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VIA ELECTRONIC FILING

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RE: Federal Reserve Principles for Climate-Related Financial Risk Management for Large Financial Institutions, 87 Fed. Reg. 75267

Attention: Docket No. OP-1793

The National Community Reinvestment Coalition (NCRC) appreciates the opportunity to comment on the Federal Reserve's principles for climate-related financial risk management. NCRC and its grassroots member organizations create opportunities for people to build wealth. We work with community leaders, policymakers, financial institutions, and regulatory agencies to champion fairness and end discrimination in lending, housing, and business.

As banks create models that quantify climate risk, their risk mitigation solutions must avoid placing the burden on our most underserved, vulnerable communities. If banks pursue climate commitments in a vacuum, without incorporating equity as a factor in climate-related financial risk management, the unintended consequence could be "bluelining" of already underserved and redlined communities, where financial institutions identify areas as having higher environmental risk and avoid offering loans and banking services, or raise costs in those areas.[1]

Black, Indigenous, and people of color (BIPOC), and low-and-moderate income (LMI), communities have benefited the least from our current energy economy, and they have less resources to manage climate risk. Regulatory guidance must require that climate risk management be aligned with other aspects of bank governance including fair lending and Community Reinvestment Act obligations – and must incorporate equity and justice for underserved and vulnerable communities as a significant, cross-cutting consideration. Previous risk management strategies pursued by the federal government created "redlining" by unjustly and inaccurately categorizing communities of color as high risk communities for mortgage lending. New climate guidance must not repeat these same mistakes, and must avoid a new era of redlining under the guise of climate risk and bluelining.

In addition, banks are chartered to serve the convenience and needs of their communities, and should be a driving force for ensuring stability and opportunity for all. The Federal Reserve, as well as the OCC and the FDIC, must take a holistic approach to minimizing the economic threat of climate change and should use their supervisory role in evaluating the Community Reinvestment Act (CRA) performance of financial institutions, as well as their role in reviewing bank merger applications, to encourage a transition to a low-carbon economy and increase resources for climate resiliency and adaptation for vulnerable communities.

This letter responds to the Federal Reserve's questions regarding their draft proposals for managing climate risk, and offers improvements to the Federal Reserve's draft proposals to reflect equity considerations. We also discuss implications this has on bank merger reviews, and the currently ongoing regulatory update to the CRA. This comment letter will focus on the following issues related to climate guidance and to the climate risk management principles:

- Fair lending concerns and disproportionate impacts to communities of color and LMI communities;

[1] Abraham Lustgarten, "How the Climate Crisis Will Shape Migration in America," The NYTimes, 15 Sept 2021.

- Ensuring bank's internal strategies are consistent with their public-facing climate commitments and how this impacts the Federal Reserve's review of merger applications;
- Proactive strategies for minimizing the economic damage of climate change and implications on the CRA – such as encouraging a transition to a low-carbon economy, discouraging additional financing of fossil fuels and fossil fuel expansion, and promoting climate resiliency and adaption, and;
- Risks to Minority Depository Institutions (MDIs) and smaller banks

Question 1: **In what ways, if any, could the draft principles be revised to better address challenges a financial institution may face in managing climate-related financial risks?**

Fair Lending Concerns and Disproportionate Impact to Communities of Color and LMI Communities

Climate risk management must acknowledge that climate change has a heightened impact on underserved communities of color, and ensure that climate risk strategies do not place an additional burden on these communities by reducing the availability of loans and financial services. Climate risk strategies developed without consideration of the needs of underserved communities that are the most vulnerable to climate change will further increase wealth inequalities, and expose financial institutions to fair lending risk. The Federal Reserve's draft principles acknowledge that "the adverse effects of climate change could also include a potentially disproportionate impact on the financially vulnerable" and that "the Board will continue to encourage financial institutions to manage climate-related financial risks in a manner that will allow them to continue to prudently meet the financial services needs of their communities." While we appreciate the Federal Reserve's recognition of the disproportionate impact climate change has on vulnerable communities, more detail is needed on how these principles will ensure that financially vulnerable communities do not face additional obstacles to securing capital.

