


## Climate Change and the Banking System



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[The reality of climate change is indisputable.](#) Average global temperatures are rising, as are sea levels, threatening coastal cities and communities. Droughts are occurring in more locations and lasting longer, affecting water and food supplies and leading to more uncontrollable wildfires. Tropical storms are becoming more severe, causing increased economic and personal damage. As has been well-documented by a number of organizations, [including the United Nations](#), unless countries around the world follow through on commitments to reduce CO2 emissions, this is just the beginning.

The impact of climate change is increasingly being felt around the world. A [report from the World Meteorological Organization](#) shows that the incidence of disasters related to climate, weather, or water hazards has increased five-fold between 1970 to 2019. This is translating into increasing societal and financial costs. The [Financial Stability Board](#) estimates that global economic losses resulting from meteorological, hydrological, and climatological events increased from \$357 billion in the 1980s to \$1.4 trillion in the 2010s (in 2019 prices). Additionally, according to the Network for Greening the Financial System (NGFS), estimates in academic literature of financial losses from rising global temperatures [range from around 2 percent of global GDP to as high as 25%](#).

The effects of climate change threaten to upend the global social and economic order. The fallout from extreme weather disasters or other climate-related effects can be catastrophic to the economy and people's livelihoods, potentially leading to mass migrations and a restructuring of the global economy and financial system. To date, banks have not been doing enough to manage and account for the risks of climate change or to support the transition toward a more sustainable economy. The Federal Reserve (the Fed) must lead efforts related to banking supervision and regulation—as well as to financial stability more broadly—to address climate-related risks along with the other banking regulatory agencies. So far, the Fed has been woefully slow in its efforts and must now act quickly to ensure banks are effectively addressing the risks from climate change.

In this report, we discuss the following actions the Fed should take along with the other banking regulatory agencies:

### ***Actions to Take for Bank Supervision***

- Formally include climate risks in the supervisory process as well as in the determination of supervisory ratings;
- Conduct supervisory (Fed-run) scenario analysis to identify climate-related risks and vulnerabilities; collaborate with international regulatory agencies;
- Require banks to run scenario analysis to complement supervisory scenario analysis and identify weaknesses in banks' climate risk management;
- Collect detailed climate exposure and risk data;
- Implement regular disclosures of climate exposures and risks as well as the results of supervisory and bank-run scenario analyses.

### ***Actions to Take for Bank Regulation***

- Implement climate risk-related capital requirements through the supervisory stress test;
- Consider increasing certain risk weights for exposures with heightened risks due to climate change;
- Implement a climate-related capital surcharge for systemically important financial institutions;
- Implement restrictions on certain commodities activities and consider broader restrictions.

This paper also discusses “commitments” made by Wall Street’s biggest banks to address climate change. While banks have announced some positive steps, many of these stated commitments are dubious, unlikely to materialize effectively or are efforts that were likely to materialize anyway.


### **Climate Change is a Threat to the Financial System, and the Banking Regulatory Agencies Must Use Their Mandates to Address Climate Risks**

The relationship between climate change and the financial system is complex. Along with the potential for broad-based societal and economic disruptions that affect the global economy and financial system, climate change poses specific risks to the financial system by increasing instability in asset prices and negatively affecting borrowers’ ability to repay, and could [make economic contractions more likely and severe](#). At the same time, financial market participants—with large banks often leading the way—facilitate increased threats from climate change through provision of financing and other financial services to companies whose activities contribute to and amplify its effects. Additionally, there is uncertainty around the timing, intensity, and frequency of climate-related changes and events, including the timing of critical global and U.S. policy decisions on the transition toward a more sustainable path.

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The interaction between these factors makes it difficult to accurately assess the risks and potential costs to financial markets and the institutions that are active in them. Nonetheless, there is certainty that, if left unchecked, climate change will lead to massive economic disruptions, large-scale losses in the financial system, and a severe increase in financial instability.

