



Regulatory Alert for Financial Services

Regulatory Insights

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Climate Risk: FRB principles climate-related financial risk management

The FRB's proposed principles demonstrate regulatory synergy of heightened regulatory expectations to climate risk management for both physical and transition risks. This action is in keeping with prior issuances by the OCC and the FDIC (see Regulatory Alert, [here](#)) and the voluntary TCFD framework. Notably, the FRB's release helps drive toward the development of interagency climate risk guidance. The current principles cover six areas for which demonstrated program maturation will be expected: 1) governance, 2) policies, procedures and limits, 3) strategic planning, 4) risk management, 5) data, risk measurement, and reporting and 6) scenario analysis. While directed at institutions over \$100 billion in total assets, all bank holding companies should be prepared to quickly advance their climate and sustainability data, controls, measurement, analysis, and overall risk and compliance management programs going into 2023.

The FRB released [draft principles](#) for climate-related financial risk management for financial institutions with over \$100 billion in assets. The six general principles and six key risk areas, highlighted below, are substantially similar to those released previously by OCC and FDIC, and are intended to focus on key aspects of climate-related financial risk management.

General Principles

The general principles put forth a high-level framework for the "safe and sound" management of climate-related financial risk ("climate risk") exposures, both physical and transition.

1. Governance. To ensure effective risk governance frameworks:

- The board should demonstrate sufficient acumen to assess the potential impacts of climate risks and address and oversee these risks within the financial institution's strategy and risk appetite, including the potential ways these risks could evolve over various time horizons and scenarios
- Assign and define climate risk roles, responsibilities, and interactions throughout the organization, integrating responsibility and accountability throughout these climate risk management structures
- Allocate appropriate resources

- Management should clearly communicate to staff regarding climate-related impacts to the financial institution's risk profile
- Management should regularly report to the board on the level and nature of climate risks to the financial institution

- 2. Policies, Procedures, and Limits.** Management should incorporate climate risks into policies, procedures, and limits to provide detailed guidance on the financial institution's approach to these risks and should modify them when necessary to reflect changing risk characteristics, operating environment, or activities.
- 3. Strategic Planning.** The board and management should consider material climate risk exposures when setting the financial institution's business strategy; risk appetite; and financial, capital, and operational plans. The potential impact of these risk exposures should factor in geographic locations; stakeholder expectations; reputation risk; and low- and middle-income and other vulnerable communities, including physical harm and access to financial services. Public statements about the financial institution's climate-related strategies and commitments



should be consistent with internal strategies and risk appetite statements.

4. Risk Management. Management should oversee the development and implementation of processes to identify, measure, monitor, and control climate risk exposures within existing risk management framework. To achieve this:

- Employ a “comprehensive process for identifying emerging and material climate risks”
 - Across a range of scenarios and various time horizons
 - Considering input from stakeholders across the organization
- Develop processes to “measure and monitor material climate risks and inform internal stakeholders about the materiality of those risks.” This includes:
 - Defining “material” climate risk exposures, both physical and transition
 - Developing tools and approaches, such as exposure analysis, heat maps, climate risk dashboards, and scenario analysis, among others
 - Aligning with the financial institution’s risk appetite
 - Supporting appropriate metrics (e.g., risk limits and key risk indicators) and escalation processes
- Incorporate climate risks into their internal control frameworks, including internal audits

5. Data, Risk Measurement, and Reporting. To facilitate the availability of relevant, accurate, and timely data for swift and sound decision-making across the financial institution:

- Incorporate climate risk information into the financial institution’s internal reporting, monitoring, and escalation processes
- Ensure effective risk data aggregation and reporting capabilities
- Monitor developments in data, risk measurement, modeling methodologies, and reporting, and incorporate them into their climate risk management as appropriate

6. Scenario Analysis. FRB states that “climate scenario analysis is emerging as an important approach to identifying, measuring, and managing climate risks... [and] an effective climate scenario analysis framework should provide a comprehensive and forward-looking perspective to apply alongside existing risk management practices when evaluating the resiliency of strategies and risk management to the structural changes arising from climate

risks.” To establish an effective framework, financial institutions should:

- Develop and implement climate scenario analysis processes in a manner appropriate for their size, complexity, business activity, and risk profile
- Develop oversight, validation, and quality control standards for climate scenario analyses, commensurate to their risk
- Clearly define the objectives of the analysis framework, reflecting the overall climate risk management strategies

Management of Risk Areas

- **Credit Risk.** Monitor climate-related credit risks across market sectors, geographies, and concentrations (including concentrations stemming from physical and transition risks and potential changes in correlations across exposures or asset classes).
- **Liquidity Risk.** Incorporate climate risks into liquidity risk management and liquidity buffers.
- **Other Financial Risk.** Monitor interest rate risk and other model inputs for greater volatility or less predictability due to climate risks.
- **Operational Risk.** Conduct climate risk assessments across all business lines and operations, as well as consideration of third-parties, business continuity, and evolving legal and regulatory landscapes.
- **Legal/Compliance Risk.** Consider how climate risks and risk mitigation measures affect the legal and regulatory landscape in which the financial institution operates.
- **Other Nonfinancial Risk.** Monitor the execution of strategic decisions and how the operating environment affects financial condition and operational resilience. Consideration should be given to:
 - The extent to which the financial institution’s activities may increase the risk of negative financial impact from reputational damage, liability, and litigation
 - Adequate measures to implement to mitigate these material risks

FRB is seeking public comments on these draft principles and risk areas and intends to incorporate feedback into subsequent interagency (FRB, OCC, and FDIC) guidance related to climate risk management. Comments are due within sixty (60) days of publication in the Federal Register.

For more information, please contact [Amy Matsuo](#) or [Adam Levy](#).

See below for more information:

- [Press Release: FRB invites public comment on proposed principles providing a high-level framework for the safe and sound management of exposures to climate-related financial risks for large banking organizations](#)
- [KPMG Regulatory Alert | OCC principles for large bank climate risk management](#)
- [KPMG Regulatory Alert | Supervisory and Regulatory Approaches to Climate-related Risks: FSB, OCC and FDIC](#)

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