [The Changing Climate for Credit Unions](#), (May 10, 2022).

⁵ Climate-Related Market Risk Advisory Subcommittee, [Managing Risk in the U.S. Financial System](#), Commodity Futures Trading Commission (Sept. 2020).

(emphasis added) may have on broader aspects of the economy.” The FDIC should consider not only the implications of risk management, but also how individual institutions are facilitating risks to the broader economy through their support for greenhouse gas (GHG) emitting activities. When individual institutions finance GHG emissions, they contribute to the increasing severity of global warming, fueling the economic damage described above. As small banks cannot manage climate-related risks without risking severe damage to their communities, the FDIC should assess how working with all financial institutions to manage their contribution to climate change can better mitigate those same risks.

Such an approach is in line with the broader mandate the FDIC has to protect the stability of the financial system. The Principles acknowledge a relationship between climate change and financial stability concerns, including the possibility of contagion from climate-related risks. Indeed, the Principles rightly define climate-related financial risks as a clear and significant risk to the U.S. financial system and a near-term threat to safe and sound banking and financial stability. As discussed above, in the context of climate risk, contagion can occur not only through a failure of large financial institutions and their links to other financial entities, but also through the interconnectedness of the environmental and financial systems and sub-systemic shocks related to this interconnectedness.

When financial institutions finance and facilitate fossil fuel-related activities and high-emitting projects, they heighten the creation of financial risks and resulting economic harms caused through connections between the environmental and financial systems. This is exactly what many large US financial institutions are doing. The [Banking on Climate Chaos](#) report and other studies have demonstrated that large US financial institutions, through their financing and facilitating of fossil fuel-related activities and other high-emitting projects, contribute significantly to GHG emissions and, in turn, exacerbate climate-related risks.⁶ Similar to financial institution action during the subprime mortgage crisis, financial institutions supporting fossil fuel-related activities are creating risks that other entities are left to deal with. The Principles should recognize that orderly reductions in such financing and support would meaningfully reduce threats to safety and soundness for all financial institutions — large and small — as well as the risks of impaired access to financial services for all communities and risks to the financial system.⁷ Because few of the financial institutions that must make these reductions are under the FDIC’s primary jurisdiction, the FDIC should promote interagency action on these concerns.

II. Large financial institutions need more detailed direction on how to address the unique characteristics of climate-related

⁶ Rainforest Action Network, et al., [Banking on Climate Chaos](#) (2022).

⁷ D. Arkush, [Unsafe At Any Charge: Why Financial Regulators Should Actively Mitigate Climate-Related Risk](#) (May 26 2021).

risks and integrate them into existing risk management processes.

The Principles reinforce that weaknesses in how financial institutions identify, measure, monitor and control potential climate-related financial risk can threaten financial institution safety and soundness.⁸ To assure the safety and soundness of financial institutions under its jurisdiction,⁹ the FDIC can prescribe standards relating to internal controls, loan documentation, credit underwriting, and other operational and managerial standards, as well as for asset quality.¹⁰ Such standards may be prescribed by either regulation or guideline.¹¹ To appropriately set financial institution expectations and act in accordance with its mandate, we encourage the FDIC to clarify that it is issuing these principles as a guideline under 12 U.S.C. § 1831p-1.

Overall, the Principles provide an important foundation for appropriately integrating climate-related financial risk into a large financial institution's broader risk management structures. The Principles make clear that financial institutions must address climate risk management at every level of their business, from the board level on down. This approach reflects international best practices, as well as the magnitude of the threat that climate risk poses. The Principles also appropriately direct financial institutions not to silo climate-related financial risks, but to make them a part of broader internal controls, including the financial institution's credit risk appetite and lending limits. This approach helps make sure that the breadth of potential climate risk impacts is incorporated into a financial institution's operations, instead of being siloed in a separate climate risk function with limited influence on risk taking.

