February 14, 2022

Chief Counsel's Office
Attention: Comment Processing
Office of the Comptroller of the Currency
400 7th Street, NW
Washington, DC 20219

RE: PRINCIPLES FOR CLIMATE-RELATED FINANCIAL RISK MANAGEMENT FOR LARGE BANKS DOCKET ID OCC-2021-0023

Ladies and Gentlemen:

The Independent Community Bankers of America ("ICBA")[1] appreciates the opportunity to provide comments in response to the Office of the Comptroller of the Currency's ("OCC" or "the agency") request for information regarding its Principles for Climate-related Financial Risk Management for Large Banks ("the draft principles"). ICBA applauds the OCC for recognizing its draft principles should be appropriately tailored to bank size, complexity, risk profile and operations. Unlike community banks, large banks have vast resources to explore climate change methodologies that are only in the nascent phases of development. Rarely, if ever, is a "one size fits all" approach to bank regulation appropriate, and climate-related financial risk management is no exception.

Nevertheless, ICBA is deeply concerned the OCC published its draft principles without first conducting any studies or gathering empirical data that shows the extent to which climate-related financial risks may, or may not, threaten bank safety and soundness or the stability of the financial system. ICBA is particularly concerned the lack of empirical data to support the publication of the draft principles coupled with the expansive scope of the proposed framework suggests the true aim of this proposal is to effectuate "Operation Chokepoint" by choking off legal but disfavored businesses and industries from the financial system. Additionally, ICBA is concerned examiners will, over time, develop a supervisory expectation that the draft principles should also apply to community banks. As is too often the case, examiners may develop supervisory expectations that large bank guidance serves as a

[1] The Independent Community Bankers of America® creates and promotes an environment where community banks flourish. With nearly 50,000 locations nationwide, community banks constitute roughly 99 percent of all banks, employ nearly 700,000 Americans and are the only physical banking presence in one in three U.S. counties. Holding nearly $5.9 trillion in assets, over $4.9 trillion in deposits, and more than $3.5 trillion in loans to consumers, small businesses and the agricultural community, community banks channel local deposits into the Main Streets and neighborhoods they serve, spurring job creation, fostering innovation and fueling their customers' dreams in communities throughout America.

model for small bank "best practices" notwithstanding the fundamental differences between large and small banks.

If the OCC applied its draft principles to community banks either expressly through rules or guidance, or implicitly through "best practices," or if the OCC implemented the misguided mission of "Operation Chokepoint," then hundreds of community banks would suffer unnecessary and costly regulatory burden, and the consumers, farmers, and small businesses that rely on community banks could be choked off from the financial system if their local industries and economies were targeted. In light of these concerns, ICBA appreciates this opportunity to share our views on why the proposed framework should not apply to community banks and offer our recommendations for how the draft principles or future guidance can be improved.

I. **The OCC Has Not Published Empirical Data to Support Its Conclusion that Climate-related Financial Risk Is a Threat to Bank Safety and Soundness**

The OCC's statutory mission is to "assur[e] the safety and soundness of, and compliance with laws and regulations, fair access to financial services, and fair treatment of customers by, the institutions and other persons subject to its jurisdiction."[1] Critically, the National Bank Act not only authorizes the OCC to carry out its mission, but it also restricts the agency from taking actions which exceed its Congressionally authorized mission.

On May 20, 2021, President Biden signed an Executive Order directing the Secretary of the Treasury, as the Chair of the Financial Stability Oversight Council ("FSOC"), to "engage with FSOC members" to assess climate-related financial risk.[2] In response to the Executive Order, the FSOC subsequently published a report on climate related financial risks, which directed FSOC members to "address climate-related financial risks consistent with their mandates, focusing on the safety and soundness of regulated institutions."[3] Only two months later, on December 16, 2021, the OCC published its draft principles and articulated a sweeping conclusion that "weaknesses in how banks identify, measure, monitor, and control the potential physical and transition risks associated with a changing climate could adversely affect a bank's safety and soundness, as well as the overall financial system."[4]

While both the President and the FSOC asked the federal financial regulators to explore climate-related financial risks consistent with their mandates, neither concluded climate-related financials risk constitutes a safety and soundness risk to individual banks. Yet, the draft principles cite only the FSOC

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[1] 12 U.S.C. 1.