Given the critical role of the banking sector in the U.S. and global financial systems, there is an important role with respect to climate change for the banking regulatory agencies (the Agencies)—the Fed, Office of the Comptroller of the Currency (OCC), and Federal Deposit Insurance Corporation (FDIC). They should be using their authorities and expertise to monitor, assess, and address both the micro-prudential (at each individual bank) and macro-prudential (across banks and the system) risks of climate change.



However, while there is much the Agencies can and should do, it is important to remember at the outset that their mandates for and authorities over the U.S. banking system are prescribed by Congress. As with other risks, their mandate with regard to direct or indirect risks from climate change is to promote a strong banking system that can withstand severely adverse financial and economic outcomes, and to promote financial stability. In other words, the mandates of the Agencies are to promote financially strong banks and financial stability more broadly. This is very different than making wide-ranging environmental policy decisions, such as decisions that by design are meant to affect the pace and scale of a reduction in fossil fuel-related emissions.

This context is necessary to understanding what can be done to address climate change through financial regulation and supervision without additional legislation from Congress. While it is tempting to project certain policy-making authorities on the Agencies in the face of a dysfunctional Congress, particularly given the speed at which the clock is ticking on climate change, the Agencies simply do not have the legal authority to undertake many desirable environmental policy actions.<sup>1</sup> This is not to say they do not have an important role to play. Their role is critical for measuring, monitoring, and managing the risks from climate change in the banking and financial system, and attempting to ensure those risks do not result in catastrophic consequences to the banking and financial system and, by extension, the broader economy and the American people.


### ***Climate Risks Could Cause Significant Losses***

Analyses of climate change-related risks to banks and the financial system commonly group them into two different sources: [“transition” risk](#) and [“physical” risk](#). Transition risks are those associated with the effect on asset prices, industrial sectors (e.g., fossil fuels-related activities) and the economy from the transition away from reliance on fossil fuels and toward renewable sources of energy. If public policy and private-sector forces move too slowly in this transition, it may be cataclysmic. And if the transition occurs much more quickly or is more broad-based than expected, markets, businesses and consumers may react in ways that lead to rapid asset revaluations and reallocations of capital, which could cause substantial negative effects on a wide range of business activity. Similar effects could arise if there is a rapid change in consumer or investor sentiment around climate risks.

Physical risks result from extreme climate-related events that cause physical damage and any associated knock-on effects. These can range from more isolated risk events, such as a single flood causing damage to a town, to risks that are more impactful because they occur with increased frequency (e.g., a series of floods) or are more chronic (e.g., increased temperatures and higher sea levels, which can result in more structural effects like the necessity of mass migrations).

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<sup>1</sup> It is important for the Agencies not to exceed their legal authority for many reasons, and not least because the industry may be looking for a reason to have a legal battle on this issue. In the “best” case, the industry could use the courts to run out the clock until there is a more favorable political environment. In the worst case, a lawsuit results in an adverse ruling that curtails the Agencies’ authority and discretion, which is a serious risk given the current composition of the federal bench. This would not only limit the Agencies ability to exercise the authority they actually do have, it would also likely chill the Agencies even more. A recent example of this was the case between [MetLife and the Financial Stability Oversight Council](#), which resulted in a District Court judge issuing a very poorly reasoned decision rescinding the designation of MetLife as a systemically important financial institution (SIFI). The Trump administration, working with the industry, dismissed the FSOC appeal before the Appeals Court could rule on it, keeping in place the lower court’s decision that limited FSOC’s subsequent actions.



Both risks can lead to substantial losses to banks. Climate risks can lead to severely damaged or lost property as well as a significant reduction of business or the closing of businesses. This would result in potentially widespread defaults on both retail and commercial loans, large declines in the value of outstanding corporate debt and an increase in corporate bond defaults, declining equity prices, and potentially massive repricing of a variety of commodities and a broad range of derivative contracts.

