

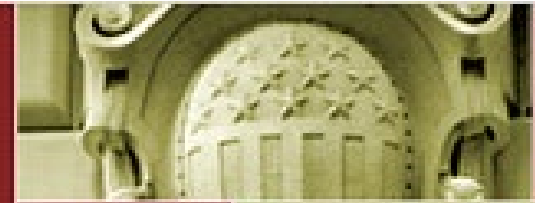
Regulatory Approach to Climate Risk at the Federal Reserve System

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For the Andrew Davidson & Co Symposium

The Impact of Climate Change on the
Mortgage Ecosystem

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Disclaimer

These views are my own and do not reflect the views of the Federal Reserve Bank of Philadelphia or the Federal Reserve System.

Focus of Remarks

1. Federal Reserve's Workplan
2. Microprudential Climate-Related Risks & Supervision
Climate Committee (SCC)
3. Macroprudential Climate-Related Risks & Financial Stability
Climate Committee (FSCC)
4. Data and Analytics



Overview of Climate Risk and the Federal Reserve

- The Federal Reserve views climate-related risks through its existing mandates:
 - Safety and soundness
 - Financial stability
- Objective: Deepen understanding of the potential implications of climate-related risks for financial institutions, financial markets and the economy.
- System-wide committees:
 - Supervision Climate Committee (SCC)
 - Financial Stability Climate Committee (FSCC)



Federal Reserve's Workplan

- Engagement
 - Private Sector: Financial industry, consumer advocacy groups, academics, consultants, data providers, climate scientists, nonprofits
 - Official Sector: Domestic regulatory agencies, FSOC
 - International: Financial Stability Board, Basel Committee on Banking Supervision (BCBS), Network for Greening the Financial System (NGFS)

- Analysis
 - Mapping financial institution exposure to physical and transition risks
 - Identifying and measuring links between climate risks and financial stability