The Principles also start to recognize the ways that climate-related financial risk differs from the other forms of risk that financial institutions ordinarily seek to manage. As other regulators have discussed, the effects of climate-related financial risk will manifest in uncertain ways over a long time horizon.¹² The Principles reflect this by encouraging financial institutions to assess climate risk over a time horizon that may extend beyond a financial institution's typical strategic planning horizon, and by recommending scenario analysis and other tools for measuring such uncertain exposures.¹³ Climate-related financial risks are also highly correlated, in ways that may make traditional hedging and insurance approaches to risk management ineffective.¹⁴ The Principles recognize

⁸ FDIC, [Principles for Climate Related Financial Risk Management for Financial Institutions](#) (Principles), 1 (April 2022).

⁹ 12 U.S.C. §1.

¹⁰ 12 U.S.C. §1831p-1.

¹¹ *Id.*

¹² *See, e.g.*, Bank of England Prudential Regulation Authority, "[Enhancing banks' and insurers' approaches to managing the financial risks from climate change](#)," Supervisory Statement, (April 2019).

¹³ Principles at 2

¹⁴ New York Department of Financial Services, [Guidance for New York Domestic Insurers on Managing the Financial Risks from Climate Change](#) at 15.

this by recommending that management assess potential changes in correlations across exposures or asset classes, and set credit risk appetite and lending limits in ways that reflect those potential correlations.¹⁵

From this foundation, the Principles can be strengthened by providing more detailed expectations for how financial institutions address climate change. These additional expectations fall into two categories: additional guidance for how financial institutions should account for the unique aspects of climate-related financial risks, and additional detail on how to integrate those risks into broader risk management structures.

A. Financial institutions need more guidance on managing the unique characteristics of climate-related risks.

1. Financial institutions must follow a precautionary approach rather than relying solely on hedging, insurance, and diversification.

A lesson of the 2008 financial crisis is that even large and sophisticated financial institutions like Lehman Brothers or Wachovia could not engineer away threats that were too uncertain, too correlated, or too profitable. Hedging and insurance are always susceptible to tail risks and unexpected developments. Particularly for longer-term scenarios where global temperatures exceed 1.5°C, relying on these solutions may introduce new risks instead of mitigating first-order ones. Climate change will continue generating new and unpredictable risks that may turn diversification into correlation. Similar to risks that were originated and distributed through mortgages and mortgage-backed securities during the 2008 crisis, climate risks originated through financing of fossil assets and distributed but unaccounted for now could lead to the kind of contagion and financial instability that the Principles discuss.

A financial institution's response cannot be to ignore uncertain or unpredictable risks until they can be appropriately modeled. Rather, the FDIC should encourage financial institutions to adopt a precautionary approach to climate-related financial risk. This is the approach to general climate risk favored by experts like the United Nations Framework Convention on Climate Change and the Intergovernmental Panel on Climate Change. It has also been endorsed as part of the White House's climate financial risk roadmap.¹⁶ It would be reasonable for the FDIC to follow the lead of climate scientists and experts who have concluded that action cannot rely on precise quantification and assessment of the risks posed by climate change.

A precautionary approach means prioritizing reducing risk even where there is not full certainty about its magnitude or probability and in the absence of perfect scientific or economic data. Implementing this approach could mean taking on

¹⁵ Principles at 4

¹⁶ "[A Roadmap to Build a Climate Resilient Economy](#)", The White House, October 14, 2021 at 17.

less risk than what models suggest is acceptable, on the assumption that those models do not accurately quantify the likelihood or magnitude of all relevant risk factors, and showing greater sensitivity to high-magnitude risks even when models suggest they are remote. This latter strategy is particularly apt in the climate context. Climate models themselves under-forecast harms, largely because significant aspects of climate change cannot be modeled yet. The science is being updated constantly, and most updates darken the outlook. One way to address this challenge is to ‘backtest’ scenario analysis models, similar to use of backtesting in other contexts.¹⁷ Backtesting involves determining the extent to which a model accurately predicts events that have already occurred, to understand the extent to which model assumptions are robust. If backtesting a model reflects a wide gap between expectations and reality, the model is less likely to predict future scenarios accurately. If scenario analysis models cannot accurately predict the last few years of climate impacts based on historical data, then banks cannot use them to conclude that they are adequately accounting for future climate risks.

