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Climate-risk disclosures are fairly easy. The next steps aren't.

By Laura Alix | January 9, 2022

U.S. banks have made early progress in sizing up the impact of climate change on their businesses, but risk disclosures, a relatively uncontroversial step, are likely just the beginning.

Environmental groups and activist shareholders want banks to do more, arguing for measures like capital requirements and increased risk weighting for fossil-fuel lending. The industry has pushed back, arguing that such measures are heavy-handed, and that the industry lacks sufficient data and methodology to carry them out.

Still, recent moves by regulators have made clear that banks will need to build upon their efforts to date. And while climate may still be a relatively nascent area of risk management, some experts are encouraging the banking industry to take a proactive approach.

"I'm a big believer that the industry will always do better by leading rather than reacting to what others perceive as the risks," said Nancy Foster, CEO of the Risk Management Association, a membership organization for risk professionals in the financial industry.

Foster, who became chief executive of the organization in 2018, began raising the subject of climate risk management at its board meetings as early as 2015, when she was a board member. The industry's rapid progress in developing climate-risk disclosures since those early days shows that it's up to tackling the challenges it faces today, she said.

"The industry very quickly caught up, especially if we look at the large banks today," Foster said.

Big-bank climate risk

A Rainforest Action Network report tallied banks' financing of 2,300 companies involved in the extraction, transportation, transmission, combustion or storage of fossil fuels

Bank	2018	2019	2020	Three-year total
JPMorgan Chase	$67.4B	$64.0B	$51.3B	$182.7B
Citigroup	$46.9B	$52.5B	$48.4B	$147.8B
Wells Fargo	$61.8B	$45.7B	$26.4B	$133.9B
Bank of America	$33.8B	$48.1B	$42.1B	$124B
Morgan Stanley	$19.5B	$22.1B	$20.5B	$62.1B
Goldman Sachs	$17.2B	$21.6B	$18.9B	$57.7B

The biggest Wall Street banks, plus a few larger regional banks, have issued climate-risk disclosures following guidelines set forth by the Task Force for Climate-Related Financial Disclosures. That group was established in 2015 by the international Financial Stability Board with the intent of developing uniform climate-risk disclosures for the financial industry.

Many of the largest banks have also announced plans to eliminate greenhouse gas emissions from their operations and businesses by 2050. Some large banks have pledged to end certain types of fossil-fuel financing, like arctic drilling and coal operations.

Environmental advocacy groups and activist shareholders say those commitments don't go far enough or fast enough. They point to dire projections by the Intergovernmental Panel on Climate Change, the U.N.'s climate research group, that the planet's warming needs to be limited to 1.5 degrees Celsius to limit the worst impacts of climate change.

If left unchecked, climate change could lead to massive physical damage to homes, businesses and infrastructure, the Sierra Club said in a recent report. Just eight large U.S. banks are collectively responsible for financing greenhouse gas emissions roughly equivalent to 80 million homes' energy use for a year, according to the report.

Between 2018 and 2020, JPMorgan Chase, the nation's largest bank, provided $182.7 billion in financing to 2,300 fossil-fuel companies, the Rainforest Action Network found in a separate report. Citi-

group was second during that three-year period, providing $147.8 billion in financing to those companies.

The Sierra Club urged regulators to incorporate climate risk into stress testing, increase risk weighting for assets tied to fossil-fuel industries, and set concentration limits for fossil-fuel exposure.

"If we are going to avert the worst ecological impacts of climate change and avoid another financial crisis potentially far more dire than that of 2008, then the Biden administration and financial regulators must address emissions from the industry that is both fueling the climate crisis and threatening economic stability: the U.S. financial sector," the report's authors wrote.

Over time, there should be capital reserve requirements for risky loans, said Steven Rothstein, managing director of the Ceres Accelerator for Sustainable Capital Markets, a nonprofit organization that works with large financial services companies on corporate sustainability issues.

"Action is needed now. We can't wait for the 2040s or even the 2030s," Rothstein said. "We need every bank to go sector by sector and publicly announce their plans to decarbonize."

