FSOC Highlights Climate-Related Risks

regulatory risk management strategic planning

Summary: The Financial Stability Oversight Council (FSOC) recently released its report on climate-related financial risk. It details how the council, including regulators, will be assessing these risks, which have become more integral with many of the activities of the financial institutions that they supervise. Here is an update on the progress of climate-related risk regulations, along with three ways community financial institutions can prepare.

Today is National Pastry Day. According to Statista, over 130MM Americans ate breakfast pastries in 2020 and that number is forecasted to rise over 134MM in 2024. The top pastry consumed was the cinnamon roll with 67.46MM people making this part of their breakfast. Making preparations for a cinnamon roll to enjoy with your cup of joe this morning may not be a bad idea!

We are not sure about cinnamon rolls, but the Financial Stability Oversight Council (FSOC) is certainly making other preparations these days. It is preparing to minimize potential "shocks" to the US financial system as institutions deal with possible disruptions due to climate change as well as bumps along the road to a net-zero emissions economy by 2050.

Released in October, the FSOC's 2021 Report on Climate-Related Financial Risk details efforts by the council's members, including federal and state financial regulators, on developing ways to assess climate-related financial risk inherent in the activities of the institutions they supervise. It also explores possible cumulative impacts to the country's overall financial stability. As part of this, the council's members are determining the best way for institutions to analyze and disclose such risks to regulators, investors, and other stakeholders. Stress testing that includes climate-risk analysis might also be required in regulatory exams.

Climate-related risk

Financial institutions will likely be required to analyze how possible physical events due to climate change could impact them, such as recurring hurricane or wildfire damage to their commercial customers' properties and business operations. Since possible impacts vary widely, regulators are expected to recommend scenario analysis to determine the level of climate-related financial risk in varying situations.

Transition risk to a net-zero economy

Regulators might also ask institutions to analyze transition risks as the country moves to a net-zero emissions economy. For instance, how would loan portfolios be impacted by the cessation of certain business operations, like coal mining or oil and gas exploration? The more abrupt or disorderly the transition, the greater the potential impact on financial stability.

Regulators might also require institutions to disclose their "*emissions footprint*," the extent to which they have financed business activities that emit greenhouse gases. A number of frameworks have been developed to assist institutions in climate-related financial disclosures, including the framework detailed by the Taskforce for

Climate-Related Financial Disclosures (TCFD). The various frameworks are set to be consolidated by a new International Sustainability Standards Board created by the IFRS Foundation.

While it will take some time for regulators to fully implement these requirements, many are already moving on proposed rulemaking or issuing guidance, including the SEC, the Federal Reserve, and the OCC. Here are **three ways community financial institutions (CFIs) can prepare for these regulations**.

1. **Start at the top.** Boards should start discussing a game plan now, in their strategic planning sessions. An executive, such as the chief risk officer, should be charged with overseeing the plan's execution. "*There is also a cultural imperative: responsibility for climate-risk management must be cascaded throughout the organization. It will be of crucial importance for top management to set the tone on climate-risk governance,*" says McKinsey experts.
2. **Set up a plan.** Determine your institution's current exposure to climate risk and then strategize what would need to be done to mitigate it. As you review your customer base's businesses, opportunities may even arise. Some institutions are creating niches serving customers who stand to thrive in a net-zero economy.
3. **Communicate to stakeholders.** Let regulators, investors, and customers know that your institution is making demonstrable steps toward becoming as compliant as possible. CFIs that walk the walk could not only lessen their compliance risk, but might also be rewarded by climate-minded customers.

The latest report by the FSOC shows that climate-related risks are becoming more important to regulators. While the rules haven't been set yet, starting to prepare for them can help CFIs make small changes now compared to big changes down the road.

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ECONOMY & RATES

Rates As Of: 12/09/2021 06:40AM (GMT-0700)

Treasury	Yields	MTD Chg	YTD Chg
3M	0.07	0.02	-0.02
6M	0.13	0.03	0.04
1Y	0.29	0.04	0.18
2Y	0.68	0.11	0.56
5Y	1.25	0.08	0.88
10Y	1.48	0.03	0.56
30Y	1.85	0.05	0.20

FF Market	FF Disc	IORB
0.08	0.25	0.15
SOFR	**Prime**	**OBFR**
0.05	3.25	0.07