The Federal Reserve's Proposed Principles for Climate-Related Financial Risk Management for Large Institutions
Four Things To Know

On December 2, 2022, the Federal Reserve Board ("Federal Reserve"), in a 6-1 vote with support from all of the Federal Reserve Governors except Governor Waller, released and requested comments on **draft principles** that would provide a high-level framework for the safe and sound management of exposures related to climate-related financial risks (the "Proposal"). Comments are due February 6, 2023.

The Proposal would apply to financial institutions supervised by the Federal Reserve—including state member banks, bank holding companies, savings and loan holding companies, and foreign banking organizations with respect to their U.S. operations—with over $100 billion in assets.

1 The Proposal is broadly consistent with similar climate risk management proposals from the other federal banking agencies.

The Proposal follows similar proposals released by the Federal Deposit Insurance Corporation ("FDIC") in March 2022 and the Office of the Comptroller of the Currency ("OCC") in December 2021. The Proposal would set forth risk-based principles and descriptions of climate-related risks that are similar to those articulated in the OCC's and FDIC's proposals. (See Covington's prior client alerts on the FDIC's proposal **here** and the OCC's proposal **here**.) In fact, the Federal Reserve noted that it developed the Proposal in consultation with the FDIC and OCC and that the agencies seek to promote consistency in their climate risk management guidance, including by coordinating with each other in issuing any final guidance.

2 The Proposal would emphasize the role of a financial institution's board in oversight of management's implementation of the climate-related financial risk management principles.

The principles are intended to supplement existing risk management standards and guidance on the role of boards and management. The Proposal specifically notes that the climate-related financial risk management principles are not intended to conflict with existing guidance from the Federal Reserve on the roles of board and senior management, such as SR Letter 21-1. Therefore, compared to the FDIC's and OCC's proposals, the Federal Reserve's Proposal would put more emphasis on separating the board's role of *oversight* from management's role of *implementation* and *execution* of risk management. And unlike the FDIC's and OCC's proposals, the Proposal would specifically note that a financial institution's board should contemplate whether considerations relating to the management of climate-related financial risks should be incorporated into the financial institution's compensation policies given that "compensation policies should be aligned with the business, risk strategy, objectives, values, and long-term interests of the financial institution."

3 The Proposal would acknowledge that differences in financial institutions' complexity of operations and business models will result in different approaches to addressing climate-related financial risks and that the incorporation of climate-related financial risks into risk management will continue to evolve over time.

The Proposal notes that the Federal Reserve encourages 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 . . . and to take a risk-based approach in assessing the climate-related financial risks associated with individual customer relationships and to take into consideration the financial institution's ability to manage the risk."

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4 The Federal Reserve is seeking comment on only three questions.

Unlike the FDIC and OCC, which included more targeted questions in their proposals, the Federal Reserve is seeking comments on only three general questions that ask: (1) how the draft principles could be revised to better address climate-related financial risks; (2) whether there are areas where the draft principles should be more or less specific and whether there are other aspects of climate-related financial risk management that should be considered; and (3) what challenges financial institutions could face in incorporating the draft principles into their risk management frameworks.

For further information on the Proposed Principles, please contact the members of Covington's Financial Institutions practices.

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