The quantification of those potential risks is a substantial challenge. Ceres, a non-profit advocacy group focused on climate change, [estimated potential climate risk-related losses](#) from just a subset of commercial loans at the largest U.S. banks to be up to \$750 billion from physical and transition risks. That analysis represents just direct losses from one portion of the banks' loan portfolios. It does not address losses from other asset types or the overall impact on banks' business models of severe global economic disruption. An [analysis of global financial market exposures by Carbon Tracker](#) shows that around \$18 trillion of global equities, \$8 trillion of bonds and possibly \$30 trillion of unlisted debt are related to sectors of the economy that produce high levels of carbon emissions.

## The Federal Reserve Must Act Now to Address the Risks of Climate Change

Given these risks from the effects of climate change on banks' financial condition, as well as on financial stability broadly, the Agencies do have a key role to play in addressing these issues through their supervision and regulation authorities. Of the three Agencies the Fed is best suited to meaningfully address climate change-related risks, since it has supervisory and regulatory authority over the consolidated operations of systemically important bank holding companies, which include both the bank and nonbank subsidiaries of the largest banking behemoths. For example, JP Morgan's holding company includes all operations, including the JP Morgan Chase bank as well as its trading and investment banking businesses, and any other operations of JP Morgan Chase. The OCC and FDIC have authority only over the banks owned by these companies. Thus, the Fed has the most complete picture of the risks both within a huge bank holding company and throughout the system. Of course, the Fed would benefit from working with the other agencies in this area, and all have a role to play. But it is the Fed that has the most direct and wide-ranging authority and capacity to play a leading role in this area.

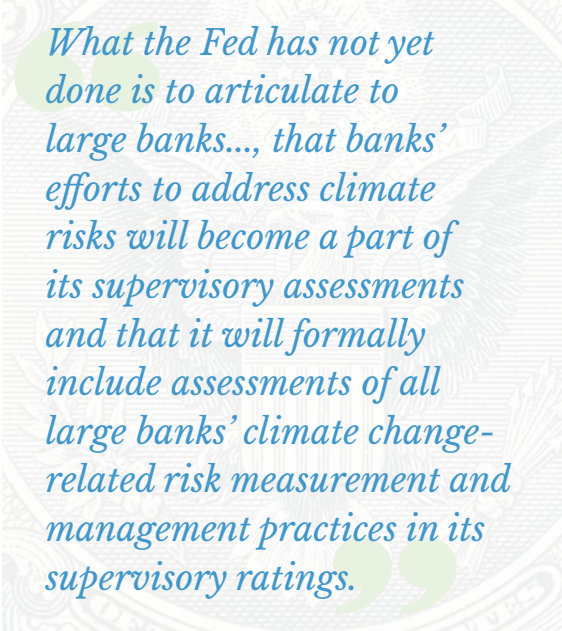
The Fed has been too slow to engage on climate change, lagging many countries in taking steps to directly address climate change-related issues. For example, in December 2020 it became one of the last major countries to join the NGFS, a global group focused on how to address the increasing impact of climate change on the economy and financial system. Additionally, in just the past year, it belatedly set up two internal groups to study and consider strategies for addressing climate change within its mandates, one in the context of financial stability (macro-prudential) and the other in banking supervision (micro-prudential). These are both positive and important steps, but they still leave the Fed woefully behind on an issue that must be addressed immediately.

The Financial Stability Oversight Council (FSOC), which is chaired by the Secretary of the Treasury, can and should also play a key role in addressing the risks of climate change. The FSOC has the authority to designate systemically important nonbank financial institutions (so-called "SIFIs"), which results



in such institutions being overseen by the Federal Reserve under their supervisory and regulatory standards, and it should consider incorporating climate risks into its SIFI designation process. The FSOC also can coordinate amongst the Agencies to promote a consistent regulatory agenda and make recommendations to the Agencies on the agenda. However, it must be remembered that the FSOC itself does not have any direct regulatory or supervisory authority.