[2] Exec. Order No. 14,030, 87 Fed. Reg. 27967 (May 20, 2021).

[3] Financial Stability Oversight Council Report on Climate-Related Financial Risk (Oct. 21, 2021) available at: https://home.treasury.gov/system/files/261/FSOC-Climate-Report.pdf.

[4] Office of the Comptroller of the Currency, *Principles for Climate-related Financial Risk Management for Large Banks* (Dec. 16, 2021) available at: https://www.occ.treas.gov/news-issuances/news-releases/2021/nr-occ-2021-138a.pdf. *See also* Office of the Comptroller of the Currency News Release 2021-138, *OCC Seeks Feedback on Principles for Climate-Related Financial Risk Management for Large Banks*, wherein Acting Comptroller Hsu stated, "Today's release takes an important, concrete step towards ensuring the safety and soundness of large banks in the face of increasing risks from climate change."

Report as support for the OCC's conclusions that climate-related financial risks may threaten bank safety and soundness. ICBA is deeply troubled the OCC has not offered any additional evidentiary, statistical, meteorological, or empirical support for its position, or cited even a single instance of bank failure related to an extreme weather event or due to a bank's failure to manage climate-related financial risk. Additionally, the agency has not acknowledged that other federal financial regulators have concluded "the average FEMA disaster is *not* detrimental to bank stability."[5]

Without more data to support its conclusions, any final rules or guidance the OCC issues on climate-related financial risk could arbitrarily and capriciously expand its mission beyond the agency's statutory mandate. To mitigate these concerns, we encourage the OCC to gather empirical data, conduct studies, and coordinate with the members of FSOC, as well as other government stakeholders including the SBA, FEMA, and USDA, prior to engaging in rulemaking or issuing additional guidance related to climate-related financial risk.

II. The OCC Should Explain Its Approach to Climate-related Financial Risk Is Not Intended to Facilitate "Operation Chokepoint"

ICBA is concerned the draft principles, however well-intentioned the framework may be, will politicize the agency, jeopardize the independence of the agency, and discourage banks from doing business with legal but climate disfavored industries such as carbon-intensive industries. Because the draft principles broadly apply to every facet of risk management, and do not provide guidance to banks or examiners to differentiate material climate-related risk exposures from all conceivable climate-related risk exposures, there is a troubling possibility the OCC could cite deficiencies in climate-related risk management at every bank in every examination. As such, ICBA is concerned the OCC could use the draft principles to implement "Operation Chokepoint" and pressure banks to terminate business relationships with clients engaged in lawful activity by "de-risking" their portfolios and declining basic banking services, such as deposit accounts and loans, to entire categories of industries the OCC believes may present climate-related financial risk.

The OCC broadly defines "transition risks" as "stresses to certain banks or sectors arising from the shifts in policy, consumer and business sentiment, or technologies associated with the changes necessary to limit climate change."[6] Although the OCC does not further define transition risks, provide examples of transition risks, or specify which industries or occurrences might pose the most material transition risks, the draft principles require large banks to analyze transition risk considerations within every aspect of risk management, including governance, policies, procedures and limits, strategic planning, risk management, data risk measurement and reporting, and scenario analysis. The draft principles also require large banks to analyze transition risks within every facet of risk assessments including credit risk, liquidity risk, other financial risk, operational risk, legal and compliance risk, and other nonfinancial risk.

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[5] Staff Reports, Federal Reserve Bank of New York, *How Bad are Weather Disasters for Banks?*, No. 990 (Nov. 2021) at page 9 (emphasis added) available at: https://www.newyorkfed.org/research/staff_reports/sr990.

[6] Office of the Comptroller of the Currency, *Principles for Climate-related Financial Risk Management for Large Banks* (Dec. 16, 2021) available at: https://www.occ.treas.gov/news-issuances/news-releases/2021/nr-occ-2021-138a.pdf.

