Addressing climate as a systemic risk:
A call to action for U.S. financial regulators

A presentation to:

NASCUS

The National Voice of the State Credit Union System

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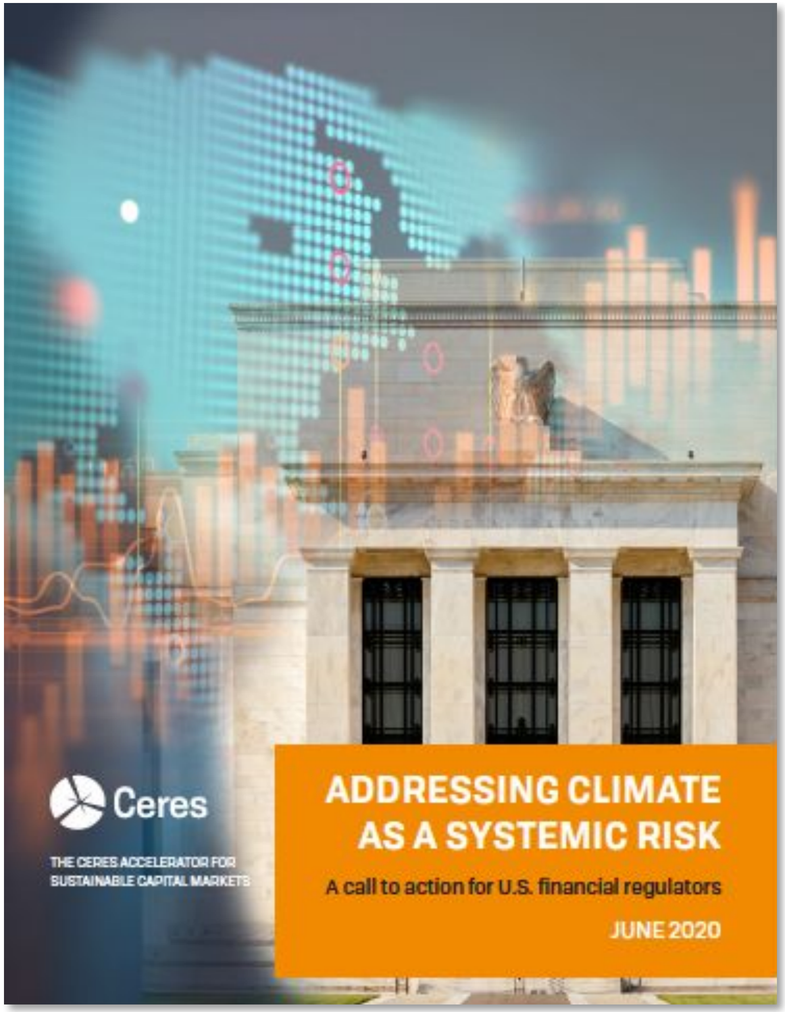
The Ceres Accelerator will, in the short term, work towards:

- **Achieving Paris-Aligned Portfolios**
- **Regulating Climate as a Financial Risk**
- **Financing a Net-Zero Economy**
- **Board governance for a sustainable future**

Addressing climate as a systemic risk:
A call to action for U.S. financial regulators

- Goals of report:
  1. Make the case that climate change is a systemic risk
  2. Outline action steps that U.S. financial regulators can take based on *their existing mandate*
- Focused on federal and state regulators
- Built on detailed legal analysis and a comprehensive literature review; 3 dozen interviews with current and former regulators, academics, investors and NGOs, assessment of evolving practice globally



The Climate Crisis and Economic Stability

Systemic risks are risks that have the potential to destabilize the normal functioning of the capital markets and lead to serious negative consequences for financial institutions and the broader economy.

Evidence strongly indicates that climate change is a systemic risk:

- **Increasingly frequent extreme weather events** have led to mounting economic losses
- **Social and environmental factors** are exacerbating economic impacts: Health & productivity; Community impacts and Population Upheaval; Biodiversity Losses

Actions US Financial Regulators Can Take on Climate Change

US financial regulators should proactively address and act on climate change across their mandates to:

- **Affirm** that climate change is a systemic risk and **assess** climate impacts on financial market stability
- **Integrate** climate change into prudential supervision
- **Mandate** climate change disclosure
- **Coordinate** with each other and the global regulator community to develop a shared approach to addressing the global crisis

- Such actions fall within the **existing mandate** of the agencies in question.
- Similar actions are being taken by **financial regulators globally.**
- As **regulators of the largest economy** in the world, US regulators risk being left behind and have an especially important reason to act. Inaction affects US competitiveness
- While this blueprint focuses on a half-dozen key institutions, all federal and state regulators should **further examine their role** for climate change.