In its role as a convener and coordinator, the FSOC recently released its [first report on climate risks to the financial system](#). Although it helpfully identifies climate risk as “an emerging and increasing threat to U.S. financial stability” for the first time, and sets a general framework for the Agencies to consider and address the issues, the recommendations in the report are broad and still leave much for the Agencies to determine. For example, the report recommends that FSOC member agencies “evaluate whether additional regulations or guidance specific to climate-related risks is necessary,” which the Agencies were already doing. If the FSOC is to live up to its mission and potential, it must ensure that cross-Agency working groups continue to focus on and prioritize climate risks and publish soon a concrete set of actions the Agencies should and will be undertaking, among other things.



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### **Addressing Climate Change Through Banking Supervision**


The Fed could and should be doing more right now with regard to large banking organizations in its role as the key supervisor overseeing the banking system. It has made some fairly vague and not particularly helpful [public statements](#) to banks, such as that it expects banks,

“to have systems in place that appropriately identify, measure, control, and monitor all of [banks'] material risks, which for many banks are likely to extend to climate risks.”

This at best understates the risks since it is clearly more than “likely” that banks will face climate-related risks (they already do) and the population of banks that will experience those risks will almost certainly be more than the use of the word “many” implies.

What the Fed has not yet done is to articulate to large banks, at least publicly, that banks' efforts to address climate risks will become a part of its supervisory assessments and that it will formally include assessments of all large banks' climate change-related risk measurement and management practices in its supervisory ratings. This should have already been done. It could and should be done immediately to ensure that if banks fail to effectively address climate-related risks it will negatively affect their supervisory ratings and by extension could lead to serious consequences such as restrictions on their operations and/or on their ability to pay dividends and make share buybacks.

Given the lack of historical precedent and data about the risks from climate change, scenario analysis will be a critical tool for assessing the potential impact of climate-related risks within and across large



banks. This can be distinct from the Fed’s formal stress testing program and, at least in the early stages, could be used to inform supervisors of vulnerabilities within and across banks rather than to set stress test-related capital requirements. The Fed should be executing its own scenario analysis as soon as possible to gain a more robust view of vulnerabilities of large U.S. banks to the risks from climate change. This would follow other regulatory authorities outside of the U.S., such as the [European Central Bank](#) and the [Bank of England](#) who have announced climate scenario analyses to be conducted between this year and next. Additionally, the NGFS has released a [set of scenarios](#) that could be utilized.

The Fed has given indications that it is undertaking preliminary steps to do this. For example, Chair Jay Powell stated in testimony on September 30 to the House Financial Services Committee that scenario analysis is “almost certainly” going to be one of the tools used to assess climate risks in the banking system. Federal Reserve governor Lael Brainard also stated [in a recent speech](#) that the Fed is “developing scenario analysis” to assess the resilience of financial institutions. In addition, in a signal that staff throughout the Fed are at least considering climate-related scenario analysis, the New York Fed [recently released a report](#) outlining a methodology to assess expected climate-risk-related capital shortfalls at large banks.

It is unclear if the Fed’s plan is for scenario analyses to be run both by the banks as well as the Fed itself, but both should be done to promote a broad range of viewpoints. Bank-run climate-related scenario analyses are important to emphasize the set of risks that are most relevant to specific firms, similar to the current bank-designed and run stress tests that are part of the Fed’s supervisory stress testing program. The ability of banks to identify their own climate risks should be a key factor in the supervisory assessments discussed above.

The Fed’s supervisory climate scenario analyses should be run for each of the large banks subject to the Fed’s current stress testing program. By using a common set of scenarios and assumptions, the Fed would be able to identify risks not only at individual firms but also more systemically across the banking system. It should also be engaged with international prudential regulators and groups, such as the Financial Stability Board, so that cross-border scenario analysis exercises can be run to develop a global picture of climate risks. Results of scenario analyses by both the Fed and large banks should be published with appropriate details so that the public can be better informed of the risks and potential losses in the banking system.