When developing risk management procedures, precautionary approaches also entail not just avoiding unacceptable harms, but also planning for resilience to inevitable failures. And they counsel financial institutions to assume every part of the business is subject to climate risk, even in seemingly implausible lines of business. Global warming is still increasing and, even if it weren’t, scientific knowledge is still developing.

2. Financial institutions should reduce risks now, even if they are unlikely to manifest for many years.

A related challenge is the long time horizon under which many climate-related risks may manifest. As the FDIC recognizes in the Principles, typical financial institution strategic plans consider the risks and opportunities of the next three to five years and may not be well suited for identifying or avoiding risks that may take 30 or 40 years to fully manifest. As the time horizon lengthens, it becomes more difficult to project how a financial institution’s operations and the broader economic context will develop.

The FDIC recommends that financial institutions use scenario analysis to better assess risks outside of the standard time horizons. But improved assessment will help mitigate risk only if financial institutions embed the findings into their risk models and management tools today. The uncertain and non-linear nature of climate harms means that adverse outcomes projected to occur in 20 or 30 years based on the best current climate science could manifest much sooner, or with much greater severity. In addition, long duration assets that appear entirely safe in a three to five year horizon may become extremely risky over two or three

¹⁷ Marie-Noëlle Woillez, [Economic impacts of a glacial period: a thought experiment to assess the disconnect between econometrics and climate sciences](#), (2020).

decades. Finally, financial institution assets can become path dependent, as even short-duration assets are typically refreshed with substantially similar ones. A failure to start reducing foreseeable risks now means that necessary future readjustments may be far sharper and more disruptive to a financial institution's business and to its customers. To better manage these risks, financial institutions should be taking steps now to mitigate risks that they believe will not manifest for years instead of assuming that they can mitigate those risks in the future.

B. Financial institutions should better integrate climate-related financial risk into existing structures

1. The FDIC should add standards for assessing asset quality to its guidance.

The FDIC's mandate to prescribe standards for safety and soundness includes standards relating to asset quality.¹⁸ The FSOC's Report on Climate-Related Financial Risk repeatedly highlights the way that both the physical harms of climate change and the ongoing transition toward clean energy and away from greenhouse gas emissions may lead to sharp changes in the values of certain assets.¹⁹ Because of this risk, financial institutions will need to incorporate climate-related risks into their assessment of numerous affected asset classes.

The Principles should provide some initial expectations for how financial institutions will undertake such assessments. This would be in keeping with standard practice, as the FDIC provides guidance on assessing asset quality as part of a safety and soundness exam. Along with the overall guidance in its Risk Management Manual, the FDIC has issued Financial Institution Letters (FILs), on asset classes that are subject to both physical and transition risks, including for example an FIL on Prudent Risk Management of Oil and Gas Exposures and an FIL on Prudent Management of Agricultural Lending During Economic Cycles.

The FDIC should immediately highlight that these and other asset classes are susceptible to climate-related risk and that climate risk is another vector for cross-asset class risks. As an example, reserve-based lending to oil and gas exploration companies is based on assumptions about the value of proven producing reserves, subject to semi-annual borrowing base redeterminations. The FDIC should explicitly state that financial institutions need to take transition risk into account in valuing those reserves and in making assumptions about how quickly the value of a producer's borrowing base may decline. It should recommend that financial institutions incorporate similar climate considerations into their asset quality assessments across the board. The FDIC should also announce its intention to revise FILs to reflect the specific approaches needed to manage climate-related risk.

¹⁸ 12 USC §1831p-1.

¹⁹ Financial Stability Oversight Council, [Report on Climate-Related Financial Risk](#), 2021.

