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# Determining the Materiality of Climate-Related Financial Risk

A guide for financial institutions from RMA's  
Climate Risk Consortium



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## Objectives

Understanding and analyzing the materiality of various climate-related financial risk exposures has become a critical goal for financial institutions. In pursuing this goal, they are motivated to ensure strong risk management practices and to meet regulatory expectations. Climate-related materiality has become a topic of discussion in various contexts such as “financial materiality,” “double materiality,” and “risk materiality,” with subtle implications depending on the context. Our intent here is to reduce some of the ambiguity inherent in the terms, as applied to risk materiality.

This guide, created by The Risk Management Association’s Climate Risk Consortium, is designed to provide institutions with a structured approach to interpret and apply “materiality” to climate risk as their risk management frameworks mature to align with the interagency [Principles for Climate-Related Financial Risk Management for Large Financial Institutions](#). The supervisory principles, published in October 2023, are guidance from the Comptroller of the Currency, the Federal Reserve System, and the Federal Deposit Insurance Corporation.

We hope this guide will be useful across the spectrum of roles engaged in climate risk management, including all three lines of defense.

## Context

The RMA Climate Risk Consortium, a group of 30 RMA member institutions, was established in 2021 to advance climate risk management in the financial services industry. The consortium aims to facilitate:

- Consistent standards and common terminology that can be disseminated industry wide.
- Thought leadership position papers to support industry mobilization.
- Range-of-practice surveys and networking.
- Discreet dialogue and education among members and regulators.
- Responses to regulatory and legislative consultative documents as an industry group.
- RMA events such as roundtables, conferences, and forums.

The consortium has sponsored several papers including:

- [Actions to Operationalize Your Climate Risk Framework: A Guide for Banks Starting Their Climate Journey.](#)
- [U.S. Climate Regulatory Guide for Banking Organizations.](#)
- [Getting Going – Accelerating Climate Risk Analytics: Climate Scenario Analysis Practices at U.S. Banks 2023.](#)

This paper is meant to add to the consortium toolkit and provide a structured approach for all RMA-member institutions contemplating climate-related risk materiality.

## Background

The U.S. interagency guidance outlines high-level principles intended to promote a consistent understanding of the effective management of climate-related financial risks. To the extent that climate-related financial risks are material, the regulatory guidance requires “the largest institutions, those with over \$100 billion in total consolidated assets,” to incorporate the supervisory principles into policies, procedures and limits, governance, strategic planning, and risk management. The guidelines give institutions discretion on how to identify and manage risks that may be material, provided their methodologies are consistent with those they use to identify other types of emerging and material risks. The consortium welcomes this principles-based approach because it allows institutions to flexibly adapt and extend their existing risk management frameworks, as appropriate.

As the industry builds out climate risk management capabilities and aligns with these supervisory principles, several important questions arise:

1. How should institutions **define** material climate-related financial risks?
2. What **methods** should institutions use to assess climate-related financial risk materiality?
3. What **time horizons** should institutions use to identify climate-related financial materiality?
4. What level of **granularity** might be needed to determine climate-related financial risk materiality?
5. How can we encourage **iterative improvement** in determining emerging or material climate-related financial risks?

This guide does not prescribe requirements but aims to expand on how institutions might define “materiality” with respect to climate-related financial risks. How an institution applies this materiality definition will depend on the institution’s risk management program, methodologies, and approach. Approaches should be commensurate with an institution’s size, complexity, business activity, and risk profile.

# Guiding Considerations for Defining Material Climate-Related Financial Risks

Institutions weighing materiality with respect to climate-related financial risks should consider the following five key points.

## DEFINITION | Consideration 1

**The definition of climate-related financial risk materiality should be consistent with and leverage existing definitions of risk materiality.**

Climate materiality should fit within an institution's definition of materiality as it relates to financial risk. There should not be a separate definition of materiality for climate-related financial risk.

Financial statement materiality and risk materiality are differentiated. Financial statement disclosures are based on actual events and not forward-looking projections. The process to determine financial statement materiality is more quantitatively precise and is suited to extensive controls that are appropriate for measuring current magnitudes. In contrast, the risk identification process—in attempting to determine materiality as it pertains to risk—considers current and future trends and situations drawn from several possible outcomes and is subject to independent judgment, estimations, and assumptions.

- **First Step:** Inventory how your institution currently defines materiality (including limits and thresholds, as applicable) for existing programs, including risk identification, CCAR/DFAST, concentration risk, etc. Consider defining risk materiality if you have not already.

## METHODOLOGY | Consideration 2

**Institutions should leverage methods for identifying other emerging and material risks while considering the unique characteristics of climate risk.**

Institutions should leverage their existing risk identification processes to identify material climate-related risk. Given the unique characteristics of climate risk, institutions may need to enhance or augment their risk identification processes. Outputs from the various tools and approaches for measuring and monitoring climate risk exposures should inform the risk identification process.

- **First Step:** Engage with your risk identification team to understand the existing process and other tools that could be utilized or enhanced to identify material climate risk.

### **TIME HORIZONS | Consideration 3**

**Institutions should account for various time horizons using short to long-term perspectives of how climate-related financial risk could manifest.**

Historically, risk processes had a bias toward near-term risks associated with the strategy and operations of institutions; however, the supervisory principles require an institution to assess climate risk across various time horizons, which may include those that extend beyond the institution's typical strategic planning horizon.

- **First Step:** Identify how your institution defines time horizons for climate-related purposes. Many institutions will already have defined these in their public climate report (i.e. TCFD report), their Carbon Disclosure Project (CDP) questionnaire, or internal documentation and might consider both climate-related risks and opportunities. If an institution has not yet done so, it should consider establishing an action plan to assess and document how physical and/or transition risks may manifest at various time horizons.

