GUIDANCE FOR NEW YORK STATE- REGULATED BANKING AND MORTGAGE INSTITUTIONS RELATING TO MANAGEMENT OF MATERIAL FINANCIAL AND OPERATIONAL RISKS FROM CLIMATE CHANGE

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Purpose

- To promote the safety and soundness of regulated organizations through their efforts in assessing and managing their material climate-related financial and operational risks
- To address material financial and operational risks related to climate change faced by regulated organizations through risk assessment, risk management, and risk appetite setting
- To foster the resilience of the global financial system

Approach

- Proportionate and principles-based guidance
- Focus on climate-related material financial and operational risks
- No cut-off by asset size
- Integrate into existing risk management framework
- Establish basis for continued supervisory dialogue
- Does not dictate what customers/investments are permitted
- Fair Lending and CRA—fair access to credit is critical

Overarching Themes

A. Financial Risks from Climate Change
B. Managing Climate-Related Financial and Operational Risks While Providing Fair Lending to All Communities
C. Operational Resiliency
D. Proportionate Approach

A. Financial Risks from Climate Change

Two Primary Channels: Physical and Transition Risks

- **Physical Risks:** Increasing frequency, severity, and volatility of acute events. Chronic shifts in weather patterns (sea level rise, heat waves, drought)
- **Transition Risk:** Arises from shifts in policy and regulations, new technologies, changing consumer and investor preferences, and liability risks

Potential economic effects:

- Reduced revenue, lower property values and household wealth, increased costs
- Revaluation of assets, increased capital costs, decreased profitability, property values and household wealth
- Both channels can have direct and indirect impacts on financial institutions

B. Managing Climate-Related Financial Risks While Providing Fair Lending to All Communities

- Manage climate-related financial and operational risks prudently and comply with existing obligations to ensure fair access to capital and credit
- In hard-hit communities, climate change impacts are likely to further undermine economic output, reduce already limited household income and wealth, and diminish access to capital
- Climate risk management must not be based on disinvesting or making access to credit more difficult/expensive
- Minimize and affirmatively mitigate disproportionate impacts of such risk management on LMI/minority communities, to ensure compliance with fair lending and consumer protection requirements
- Climate Resiliency: Opportunities for credit under New York’s CRA

C. Operational Resiliency

- Operational resiliency is essential to our regulated organizations' safety and soundness
- Regulated organizations' operational resiliency is also critical for preventing disruptions to financial services
- Given New York's importance as a global financial center, the disruption of the financial sector's ability to operate also can cause systemic risk
- As severe weather events have increased in frequency and become more costly, regulated organizations are facing growing challenges to ensuring operational resilience
- Organizations should ensure that their governance structures and risk management processes are adequate to preserve and strengthen their operational resiliency on an ongoing basis

D. Proportionate Approach

- Smaller organizations may not have less climate-related financial or operational risk
- Smaller organizations can have concentration of risk through less diversification
- Governance, strategy, and risk management approach should be tailored to organization’s type and degree of exposure
- Not one-size-fits-all: organizations have different resource levels, capacity, and complexity

Approach for Developing Final Guidance

- Public feedback solicited, including four questions
- Feedback received from variety of stakeholders
- Final Guidance reflects a balanced approach, incorporating many suggestions
- Maintains overall consistency with other regulatory authorities: climate risk principles, risk management guidance, exam manuals
- Next: Discussion of key areas clarified in final Guidance

Scope & Proportionality

- Covers all DFS-regulated banking organizations, branches and agencies of FBOs, mortgage bankers and mortgage servicers (“Regulated Organizations”)
    - “All financial institutions, regardless of size, may have material exposures to climate-related financial risks” (Federal Interagency Principles Oct. 2023)
    - Smaller organizations may have more concentrated exposures
    - Regulated organizations have flexibility to develop governance and risk management framework suitable for an organization’s size, business model, and exposure
- DFS will continue to support smaller organizations’ implementation process

Timeline for Implementation

- **DFS is not setting a timeline for implementation of Guidance expectations at this time**
- DFS's objective is to provide sufficient opportunity for regulated organizations to develop an implementation framework
- Implementation of Guidance expectations can be an iterative process
- DFS will review and factor in responses to an RFI to be issued during 2024, including information on challenges to implementation, before setting a concrete timeline

Governance: Board Oversight Role; FBOs

- Boards should consider material climate-related financial and operational risk exposures when setting and monitoring overall business strategy and risk appetite
  - Guidance further clarifies board's oversight role: to set the risk management framework and strategy, and monitor management's implementation
- Board and senior management need adequate understanding of climate-related financial and operational risks
  - Specialized board expertise not needed if members receive sufficient training and internal reporting on level/nature of these risks, including concentrations
- Flexibility on how to integrate governance of these risks into an organization's corporate structure
  - Permits reliance on policies, procedures, and processes of Group, FBO head office, or intermediate holdco, if meet Guidance conditions

Risk Management Processes

- Consistent with a risk-based approach
- Organizations need to understand and appropriately manage material climate-related financial and operational risks through their risk management processes, as a matter of safety and soundness
- Consideration of climate-related financial and operational risks should be integrated into risk management processes, using a forward-looking approach
- **Guidance doesn’t: prohibit lending or providing services to any specific class or type of customer or otherwise place restrictions on credit availability**

Materiality & Data Challenges

- A regulated organization's determination of materiality of climate-related financial and operational risks can be an iterative process
- Data gaps exist, but organizations can proceed with initial materiality assessments based on available data and methodologies, and refine over time as these improve

Fair Lending & New York CRA

- Guidance not imposing new legal obligations; these already apply under fair lending laws and other applicable consumer protection laws, regulations, and guidance.
- To manage compliance risk, the board should direct management to incorporate consideration of these requirements into internal processes for management of climate-related financial and operational risks
- Under New York's CRA, financing or investments that enhance LMI and other underserved communities' climate resiliency may be eligible for credit
    - See examples in 2021 Industry Letter
- Measures to reduce flooding, heat risks or other physical risk impacts on these communities may help mitigate organizations' own climate-related risks

Scenario Analysis; Other Risk Management Tools

- Utility of scenario analysis as a forward-looking risk management tool for multiple purposes
- Climate scenario analysis is distinct from traditional stress testing
- Organizations can use a proportionate and iterative approach to selecting appropriate risk management tools

Reporting Requirements

- Objective of RFI to be issued during 2024: to collect information about steps organizations are taking, or plan to take within a specified period, to assess and manage their climate-related financial and operational risks
- To preserve confidentiality, DFS will not disclose individual responses but may report on its findings on aggregate basis
- Data collected will be used to inform DFS's determination of a reasonable implementation timeframe for the Guidance

Supervisory Approach

- DFS's supervisory examinations will not cover the Guidance expectations at this time
- Before incorporating Guidance expectations into examinations, DFS will coordinate with federal banking agencies to align on joint supervision process

Additional Resources

- DFS is providing a list of publicly available resources that may support operational implementation of the Guidance
- Organized by topic, with links to easily access those resources
- These resources can assist organizations as they work to adopt measures that address their material climate-related financial and operational risks in a proportionate manner
- Located on the Climate Change page of DFS's website, under Industry Guidance

Conclusion/Wrap-Up

- DFS will continue to support and engage with its regulated organizations on these topics through webinars, roundtables, and other opportunities for engagement and discussion

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