In order to prevent additional obstacles to vulnerable communities from climate risk management the Federal Reserve should clarify that fair lending risk is an essential component of all aspects of a bank's climate risk strategy, and that all aspects of climate risk management must be aligned with fair lending and fair housing obligations.

Further, we support comments submitted previously that urge the regulators to collect data to determine how prevalent climate-induced curtailing of financial services, or bluelining, has become for LMI communities and communities of color.[2] The Federal Reserve's guidance should require that banks identify, measure, monitor, and address potential and occurring disproportionate impacts on communities of color and LMI communities. Banks should have a system for tracking their actions to avoid or address disproportionate impacts and documenting their progress on addressing those impacts, and the public should have access to information about these internal monitoring systems and the results of corrective actions. The Federal Reserve should also provide examples of climate risk mitigation strategies that pose potential fair lending risk exposure for banks.

Question 2: **Are there areas where the draft principles should be more or less specific given the current data availability and understanding of climate-related financial risks? What other aspects of climate-related financial risk management, if any, should the Board consider?**

Ensuring Bank's Internal Strategies are consistent with their Public-Facing Climate Commitments

We appreciate that the principles drafted by the Federal Reserve and other regulators call attention to the need for a bank's internal strategies to be consistent with their public-facing climate commitments. The regulators must commit to actively monitoring banks internal strategies for alignment

[2] Letter to OCC from Americans for Financial Reform et al., re OCC Principles for Climate-Related Financial Risk Management for Large Banks, Attention: Docket ID OCC-2021-0023-0001, February 14 2022

with their public commitments. This will ensure the integrity of a financial institutions climate commitments, and assure the public - including investors and other stakeholders - that climate commitments are aligned with a banks overall business strategy and are factored into decision making regarding their loan and investment portfolios. Furthermore, we request additional detail in the principles on the role regulators will play in ensuring the alignment between public climate commitments and internal strategies, such as issuing conditional approvals on the achievement of climate commitments.

The Federal Reserve has a unique role to play on this issue given its role in reviewing bank mergers involving state member banks of the Federal Reserve System, as well as mergers that involve bank holding companies. An important part of this review is the bank's record of serving the convenience and needs of the communities where they do business, and how the bank will continue to meet community needs if the merger is approved. Banks are increasingly including climate commitments in the convenience and needs section of merger applications, including the recently approved application of BMO Harris Bank and Bank of the West that highlights how both banks are members of the Net-Zero Banking Alliance.[3]

Currently, the Federal Reserve has refused to consider climate issues raised in comments on merger applications. In the recent approval of the Bank of Montreal-Bank of the West merger, the Federal Reserve's order stated: "Some commenters expressed concerns regarding the amount of funding that BNP Paribas [Bank of the West's holding company] and Bank of Montreal have provided to fossil-fuel companies, while one commenter requested that the combined organization publish annual disclosures related to environmental issues… These comments concern matters that are outside the scope of the limited statutory factors that the Board is authorized to consider when reviewing an application under the BHC Act."[4] This is at odds with the Federal Reserve's stated concerns about climate risk – and we disagree with the assertion that the Board cannot consider and act on critically important issues like climate change caused by investments in fossil fuel infrastructure and production. If banks are citing climate commitments as evidence of how they serve communities in order to help secure merger approvals, then regulators should use their authority under the Bank Holding Company Act to issue conditional approvals related to convenience and needs to ensure that banks have the required strategies in place to meet these commitments, and ultimately should ensure that commitments are met in full.[5] In general, regulators could significantly improve the merger review process by increasing monitoring of compliance and timely completion of all commitments made in merger applications, including community benefits agreements negotiated with community groups.

