United States Senate
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
WASHINGTON, DC 20510–6075

March 18, 2021

The Honorable Jerome Powell
Chair
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Dear Chair Powell,

As you have previously acknowledged, "society's broad response to climate change is for others to decide—in particular, elected leaders."[1] We agree with that sentiment, but remain concerned that the Federal Reserve Board (Federal Reserve) may be preparing to use financial regulation and supervision to further environmental policy objectives. That would be beyond the scope of the Federal Reserve's mission. We urge you to refrain from taking any additional actions with respect to climate-related risks that would impose certain costs for uncertain benefits.

The Federal Reserve's recent actions suggest that the Federal Reserve may be considering using its financial regulatory authority to play an indirect role in regulating climate change. Last year, the Federal Reserve included climate change in its report on financial stability for the first time,[2] and then announced that it joined the Network of Central Banks and Supervisors for Greening the Financial System.[3] Following that announcement, the Federal Reserve established a new "Supervision Climate Committee" to further analyze the potential implications of climate change for financial institutions, infrastructure, and markets.[4] And last month, Federal Reserve Governor Lael Brainard suggested that the Federal Reserve may consider subjecting banks to "[c]limate scenario analysis."[5] We question both the purpose and efficacy of climate-related banking

[1] Bd. of Governors of the Fed. Reserve Sys., Tr. of Chair Powell's Press Conference (Dec. 16, 2020), https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20201216.pdf.

[2] *See* BD. OF GOVERNORS OF THE FED. RESERVE. SYS., FINANCIAL STABILITY REPORT 58 (Nov. 9, 2020), https://www.federalreserve.gov/publications/files/financial-stability-report-20201109.pdf.

[3] *See* Press Release, Bd. of Governors of the Fed. Reserve Sys., Federal Reserve Board announces it has formally joined the Network of Central Banks and Supervisors for Greening the Financial System, or NGFS, as a member (Dec. 15, 2020), https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201215a.htm.

[4] *See* Fed. Reserve Bank of New York, Kevin Stiroh to Step Down as Head of New York Fed Supervision to Assume New System Leadership Role at Board of Governors on Climate (Jan. 25, 2021), https://www.newyorkfed.org/newsevents/news/aboutthefed/2021/20210125.

[5] Although Governor Brainard acknowledged that climate scenario analysis would be distinct from traditional stress testing given the short time horizon of the stress tests versus the long-term nature of potential climate-related risks, this does not alleviate the underlying concerns regarding such long-term assessments. *See* Lael Brainard, Governor, Bd. of Governors of the Fed. Reserve Sys., The Role of Financial Institutions in Tackling the Challenges of Climate Change, Remarks at the "2021 IIF U.S. Climate Finance Summit: Financing a Pro Growth Pro Markets Transition to a Sustainable, Low-Carbon Economy" (Feb. 18, 2021), https://www.federalreserve.gov/newsevents/speech/brainard20210218a.htm.

regulation and scenario analysis, especially because the Federal Reserve lacks jurisdiction over and expertise in environmental matters.

We are also concerned about the value of assessing banks based on inherently uncertain climate models. While regulators, including Federal Reserve researchers and global bodies, have emphasized the need to address gaps in climate data,[6] there are also substantial methodological challenges associated with assessing climate-related risks that undermine the usefulness of this endeavor. As researchers have noted, current climate models provide little financially meaningful information.[7] Also concerning is the possibility of assessing banks against predictions of what the climate *may* look like decades in the future—predictions climate scientists have acknowledged are inherently and irreducibly uncertain.[8] Nor can financial institutions be certain of their business model or holdings in the future. Contrary to the misguided assertion that energy-related assets will become "stranded" during a transition to alternative energy sources, the underlying economics do not forecast such a decline in value. Rather, a major threat to these assets is the effort by regulators to impair their value, including through onerous regulations and increased financing costs. This effort is not grounded in science or economics, but is instead a self-fulfilling prophesy: claim there are financial risks with energy exploration and other disfavored investments then use the levers of government—via the unelected bureaucracy—to ban or limit those activities. Such an approach raises serious questions about the relative costs and benefits of climate-related banking regulation.

