

June 30, 2022

Dietrich Domanski, Secretary General
Secretariat to the Financial Stability Board
Centralbahnplatz 2
CH-4002 Basel, Switzerland
Via Email to fsb@fsb.org

Re: Supervisory and Regulatory Approaches to Climate-Related Risks: Interim Report (29 April 2022) – Response to Request for Comment

Dear Secretary General Domanski:

It is a pleasure to submit comments on behalf of [Ceres](#) and the [Ceres Accelerator](#) for Sustainable Capital Markets. Ceres is a nonprofit organization with over 30 years of experience working on climate change. The Ceres Accelerator works to transform the practices and policies that govern capital markets in order to reduce the worst financial impacts of the climate crisis. It spurs capital market influencers to act on climate change as a systemic financial risk—driving the large-scale behavior and systems change needed to achieve a just and sustainable future and a net zero emissions economy.

Ceres works with leading global investors and companies. Our Investor Network is currently over 220 investors that collectively manage over \$60 trillion in assets. Ceres is a founding partner of the [Net Zero Asset Managers Initiative](#) and the [Paris Aligned Investor Initiative](#), which includes investors focused on sustainable investments within their portfolios and other assets. Our Company Network includes approximately 60 of the largest global companies with whom we work on an in-depth basis on climate strategy and disclosure, among other issues.

We congratulate the Financial Stability Board (FSB) for designing this interim report on Supervisory and Regulatory Approaches to Climate-Related Risks. Below, we provide our comments to the questions posed in the report.

I. SUPERVISORY AND REGULATORY REPORTING AND COLLECTION OF CLIMATE-RELATED DATA FROM FINANCIAL INSTITUTIONS

A. The most important climate-related data for supervisors' and regulators' identification of exposures and understanding of the impacts of climate-related risks of financial institutions and across financial sectors

Ceres has published two reports on climate-related financial risks for banks – one on [Transition Risk](#) and another on [Physical Risk](#). In these reports, we make recommendations that the existing capital adequacy regime be expanded to include climate stress testing with eventual adjustments

to both bank liquidity and capital requirements.¹ These reports also recommend that financial institutions engage with their borrowing clients on a sector-by-sector basis to obtain climate-relevant data, with consideration given to the unique transition risks (including legal and reputational) and physical risks inherent to each industry sector. Banks should update or refine their decisions based on this data as they obtain new information. Specifically, we recommend that financial institutions obtain the following data in support of effective climate risk management:

- Scope 1, 2, and 3 GHG emissions data from borrowers;
- Information on planned capital expenditures and their likely impact on company emissions, as well as transition plans (if available);
- Geolocational information of all critical borrower infrastructure; and
- Borrower climate disclosures prepared using the TCFD framework (banks should encourage borrowers to disclose this information using the TCFD framework to ensure that climate-relevant data is comparable across industries and geographies).

To minimize compliance costs, the FSB should also encourage financial institutions to actively contribute to the development and sharing of climate-relevant borrower data, as appropriate. Financial institutions should collaborate with customers, peers, academics, and regulators to obtain and understand these data. The FSB should also encourage financial institutions to use a common set of standards, such as the [PCAF framework](#), for measuring their Scope 3 emissions associated with client activities.² Without a standardized framework, it may be difficult to accurately assess banks' risk and the effectiveness of their mitigation strategies.

B. Appropriate areas to increase the reliability of climate-related data reported by financial institutions

The FSB should consider recommending that supervisors and regulators issue binding guidance that would provide standards for financial institutions to ascertain data on their GHG emissions to guarantee that disclosures among institutions are consistent, comparable, and reliable. Moreover, we recommend that existing regulatory reporting requirements for financial institutions be expanded to require the use of the TCFD framework to ensure that public disclosure of climate relevant information is comparable globally and across financial institutions of varying asset size, location, and business model.

Regulators should provide clear guidance on the minimum requirements to conduct a materiality assessment. In conducting these assessments, financial institutions should be required to report

¹ In 2021, Ceres also provided [testimony to the United States House of Representatives](#) on the importance of climate stress tests as part of an effective bank capital adequacy regime.