- Policy
 - Engagement and analysis will inform any future policy decisions

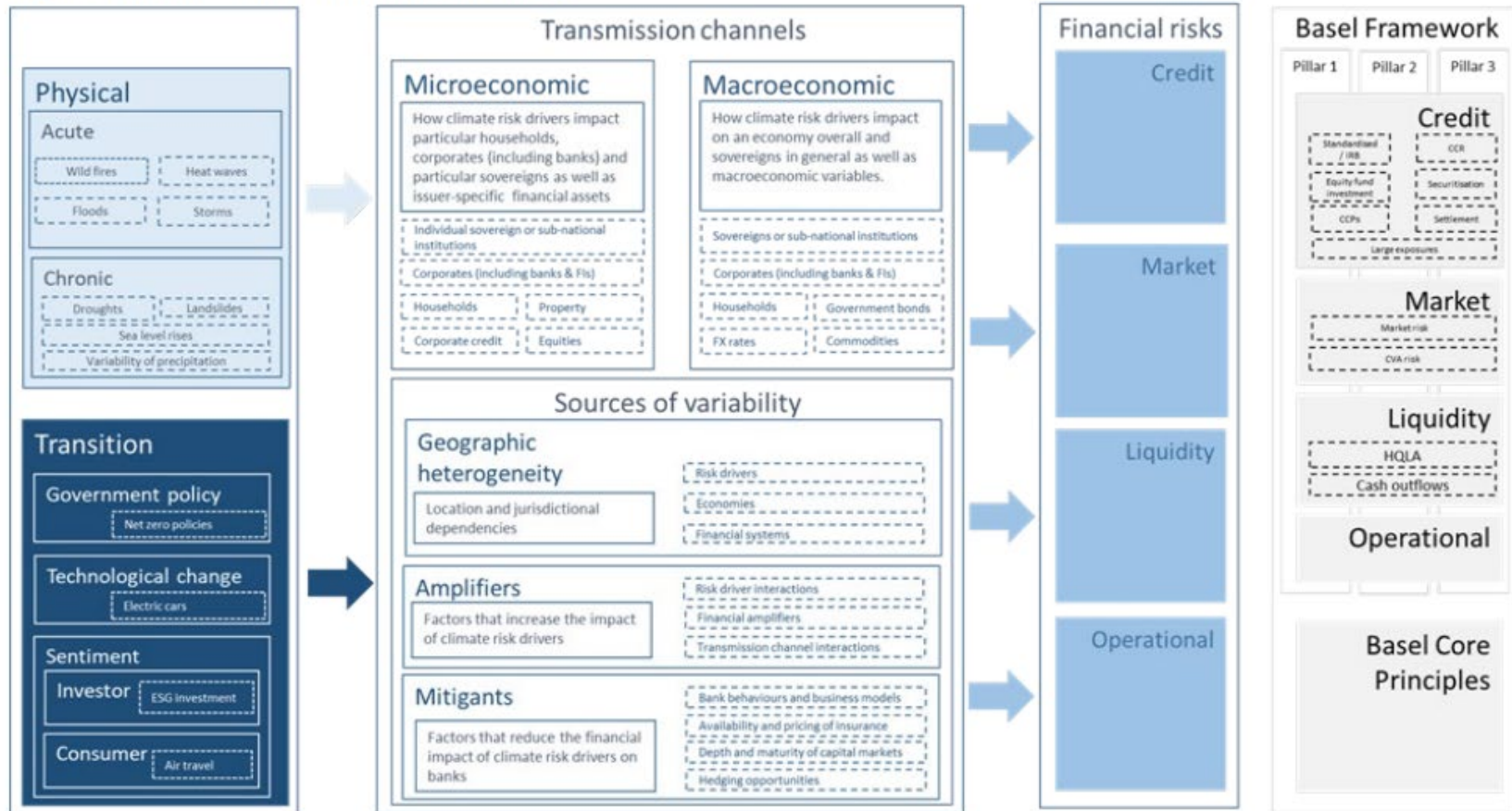
Climate-Related Risks and Supervision*

- Promoting the safety and soundness of supervised institutions is key to the Federal Reserve's *microprudential* mission.
- SCC established to promote the resilience of supervised institutions to climate-related financial risks, including:
 - Analysis of transmission channels, measurement methodologies, data gaps
 - Measuring exposures of banks to physical and transition risks
 - Understanding how supervised institutions incorporate physical and transition risks into their risk management frameworks and the challenges they face
 - Incorporating climate-related risks into the supervision of financial firms
- SCC approach
 - Risk management perspective
 - Cross-system perspective
 - Tailored approach
 - Transparency

*See Federal Reserve Board, Supervision and Regulation [Report](#) (November 2020), p. 26.

How Do Climate Risks Impact Banks?

Figure 1: Financial risks from climate risk drivers



*See Basel Committee on Banking Supervision, "[Climate-related risk drivers and their transmission channels](#)," April 2021.