Vision for Key Financial Regulators

- **Federal Reserve System:** Financial Stability, Supervision, Prudential Regulation, Monetary Policy, Community investment, International Cooperation
- **Office of Comptroller of the Currency & Federal Deposit Insurance Corporation:** Supervision, Stress Tests, Deposit Insurance Fund impacts
- **Securities and Exchange Commission**: Research on impacts on securities market; Fiduciary Duty, Disclosure, Accountants and auditors, Credit Raters
- **Commodity Futures Trading Commission:** Climate Change Sub-committee (Ceres CEO, Mindy Lubber is a key member)
- **State & Federal Insurance Regulators:** Risk Management, Investments, Disclosure, Products
- **Federal Housing Finance Agency:** Climate impacts of mortgage backed assets
- **Financial Stability Oversight Council:** Prioritize and coordinate between federal agencies on climate

Roles of the Federal Reserve in addressing climate change

1. **Financial stability**

    - Acknowledge climate change poses risks to financial market stability
    - Assess climate change's impacts on financial stability
    - Build awareness of regional climate vulnerabilities
    - Organize events and conduct research on economic impacts unique to jurisdictions

2. **Monetary Policy**

    - Integrate climate risk into collateral frameworks
    - Integrate climate risk into economic outlook assessments

Roles of the Federal Reserve in addressing climate change

3. **Prudential supervision**

    - Integrate climate change into prudential supervision and regulation
    - Ensure climate risk, including transition risk, is integrated into micro-prudential supervision of financial institutions
    - Conduct climate stress tests on financial institutions and define scenarios, time horizons and modeling approaches that should be used
    - Coordinate with the SEC and other regulatory agencies to require banks to assess and disclose climate risks, including carbon emissions from lending and investment activities
    - Define activities more likely to exacerbate climate change risk and those likely to mitigate risks, building on work being done globally

Roles of the Federal Reserve in addressing climate change

4. **Community reinvestment**
   - Integrate climate adaptation efforts to bolster the resilience of low-income communities to climate change
5. **Community International efforts**
   - Join the Network for Greening of the Financial System (NGFS)
   - Become part of international community of central banks pledging coordinated action on climate risk

"I do think that the public will expect and has every right to expect that in our oversight of the financial system, we will account for all material risks and try to protect the economy and the public from those risks. Climate change is one of those risks. [...] the science and art of incorporating climate change into our thinking about financial regulation is relatively new, as you know. And we are very actively in the early stages of this, getting up to speed, working with our central bank colleagues and other colleagues around the world to try to think about how this can be part of our framework."

— Federal Reserve Chairman Jerome Powell at Fed Press Conference on November 5, 2020

Ceres Welcomes Federal Reserve Chairman comments on climate risk

Roles of the NCUA & NASCUS in addressing climate risk

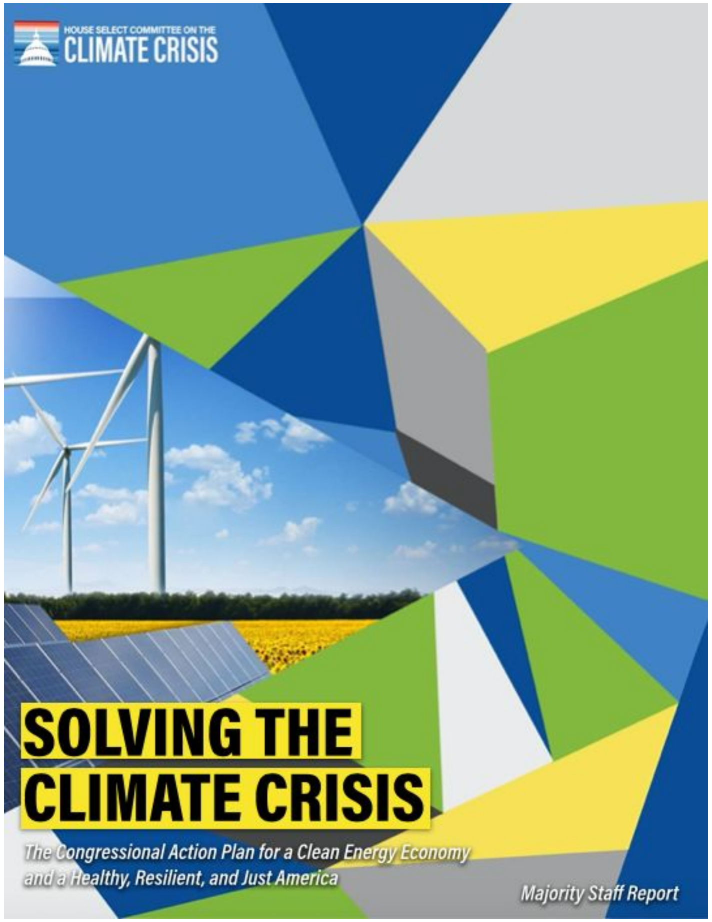
The National Credit Union Administration and state credit union regulators should consider the guidance provided by banking regulators to assess how climate change could affect the market segments they supervise.