² Investors are [increasingly requesting](#) companies' Scope 3 data.

their results, including what data was used in the assessment to allow comparability across sectors, and an explanation of why information was determined material or not. Financial institutions should also focus their assessments on financial opportunities as well as financial risks, and consider context-specific metrics such as asset locations, local laws, and geographical information. Determination of whether such climate-related financial risks are material should mirror those determinations made in other risks assessments by a bank.

Many financial institutions have identified specific tools and/or strategies in at least some detail in their general reporting, integrating climate risk into existing risk types and systems rather than treating it as a separate risk. When financial institutions are unable to quantify risks, they have reverted to describing the risks in qualitative terms, which we would consider a minimum threshold for climate risk management. Ceres recommends that FSB encourage regulators to develop consistent data standards, definitions, climate-related data terms, and relevant metrics to inform discussions. Regulators should continue to coordinate with their international regulatory counterparts to identify and evaluate regulatory, policy, and data gaps.

Additionally, financial institutions can take action on many climate-related financial issues despite uncertainty in other areas. For example, the [New York Department of Financial Services notes](#) that institutions “should establish board governance and an organization structure that supports the effective management of climate risks and develop their expertise and capacity to assess and manage climate risks on both sides of their balance sheets.” Such actions could “be implemented with relative speed and confidence.”

C. Identification of the elements of a common high-level definition of climate-related risks

Climate risk permeates all aspects of the capital markets, similar to cyber security risks and the coronavirus pandemic, presenting an increasing threat to financial stability and posing grave threats to financial institutions of all sizes and business models. The FSB should encourage regulators to promulgate guidance that assists financial institutions in factoring the climate change-related transition, physical, liability, and reputational risks of their borrowers into their capital, loan pricing and credit allocation decisions. We believe it is important that large financial institutions do so on a sector-by-sector basis, with consideration given to the unique transition risks (including legal and reputational) and physical risks inherent in each industry sector and client vertical. Likewise, financial institutions must develop the ability to assess if climate-related transition and physical risks will cause certain assets (including trading book assets) to become so illiquid that they are effectively “stranded.” Future FSB guidance should assist authorities and financial institutions in developing plans to unwind such assets, or set aside more capital against these potential “stranded assets.”

In addition to transition, physical, and liability risks, financial institutions face reputational risks. Based on Ceres’ interactions, many of the largest financial institutions currently offer their borrowers a variety of “green” products, such as sustainability-linked loans and derivatives with

embedded sustainability KPIs. While we encourage financial institutions to support their client’s climate risk management and sustainability efforts, they should pay attention to the potential unique reputational risks these products entail, such as the risk of “greenwashing” by the financial institution and/or the borrower. Greenwashing is the process of knowingly or unknowingly conveying a false impression as to how sustainable or environmentally sound a product or service actually is. It can occur when the benefits conferred by the product or service are not material to the bank or borrower, or relevant to the borrower’s primary business activity. Such practices may also be considered “deceptive” in some nations, such as the [United States](#). As such, we ask the FSB to consider defining this risk. We also recommend that the FSB encourage regulators to update bank compliance frameworks to include greenwashing surveillance similar to the U.S. SEC’s current [initiatives](#) to proactively identify ESG-related misconduct.

Further, FSB should provide guidance as to the cross-cutting nature of climate-related financial risk. Capital and asset quality could be significantly affected by both transition and physical risks, particularly where an institution has geographical or sector concentrations vulnerable to these risks. Management’s ability to adequately assess, plan for, and mitigate these risks, including through access to appropriate and timely data to measure the bank’s exposure, could be factored into the management component. Earnings and liquidity could also be implicated where a bank has made significant amounts of loans to sectors that are heavily reliant on fossil fuels and the bank (and its customers) has failed to adequately plan for transition or the bank’s loans are supported by collateral increasingly at risk from severe weather events and rising sea levels.