Furthermore, the Federal Reserve would also have authority under the Bank Holding Company Act to issue conditional approvals relating to climate commitments due to safety and soundness concerns raised by climate change, regardless of whether a bank included these commitments in merger applications.[6] Climate change poses significant safety and soundness concerns due to increased climate-related economic disruptions, as well as the transition risk facing financial institutions heavily invested in fossil fuels. Transition risk related to fossil fuel loans and investments will steadily increase due to massive incentives for renewables provided by the Inflation Reduction Action Act, by technological change, and increasing public demand for a transition to a low carbon economy. Given the increasing physical and transition risk of loans and investments in fossil fuels, the regulators should incorporate climate related risk into the safety and soundness review of merger applications, and use their authority to conditionally approve mergers to require banks with significant financing of fossil fuels to detail plans for

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[3] In addition to the BMO Harris Bank-Bank of the West merger application, climate commitments have also been cited in the recent applications for the PNC Bank-BBVA USA merger, and the U.S. Bank-MUFG Union merger.
[4] FEDERAL RESERVE SYSTEM Bank of Montreal Montreal, Canada BMO Financial Corp. Wilmington, Delaware Order Approving the Acquisition of a Bank Holding Company and the Merger of Bank Holding Companies. FRB Order No. 2023-01 January 17, 2023. Page 13.
[5] 12 CFR § 225.13 - Factors considered in acting on bank acquisition proposals.
[6] Ibid.

how they will manage and minimize the physical and transition risk associated with these loans and investments.

As part of the review of public climate commitments and internal strategies, we support the comment submitted by Public Citizen that urges the regulators to clarify that financial institutions committing to net zero by 2050 must have in place, and must implement, credible internal strategies that meet the imperatives of climate science, technological realities, and safety and soundness.[7] When net zero commitments are cited in merger applications, the Federal Reserve should conditionally approve the merger based on adoption of credible plans to achieve commitments that include milestones such as a 50% reduction in absolute financed emissions by 2030, and also require disclosure of Scope 1, 2, and 3 emissions. Scope 3 emissions are particularly important in the case of financial institutions since this captures the environmental impact of a bank's loans and investments. We also urge the Federal Reserve and other regulators to clarify that offsets have deep limitations, and should be reflected in transition plans only as measures to negate residual emissions that remain after financial institutions have reduced financed emissions as much as technologically possible. A recently released investigation of the carbon offsets offered by Verra, the world's largest provider of carbon offset credits, questions whether many carbon offsets actually represent genuine carbon reductions, and may have even increased global heating in some cases.[8] Financial institution commitments to net-zero must also include a bar on financing new fossil fuel projects. In addition, the Federal Reserve should explain that, regardless of whether banks have made a public commitment to reduce financed emissions, establishing a science-aligned transition plan is an effective and increasingly important way to reduce transition risk, as well as physical risk, in the longer term.

The Federal Reserve has also not provided detail on when a public-facing commitment would potentially trigger a review of internal strategies. We encourage the regulators to include any climate commitments made by financial institutions as triggering this review, and to not limit this only to climate commitments included in merger applications due to safety and soundness concerns cited above. Additionally, this review should not be limited to commitments cited in merger applications since it assures the public, including investors, that a bank's public commitments genuinely reflect the business strategy of the bank.

Proactive Strategies for Minimizing Economic Risk of Climate Change

The recommendations to the principles we have already discussed are critical, but we also must acknowledge that these steps alone will not go far enough to reduce the economic and financial risks caused by climate change. As comments submitted previously to the OCC and the FDIC on the development of their climate risk principles have stated, climate impacts–especially in underserved communities–are leading to ever-increasing annual direct damages in the form of disruption to local economies based on agriculture, tourism, and energy, and even emigration and loss of tax base, effectively bankrupting small towns across the country and destabilizing local financial institutions.[9]

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[7] Letter to Federal Reserve from Public Citizens et al., re Federal Principles for Climate-Related Financial Risk Management for Large Banks, Attention: Docket No. OP-1793. February 6 2023.

[8] "Revealed: more than 90% of rainforest carbon offsets by biggest provider are worthless, analysis shows" The Guardian. January 18 2023. Available online at https://www.theguardian.com/environment/2023/jan/18/revealed-forest-carbon-offsets-biggest-provider-worthless-verra-aoe

[9] Letter to OCC from Americans for Financial Reform et al., re OCC Principles for Climate-Related Financial Risk Management for Large Banks, Attention: Docket ID OCC-2021-0023-0001, February 14 2022 and NOAA, "Billion-Dollar Weather and Climate Disasters," 2022. https://www.ncdc.noaa.gov/billions/ and U.S. Global Change Research Program, "Fourth National Climate Assessment -Volume II: Impacts, Risks, and Adaptation in the United States," 2018. https://nca2018.globalchange.gov and The NYTimes and ProPublica, "The Great Climate Migration," 2020. https://www.nytimes.com/interactive/2020/07/23/magazine/climate-migration.html and Organisation for Economic Co-operation and Development (OECD), "Climate Change and Long Term Fiscal Sustainability," 2021.