Both the breadth and lack of specificity in this proposal leave open the possibility that any number of lawful industries could be choked off from the financial system for posing climate risk, including industries that are carbon-intensive, or consume large amounts of water, energy and other natural resources, or produce, supply, or consume fertilizer and chemicals, or generate waste, and list goes on. In a recent speech, Acting Comptroller Hsu stated banks should monitor their exposure to a potential carbon tax, and prepare for resulting "transition risks" that come from a shift to a low-carbon economy.[7] Yet, the Acting Comptroller did not explain how banks could measure and prepare for the impact of a hypothetical carbon tax. Given the degree of speculation involved in this analysis, and the lack of specificity from the OCC, it is plausible an examiner could interpret the draft principles such that the only way to prepare for a speculative risk would be to take the extreme measure of eliminating the risk entirely. Banks should not be forced by their regulator to de-risk entire categories of business customers based on speculation that that transition risks, no matter how remote, could arise related to the "changes necessary to limit climate change." Further, while community banks typically are not the primary source of financing for large energy producing companies, they do provide the majority of small business credit in those communities where energy production, refinement, transportation and other ancillary businesses exist. Policies that would reduce access to credit to those businesses because they are connected to the fossil fuel industry would have devastating impacts on the local economies served by community banks.

The Department of Justice has concluded that Operation Chokepoint was a "misguided initiative" and that "law abiding businesses should not be targeted simply for operating in an industry that a particular administration might disfavor."[8] If the OCC has no intention of forcing banks to de-risk their portfolios or choke off lawful but climate disfavored industries from the financial system, the agency should make this abundantly clear in any finalized guidance and/or rules and state there will not be a supervisory expectation that banks de-risk entire geographies or industries from their lending portfolios.

III. <u>Current Risk Management Practices Adequately Protect Community Banks from Climate-related Financial Risks</u>

As stewards of their local communities, community bankers have every incentive to ensure their lending practices support the long-term prosperity of their local economies. A community bank cannot flourish without the success of the local community because its customers and loan portfolios are geographically concentrated within the local markets the community bank serves. The risks of economic shocks, customer displacement and damaged collateral (risks the OCC characterizes in the context of climate change as "transition risks" and "physical risks") are not novel risks for community banks to manage, and each of these risks, if not properly managed, undoubtedly has the potential to impact a community bank. But history has shown that because community banks are experts in managing their risk, community banks do not fail simply because climate-related financial risks exist. This fact is evidenced by the OCC's failure to publish any empirical data related to its draft principles to explain the agency's conclusion that climate-related financial risks are correlated with systemic risk and bank safety and

[7] Acting Comptroller of the Currency Michael J. Hsu, *Five Climate Questions Every Bank Board Should Ask* (Nov. 8, 2021).

[8] Letter from Stephen E. Boyd, Assistant Attorney General, to the Honorable Bob Goodlatte, Chairman, Committee on the Judiciary, U.S. House of Representatives (August 16, 2017) available at: https://www.consumerfinance monitor.com/wp-content/uploads/sites/14/2017/08/2017-8-16-Operation-Chokepoint-Goodlatte.pdf.

soundness. While FDIC data shows 4,104 U.S. banks have failed since 1934, the draft principles do not refer to a single instance of bank failure due to a bank's improper management of "physical risks" and "transition risks" related to climate change.[9]

While the OCC believes "banks are likely to be affected by both the physical risks and transition risks associated with climate change," these "affects" are not necessarily negative, and do not *ipso facto* constitute threats to bank safety and soundness. In fact, in a recent New York Federal Reserve staff report titled, "*How Bad are Weather Disasters for Banks?"* ("the Staff Report"), the financial regulator evaluated all FEMA disasters and found "generally insignificant or small effects on bank performance and stability. In particular, loan losses and default risk at local banks [did] not increase significantly . . . [m]oreover, not all effects are bad; income of multi-county banks increase significantly with disaster exposure." According to the Staff Report, "local banks" (i.e. community banks) have "superior geographic knowledge" that "helps them avoid areas where disaster risks are more frequent than expected based on common knowledge."[10] Community banks have superior geographic knowledge as compared to their large-bank counterparts because "banks located closer to their borrowers have been found to harbor knowledge of both borrowers and local risk that more distant lenders may lack."[11] For example, "local banks reallocated mortgage lending from census tracts where flood risks seem understated relative to the FEMA maps (given recent flooding experience)."[12] By contrast, the Staff Report's authors did not observe similar behavior at multi-county banks.[13]