- As a first step, the National Credit Union Administration (NCUA) and state credit union regulators should issue a statement highlighting that climate is a systemic risk to financial institutions including credit unions.
  - This is especially important because credit unions are especially susceptible to the growing physical risks and play a vital role in our nation’s financial system, especially serving low and moderate income members.
  - Credit union loan portfolios are also heavily concentrated in auto lending, requiring credit unions to consider both their portfolio risk and underwriting standards as the auto industry transitions to EV.
- In conjunction with the Federal Financial Institutions Examination Council's interagency group, modernize its risk definitions as a part of the credit supervision process to include climate risk.
  - This can be either as a stand-alone category or as something more explicitly articulated throughout the seven established categories.

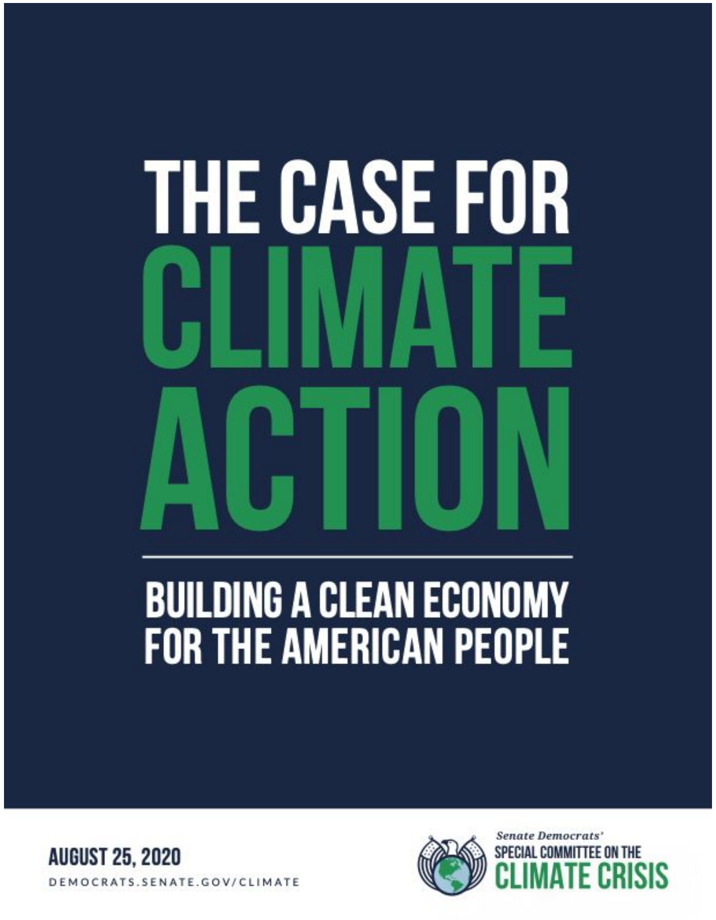
Roles of the NCUA & NASCUS in addressing climate risk

- As a member of the FSOC, the NCUA should use its voice to address climate risks.
- As the NCUA considers updates to its charter process for credit unions, consider climate risk competence among the areas to address.
- Any guidance on climate informed supervision should be integrated into the NCUA's examination manual.
- The NCUA and state credit union officials should, among other steps, explore working closely with the largest credit unions that they serve to run pilots on best practices in credit union-specific climate risk management techniques and risk analysis tools and methods.
- Seek consultation from key state and federal stakeholders in these changes.