Additionally, more general disclosures would also be beneficial to the public. The Fed and other Agencies should substantially increase required (and public) regulatory reporting by large banks in this area. This information would be necessary anyway to design and execute a more robust scenario analysis program. Requiring regular, consistent reporting and disclosures of climate-related exposures and risks would force individual banks to enhance processes for identifying, measuring and managing their risks as well as provide needed transparency to the public and markets so they can assess the banks’ potential vulnerabilities. The Fed should also be including its assessment of climate risks in the banking system within its semiannual reports on supervision and regulation and financial stability. These disclosures could lead to better informed pricing in lending and financial markets and allow financial institutions and consumers to make better informed decisions.

Setting up permanent data collections would take some time, with the collections having to be designed and then taken through the formal public proposal process. Data collection is critical to addressing climate risks and so should be set up as quickly as possible. Modifications or additions can be introduced to the data collection over time, allowing an initial collection to be in place more quickly. In the meantime, the Fed should begin collecting and utilizing the needed data as soon as possible in coordination with the Office of Financial Research (OFR), which was created under the Dodd-Frank Act to serve the FSOC and its agencies to improve financial data, conduct and sponsor research, and promote best practices in risk management. The Dodd-Frank Act gave the OFR the [authority to collect data from a “financial company”](#) that is not currently being collected by any of the regulatory agencies, even through the use of subpoena power if necessary.

That being said, the Fed is already collecting some data through its current stress testing program that would allow it to more immediately start sizing and assessing climate risks through scenario analyses. This data could also serve as a basis for disclosures by the largest banks. Importantly, the Fed can determine the location of borrowers or issuers, which can be used for physical risks, and the industry type, which can be used for both physical and transition risks.




Nearly all retail and commercial lending exposures are reported on a loan-level basis with numerous descriptive variables, including location and – for commercial loans – the specific industry type of the borrower. Similarly, each security that is not held for trading is reported in a way that allows the Fed to obtain all relevant details of a security, including the issuing company and its industry. For trading exposures, the Fed collects information that allows it to extrapolate losses based on market movements for various energy and commodity assets. This data could also be utilized to incorporate climate risks into their stress testing program, a regulatory action that is discussed below.

### ***Addressing Climate Change Through Banking Regulation***

In addition to what the Agencies can do in supervision, they could enact or modify existing regulations to specifically target climate-related exposures. However, any regulatory changes would need careful consideration and clear legal authority since they would have to go through the formal public proposal process under the Administrative Procedures Act and could face litigation when finalized or implemented. New or modified regulations would need to be fully defensible, in line with identified risks, and within the explicit mandates of the Agencies, even if on the outer edges of those mandates.

The most direct regulatory modification would be to increase capital requirements for risks associated with fossil-fuel related exposures. One way to do this would be through increasing risk weights for such exposures, since a higher risk weight on an asset will result in more capital being required for that asset. Risk weights effectively set capital requirements for various asset types based on their level of riskiness. For example, a risk weight of 200 percent would require twice as much capital to be held as a 100 percent risk weight for the same asset at the same bank.





The Fed proposed (but never implemented) a [rule in 2016](#) that would have applied a very high capital charge to certain commodities activities that could raise significant environmental liability for banks. One of the proposed risk weights would have required banks to hold a dollar of capital for every dollar of the associated asset or exposure. Although that proposal in part was aimed at the direct legal liability a bank could face from such events, it nonetheless exemplified a rule that would have introduced especially punitive risk weights for assets that pose environmental risks with losses that are uncertain and potentially substantial. That is, these higher risk weights were proposed because the potential losses to banks from these assets could not be adequately determined based on historical data but could end up being substantial. This is similar to the issues faced in determining risk weights for climate-related risks.

Designing and calibrating increased risk weights for both physical and transition risks would be challenging. First, more extreme, systemic and/or repeated events that cause substantial related losses to banks are still yet to come, and nearly all existing risk weights that are applied to non-climate risks are based on historical data from severe market and economic downturns. Risk weights for climate-related risks cannot be based on the same historical data standard. Second, once risk weights were in place, it would be difficult to modify them to capture the evolution of risks as they grow. Each modification would have to go through the public proposal process again, and typically risk weights are negotiated and broadly agreed upon in international forums—a very lengthy process.