The detailed findings from the New York Federal Reserve are strong evidence community banks do not need additional regulation to manage climate-related financial risks. Since the late 19th century, community banks have successfully implemented risk management practices, and in so doing, have weathered and survived every type of natural disaster, including catastrophic hurricanes, tornadoes, earthquakes, wind events, droughts, freezes, snowstorms, wildfires, landslides, volcanoes, and flooding. As detailed below, community banks' current, validated, and long-standing risk management practices are not only adequate for community banks to evaluate climate-related financial risks, but they are also effective in ensuring community banks are operationally resilient and protected from failure in the aftermath of economic shocks and natural disasters.

a. *Disaster Preparedness and Response*

Community banks are well-equipped to prepare for and respond to natural disasters and property losses. Community banks maintain detailed business continuity plans which outline the processes the

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[9] *See* FDIC BankFind Suite: Bank Failures and Assistance Data available at: https://banks.data.fdic.gov/explore/failures?aggReport=detail&displayFields=NAME%2CCERT%2CFIN%2CCITYST%2CFAILDATE%2CSAVR%2CRESTYPE%2CCOST%2CRESTYPE1%2CCHCLASS1%2CQBFDEP%2CQBFASSET&endFailYear=2022&sortField=FAILDATE&sortOrder=desc&startFailYear=1934.

[10] Staff Reports, Federal Reserve Bank of New York, *How Bad are Weather Disasters for Banks?*, No. 990 (Nov. 2021) at page 9 (emphasis added) available at: https://www.newyorkfed.org/research/staff_reports/sr990.

[11] *Id.*

[12] *Id.*

[13] *Id.*

bank will follow before, during, and after a natural disaster to safeguard employees, customers, products and services, and remain operational with limited business disruption.[14] These disaster plans are not obscure documents buried in dusty file drawers but are instead meticulously prepared, diligently tested, and carefully guarded reference guides that bank employees are ready to follow at any moment's notice. Business continuity plans not only contemplate the physical destruction of bank collateral, including the bank headquarters, ATMS, and branches, but also detail how the bank will respond to the needs of its customers and the community-at-large, and, in particular cash needs, in the aftermath of a disaster's destruction. As part of these plans, community banks proactively ensure they have enough cash on hand to meet customer needs and that redundant systems are in place so customers can continue to use debit cards and banks can readily access digitally stored bank records. Community banks also contemplate how bank employees can continue to utilize operationally critical systems and communicate with bank personnel, emergency responders, regulators, customers, and vendors in the event there is a loss of power, loss of physical bank records, inaccessible roadways, and displaced bank employees and customers.

b. *Concentration Risk Management*

Community banks are also adept in managing other types of risks, such as concentration risk, under the OCC's existing risk management framework.[15] Every community bank portfolio is concentrated geographically, thus all community banks are exposed to some degree of credit concentration risk. Yet, exposure to concentration risk, even significant concentration risk, is not indicative that a bank will fail or that the bank should be subject to heightened supervisory scrutiny. Instead, the relevant inquiry is whether the concentration risk is material and whether the bank has properly managed its risk exposures. To measure the materiality of concentration risk, community banks and their regulators evaluate the quantity of risk exposures, the quality of a bank's risk management framework, the strength of bank governance, the adequacy of internal controls, and perform stress tests. As demonstrated during thousands of examinations, community banks are adept in mitigating risk due to seasonal weather changes and natural disasters, and credit concentration and should not be subject to additional burdensome, costly, duplicative, and unnecessary climate-related risk management practices.

c. *Underwriting Practices and Estimating Allowance for Loan and Lease Losses ("ALLL")*

Existing due diligence and underwriting practices enable community bankers to carefully assess the level of risk posed by every customer relationship and ensure effective controls are in place to monitor these relationships on an ongoing basis. If necessary, community banks will shorten the maturity of their loans to protect the bank not only from interest rate risk but also from many different types of underwriting risks including climate risks.

Additionally, under the current supervisory framework for estimating credit losses, banks are expressly required to consider "qualitative or environmental factors that are likely to cause estimated credit losses

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[14] *See* OCC Bulletin 2019-57 *FFIEC Information Technology Examination Handbook: Revised Business Continuity Management Booklet* (November 14, 2019) available at: https://www.occ.treas.gov/news-issuances/bulletins/2019/bulletin-2019-57.html.