Recent climate change reports from Congress

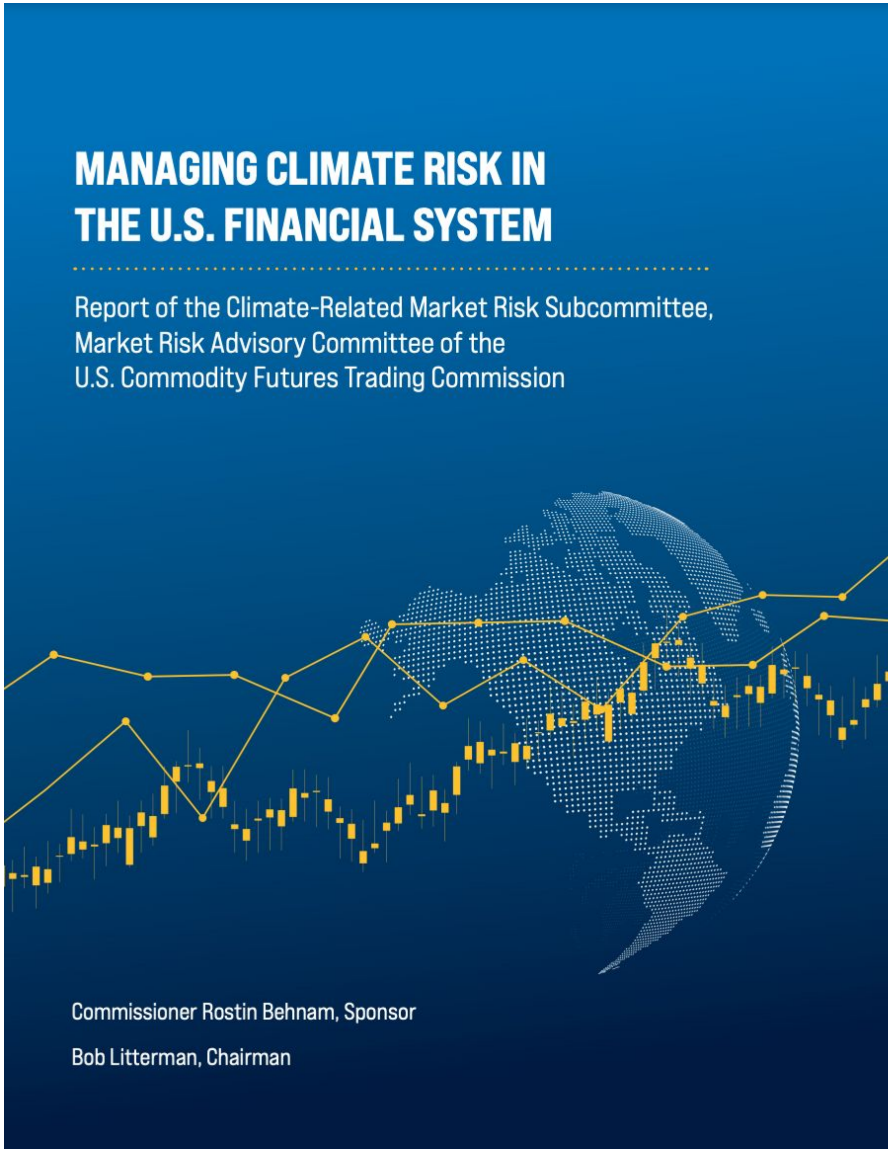


House Committee on the Climate Crisis



Senate Committee on the Climate Crisis

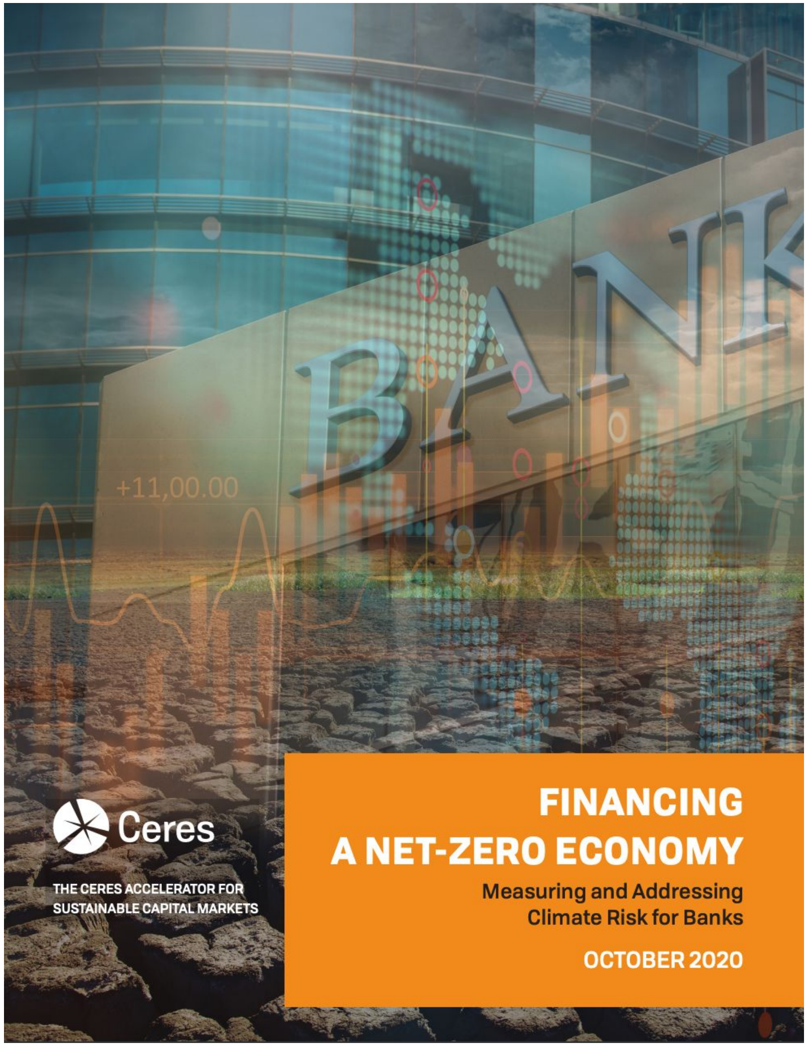
Climate change report from CFTC



- Climate change poses a major risk to the stability of the U.S. financial system and to its ability to sustain the American economy.
- This reality poses complex risks for the U.S. financial System.
- A major concern for regulators is what we don't know.
- U.S. financial regulators must recognize that climate change poses serious emerging risks to the U.S. financial system, and they should move urgently and decisively to measure, understand, and address these risks.
- At the same time, the financial community should not simply be reactive—it should provide solutions.

Financing a Net-Zero Economy:

Measuring and Addressing Climate Risk for Banks



- Reveals that more than half of syndicated lending of major U.S. banks is exposed to climate risk, potentially leading to significant losses for the banking sector and the broader economy
- Finds that the current view of bank transition risk is incomplete, as it does not consider financing of industries that rely on fossil fuels (e.g. agriculture, manufacturing, construction, and transportation)
- Proposes 13 actionable recommendations for the banking sector to implement, spanning (i) climate risk analysis; (ii) climate change disclosure; (iii) stress testing and scenario analysis; (iv) integrating climate risk into day-to-day decision-making tools
- These recommendations are based on the underlying analysis, done in collaboration with the consultancy CLIMAFIN, using publicly available syndicated loan data

Ceres Bank Report Key Elements

What this report IS

1. The focus of this report is the 13 actionable recommendations for the banking sector to implement, spanning 1) climate risk assessment and disclosure; 2) related tools & methods; and 3) risk and impact mitigate

2. These 13 recommendations are based on the underlying analysis, done in collaboration with the consultancy CLIMAFIN, using publicly available syndicated loan data.