### **GRANULARITY | Consideration 4**

**Institutions may need to leverage new or additional data sources and undergo more in-depth data analysis than has been used historically to evaluate climate-related financial risk, taking a risk-based approach.**

Each institution will exhibit a unique climate-related financial risk profile. Institutions should identify areas that exhibit evident exposure to climate-related physical and/or transition risk, assess their own exposure to these areas, and prioritize risk management efforts on areas of significant concentration.

To do this, institutions may require a more granular approach to identifying risk—such as across sectors, products, or geographies—or may need to enhance existing tools for climate-related factors. Institutions may need to procure and use new types of data—based on the complexity and types of climate risk exposure, as appropriate—and analyze, scrub, and transform them for use in existing risk management processes.

- **First Step:** Identify how climate risk is covered in your existing risk taxonomy and risk reporting. Taking a risk-based approach, focus on the level of granularity and the data that may be needed to assess climate-related financial risks.

## ITERATION | Consideration 5

**Determining material and emerging climate risk will involve an iterative process of improvement, utilizing tools and approaches that will be continually enhanced over time.**

The supervisory principles recognize that the incorporation of material climate-related financial risks into various risk procedures will be iterative. As measurement methodologies, models, and data are used to analyze climate-related financial risks, institutions will accumulate valuable feedback to measure the utility of certain tools and processes and prioritize incremental enhancements in a logical sequence.

Institutions should have processes in place to identify material and emerging climate-related financial risks and revisit their efficacy as measurement methodologies, models, and data mature.

The tools used to manage climate risk will evolve over time and vary by institution. In some cases, tools based on qualitative judgment may be superior given lack of data, high uncertainty, and/or methodological limitations.

- **First Step:** Inventory existing risk management tools and consider how they may be best leveraged and/or enhanced for climate-related financial risk management.



## Moving Forward

Stakeholders recognize the dynamic and evolving nature of climate risk management and its inherent challenges. Adopting overly precise and rigid processes to define material climate risks today could block progress toward meaningful learning and adaptation tomorrow.

We hope that this guide provides further clarity on how to continue developing strong climate risk management practices, promotes industry consistency in approach, and offers ideas on first steps institutions might take in assessing climate risk materiality. In addition, we hope that it is helpful to financial institutions as they interpret regulatory guidance on climate-related financial risk materiality and apply it to their own risk management frameworks.



## **Appendix: References to Materiality from the Principles for Climate-Related Financial Risk Management for Large Financial Institutions**

- **General Principles - Governance**

- Management is responsible for regularly reporting to the board on the level and nature of risks to the financial institution, including material climate-related financial risks.
- Management should provide the board with sufficient information for the board to understand the impacts of material climate-related financial risks to the financial institution's risk profile and make sound, well-informed decisions.

- **General Principles - Policies, Procedures, and Limits**

- Management should incorporate material climate-related financial risks into policies, procedures, and limits to provide detailed guidance on the financial institution's approach to these risks in line with the strategy and risk appetite set by the board.

- **General Principles - Strategic Planning**

- The board should consider material climate-related financial risk exposures when setting and monitoring the financial institution's overall business strategy and risk appetite, and when overseeing management's implementation of capital plans.
- As part of forward-looking strategic planning, the board should consider and management should address the potential impact of material climate-related financial risk exposures on the financial institution's financial condition, operations (including geographic locations), and business objectives over various time horizons.

- **General Principles - Risk Management**

- Financial institutions with sound risk management employ a comprehensive process to identify emerging and material risks related to the financial institution's business activities.
- As part of sound risk management, management should develop processes to measure and monitor material climate-related financial risks and to communicate and report the materiality of those risks to internal stakeholders.
- Material climate-related financial risk exposures should be clearly defined, aligned with the financial institution's risk appetite, and supported by appropriate metrics (e.g., risk limits and key risk indicators) and escalation processes.
- Management should incorporate material climate-related financial risks into the financial institution's risk management system, including internal controls and internal audit.

- **Management of Risk Areas**

- A risk assessment process is part of a sound risk management framework, and it allows management to identify emerging risks and to develop and implement appropriate strategies to mitigate those material risks.

- **Management of Risk Areas - Credit Risk**

- Consistent with the financial institution's risk appetite statement, management should determine credit risk tolerances and lending limits related to material climate-related financial risks.

- **Management of Risk Areas - Other Nonfinancial Risk**

- Management should also consider the extent to which the financial institution's activities may increase the risk of negative financial impact and should implement adequate measures to account for these risks where material.

## About the Climate Risk Consortium

RMA formed the Climate Risk Consortium in 2021 to fulfill its mission to advance sound risk management principles. Since its inception, the CRC has fostered the integration of climate risk management throughout banking operations; helped the industry prepare to navigate the economy's transition to a low-carbon future; and advanced the development of financial industry-wide taxonomies and practices.

## About RMA

For more than 100 years, RMA has been laser focused on one thing: helping its members in the world's financial institutions better understand and address risk. As a trusted partner, RMA has weathered the many economic ups and downs of the last century alongside its members, which now number 1,600+ financial institutions of all sizes, from multi-nationals to local community banks. These institutions are represented by over 65,000 individual RMA members located throughout North America, Europe, Australia, and Asia.

Our members rely on us to keep them abreast of important industry trends and prepare them to face new challenges head-on. Our sound risk management principles are developed for members, by members, and help to build safer, stronger financial institutions, impacting local communities and the global economy.

All of this makes RMA unique—we are the only comprehensive source of risk management tools and education that has spanned the last 100 years. And we look forward to the next 100 as we help the industry come together on the transformative issues of climate, cyber, culture, technology, and more.