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February 16, 2022

Mr. François Villeroy de Galhau
Chairman of the Board
Bank for International Settlements
Postfach, CH-4002 Basel
Centralbahnplatz 2, 4051
Basel, Switzerland

Re: Principles for the Effective Management and Supervision of Climate-Related Financial Risks

Dear Ladies and Gentlemen:

The Independent Community Bankers of America (“ICBA”)¹ appreciates the opportunity to comment on the Basel Committee on Banking Supervision (“Basel Committee”) consultative document titled “Principles for the Effective Management and Supervision of Climate-Related Financial Risks”. This paper seeks to address risks to financial stability in the international banking system caused by climate change. The principles methodology is designed to align the management activities of individual banks with the supervisory review process of prudential supervisors to create a common baseline for dealing with climate-related financial risks while acknowledging the need to apply flexibility as both the role of management and supervisors evolve. Prudential supervisors will incorporate the principles described in this document into the existing Core Principles for Effective Banking Supervision as a broad extension of the existing flexible supervisory review process.

Regulators in the United States have yet to find any baseline climate disaster scenarios that would impair the safety and soundness of community banks. Regardless, any future assumptions about the impact of a climate disaster on asset credit quality will soon be captured in the allowance for credit losses as the current expected credit loss model (“CECL”) is adopted. Any methodologies used by community banks to assess the forward-looking impact of climate disasters through robust forecasts will be prohibitively expensive and should be used exclusively at the largest banks. Only when standardized, cost-effective

¹ The Independent Community Bankers of America® creates and promotes an environment where community banks flourish. ICBA is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education, and high-quality products and services. With nearly 50,000 locations nationwide, community banks constitute roughly 99 percent of all banks, employ nearly 700,000 Americans and are the only physical banking presence in one in three U.S. counties. Holding nearly \$5.9 trillion in assets, over \$4.9 trillion in deposits, and more than \$3.5 trillion in loans to consumers, small businesses and the agricultural community, community banks channel local deposits into the Main Streets and neighborhoods they serve, spurring job creation, fostering innovation and fueling their customers’ dreams in communities throughout America. For more information, visit ICBA’s website at www.icba.org.

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tools become available to model climate disasters in local communities should they be imposed on community banks.

The consultative document focuses on the corporate governance duties required to manage climate-related financial risks and highlights the belief that any negative impact could be realized by banks regardless of their business model, complexity, or size. The risks inherent in climate could vary widely based on geography requiring banks to assess impacts to present business models and how they deliver banking services to customers. Because banks conduct strategic planning around two-to-three-year cycles, managers will need to broaden their horizon to much longer time horizons to incorporate the impact of climate changes that get worse over time. Such incorporation should include the infrastructure required to source capabilities and expertise to handle climate-related financial risks.

ICBA's Comments

Community banks in the United States are small, local, customized lenders that serve a broad range of consumers and small businesses across the country. With charters numbering in the thousands, these institutions provide an important source of liquidity for American productivity in large city centers as well as rural and underserved populations with limited banking services. Federal prudential bank regulators have historically applied oversized regulatory packages meant for the largest banking organizations to community banks of all sizes without sufficient regard for how those banks cope with the many compliance and reporting burdens that accompany such regulation. Community banks fear the encroaching principles of regulatory climate change supervision will not take adequate account of the methods they use to manage their risks.

Any regulatory climate change loss identification and mitigation strategies applied to community banks need to be robust enough so that the asset management models used to estimate the severity of future climate events is based on in depth scientific analysis. Most if not all community banks would need to utilize the services of third parties in order to accurately capture the data necessary to build appropriate models that would forecast future climate events and their impact on bank earnings, capital, asset quality, and other factors. Such an endeavor would be prohibitively expensive for all community banks and would seriously impair their ability to remain competitive in the financial services marketplace. The survivability of these institutions should be paramount in any consideration of climate change regulation.