2. The FDIC should monitor climate-related risk data used for decisionmaking.

The Principles direct financial institutions to consider climate-related financial risks as part of their underwriting and monitoring of portfolios.²⁰ For financial institutions to do this effectively, they must require useful climate-related risk information from potential clients and have the capacity to assess that information's veracity and completeness. At a minimum, the information financial institutions need should include information compliant with the Task Force on Climate-Related Financial Disclosures recommendations, including a company's metrics, targets, and transition plans.²¹ For instance, for underwriting credit, financial institutions should review the direct and indirect emissions attributable to a company at present, as well as projections of how an extension of credit would affect those emissions. This will help a financial institution assess the transition risk it assumes from extending credit. Financial institutions should also ask for a company's own transition plans and understand how it is preparing for a coming net zero transition. That will help the financial institution better understand a potential client's vulnerability to transition risk.

Financial institutions may find it difficult to obtain such information from some clients and resist such a process. But a company's failure to generate this information is itself a red flag about its ability to effectively manage climate risk, and should raise concerns about the safety and soundness of a loan. If financial institutions feel that the current state of available information is insufficient to appropriately assess climate-related risk, then they should work with the Securities and Exchange Commission to develop and adopt disclosure and audit rules that standardize and improve the transparency of such information for reporting companies, as well as to broaden the scope of companies that must report such information.

To help it assess how effectively financial institutions are managing these risks, the FDIC should also work with the Federal Financial Institutions Examination Council (FFIEC) to require disclosure of relevant climate risk-related information in the Reports of Condition and Income, colloquially known as "call reports," that financial institutions periodically file. Call reports today capture certain climate-related risk data, such as agricultural, automobile, and real estate assets, but they do not provide details on the geographic distribution of loans or exposure to the fossil fuel industry. The report should add a series of line items to each applicable schedule about loans for fossil fuel exploration, production and fossil electricity generation, as well as securities backed by these assets and derivatives referencing them. As with real estate lending on the current call report, these loans should be broken out by duration, with detailed information about

²⁰ Principles at 4.

²¹ Task Force on Climate-Related Financial Disclosures, [Guidance on Metrics, Targets, and Transition Plans](#), 2021.

allowances for losses on loans with terms of three or more years, which are particularly exposed to transition risk. The call reports should also add additional information about exposure of existing loan types to physical risks, such as separate line items for loans and asset-backed securities secured by real estate in flood zones or high wildfire risk areas.

It should not be any additional burden on financial institutions to disclose this information, even if it does not align precisely with other reporting frameworks, such as the one proposed by the Securities and Exchange Commission. Information about financial institution exposures to high-risk assets should already be part of management information systems and risk monitoring reports. If financial institutions struggle to gather this information, then the FDIC should be deeply concerned. It is likely that these financial institutions will also struggle to monitor and mitigate risks properly.

III. To be aligned with common types of public climate commitments, financial institutions' internal management strategies must follow climate science.

We applaud the Principles for addressing financial institutions' climate commitments. As we observe earlier, while the FDIC regulates only a small number of institutions that have made commitments to "net-zero" emissions, the FDIC has a strong interest in working with the OCC and the Fed to ensure that all banks making such commitments align their strategies to climate science.

A number of watchdog groups have raised questions about the sincerity of bank commitments to net zero, pointing out that financial institutions with insured depositories are large fossil fuel funders.²² This disconnect should raise serious concerns for financial institution regulators. It suggests that public management statements about a financial institution's strategic direction are not reflected in its operational decision-making and internal controls. If the failure occurs in such a public, high stakes arena, it should create doubts about how effectively management can transmit other strategic direction and risk management initiatives throughout the business. Such doubts indicate serious risks to a financial institution's safety and soundness.

The Principles' direction that financial institutions must align their internal management strategies and public climate commitments demonstrates the FDIC's understanding of this connection. Along with positive reputational benefits, transitioning from financed emissions is a way to manage climate risk.²³ Where financial institutions cannot or do not bring their internal practices in line with their commitments, that failure should serve as an early warning sign that the financial institution may not be able to implement other climate risk management imperatives into its operations. Like climate risk management,

²² Rainforest Action Network et al., [Banking on Climate Chaos: Fossil Fuel Finance Report 2021](#).