[15] *See generally* Office of the Comptroller of the Currency, *Comptroller's Handbook, Safety and Soundness, Concentrations of Credit, Version 2.0* (Oct. 2020) available at: https://www.occ.gov/publications-and-resources/publications/comptrollers-handbook/files/concentrations-of-credit/index-concentrations-of-credit.html.

associated with the institution's existing portfolio to differ from historical loss experience."[16] The OCC and other prudential regulators expect allowance estimates for ALLL to be "based on a comprehensive, well-documented, and consistently applied analysis of the loan portfolio, and should take into consideration all available information existing as of the financial statement date, including environmental factors such as industry, geographical, economic, and political factors."[17]

Plainly stated, the qualitative and environmental factors community banks currently use to analyze the adequacy of ALLL already estimate and quantify climate-related financial risk. For example, if a bank is located in a market that is in severe drought, the bank will increase qualitative and environmental factors to account for this increased risk to the loan portfolio, which in turn results in an increase in the bank's allowance estimate. Since community banks already consider qualitative and environmental factors as part of their "comprehensive, well-documented, and consistently applied ALLL analysis," and since most community banks will be subject to CECL by 2023 and be required to be forward looking with their estimates of loan losses, a separate risk management framework for climate risk is unnecessary.

d. *Securing Insurance Policies to Offset Risk*

With respect to their lending and investment activities, community banks are keenly aware of the importance of risk mitigation particularly during times of economic stress or extreme weather events. To mitigate climate, disaster, and concentration risks, community banks ensure their property loans have adequate flood insurance and their agricultural loans have adequate crop insurance. Crop insurance allows agricultural producers to recover from severe weather disasters and repay their farm loans.

Additionally, community banks diversify their agricultural loan portfolios by utilizing the safety nets, insurance, and market protections for farmers and agricultural lenders authorized by the farm bill, including the Farm Service Agency's Guaranteed Farm Loan Programs. The farm bill, adopted by Congress approximately every five years, provides an income safety net for commodity prices to bolster income for farmers and ranchers. The farm bill also offers farmers and ranchers several guaranteed farm loan programs. The guaranteed farm loan programs protect up to 90 – 95 percent of the loan principal, thus ensuring the repayment of most of the loan principal should farmers and ranchers become unable to repay their loans. These programs also help protect community banks against loan losses by providing tools to manage their concentration risks, which is particularly important to banks that specialize in agricultural lending.

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[16] Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of Thrift Supervision, *Interagency Policy Statement on the Allowance for Loan and Lease Losses,* available at: https://www.occ.gov/news-issuances/bulletins/2006/bulletin-2006-47a.pdf.

[17] Office of the Comptroller of the Currency, OCC Bulletin 2001-37, *Policy Statement on Allowance for Loan and Lease Losses Methodologies and Documentation for Banks and Savings Institutions: ALLL Methodologies and Documentation* (July 20, 2001) available at: https://www.occ.gov/news-issuances/bulletins/2001/bulletin-2001-37.html.

IV. Mandatory Scenario Analysis Is Not Appropriate for Community Banks

Scenario analysis is a complex, data-driven modeling exercise that should not be mandatory for community banks. To perform mandatory scenario analysis, community banks would likely need to hire specialized third-party consultants and experts to perform the work. Our members report that even conservative estimates for an independent audit can exceed $100,000. Because there are few individuals and firms qualified to perform climate change scenario analysis, the demand for this service, if mandatory for community banks, would only push the costs of these audits and exercises even higher. Community banks cannot afford to pay hundreds of thousands of dollars to third parties to perform climate change scenario analyses, particularly if these analyses are evaluating immaterial or remote climate-related financial risks or are unlikely to result in any measurable changes to business operations.

Since most community banks will be subject to CECL beginning in 2023, many of them will find it necessary to stress test their loan portfolios to make accurate estimates of future losses under the new accounting standard. Further, community banks can test and validate their business continuity plans by participating in FEMA's National Exercise Program and the Homeland Security Exercise and Evaluation Program. Given that community bank portfolios are generally not as complex as large bank portfolios, and because community banks already perform numerous stress testing exercises, community banks simply do not need to perform yet another duplicative scenario analysis.