D. Recommendations to help accelerate the identification of authorities’ climate-related information needs from financial institutions and work towards common regulatory reporting frameworks

In addition to the data reporting and collection recommendations, the FSB could suggest authorities implement an assessment program to assist financial institutions in determining their risk profile and level of climate-related risk preparedness.³ Authorities could provide resources to help financial institutions understand supervisory expectations, how climate risks relate to traditional financial risks, and assess and manage these risks. This could include a pilot program at smaller institutions to enable authorities to assess how these institutions manage and mitigate climate risks. Authorities could then use the data it collects from such a program to develop a self-assessment tool to assist smaller institutions in evaluating those risks and their risk management capabilities. Data, results, and observations from the program could be published publicly to increase the efficiency and quality of data collection and risk management, including findings

³ For example, the U.S. Federal Financial Institutions Examination Council’s (FFIEC) [Cybersecurity Assessment Tool](#) (CAT) was launched to assist banks and examiners determine a bank’s risk profile and level of cybersecurity preparedness, and enable state and federal regulators to assess how the institutions manage cybersecurity and mitigate cyber risks.

regarding inherent climate-related financial risks reflecting institution size, complexity, risk profile, and scope of operations differences.

II. INCORPORATING SYSTEMIC RISKS INTO SUPERVISORY AND REGULATORY APPROACHES

A. Identification of relevant system-wide aspects that should be considered as part of supervisory and regulatory approaches to incorporate systemic risks arising from climate change

Ceres has published reports on the [physical](#) and [transition](#) risks which address related systemic risks, as well as a report specifically exploring the [systemic risks](#) presented by climate change to financial institutions and the broader economy. This report outlines numerous cumulative impacts, as well as recommendations to regulators for addressing these risks.

B. Extent to which current supervisory and regulatory tools and policies address climate-related risks

The FSB should consider recommending authorities expand their existing capital adequacy regimes to include climate stress testing with eventual adjustments to both liquidity and capital requirements. Existing regulatory reporting requirements for financial institutions should also be expanded to require the use of the TCFD framework to ensure that public disclosure of climate relevant information is comparable globally and across financial institutions of varying asset size, location, and business model.

Additionally, current approaches to climate risk modelling by many large financial institutions treat climate risk in a manner analogous to credit risk – climate risk is quantified using sophisticated models, and capital or risk limits are adjusted to account for this risk. For financial institutions without these capabilities, or where the cost of implementation would be prohibitive, we suggest that future FSB guidance treat climate risk in a more prescriptive manner similar to its operational risk guidance.

Furthermore, as part of identifying and quantifying climate-related financial risks, large financial institutions should establish and disclose [net zero plans](#) that describe in detail how they plan to decarbonize their business activities and achieve net zero emissions by no later than 2050. These plans should provide practical, actionable steps for financial institutions to create an effective net zero transition, [including](#) assessment of assets that may be exposed to climate transition risk, internal valuation tools, and disclosure of risk assessments that identify climate-relevant sectors and the percentage of at-risk assets in these sectors. Large financial institutions should also set

detailed interim decarbonization goals (for example, 2030 or 2040 Paris-aligned goals) and provide a timeline with regular updates towards achieving them.⁴

Finally, all interim goals and 2050 net zero commitments should incorporate the latest science, use credible climate scenarios, and disclose decarbonization progress on a sector-by-sector basis. Banks should engage clients on their own climate strategies by, for example, requiring clients to provide data in key climate-related areas, such as energy technology and emissions profiles; aggregating those data using methods such as carbon accounting; and building climate risk into day-to-day decision-making tools, such as client earnings models. Ceres encourages the FSB to consider recommending augmentation of existing regulatory reporting requirements to include integrated assessment models and their usage in a climate-risk loss forecasting context.

C. Recommendations on incorporating systemic risks into supervisory and regulatory approaches in the appropriate areas

Ceres maintains an active and regular dialogue with U.S. financial institutions of varying asset size, location, and business model, and most of the U.S.-based G-SIBs are members of Ceres' Company Network. Based on our interactions, it is clear that the uses and challenges financial institutions face regarding climate risk management varies greatly by size. For example, many of the largest financial institutions currently use some form of climate-risk scenario analysis and/or climate-risk stress testing to evaluate the transition and physical risks associated with their lending portfolios. The main challenges they face in advancing their climate scenario analysis and stress testing programs are technical in nature:

- Even with considerable client engagement, they face difficulty in obtaining borrower-specific climate data (for example, GHG emissions).
- In general, larger, publicly-listed borrowers are more likely to provide financial institutions with climate data, whereas small to mid-size and privately-owned borrowers are less willing or able to generate this information.
- In some cases, large financial institutions are unsure of which climate scenarios are most relevant for their business model or the most relevant scenarios do not provide sufficient detail in some areas critical to financial institutions.