Inflation-adjusted, climate-related losses in the insurance sector alone have been increasing from an average of around $50 billion per year in the 1980s to around $200 billion per year during the period from around 2007 – 2017.[10] Given the unprecedented threat posed to our economic security posed by climate change, the regulators must do more to discourage additional financing of the fossil fuel industry, while also encouraging banks to dramatically increase resources for climate resiliency and adaptation for vulnerable communities.

Just as the Federal Reserve's principles call on financial institutions to adopt a whole-of-business approach to mitigating climate risk by considering "material climate-related financial risk exposures when setting the financial institution's overall business strategy, risk appetite, and capital plan," the regulators must also adopt a similar whole-of-business approach to mitigating economic damages caused by climate change – in particular, the harms faced by communities, and not only those faced by financial institutions. This letter has already discussed how the Federal Reserve and other regulators involved in reviewing bank merger applications can use that process to ensure alignment between public commitments and internal strategies. We will now turn to proactive steps the Federal Reserve, as well as the OCC and the FDIC, should take to protect the convenience and needs of the communities most vulnerable to climate change, and implications on the ongoing update to the CRA.

Encouraging a Transition to a Low-Carbon Economy

Climate change is increasingly disrupting the economies and livelihoods of communities across the country, with most of the burden falling on communities of color. To effectively address this, we must encourage banks to reduce the carbon footprint of their loan and investment portfolio due to the overwhelming risks to economic stability posed by increased reliance on fossil fuels, and must also encourage climate mitigation investments in underserved communities. The Federal Reserve should take a more proactive approach to encouraging the transition to a sustainable, low carbon, economy, as well as encouraging financial institutions to finance climate resiliency and remediation. The European Central Bank has established core objectives for climate guidance that include "promoting sustainable finance to support an orderly transition to a low-carbon economy".[11] The Federal Reserve should also adopt promoting an orderly transition to a low-carbon economy as a core objective of climate related guidance to financial institutions. In order to accomplish this critically important objective, the Federal Reserve should encourage banks to adopt credible science-based net-zero transition plans.

In addition, the Federal Reserve should use its role as the primary regulator in charge of evaluating Community Reinvestment Act (CRA) performance of member banks of the Federal Reserve System to both discourage additional investment in fossil fuel infrastructure and expansion, and encourage financing for climate resiliency and adaptation targeted to underserved communities. These are necessary steps in order to accomplish the goal of a "net-zero emissions economy by no later than

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https://www.oecd.org/gov/budgeting/scoping-paper-on-fiscal-sustainability-and-climate-change.pdf and The NYTimes, "Climate Change is Bankrupting America's Small Towns," September 2021. https://www.nytimes.com/2021/09/02/climate/climate-towns-bankruptcy.html and The Wall Street Journal, "Banks Take a Hit from Hurricanes Katrina, Rita," 2005. https://www.wsj.com/articles/SB112993899645076384

[10] Stranded Assets, page 8, citing (a) CISL 2015. Unhedgeable risk: How climate change sentiment impacts investment. Available at: http://www.cisl.cam.ac.uk/publications/publication-pdfs/unhedgeable-risk.pdf; (b) Caldecott, B. & McDaniels, J. 2014. Financial Dynamics of the Environment: Risks, Impacts, and Barriers to Resilience. Available at: https://www.environmental-finance.com/assets/files/2014-07-15%20UNEP-SSEE%20Working%20Paper%20-%20Financial%20Dynamics%20of%20the%20Environment.pdf; and (c) Kollewe, J. 2014. Lloyd's calls on insurers to take into account climate-change risk. The Guardian, 8 May 2014. Available at: https://www.theguardian.com/business/2014/may/08/lloyds-insurer-account-climate-change-extreme-weather-losses