Considering these challenges, the uncertainty around the timing of the effect of climate risks, and the certainty that—without significant and meaningful action—climate change will have catastrophic effects, the argument can be made simply to apply punitive risk weights, similar to the 2016 proposal. These risk weights could be used for certain exposures that are considered to be at higher and more obvious risk of losses. For example, financing provided for extraction and production of new fossil fuels would be at greater and greater risk of loss as the economy transitions to being more sustainable. Any exposures banks have that are backed by the future production or sale of fossil fuels are inherently high risk, and this risk is increasing as the transition to a less fossil fuel driven economy gains speed. Banks could reasonably be required to have more capital for these types of exposures.

Calibrating risk weights would necessitate estimations. There has been a near-exponential increase in extreme climate-related events and physical damage over time, so it is possible to extrapolate to calibrate risk weights for certain physical climate-related events such as floods, wildfires, and hurricanes, but that would still require estimations and these events are expected to only get worse over time. With transition risks, which are lurking but have yet to be realized, there is even greater uncertainty across all the key factors. For example, when will the transition take place, how quickly will it occur, how broad-based will it be, and what impact will it have on banks' financial condition? Therefore, the calibration of climate-related risk weights reasonably would be based upon scenario analyses using a variety of assumptions. This could complicate their justification when being proposed.

Given this and the tremendous uncertainty about both the path and timing of climate change and policy implementation, the scenario-based stress testing process is a natural means to incorporate climate risks into capital requirements. Losses in the stress test translate into increased capital through the so-called stress capital buffer requirements. These capital requirements could be effectively recalibrated each

year under the Fed’s supervisory stress testing program through their scenario design process. Also, the requirements could be increased over time by making the scenarios more broad-based and severe, in-line with the increasing threat of climate change.

The Fed has yet to incorporate climate change-related scenarios in their stress test. It could start with specific, physical risk scenarios using observed extreme climate events as the backdrop, such as a severe hurricane causing a major disruption to the oil production process or wildfires that destroy businesses and disrupt economic activity in a region. It would be easily defensible to begin with physical risk scenarios, since climate events that cause significant physical damage are currently occurring and with increasing frequency, and expand to include transition risks. Although, it would be defensible as well to begin with full scenarios capturing both physical and transition risks. The data already collected through the Fed’s current stress testing program would allow it to incorporate climate risks in some form fairly quickly.



Another method of incorporating climate risk-related capital into overall capital requirements would be through a capital surcharge on the most systemically important banks, similar to the global systemically important bank (GSIB) surcharge. Use of such a surcharge would be conceptually sensible. It would account for the increase in climate-related risks that larger financial institutions are creating through their financing of climate-harming activities which in turn increases their own risk of failure through those climate-related risks. Furthermore, it is clear that climate change poses systemic risks as it threatens the banking system as a whole as well as the economy and financial stability.

Such a surcharge would seem to fall clearly within the Fed’s mandate—increasing capital requirements would decrease probability of default of the largest firms and could provide incentives for large banks to reallocate funding away from climate-harming activities, which would reduce overall systemic risk. The surcharge could apply to GSIBs and financial institutions designated by the FSOC as systemically important.

Calibrating a climate risk-related surcharge would face the same challenge as risk weights of not having historical experience to rely upon. Here the surcharge also would benefit from scenario analysis that estimates the increased risk to the financial system and economy from climate-harming activities funded by these banks and SIFIs, as opposed to just estimating the specific risks to a bank as with risk weights or bank-specific scenario analysis/stress testing. This could be tied to international estimates of the effect of climate change and based on the level of climate-related activity in which each bank is engaged. If banks were to maintain their activities over time, the level of the resulting surcharge could increase, reflecting the increase in climate-related risks.