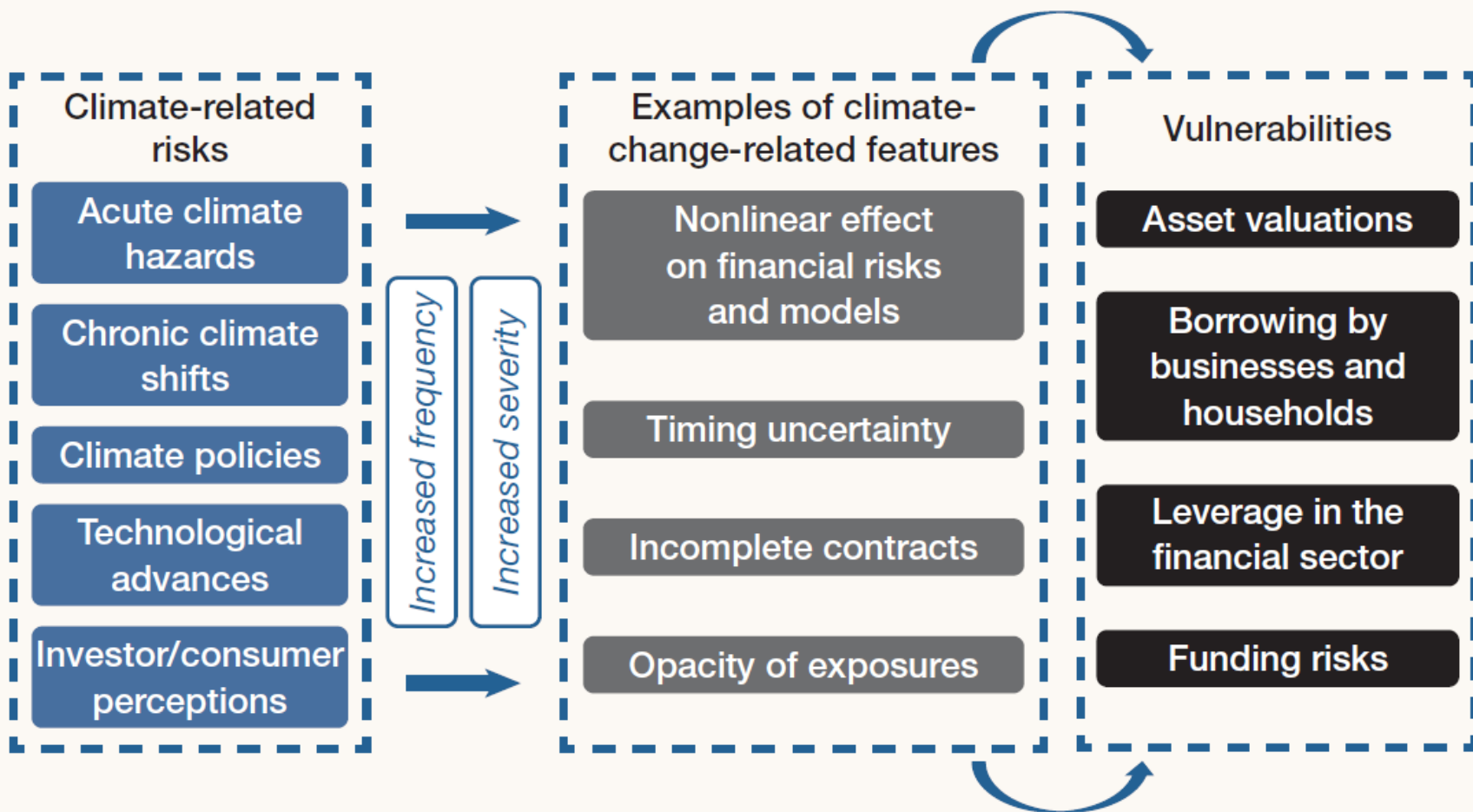
Climate-Related Risks and Systemic Risk*

- Promoting financial stability is key to the Federal Reserve's *macroprudential* mission.
- The Financial Stability Climate Committee (FSCC) established to rigorously identify and measure links between climate risk and financial stability, including:
 - Improving analysis of how economic effects of a changing climate will affect firms
 - Investigating how climate risks increase financial sector vulnerabilities
 - Looking for climate-related amplification channels, e.g., mispricing of assets

*See Federal Reserve Board, Financial Stability [Report](#) (November 2020), pp. 58-59.

Climate Risk and Systemic Risk*

Possible Transmission from Climate-Related Risks to Financial System Vulnerabilities



Source: Federal Reserve Board staff.

*See Federal Reserve Board, Financial Stability [Report](#) (November 2020), p. 58.

Data and Analytics

- *“Central banks clearly can play an important role in building data and analysis to understand the macroeconomic consequences of climate change, to quantify the risk of the financial system through scenario analysis, for example, and to promote the resiliency of the financial sector to climate change.” – Chair Powell*
- Data
 - To understand the risks posed by the climate, we rely on a wide variety of data from government agencies and private-sector organizations.
- Disclosure
 - Consistent, comparable, and reliable disclosures help supervised institutions and other market participants make informed decisions about climate-related risks and exposures.

Data and Analytics

- Climate scenario analysis is being developed broadly across the financial sector, including by large financial institutions, central banks and supervisory authorities in other jurisdictions.
- There are critical differences between stress testing and climate scenario analysis.

Main differences between macroeconomic stress testing and climate scenario analysis Table 1

Risk	Macroeconomic	Climate-related risks
Scope	Elements of the profit and loss statement and balance sheet	To date focus more on selected exposures
Time frame	Two to five years	Short, middle, long term (over decades)
Current use of risk assessment exercise	Used in a regulatory context, eg for estimating capital needs and planning capital management	To understand and evaluate the potential impact on a bank's risk profile and strategy due to climate-related risk and raise awareness at financial institutions

Source: adapted from UNEP FI (2018).

*From Basel Committee on Banking Supervision “[Climate-related financial risks—measurement methodologies](#)” April 2021, p. 19.