What this report is NOT

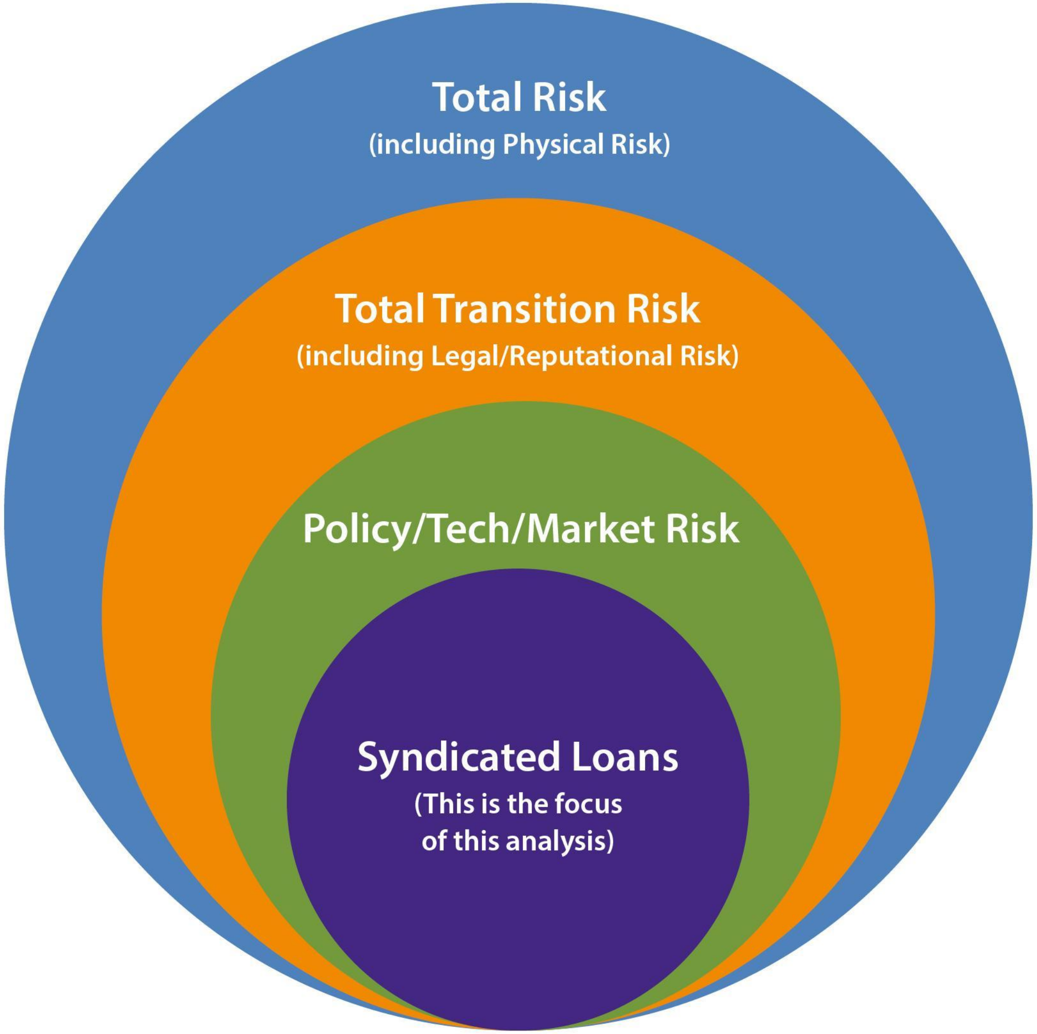
1. A bottom-up analysis of banks' lending portfolio, based on complete, proprietary data.

2. A benchmark that compares banks to each other and highlights leaders and laggards.

3. Because this is a top-down analysis, the data pertaining to banks' climate risk exposure and the potential losses from that exposure should be viewed as indicative, not definitive.