The Fed could also consider directly restricting banks from engaging in certain fossil fuel-related financial activities, including lending, or set “concentration limits,” which limit the amount of activity a bank can engage in with an industry based on a certain percentage of the bank’s total capital. Both direct restrictions and concentration limits on banks could remove or reduce, respectively, the climate-related risk to the banking system for the restricted assets. However, direct restrictions would need

to be well supported and demonstrate that the associated risks from the restricted exposures clearly pose safety and soundness concerns by their nature. Concentration limits would need similarly strong justification.

There are additional complications from this approach. For example, if the intention is to limit credit supply for certain fossil-fuel-related activities, this may not be particularly effective since restrictions could simply push these financial activities into the nonbank financial sector. Concentration limits, as opposed to outright restrictions, could result in exposures gravitating even further toward the largest banks, which have more capital and thus greater capacity under which to make such loans. Importantly, if the Agencies move to directly restrict or limit banks' exposures that are getting riskier because of the climate crisis, such restrictions would have to go well beyond fossil fuel companies.

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That being said, certain restrictions likely could be implemented more easily. As noted above, the Fed has [previously considered](#) applying more stringent restrictions to commodities-related activities, and eventually proposed heightened restrictions that were never finalized. These efforts should be pursued again, and the Fed should be using its safety and soundness-related authority to restrict such activities to the fullest extent possible.<sup>2</sup>


## Climate “Commitments” Made by the Largest U.S. Banks are Dubious

Each of the largest banks have made public “commitments” to reduce their contributions to climate change. However, while any progress is welcome, many of their claims are either dubious and unlikely to materialize effectively or are developments that were likely to happen on their own anyway as the economy transitions to being less fossil fuel-based. Additionally, without clear, standardized disclosures, there is no way to verify their claims or ensure that progress is made.

The banks' commitments generally fall into one of three categories:

1. Supporting and accelerating the transition to a low-carbon economy;
2. Identifying, sizing, and managing the climate risks in their portfolios and reducing those portfolio risks as well as the risks they pose to climate;
3. Improving the sustainability of their facilities and employee culture around sustainability.

<sup>2</sup> The Gramm-Leach-Bliley Act of 1999 established a framework that allows bank holding companies that are generally in good standing to engage in commodities activities, subject to certain provisions. However, the Fed has discretionary authority to restrict the authorization of many of these activities. For example, starting in 2003, the Fed issued orders permitting twelve financial holding companies to engage in physical settlement of derivative contracts as well as direct trading of certain commodities under one of the provisions of the Gramm-Leach-Bliley Act. The orders limited the total market value of all commodities held to five percent of tier 1 capital. Orders can be reviewed by the Fed and be modified to have tighter concentration limits or restrict more commodities within the orders.



Supporting and accelerating a low-carbon transition involves routing a minimum amount of financing and capital specifically toward low- or lower-carbon investments. This would include, among other examples, lending to or underwriting debt for companies that have low carbon footprints or that have products and services related to cleaner sources of energy. All of the largest banks have stated they are aligning their low-carbon transition goals to the 2015 Paris Agreement, which broadly seeks to keep the rise in mean global temperature to well below 2 °C. They have also “committed” to net-zero emissions by 2050 in their operations and across their portfolios, which could mean having some type of carbon offset rather than just reducing carbon-increasing activity.

The banks have attributed seemingly large dollar figures and stated impact to their low-carbon transition activities. Bank of America and J.P. Morgan have each committed to conducting \$1 trillion of financial activities by 2030 that are related to transition efforts, which includes lending but also other activities such as bond underwriting. Goldman Sachs and Morgan Stanley have committed \$750 billion, and \$500 billion has been committed by Citigroup and Wells Fargo over that same timeframe. Some of these figures have been increased significantly from prior commitments. For example, Bank of America initially announced a \$300 billion commitment in 2019.