²³ NYDFS Guidance, *supra* note 10.

climate commitments are a developing field. Although a number of standard setters like the Net Zero Banking Alliance are working to align criteria across financial institutions, there is still no single definition or standard for what a commitment means. To help financial institutions understand how banking regulators will evaluate the alignment of their public commitments and internal management strategies, the FDIC should work with the OCC and the Federal Reserve to quickly follow these Principles with additional guidance on this topic. Among the most significant questions this guidance should address are (1) reliance on offsets; (2) limits on new fossil fuel development and phasing out of fossil fuels; and (3) measurable near-term targets.

1. *Financial institutions should not rely on offsets to achieve their net zero commitments.*

Some financial institution climate commitments rely, either implicitly or explicitly, on financing reductions of carbon in the atmosphere in addition to reducing the level of emissions financed by the financial institution.²⁴ As implemented, these reductions are intended to cancel out existing emissions instead of ending them. This is the “net” in net zero commitments. Such approaches are referred to as offsets.

Significant concerns exist about the efficacy of relying on nature-based offsets, such as forests and wetlands, as sinks of greenhouse gasses. These include the exaggeration of the level of additional carbon emissions actually avoided for preservation of existing forests, the limits on the level of emissions that can reasonably be sequestered via the creation of new natural carbon sinks, and the challenges of protecting natural sinks from human and natural impacts in ways that keep the emissions from being returned to the atmosphere at a later date.

- *Exaggeration of additional emissions reductions:* Many carbon offset deals pay for the manager of a forest to continue what they are already doing, creating a challenge for assessing the “additionality” of an offset. For instance, in 2019, the Albany Water Board sold carbon credits generated by “preserving” forestland in the city’s watersheds.²⁵ It calculated the purported level of avoided emissions by using as a baseline the amount of carbon that would be emitted if the land were industrially managed. But the Albany Water Board does not harvest timber, and had not previously indicated any intention of selling the land. Any emissions avoided as a result of this deal were purely hypothetical. At best, the carbon credits had no impact on emissions; at worst, they were used to justify *increased* emissions. Such baseline accounting is typical of large

²⁴ Anne Finucane, “[Carbon Offsets Can Help in the Transition to Net Zero](#),” Bank of America Newsroom (Jun. 8, 2021).

²⁵ Dr. Charles D. Canham, “[Rethinking forest carbon offsets](#),” Cary Institute of Ecosystem Studies, (May 19, 2021).

dealers in carbon offsets and acceptable to many offset standard setters.²⁶ Financial institutions relying on this kind of offset are performing an accounting trick, not reducing carbon emissions. These offsets should not be permitted, and a financial institution's attempt to rely on them should raise questions regarding management's competence to meet any of its commitments or, alternatively, its willingness to use other accounting tricks to create the appearance of meeting them.

- *Limits on sequestration:* Another approach to carbon offsets is afforestation or, more plainly, planting trees. This superficially appealing idea rapidly runs into challenges of scale. As of 2021, global climate pledges already set a near term goal of using afforestation to sequester 2 gigatons of CO₂ emissions annually.²⁷ Meeting those commitments would require ecosystem restoration of 678 million hectares—twice the land area of the country of India.²⁸ That level of afforestation is not plausible for one year, much less annually, and attempts to pursue it on that scale would likely trigger negative consequences for Indigenous peoples and local communities residing on the land targeted for afforestation. Reliance on afforestation for offsets at any scale is simply implausible, and should raise questions about management's ability to assess the feasibility of a project.
- *Protecting carbon sinks:* Even assuming that some nature-based projects actually sequester carbon emissions relative to a reasonable baseline, there is still a challenge of maintaining them over time. Unfortunately, the increasing physical impacts of climate change create a new set of hazards. The increasing frequency of wildfires in 2020 and 2021 has burned a number of projects designed to sequester carbon in Oregon.²⁹ Some offset projects have “buffer pools” of unused emissions, but the growing frequency of wildfires will only increase the risk that those pools will be exceeded, rendering their contribution to a net zero pledge null.