Ironically, applying climate change regulatory and management principles to smaller institutions discounts the fact that these lenders have been able to effectively assess all key climate risks as part of the standard underwriting process without the need for government oversight. Any form of credit risk that presents the possibility of an inability to meet debt service obligations has always been thoroughly vetted by community banks as part of their loan review process. Associated climate risks are included herein.

The consultative document, though well intended, does not properly consider the current risk management practices at community banks or even those of the largest international banks. For example,

the Basel Committee asks banks to identify and quantify climate-related financial risks that could negatively impact liquidity buffers, solvency analysis, and overall capital adequacy. The Basel Committee points to hypothetical stress conditions as key drivers in risk assessment of climate risks that could mature over time. Banks in the United States are already required to assess such risks as part of the assessment of regulatory capital adequacy in the scoring matrix that determines the categories of overall bank health. Banks in the United States maintain very high levels of high-quality regulatory capital in order to be deemed “well capitalized” by prudential bank regulators. All banks in the United States are required to set aside regulatory capital for events that could result in an impairment event based on current or forecasted economic conditions if the bank concludes that it has incurred a loss. The largest banks apply existing and contingent liquidity buffers to ensure that all potential foreseen financial risks are considered where appropriate. Even the smallest community banks use their local expertise to consider elevated risk factors like climate and its impact on financial instruments when underwriting credit risk for the origination of a new loan.

In addition to the robust, risk centric capital framework that exists, all banking organizations in the United States will be subject to CECL for the recognition and management of credit losses and management of the allowance for credit losses starting in 2023. CECL will require community banks to conduct a forward-looking assessment of credit risk and the probability that the institution will suffer a credit loss on all loans in their portfolio. Such risks include a host of climate-related risks that the bank will need to consider as part of its estimation of future credit losses. If new climate-related risks emerge for the institution to consider in determining risk of loss, generally accepted accounting principles are already designed to capture any potential impact, including the probability of such impact occurring.

ICBA notes that the consultative document explores the idea of comprehensive management of key management risk considerations including liquidity and operational risk through the use of risk management systems and processes when those risks are considered material. When the material risks are identified, the bank acts by amending risk management framework to incorporate the impact of increased risks including increase in net cash outflows. However, no such material risk can be presently identified in the scientific community. For a risk to be material for a community bank, an ecosystem would need to be altered in such a way and in such a short time period that living creatures, structures and economic activity in that environment are subject to climate-related harm. Until such time that material climate change impact presents itself to community financial institutions, there will be little need to adopt any new key risk management considerations as part of the risk management architecture.

In the event that the Basel Committee concludes that some form of climate risk can be supported strongly enough for key management risk considerations to be heightened through the use of new tools and processes, such regulation should first be exclusively applied to the largest banks that have the resources and scalability to apply new rules without great expense to the institution. Community banks should be exempt from any regulation imposed on the largest banks. Only once regulators can formulate a standard, simple approach to adopting an effective risk management approach that can be easily incorporated by smaller banks should they consider the use of such techniques by those institutions.

Regulators have yet to put forth evidence that the natural disasters experienced in the areas served by community banks has actually had a long-term detrimental impact on a bank's ability to maintain sufficient capitalization. Even if one or more risk profiles evidencing the presence of climate risk is able to be put forth in the future, the Basel Committee will need to seriously consider whether such a risk could have a material financial impact on the banking system of the United States or if such a risk could even impair a bank's ability to operate in a safe and sound manner. The Federal Reserve Bank of New York conducted a regression analysis² to determine what impact a weather disaster could have on a bank's net income, charge-offs, and return on assets. They conclude in a baseline scenario that a typical weather disaster is not detrimental to a bank's stability, although it would have a small detrimental impact on expected credit losses.

ICBA appreciates the opportunity to provide comment on this consultative document and hopes that the Basel Committee will consider our observations. If you have any questions or would like additional information, please do not hesitate to contact me at james.kendrick@icba.org.

Sincerely,

/s/

James Kendrick
First Vice President, Accounting & Capital Policy

² See Federal Reserve Bank of New York Staff Report No. 990 issued November 2021