ICBA is also concerned mandatory scenario analysis could force community banks to engage in an impossibly difficult exercise of forecasting for remote risks that may occur decades in the future, or which may never transpire. The longer the timeframes that are selected in scenario analysis for default and loss projections, the more speculative and expensive the analysis becomes, while the utility of the exercise, and the likelihood of any measurable changes to the business, are greatly reduced.

V. Any Approach to Climate-related Financial Risk Management Must be Guided by Materiality

One of the biggest challenges community banks would face in incorporating the draft principles into their risk management systems is anticipating, measuring, forecasting, and analyzing unknown and unquantifiable risks. As proposed, the draft principles are incredibly broad and lack specificity to help banks and examiners identify material climate-related financial risks that could warrant heightened scrutiny. The draft principles do not contain any guardrails to ensure examiners cannot get carried away in criticizing financially healthy banks on the basis of remote, or highly speculative, or immaterial climate-related risks.

The draft principles also do not contain defining terms, detailed hypothetical or explanatory examples, time periods for forecasting, or even specify a common data set banks should use to analyze climate related financial risks. ICBA is concerned that without any of these limits, the draft principles can broadly apply to every type of physical risk or transition risk imaginable, no matter how immaterial or remote, and banks could therefore be subject to undue regulatory scrutiny for minor deficiencies in their risk management programs that are only tenuously related to climate-risk. The resources and costs that would be necessary to comply with the draft principles could quickly overwhelm a community banks' limited staff or force a community bank to de-risk entire industries or loan portfolios even if the bank had no other safety and soundness weaknesses.

VI. ICBA Recommendations

- To the greatest extent possible, the OCC should coordinate with other agencies and develop a harmonized approach to climate change with the members of the FSOC, as well as the SBA, FEMA, and USDA. These agencies should adopt a flexible approach that acknowledges evolving bank and supervisory practices as well as varying degrees of material climate-related financial risks.

- The OCC should conduct outreach meetings with community banks to better understand why climate risk principles that may be appropriate for large institutions are not appropriate for community banks.

- The OCC should not apply its draft principles or any climate-related financial risk framework to community banks with fewer than $100 billion in assets.

- Before finalizing the draft principles or any additional guidance, the OCC should conduct studies jointly with the members of FSOC, as well as the SBA, FEMA, and USDA to understand whether empirical data supports the conclusion that climate risks are a significant threat to the safety and soundness of the financial system, and to determine whether a separate climate-related financial risk management framework is necessary.

- The OCC should host voluntary climate risk exercises, similar to tech sprints, to facilitate an open dialogue among government stakeholders, banks, insurers, vendors, and other third parties and to identify whether a separate climate-related financial risk management framework is necessary.

- If the OCC's climate-related financial risk management framework not intended to "choke-off" specific industries from the financial system, any future guidance should expressly inform examiners there is no supervisory expectation that banks de-risk legal but climate disfavored industries.

- ICBA is supportive of some incentive-based solutions to address climate change. For example, the New York Department of Financial Services ("NYDFS") recently issued an industry letter which describes the circumstances in which banking institutions subject to the New York Community Reinvestment Act ("NY CRA") may receive credit in connection with financing projects addressing climate change, including credit for financing activities that reduce or prevent the emission of greenhouse gases that cause climate change, and adapt to life in a changing climate. The NYDFS has stated banks may qualify for credit under the NY CRA for community development lending or qualified investments that stabilize community development such as investments in renewable energy and water conservation equipment to reduce utility payments for low and moderate income ("LMI") tenants, community solar projects, microgrid or battery storage projects in LMI areas with high flood and/or wind risk, projects addressing flooding or sewer issues or reducing storm runoffs, flood resilience activities for multifamily buildings offering affordable housing, and installation of air conditioning in multifamily buildings offering affordable housing.[18]

Once again, ICBA appreciates this opportunity to share our views on the OCC's draft principles. Please feel free to contact Jenna Burke at jenna.burke@icba.org should you wish to discuss our comments in further detail.

Sincerely,

/s/ Jenna Burke

Jenna Burke
Senior Vice President, Senior Regulatory Counsel
Independent Community Bankers of America

[18] New York Department of Financial Services, *Industry Letter: CRA Consideration for Activities that Contribute to Climate Mitigation and Adaptation* (Feb. 9, 2021) available at: https://www.dfs.ny.gov/industry_guidance/industry_letters/il20210209_cra_consideration.