In addition to these nature-based offsets, there are efforts to develop or deploy carbon removal technologies, such as carbon capture, utilization and storage (CCUS), and direct air capture (DAC). Both technologies are largely unproven with existing demonstration projects exhibiting challenges. For instance, a hydrogen plant that Shell touted as using a carbon capture system actually emitted 50% more greenhouse gasses than it sequestered during the period of its

²⁶ Ben Elgin, “[JPMorgan, Disney, Blackrock Buy Nature Conservancy's Useless Carbon Offsets](#),” Bloomberg, (Dec 9, 2020).

²⁷ Doreen Stabinsky, [Chasing Carbon Unicorns: The Deception of Carbon Markets and Net Zero](#), Friends of the Earth International (Feb. 2021).

²⁸ *Id.*

²⁹ Debra Kahn, [Wildfires rage and a tool to combat climate change goes up in smoke](#), POLITICO (July 27, 2021).

operation.³⁰ Meanwhile, the cost to capture carbon dioxide at the world's largest direct air capture plant is four to eight times higher than what is needed to turn a profit.³¹ The plant's operator does not expect direct air capture to be cost competitive until the late 2030s at the earliest. Assuming for the sake of argument that this projection is accurate, the technology will be far too late to play a significant role in meeting science-based emissions targets. Given these challenges, financial institutions relying on these technologies in their net zero plans should have to demonstrate specific, committed projects that are fully proven to reduce carbon safely and permanently at scale, and appropriately incorporate the cost of both funding and adequately monitoring those commitments into their profitability forecasts. No projects currently meet these criteria, and there may be none for decades, if ever. Given the current state of development, reliance on this technology to generate meaningful emissions reductions as part of a net-zero commitment should be viewed with extreme skepticism.

As a result of these concerns, and the current scarcity of offsets that meet quality standards, offsets are becoming increasingly disfavored among those seeking to reduce emissions in the financial sector and beyond. Global Financial Alliance for Net Zero (GFANZ) Chair Mark Carney has indicated that use of such "carbon offsets" should be a "last resort" to cover residual emissions that remain at the conclusion of an extensive process to reduce absolute emissions to zero. Similarly, the European Commission and Parliament provisionally agreed on the need to prioritize emissions reductions over emissions removals. The clear global standard is that claims of alignment with science-based targets should be based almost entirely on reducing financed emissions. The OCC, FDIC and the Fed should provide guidance on how it will assess the emissions removal component of climate commitments that reflects the challenges in employing them.

2. Any science-based climate commitment must include a bar on financing new fossil fuel projects.

The International Energy Agency's Net Zero Emissions Scenario and related Roadmap for the Global Energy Sector say that, to limit global temperature rise to 1.5°C and meet Paris Agreement goals, new fossil fuel development cannot be permitted. But, as discussed above, U.S. financial institutions are the most significant financiers of fossil fuels globally and have continued to fund both new and existing development despite voicing their support for the Paris Agreement. Financial institutions are not aligning their management plans with their climate commitments, and cannot do so as long as they do not exclude fossil fuel expansion from their business. The FDIC should work with the OCC and the Fed to explain how it will assess the alignment of continued support for fossil fuel expansion and other high emissions sectors, with net-zero climate commitments.

³⁰ Global Witness, [Hydrogen's Hidden Emissions](#) (Jan 20, 2022).