[11] "ECB Climate Agenda 2022." July 4 2022. Available online at https://www.ecb.europa.eu/press/pr/date/2022/html/ecb.pr220704_annex~cb39c2dcbb.en.pdf

2050" as stated in Executive Order 14030 issued by the Biden Administration in 2021, and to avoid the worse outcomes of climate change.[12]

Discouraging Fossil Fuel Infrastructure and Expansion

The Paris Agreement defines 2° Celsius as the upper limit for global warming, but also notes that 1.5° is a more desirable goal because it reduces the risk for the worst outcomes of climate change in most of the world.[13] The potential carbon emissions from the oil, gas, and coal in the world's currently operating fields and mines would take us beyond 2°C of warming, and the reserves in currently operating oil and gas fields alone, even without coal, would take the world beyond 1.5°C.[14] This is why it is critically important that the Federal Reserve and the other agencies in charge of evaluating CRA performance use the ongoing CRA rulemaking process and subsequent bank examinations to establish that not only will banks not receive credit for financing of fossil fuel infrastructure, but take an additional step of giving negative credit for financing fossil fuel infrastructure and expansion. Regulators should review a bank's loan and investment portfolio for these types of loans and investments, and reduce their total from the banks reported CRA-eligible community development loans and investments. Banks would then be encouraged to reduce financing for fossil fuel infrastructure and expansion, and instructed that the reduction they received in their total CRA-eligible community development portfolio could only be offset through financing of climate resiliency and remediation activities specifically targeted to underserved communities, such as LMI communities, communities of color, and rural communities.

These improvements to the CRA framework would not only discourage financing for fossil fuel expansion, but would also dramatically encourage banks that have been financing fossil fuels to finance additional climate resiliency and remediation efforts. For example, a 2022 report prepared by several environmental organizations found that many US banks provided billions in financing to the fossil fuel industry from 2016 to 2021.[15] With these recommended changes, CRA evaluations would determine the amount of US based fossil fuel loans and investments a bank originated or held during their evaluation period, and would reduce that amount from the CRA eligible community development loans and investments reported by that institution. This would only be offset by financing of climate resiliency and remediation efforts, therefore encouraging banks active in financing the fossil fuel industry to pursue billions of dollars of this type of needed community development.

Promoting Climate Resiliency and Adaptation

As NCRC and others noted in our comments on rule changes to the CRA, the Federal Reserve could further encourage financing for climate resiliency and remediation by providing in the final updated CRA rule that the following activities are eligible for CRA community development credit, and would

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[12] Exec. Order No. 14,030, 87 Fed. Reg. 27967 (May 20, 2021), at https://www.federalregister.gov/documents/2021/05/25/2021-11168/climate-related-financial-risk.

[13] "Why did the IPCC choose 2° C as the goal for limiting global warming?" MIT Climate Panel. June 22 2021. Available online at https://climate.mit.edu/ask-mit/why-did-ipcc-choose-2deg-c-goal-limiting-global-warming#:~:text=This%20agreement%20clearly%20defines%202,in%20most%20of%20the%20world.

[14] "The Sky's Limit: Why the Paris Climate Goals Require a Managed Decline of Fossil Fuel Production," Oil Change International, 22 September 2016. Available online at https://priceofoil.org/2016/09/22/the-skys-limit-report/ and "Banking on Climate Chaos: Fossil Fuel Finance Report 2022" Available online at https://www.bankingonclimatechaos.org//wp-content/themes/bocc-2021/inc/bcc-data-2022/BOCC_2022_vSPREAD.pdf

[15] "Banking on Climate Chaos: Fossil Fuel Finance Report 2022" Available online at https://www.bankingonclimatechaos.org//wp-content/themes/bocc-2021/inc/bcc-data-2022/BOCC_2022_vSPREAD.pdf

also receive positive consideration in the newly proposed "impact review" of the community development test:

