

6th February 2023

To The Board of Governors of the Federal Reserve System

Ref. Principles for Climate-Related Financial Risk Management for Large Financial Institutions

Docket No. OP-1793

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[Federal Register :: Principles for Climate-Related Financial Risk Management for Large Financial Institutions](#)

Dear Sir/Madam

The World Benchmarking Alliance (WBA) appreciates the opportunity to provide comments on the draft principles on a high-level framework for the management of exposures to climate-related financial risks for Board-supervised financial institutions with over \$100 billion in assets.

We are respectful of your role ensuring the stability of US financial institutions and recognise the parameters of your mandate. We trust that the following feedback is informative in defining your final framework.

Our specific recommendations are:

1. Recognition of the wider implications of climate risk beyond the physical and transition risks identified. Climate risk is inextricably intertwined with societal risk, which affects market sentiment and therefore influences financial stability. Risk management frameworks need to incorporate both quantitative and qualitative assessments. In particular, they need to evolve beyond the assets, operational and business risk of the banks. Systemic risk comes from system failure beyond financial assets.
2. We agree that risk management of climate-related risk is a governance issue which needs to sit at the highest accountability structure within the bank. We recommend strengthening the wording of this principle so that the board has mandatory responsibility, not just oversight of climate-related risk.
3. Ensure that the principles incorporate these banks' influence and effect beyond your domestic border and the management of risk beyond your domestic financial markets. Contagion of climate-related risk across global markets is inevitable. The USA and its largest banks play a critical global role in managing global financial risk and ensuring global market stability.

4. Alignment with global frameworks, principles and standards to ensure that your regulations keep up with the demands of other actors in the financial system who have risk management responsibilities and regulatory requirements. Avoid 'black-box' internal frameworks and ensure public transparency to build trust in these institutions from all stakeholders; an increasingly important requirement to ensure stable institutions and markets. For example, of 187 financial institutions we assessed who disclosed their financing of climate solutions, only 52 aligned with internationally recognised frameworks.

Assessment of 400 leading financial institutions informs this feedback

WBA is an independent, global non-profit organisation that assesses 2,000 of the world's most influential companies and financial institutions on their governance, influence on planetary boundaries and societal issues and conventions. Their revenue is approximately a third of global GDP. The data and insight from these assessments, and engaging with these companies and their wider stakeholder group, provide a clear barometer and focal point for where market forces work, where they do not and where regulatory focus is needed.

For this specific feedback we draw from our experience of building our Financial System Benchmark in 2022. It assessed 400 financial institutions against a broad range of internationally agreed principles and recognised standards. It is informed by multi-stakeholder consultation, including many financial actors, policymakers and standard setters as well as civil society organisations. The financial institutions in scope of the Benchmark can affect financial markets due to their outsized influence. These include commercial and state banks, development banks, asset owners such as state and private pension funds, sovereign wealth funds, investment consultants, asset managers including alternative asset managers as well as insurers. 155 banks made up the largest component of the Benchmark, of which 18 were headquartered in the US. In total we assessed 118 US head-quartered institutions, most of which will be clients of the banks included in the scope of these proposed principles. The USA is the largest single country represented in our Benchmark and demonstrative of the reach of your institutions. Given the interconnection between these financial actors and representation of the USA within the Benchmark, both our experience constructing the methodology as well as the findings and subsequent engagement can meaningfully inform this consultation.

Question 1: In what ways, if any, could the draft principles be revised to better address challenges a financial institution may face in managing climate-related financial risks?

We welcome these principles being embedded into existing risk management frameworks and receiving an equivalent weighting of attention at the Board level to existing risk management regulations.

We strongly recommend the following wording in the principle on ‘Governance’ be strengthened so that the board is accountable for risk governance. The current wording infers responsibility is with management.

“The board should oversee the financial institution’s risk-taking activities and hold management accountable for adhering to the risk governance framework.”

From our assessment of leading global financial institutions, those who disclose board-level accountability score on average 98% higher on our climate assessment than those who do not. Across all measurement areas, including social factors, they score 153% higher than peers.

Under the principle of ‘Governance’ we also recommend strengthening the language in the following wording to strongly recommend linking compensation policies to risk management, and if this is not done, a reason why is presented:

“The board should consider whether the incorporation of climate-related financial risks into the financial institution’s overall business strategy and risk management frameworks may warrant changes to its compensation policies, taking into account that compensation policies should be aligned with the business, risk strategy, objectives, values, and long-term interests of the financial institution.”

From our assessments, financial institutions that linked their executive pay to sustainability targets on average scored 221% higher on climate assessments than those who did not. They scored 192% higher across all measurement areas including social factors. This evidences that setting appropriate compensation policies has a strong motivating effect on the performance of the institution.

Under the principle of ‘Risk Management’ we strongly recommend that the wording in the following statement to incorporate external stakeholders is strengthened:

“The risk identification process should include input from stakeholders across the organization with relevant expertise”.

It is of high importance that these principles incorporate recognition of the banks’ wider role in ensuring stability not just within their own operations, but also their amplifying effect through

their financing activities. These principles need to recognise external stakeholders who can inform the banks on the wider risks and ensure these are incorporated into risk management policies and frameworks. Evidence of external stakeholder engagement is strongly recommended.

Question 2: Are there areas where the draft principles should be more or less specific given the current data availability and understanding of climate-related financial risks? What other aspects of climate-related financial risk management, if any, should the Board consider?

To better address the challenges financial institutions face and capture the scope of risks that climate change poses, we strongly recommend widening the definition of climate risk to ensure it captures the full extent of non-financial risks. For example, taking into account the communities and societies who will be directly impacted by climate change within the USA and also in the banks' wider stakeholder community. Stable financial markets rely on robust economies which in turn require a functioning society. It is of high importance that the banks' boards also take these into account in their risk assessments, ensuring that a blunt approach on risk mitigation is not applied in reducing assets that are in direct risk, which could have unintended consequences of increasing societal risk. It cannot be assumed that this will be included automatically, as historically this has not been within the banks' traditional remit.

For example, of the 18 US banks we assessed, disclosure on adherence to human rights risks frameworks was exceptionally low. Only one bank's disclosure noted adherence to international standards, and none disclosed that they identify human rights risks within their financing activities. Given the increasing societal issues, and the threat societal instability causes to financial markets, there is urgent improvement needed.

Question 3: What challenges, if any, could financial institutions face in incorporating these draft principles into their risk management frameworks?

Many global financial institutions are already recognising climate-related risk, not only physical assets and operations, also to businesses models, communities, societies, regions and countries. Many are already doing so for other regulatory jurisdictions. As evidence of this, financial institutions in our benchmark in Europe, Canada and Asia on average scored higher than financial institutions in the USA.

These principles will be catching up with international standards and level the playing field for those institutions who are already moving forward with these principles. They bring important regulatory clarity.

The greatest recognised challenge is currently regarding data availability, however it is well recognised that risk identification is still necessary even if imperfect. Using internationally recognised frameworks and standards to meet these principles, and disclosing against them transparently and with clarity, enables the banks to meet these principles whilst also evolving against the developing work in this area of risk management.

We trust that this feedback is constructive and valuable to your process. You can find more information on our benchmark at www.worldbenchmarkingalliance.org. We remain available to share more data or feedback as necessary.

Yours faithfully

Andrea

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