³¹ *Id.*

3. Climate commitments must include short and medium-term targets.

Most financial institutions' climate commitments promise net-zero financed emissions by 2050. Few, however, give any intermediate timelines or metrics for how they will achieve them. Given the transition risk faced by high-emissions assets, this is not a safe and sound practice. Financial institutions that expect to do the bulk of their emissions reductions in the late 2030s and 2040s may find a limited market for those assets, especially if other financial institutions have the same idea. Such a situation could require write downs of asset values that would threaten a financial institution's solvency. Measurable, near-term, sector-specific targets for absolute financed emissions are centrally important to monitoring whether a financial institution has a credible plan to meet its climate commitments and is executing the plan effectively. The FDIC should provide guidance on what a safe and sound emissions reduction pathway looks like, and the specific milestones that will help examiners assess whether a financial institution can credibly align its business with climate commitments in a safe and sound fashion.

IV. The FDIC should work with the OCC and the Fed to issue additional guidelines to protect vulnerable communities from the disparate impact of climate-related risk management.

The guidance also addresses two key ways climate risk threatens fair access to financial services. The first threat to fair access, as described above, is through impacts to the safety and soundness of local financial institutions. As indicated above, the vast majority of financial institutions in the US are local financial institutions. They are more vulnerable to climate risk than larger financial institutions due to the financial needs they meet, but are also critically important for rural communities and marginalized communities. Along with addressing the threats that the climate crisis poses to individual financial institution safety and soundness for all financial institutions, the FDIC, in collaboration with the OCC and the Fed, could also focus on limiting financial institution mergers and strengthening the Community Reinvestment Act (rules) as tools for extending credit in underserved areas. The recent proposal to revise CRA rules is a good vehicle to implement such changes.³²

The second threat to access is through measures taken by financial institutions to reduce their own exposures to climate-related credit and other financial risks. As the impacts of climate change become more severe, they exacerbate long-standing issues of environmental racism. Environmental racism is when communities of color suffer disproportionate exposure to toxins and other environmental threats.³³ It is the product of choices over decades by governments

³² Department of the Treasury, Federal Reserve System, Federal Deposit Insurance Corporation, [Community Reinvestment Act, Joint Notice of Proposed Rulemaking, Request for Comment](#) (June 3 2022).

³³ Michela Zonta and Zoe Willingham, *A CRA To Meet the Challenge of Climate Change: Advancing the Fight Against Environmental Racism*, Center for American Progress, (December

and corporations across a range of decision-making areas, from land use permissions to lax law enforcement for polluters. For similar reasons, climate change will disproportionately hurt communities of color and low-income communities. For instance, communities of color comprise a majority of the two million Americans who reside within a mile of locations vulnerable to increasing flooding.³⁴ Due to decades of disinvestments and the resulting low tax base, these communities lack the drainage and sewer infrastructure necessary to withstand more frequent flooding—and also lack the resources to build it. Other effects of outdated housing and infrastructure will also expose already vulnerable communities disproportionately to increasing severity and frequency of extreme weather and heat.³⁵

As financial institutions recognize the negative impacts of the climate crisis on their business, these structural disadvantages are increasingly reflected in the practice of “bluelining,”³⁶ or identifying areas as at higher environmental risk and raising costs or avoiding underwriting in those areas. A financial institution’s seemingly risk-based analysis will follow the same or similar boundaries as those established by previous redlining decisions that have created and perpetuated racial and economic inequality in the United States. This bluelining itself will further entrench inequality and racial disparities. Areas free of the negative effects of bluelining can use their existing tax base to invest in climate adaptation, which will allow them to retain access to credit, while the loss of insurance in bluelined areas will lower property values, degrade the tax base, and make it harder for those communities to invest in necessary adaptation.

Potentially harmful financial institution measures are likely to include closing branches in ‘hot-spot’ areas, increasing costs related to financing in these areas or limiting the availability of credit, and pursuing other measures that could reduce access to services. Such concerns may be particularly exacerbated in certain lines of business, like mortgage lending, if insurer withdrawals occur at the same time.³⁷

The proposed guidance recognizes this threat, indicating, as part of its “Management of Risk Areas” principle, that financial institution boards and management should consider how risk mitigation measures disproportionately impact communities on the basis of race, ethnicity, or another prohibited basis.