For the goals of reducing their portfolio climate risks and lowering the climate impact of their operations, banks have focused on sizing the levels of impact on the climate and then setting targeted reductions in those levels. This usually involves creating an “impact” number that relies on an appropriate metric, such as weighted average kilograms of CO<sub>2</sub> per megawatt hour for energy industry-related activities or company-wide energy usage for their operations.

While these stated commitments by large banks represent positive goals, they should not be taken at full face value as an active effort banks are undertaking because they are committed to addressing climate change. Large banks are likely to be meeting a substantial part of these goals anyway even without such public commitments. The economy already has started to transition toward cleaner, renewable energy sources and more efficient energy production. This trend will only continue to increase, a fact on which banks are relying when setting their goals for financing more “green” initiatives or reducing climate risks as a share of their portfolios. Additionally, reducing the climate footprint of their own operations is beneficial to the environment, but it also lowers the overall cost of running their businesses.

It is impossible to know how the big-dollar commitments compare to the amount they are currently routing to carbon-intensive activities or have routed over the years. Also, it is difficult to truly measure progress toward the achievement of their carbon-transition goals, such as net-zero emissions by 2050. This is not only because they have not happened yet, but also because there are no climate-related reporting requirements. Currently, all of the largest banks are voluntarily following some reporting standards, such as those laid out by the [Global Reporting Initiative Standards](#), and releasing reports that provide updates on their progress. But so far these disclosures do not include exposure information by portfolio and risk type, nor do they include a listing of the activities conducted toward their commitments, leaving the public without sufficient information to assess bank commitments and understand their activities in this regard.

For example, JP Morgan has disclosed that they facilitated \$55 billion worth of “green initiatives” in 2020 but [provided only two examples](#): raising \$230 million for a company that produces efficient energy generators and providing an undisclosed amount of financing to support the development of a wind farm. While they have published criteria that they use to qualify activities toward their sustainable energy facilitation commitments, the criteria establish a broad standard that seems to be open to a significant amount of discretion. That makes verification, oversight, and accountability virtually impossible. Unsurprisingly, this example is similar to the other large banks.

## Conclusion

Climate change poses an existential threat. It will negatively affect the global economy and the financial system, and will undermine the safety and soundness of the banking system. Based on available information, there is a substantial amount of climate-related exposure in the banking system. While there is little available exposure information about U.S. banks, the [European Central Bank estimates](#) that the proportion of European banking system total exposures with current or projected physical risks is around 80% and that these exposures are concentrated in a few large banks. In the U.S., Ceres estimates that of all commercial loans at the largest banks that are syndicated with banks and other investors, somewhere between 65% to nearly 80% are to climate-sensitive sectors.

Incorporating the assessment of climate risks into bank supervision and modifying regulations to increase capital or implement certain restrictions are not, as some have claimed, the Fed and the other Agencies going beyond their mandate or engaging in social policymaking. The Fed is specifically charged with not just supervising the banking industry, but also doing what is necessary to maintain financial stability and limit financial crashes. The climate crisis materially threatens to impact every aspect of the economy and financial system. The Fed—along with the other regulatory agencies and FSOC—have to start taking those threats seriously and must act now to ensure the resiliency of our banking system and stability of the financial system as a whole.







Better Banks | Better Businesses  
Better Jobs | Better Economic Growth  
Better Lives | Better Communities

**Better Markets** is a public interest 501(c)(3) non-profit based in Washington, DC that advocates for greater transparency, accountability, and oversight in the domestic and global capital and commodity markets, to protect the American Dream of homes, jobs, savings, education, a secure retirement, and a rising standard of living.

Better Markets fights for the economic security, opportunity, and prosperity of the American people by working to enact financial reform to prevent another financial crash and the diversion of trillions of taxpayer dollars to bailing out the financial system.

By being a counterweight to Wall Street's biggest financial firms through the policymaking and rulemaking process, Better Markets is supporting pragmatic rules and a strong banking and financial system that enables stability, growth, and broad-based prosperity. Better Markets also fights to refocus finance on the real economy, empower the buy-side, and protect investors and consumers.

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