But financial trade groups have pushed back against the Sierra Club's recommendations, calling them counterproductive and draconian. Capital requirements and traditional stress testing are too blunt and not the way to go about financing the transition to a low-carbon economy, they said.

"Climate change and the transition ahead is both long-term and anticipated," Kevin Fromer, president and CEO of the Financial Services Forum, said in a statement. "The solutions are complex and require collaboration and cooperation among the public and private sectors, across a broad range of industries. It will not be solved through the blunt and poorly conceived use of capital requirements, which cushion against short-term and unanticipated severe events."

The Bank Policy Institute, which represents many of the biggest U.S. banks, said climate risk analysis is still in its early stages, and the industry is still dealing with data and methodological shortfalls. Therefore, it said, stricter measures like credit limits and surcharges on global systemically important banks would be inappropriate.

Some observers say that what's most striking about the Sierra Club report isn't necessarily its message, but the fact that its message is getting more traction today than would have been the case several years ago.

Banks have been under pressure from advocacy groups and environmentally minded investors, but increased attention by regulators, lawmakers and even clients is amplifying that pressure, said Alexandra Mihailescu Cichon, an executive vice president with RepRisk, a data science firm specializing in environmental, social and governance risk.

"Reports like this were easier to relegate to the side 10 years ago," she said. "Today you have to have a much better plan in place. … You have to actually show that you're doing something to reduce exposure to fossil fuels."

Pronouncements by regulators carry more weight with banks than reports by environmental groups, and industry groups have so far had a muted response to new recommendations by the Office of the Comptroller of the Currency.

The OCC's draft supervisory principles for managing climate risk state that banks with more than $100 billion of assets should incorporate climate change into their risk frameworks and business strategies, and make sure their boards are educated on the subject.

The OCC's draft guidance marks the first time a federal banking regulator has set standards for managing climate risk, though other agencies are likely to get involved soon.

The Securities and Exchange Commission is working on a climate disclosure rule for publicly traded companies, and Federal Reserve Board Gov. Lael Brainard said last fall that the central bank was moving forward with scenario analysis exercises looking at the impact of extreme weather events on financial institutions.

What's more, Sarah Bloom Raskin, who is reportedly the top candidate for vice chair of supervision at the Fed, has taken a strong interest in climate risk for banks.

The OCC's draft guidance recommends climate-related scenario analysis, but it also distinguishes such work from traditional stress testing that is used as a short-term capital adequacy exercise. Scenario analysis in this context might tell a bank, for example, how vulnerable some of its portfolios could be to physical risk over the next five years.

A major challenge for banks will be collecting the relevant data they need from their clients in order to conduct those analyses.

"The sooner you start collecting data, the better. I think that it could start with data that's going to be required for disclosures, which also will help with stress testing," said Foster of the Risk Management Association. "We anticipate banks are going to be asked to collect data from their clients."

Bankers see value in the kind of disclosures that are recommended by the international task force, but they also have concerns with how those disclosures will get translated into U.S. securities law, said Lauren Anderson, associate general counsel at the Bank Policy Institute.

That's in large part because banks will need copious amounts of information from their clients in order to put the disclosures together. Stricter standards could introduce a greater degree of liability if a bank isn't working with a complete and correct set of data.

Disclosures cover both a bank's direct emissions, which relate to the bank's own activities, and financed emissions, which relate to the activities of the bank's clients.

"Very little of a bank's emissions profile is direct emissions," Anderson said. "The vast majority is financed emissions. That disclosure is only as good as the information you're getting from your clients. Even when there is data, it's hard to verify many times."

Despite disagreement about the details and timing of how to address climate change's impact on the financial system, some industry experts say there's a willingness to engage on climate risk that didn't exist a few years ago.

"That was one of my concerns, that because it was so politicized it was going to be difficult to have conversations around it, and I'm seeing that that's no longer a barrier," Foster said. "I won't say it's completely disappeared, but I will say there's an acceptance, at least, that this is an issue that we have to deal with."