These suggestions also raise the troubling possibility that the Federal Reserve could similarly seek to impose heightened regulation based on other catastrophes such as a global pandemic or widespread famine, scenarios that clearly fall outside the scope of financial regulators' purview. Simply put, financial regulation does not and should not seek to guard against every type of unforeseen event; rather, it should ensure that financial institutions are resilient and have the capability to withstand unique economic and financial market stresses as they arise.

Finally, banks are in the best position to assess and price for risks in their portfolios. We recognize that many banks do have asset portfolios with exposure to severe weather events. For example, banks with residential and commercial loans in certain coastal areas may be impacted from such events more so than banks in other parts of the country.[9] However, banks are in the best position to consider all applicable risks—including climate-related risks—in their lending activities, and research shows that banks do indeed price in climate-related risks.[10] Due diligence

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[6] *See* Chicago Fed Letter, A new framework for assessing climate change risk in financial markets, Fed. Reserve Bank of Chicago (Nov. 2020), https://www.chicagofed.org/publications/chicago-fed-letter/2020/448 ("...historical data sets alone are not sufficient to make accurate predictions of future climate change scenarios."); *see also* BASEL COMM. ON BANKING SUPERVISION, CLIMATE-RELATED FINANCIAL RISKS: A SURVEY ON CURRENT INITIATIVES 4 (Apr. 2020), https://www.bis.org/bcbs/publ/d502.pdf (finding that 10 of 15 respondents indicated that "current data are not sufficiently granular or reliable to feed into the potential assessment models").

[7] *See* Tanya Fiedler et al., *Business risk and the emergence of climate analytics*, NATURE CLIMATE CHANGE 11, 87–94 (Feb. 8, 2021), https://www.nature.com/articles/s41558-020-00984-6.

[8] *See* Ed Hawkins et al., *Irreducible uncertainty in near-term climate projections*, CLIMATE DYNAMICS 46, 3807–3819 (Sept. 4, 2015), https://doi.org/10.1007/s00382-015-2806-8.

[9] *See* FINANCIAL STABILITY REPORT, *supra* note 2, at 59.

[10] *See* Duc Duy Nguyen et al., *Climate Change Risk and the Costs of Mortgage Credit*, SWISS FIN. INST., 20-97 (Dec. 3, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3738234 (analyzing over one million U.S. mortgage loans originated between 1992 and 2018 and finding that the interest rate for mortgages in a ZIP code where all properties are exposed to the risk of sea level rise is approximately 13 basis points higher than the interest rate for mortgages in a ZIP code where none of the properties are exposed to the risk of sea level rise).

requires banks to consider all applicable and reasonable risks in their lending activities, but they should not stop doing business with entire sectors of the economy simply to manage political and reputational risk. Rather, they should review applications for services on a case-by-case basis, looking for standard metrics like creditworthiness and financial viability. If there is a genuine risk to a particular institution that arises from climate-related issues and has yet to be priced into the market, it is the bank's role to evaluate it and respond accordingly. Any actions in response to risks, including those related to severe weather events, are properly made by the bank's board of directors and senior management—not proscribed by regulatory dictum.[11]

As you continue to analyze the potential implications of climate change for financial institutions and markets, we urge you to remain mindful of both the inherent challenges of modeling severe weather events and the limits of the Federal Reserve's statutory authority in this area. Moving forward, we call on the Federal Reserve to be fully transparent with this process and undertake public notice and comment on any contemplated changes to bank regulation or supervision that could result from the Federal Reserve's analysis.

Thank you for your consideration of our views on this issue.

Sincerely,

Pat Toomey
U.S. Senator

Richard Shelby
U.S. Senator

Mike Crapo
U.S. Senator

Tim Scott
U.S. Senator

M. Michael Rounds
U.S. Senator

Thom Tillis
U.S. Senator

[11] The Federal Reserve has long recognized that boards of directors "have ultimate responsibility for the level of risk taken by their institutions." Bd. of Governors of the Fed. Reserve Sys., SR 95-51: Rating the Adequacy of Risk Management Processes and Internal Controls at State Member Banks and Bank Holding Companies (Nov. 14, 1995), https://www.federalreserve.gov/boarddocs/srletters/1995/sr9551.htm.

John Kennedy
U.S. Senator

Bill Hagerty
U.S. Senator

Cynthia Lummis
U.S. Senator

Jerry Moran
U.S. Senator

Kevin Cramer
U.S. Senator

Steve Daines
U.S. Senator