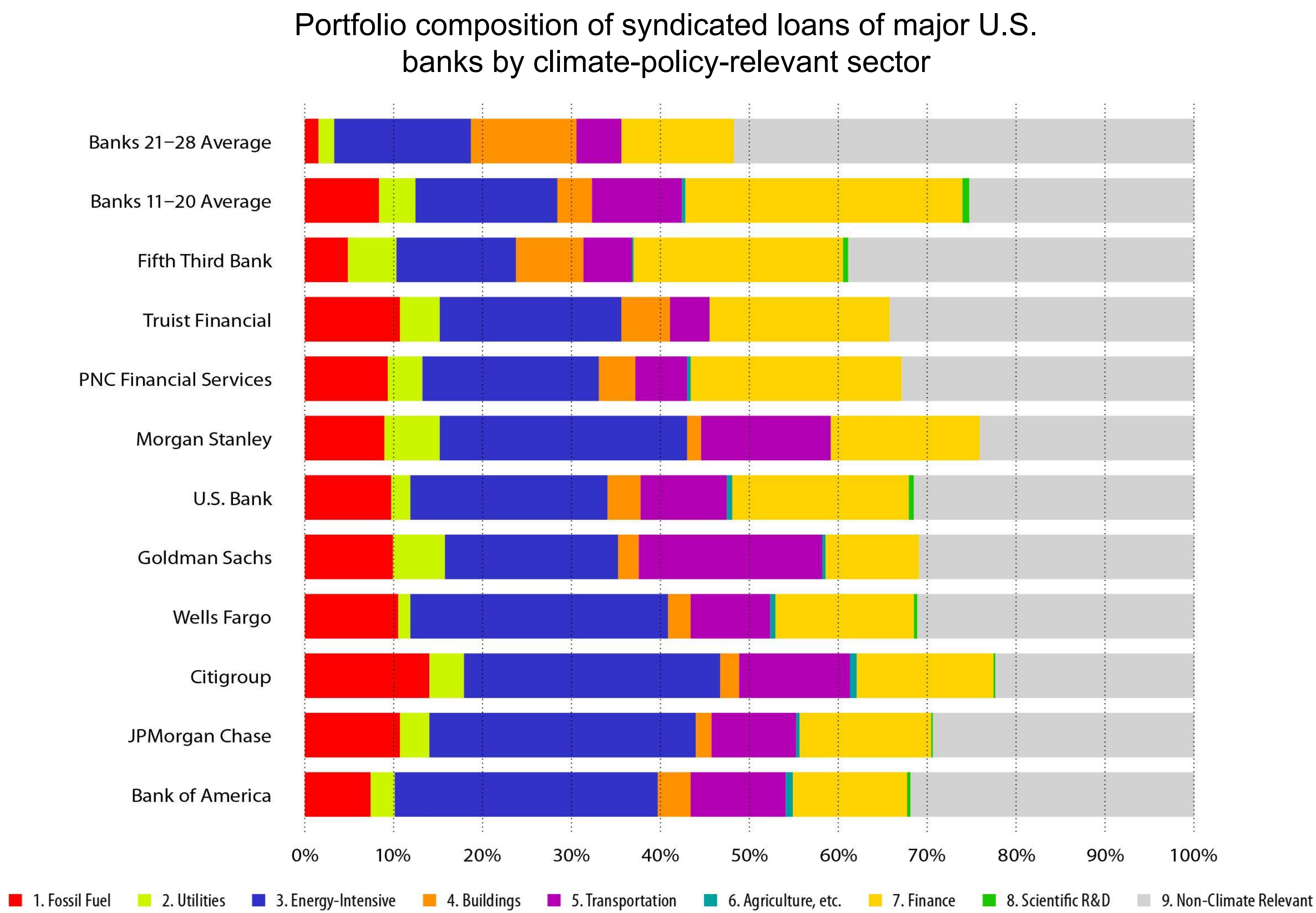
Scope of the Analysis

Our analysis covers only a portion of transition risk, and only for a portion of bank portfolios (syndicated loans). Therefore, the financial impacts we show are *indicative*. Banks need to expand the scope to cover all risks and asset classes and disclose a *definitive* estimate.



*Adapted from TCFD

Key Finding #1: Direct Exposure



13 Recommendations

Assess & Disclose

1. Assess all forms of climate risk and opportunity and disclose high-level findings
2. Assess entire balance sheet with regard to climate transition risk
3. Disclose portfolio-wide assessment, including identification of exposed sectors and percentage of at-risk assets
4. Conduct and disclose stress tests incorporating both backward- and forward-looking data
5. Align policy and advocacy with stated own climate policy positions and Ceres recommendations

Tools & Methods

1. Improve tools that translate climate data into financial decision-making
2. Incentivize clients' disclosure of own climate backward- and forward-looking data
3. incentivize employees to integrate climate considerations into day-to-day decision-making.
4. recognize the risk mitigation potential of constructing a more sustainable economic system.

Mitigation

1. Use engagement to accelerate client transitions and wind down relationships that do not include such plans.
2. Communicate any risk-mitigation value ascribed to sustainable finance programs.
3. Set and disclose financing portfolio targets that are aligned with the goals of the Paris Agreement and net zero by or before 2050.
4. Publicly commit to and begin work on the 12 recommendations above within the next year.

Thank You

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