While the guidance’s attention to disproportionate impacts is welcome, financial institutions may find that it pushes them in multiple directions. That is, while the

2020,) <https://www.americanprogress.org/issues/economy/reports/2020/12/17/493886/cra-meet-challenge-climate-change>

³⁴ *Id.*

³⁵ Johanna Bozuwa and Thomas Hanna, “Building Community Wealth Through Community Resilience” 14 *Comm. Dev. Innov. Rev.* 1, 87 (Oct. 2019)

³⁶ Abraham Lustgarten, “[How the Climate Crisis Will Shape Migration in America](#),” *The New York Times* (Sept. 15, 2021).

³⁷ Brainard, *supra* note XX.

guidance directs financial institutions to do what they can to reduce their exposures, it also notes that some key measures are not acceptable due to disproportionate impacts to marginalized communities. The FDIC should move quickly to issue additional guidance on how financial institutions can continue to extend credit to vulnerable communities while acting in a safe and sound manner. For instance, the FDIC could encourage financial institutions to reduce risk elsewhere, such as lending that is particularly vulnerable to transition risk, while preserving access to credit for low- and middle-income communities. This approach will allow a financial institution to manage risk and bolster its resilience without unduly restricting credit for marginalized communities.

This guidance should be particularly attentive to the needs of smaller financial institutions, who may feel that climate risk management would render large swathes of their business unsafe. The FDIC's expanded guidance on fair access should reinforce the important role that these local and community financial institutions can serve in expanding access to credit. It should explicitly tell these financial institutions how they can incorporate climate risk data into their existing local knowledge without drawing concerns about unsafe and unsound practices. And it should make it clear that examiners will assess the risk associated with lending in support of climate resilience and adaptation for underserved communities with more leniency, as long as it follows well-designed policies and procedures.

To help small financial institutions further, the FDIC should look for ways to offer standardized climate data and modeling tools to these financial institutions. With a growing attention to climate risk, providers are raising prices or increasingly being absorbed by large financial institutions.³⁸ The FDIC, in conjunction with the Federal Reserve Board and the OCC, could help provide needed data and modeling to financial institutions that lack the resources to develop or purchase it, helping keep them safe.

V. The FDIC should continue seeking alignment with other jurisdictions.

The Principles state that the FDIC aims to consider best practices from other jurisdictions that are advancing efforts and measures that might have significance for the US. We encourage the FDIC to use these efforts as a guidepost on where to go from here. Such efforts include, for example, plans by the European Central Bank (ECB) and European Commission to require financial institutions to develop “Paris-compatible transition plans” that will “steer their business towards a smooth transition to carbon neutrality.”³⁹ UN Secretary-General Antonio Guterres is establishing an expert panel “to propose clear standards to measure and analyze net-zero commitments from non-state actors,”

³⁸ Andrew Freedman, [Why big financial firms are scooping up climate modeling companies](#), Axios (Jan. 7, 2022).

³⁹ Frank Elderson, “[Overcoming the Tragedy of the Horizon: requiring banks to translate 2050 targets into milestones](#),” Financial Markets Authority’s Supervisory Conference, (Oct. 20, 2021).

as the GFANZ begins to “start moving transition plans to a rules-based (regulatory) footing.”⁴⁰ Moreover, the Bank of England, the ECB, China’s central bank, and other central banks are actively exploring the need for other supervisory measures to respond to climate risk, including the need for increased attention to capital requirements.⁴¹

Conclusion

The Principles are an important step in protecting the safety and soundness of the American banking system from the threat of climate change. But they can have this effect only if they are quickly finalized as guidelines, and used as a departure point for issuing more detailed, tailored guidance applicable to all of the financial institutions under the FDIC’s jurisdiction. We look forward to working with you on these next steps.

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Thank you,
Public Citizen

⁴⁰ Antonio Guterres, [Statement at COP 26](#), (Nov. 1, 2021).

⁴¹ Frances Schwartzkopff, A Warming Planet is About to Revolutionize How Banks Define Risk, Bloomberg (May 27, 2021).