In contrast, the use of climate-risk scenario analysis and/or climate-risk stress testing for regional and community banks can be characterized as being in its infancy. Moreover, the main challenges

⁴ For example, financial institutions could validate their goals through the [Science Based Targets initiative](#), a recently launched a methodology for banks to set targets that include financed emissions. Although aligning with this methodology will enhance comparability, banks should focus first on a goal that will incentivize action internally and reflect their risk management strategy to the greatest possible extent.

they face in advancing their climate scenario analysis and stress testing programs are both technical and operational in nature:

- Some regional and community financial institutions do not yet consider climate to be a material risk factor, and so are not engaging their borrowers in obtaining climate-relevant data.
- When client engagement does occur, borrowers are unable or unwilling to provide climate data (for example, GHG emissions).
- In some cases, regional and community financial institutions are unsure of which climate scenarios are most relevant for their business model.
- Often, financial institutions wait for regulatory guidance before investing resources in the design of climate-risk scenario analysis and/or climate-risk stress capabilities.

When designing and executing scenario analysis, at a micro-level, we believe that the scientific rigor and transparency of the scenarios are paramount. As such, financial institutions should ensure that their scenarios:

- Are science-based and aligned with the most current climate science;
- For transition risk, the scenarios should consider both an “orderly” and “disorderly” transition;
- For physical risk, the scenarios should contain at least one “worst case” scenario;
- Assumptions regarding both demand and prices for commodities (such as oil) should be transparent and clearly stated; and
- Scenarios should be aligned with current best practices (i.e., IEA and NGFS scenarios).

The FSB should encourage regulators to begin conducting these exercises quickly. Although initial models may be simplistic, regulators should eventually provide multiple scenarios as described above. Additionally, as climate risk permeates all aspects of the capital markets and poses grave threats to financial institutions of all sizes and business models, we recommend that these scenario analyses eventually be adopted by all financial institutions irrespective of asset size, location, or business model. For example, regional banks may experience higher rates of failure climate events and natural disasters that impact discrete geographic areas. Scenario analysis implementation could initially be tailored by financial institution size, with the threshold lowered overtime as more data becomes available to smaller banks, allowing those banks to build capacity. Regulators must also ensure that banks have access to educational resources in support of bank innovation regarding climate scenarios, models, and data.

Finally, Ceres believes that climate scenario analysis exercises should eventually [evolve](#) into a formalized climate stress testing regime which informs regulatory capital adequacy metrics.

Regulators should review financial institutions’ models to ensure they are suitably robust, and that financial institutions are not “model shopping” to avoid poor outcomes. Without climate stress testing (including a comprehensive capital adequacy regime), we believe that financial institutions are at risk of running a higher quantum of enterprise risk than they are aware of, posing a danger to the safety and soundness of our financial system.

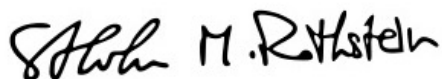
III. EARLY CONSIDERATIONS ON OTHER MACROPRUDENTIAL TOOLS AND POLICIES

A. Other areas of work, literature, or research being conducted on macroprudential tools and policies on climate-related risks that should be considered in the report

The New York University (NYU) Stern Volatility and Risk Institute (VRI) has established a research program on climate-related financial risks. This research includes the effects of sea level rise on real estate prices, discount rates for long horizon investments, portfolio strategies for sustainable investing, and macroeconomic consequences of decarbonization. A recent [conference](#) hosted by the VRI highlighted research on critical macroeconomic and policy issues associated with the climate transition.

Once again, we congratulate the FSB for its fine work in developing this report. The Board’s leadership on this critical issue is deeply valued. We would be pleased to discuss any questions you may have on our feedback.

Sincerely,



Steven M. Rothstein
Managing Director
Ceres Accelerator



Kelsey Condon
Manager, Banking Financial Regulation
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