- the development of climate resilient affordable housing, schools, and businesses;
- clean electricity projects and microgrids;
- nature-based protective infrastructure ("green infrastructure");
- building decarbonization, which includes holistic home weatherization and health interventions;
- lending to green small businesses and corporations with legitimate decarbonization transition
- strategies;
- electric public transit and electric vehicle charging infrastructure;
- investments in weatherization and climate resilience for local businesses; and
- operational support and capacity building for environmental and climate justice organizations, including support for community groups active in environmental testing and training of community members to identify environmental risks in their communities

These activities need to be structured with the specific goal of increasing the resiliency and adaptability of the underserved, or else they run the risk of increasing disparities. In order to receive CRA credit for these activities, banks should have to demonstrate that these activities substantially benefit underserved communities most affected by climate change, and show evidence of community participation in decision-making related to these loans and investments. Updated CRA exams after the adoption of a new CRA final rule should include data fields concerning the numbers and percentages of LMI families or households benefiting from these activities, and information on the community groups consulted and how these loans and investments respond to community input. Additional recommendations for how the CRA can address climate issues can be found in NCRC's comment letter on the regulators Notice of Proposed Rulemaking regarding the CRA submitted in August 2022.[16]

Question 3: **What challenges, if any, could financial institutions face in incorporating these draft principles into their risk management frameworks?**

Risks to MDIs and Smaller Banks

We recognize that these draft principles are intended for banks with $100 billion in assets or more, but difficulties associated with managing climate risk will be more challenging for smaller banks that have fewer resources and tend to have loan and investment portfolios tied to specific markets and regions, as opposed to larger, national banks. Climate related disruptions will disproportionately affect MDIs since many of them are located in communities highly vulnerable to climate change. The University of Notre Dame's Urban Adaptation Assessment tool indexes specific cities risk using historical and projected costs from climate-related hazards, as well as calculating a cities readiness to adapt based on social, governmental, and economic indicators.[17] Using this tool and information on the location of MDIs from the FDIC, at least 80 of the 145 active MDIs are headquartered in cities with high climate risk (55%), and 42 are headquartered in cities with high climate risk and low readiness (29%).[18] MDIs are a critical source of affordable financial products and services for many underserved

[16] NCRC's Full Public Comment Letter On Community Reinvestment Act Interagency Rulemaking. August 4 2022. Available online at https://ncrc.org/ncrcs-full-public-comment-letter-on-community-reinvestment-act-interagency-rulemaking/

[17] University of Notre Dame's Urban Adaptation Assessment. Available online at https://gain-uaa.nd.edu/?referrer=gain.nd.edu

[18] These are the minimum number of MDIs headquartered in cities with higher climate vulnerability. Incomplete data from the FDIC prevents an analysis of all 145 MDIs. FDIC information on financial institutions is available online at the FDIC's BankFind Suite at https://banks.data.fdic.gov/bankfind-suite/bankfind?activeStatus=1&branchOffices=true&pageNumber=1&resultLimit=25

communities, and the Federal Reserve should act as quickly as possible to offer MDIs and small banks tailored guidance and best practices for climate resiliency and green lending strategies.

To accomplish this, we support comments previously submitted that direct the regulators to work with MDIs and smaller banks to disseminate policies and procedures that have worked to maintain resilience during previous disasters and encourage their implementation.[19] The Federal Reserve should prioritize providing guidance on green lending for underserved communities, which will help small banks deploy capital in socially productive ways. To do this, the Federal Reserve can survey what has worked for MDIs and smaller banks, or even green banks, who have successfully underwritten such loans, and transmit the specific policies and procedures that could be put in place to underwrite green loans in novel markets. Such guidance will provide confidence to smaller banks and MDIs in moving forward on these kinds of loans.

Conclusion

We thank the Federal Reserve for moving forward with principles for managing climate risk within the banking system, and we urge your consideration of the racial and economic equity considerations discussed in this letter, as well as the recommendations for minimizing the economic damage of climate change. If you have any questions about this comment, please contact Kevin Hill, NCRC Senior Policy Advisor, at khill@ncrc.org.

Sincerely,

Jesse Van Tol
President and CEO
National Community Reinvestment Coalition

[19] Letter to OCC from Americans for Financial Reform et al., re OCC Principles for Climate-Related Financial Risk Management for Large Banks, Attention: Docket ID OCC-2021-0023-0001, February 14 2022