Statement by Vice Chairman Travis Hill on the Interagency Guidance on Principles for Climate-Related Financial Risk Management for Large Financial Institutions

October 24, 2023

The interagency guidance ("Guidance") under consideration today describes how the banking agencies expect large banks to manage climate-related financial risks, and would significantly elevate the relative importance of climate risks in many aspects of a bank's decision-making.

The Guidance addresses both physical risks and transition risks related to climate change. I have spoken recently about my views on physical risks,[1] so I won't spend much time on them here. The FDIC has long expected banks of all sizes to consider and appropriately address potential climate risks that could arise in their operating environment.[2] In the U.S., despite years of record- or near-record-setting climate-related damage,[3] there is no record of banks ever failing because of climate events, and it has been extremely rare for banks to even suffer meaningful losses.[4]

Transition Risks

I'll spend a little more time on transition risks. Virtually everything a bank does is subject to transition risks. We live in a dynamic society with a dynamic economy, where companies and industries regularly rise and fall, and all industries are constantly vulnerable to changing customer preferences, changing technologies, and changing laws and regulations. Transitions frequently come and go without resulting in material stress at banks, and, as a matter of practice, the banking agencies do not issue a new set of principles every time a new transition risk arises.

Theoretically, we could try. For example, we could issue guidance on China-related financial risks, and tell banks to elevate the risks associated with rising tensions with China when doing business in China or with companies or industries reliant on China; and we could issue guidance on pandemic-related financial risks, and tell banks to elevate the risks associated with

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[1] *See* Travis Hill, Insights on the FDIC's Agenda (Sept. 21, 2023).

[2] *See, e.g.,* Statement by Jelena McWilliams at the Financial Stability Oversight Council Meeting (March 31, 2021).

[3] *See* National Oceanic and Atmospheric Administration, Billion-Dollar Weather and Climate Disasters.

[4] *See, e.g.,* Federal Reserve Bank of New York, Liberty Street Economics, Climate Change and Financial Stability: The Weather Channel (April 4, 2022) ("We find even the most destructive disasters had insignificant or small effects on bank stability and small and positive effects on bank income.").

future quarantines when doing business with hotels or airlines. We could play this game with any type of external shock, but I am skeptical that this would be a worthwhile use of our time.

It is also instructive to compare the FDIC's approach to climate transition risks with our approach to another recent transition that directly impacted the banking industry: the transition away from LIBOR. Starting in 2020, the FDIC participated in several interagency statements identifying the safety and soundness risks associated with LIBOR transition.[5] Notably, these statements were issued *after* it became clear that LIBOR would come to an end, and *after* there was clarity around the timeline.

By contrast, the energy transition referenced in the Guidance is both already underway and a long ways away. At the FDIC, we know nothing about how the transition will unfold; how long it will take; how it will impact companies and communities; and, most importantly for our purposes, how it will impact the banking industry.

Meanwhile, it is worth remembering that the energy industry has always been volatile. Recall, for example, that less than a decade ago, the price of oil fell from $108 per barrel to $44 per barrel over a seven-month period, and continued to decline for an additional year, ultimately hitting a low of $26 per barrel.[6] While this caused a significant spike in bankruptcies in the oil and gas industry,[7] not a single bank failed as a result.[8] A future shock in energy prices – whether a crash due to decarbonization, a spike due to higher taxes or limits on supply, or any shock due to any other factors – would follow a long history of booms and busts.

The probability that climate-related risks could someday result in bank failures is of course not zero, but I am unpersuaded that it is sufficient to justify elevating climate above a range of other risks banks face. We should focus on ensuring our banking system is resilient to a range of risks, rather than layering ever-more stringent expectations around the management of every discrete risk.

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[5] *See, e.g.,* Federal Financial Institutions Examination Council, Joint Statement on Managing the LIBOR Transition (July 2020); Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, Statement on LIBOR Transition (Nov. 30, 2020).

[6] U.S. Energy Information Administration, Petroleum & Other Liquids, Cushing, OK WTI Spot Price FOB.

[7] *See, e.g.,* Tom DiChristoper, Oil Bankruptcies: 100 down, maybe 100 more to go, CNBC (Sept. 28, 2016).

[8] *See, e.g.,* FDIC, Supervisory Insights, Oil Price Volatility and Bank Performance: A View from the Supervisory Process (Summer 2018) ("Overall, relatively few FDIC-supervised banks have become severely stressed by the developments in the O&G sector during the past few years, in part due to healthier capital levels and stronger risk management practices going into the most recent oil price downturn."); FDIC, 2019 Risk Review, p. 25 (July 30, 2019) ("Banks in oil-concentrated areas remain resilient to oil price volatility. Examination findings show that only a handful of FDIC-supervised banks, concentrated in the FDIC's Dallas Region, have more than 25 percent of loans tied directly to oil and gas lending…. Credit deterioration resulting from low oil prices has been relatively mild. At first quarter 2019, the past-due loan rate for oil-reliant states was 1.4 percent, only slightly above the 1.2 percent rate for all other states. Few banks in oil- and gas-concentrated areas exhibited severe stress, and no bank failures occurred in the concentrated areas during the recent period of low oil prices.").

Underserved Communities

I also find it noteworthy that on the same day the Board is voting on updating the Community Reinvestment Act rule, which is intended to encourage more lending to low- and moderate-income (LMI) communities, we are also considering guidance on the safety and soundness risks of climate change, which pushes in the opposite direction. As a general matter, when bank regulators declare something a safety and soundness concern, we should expect banks to do less of it or charge more for it.

The Guidance notes that "many commenters" requested acknowledgment of the Guidance's potential impact on LMI communities and clarification on whether this impact can be mitigated. Instead of providing either, the agencies respond that banks should "manage climate-related financial risks in a manner that will allow them to continue to *prudently* meet the financial services needs of their communities, including LMI and other underserved consumers and communities."[9] But the whole point of the Guidance is to alter whether loans in areas vulnerable to climate risks are *prudent*.[10] Or alternatively, it might be the case that the Guidance overall has no impact on banks' lending, in which case … why are we here?

In my view, the agencies' approach to climate risks is backwards. We should view banks as a source of strength to serve communities most vulnerable to the impact of climate change. Instead, we are telling banks to retrench.

Conclusion

I plan to vote against the Guidance, but I do want thank the staff for all their work on the topic.

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[9] *See* Interagency Guidance, Principles for Climate-Related Financial Risk Management for Large Financial Institutions, p. 18 (Oct. 24, 2023) (emphasis added).

[10] This also would not be the first time that banking agencies make policy that encourages de-banking on the one hand, while offering a statement suggesting that banks not de-bank on the other hand.