



MORTGAGE BANKERS ASSOCIATION

February 14, 2022

The Honorable Michael J. Hsu
Acting Comptroller of the Currency
Office of the Comptroller of the Currency
400 7th Street SW
Washington, DC 20219

RE: MBA Feedback on Draft Principles for Climate-Related Financial Risk Management for Large Banks

Dear Acting Comptroller Hsu:

The Mortgage Bankers Association (MBA)¹ appreciates the opportunity to respond to the Office of the Comptroller of the Currency's (OCC) invitation to provide feedback on its draft *Principles for Climate-Related Financial Risk Management for Large Banks* (hereinafter "Draft Principles").²

MBA is the national association representing the real estate finance industry, including banks with over \$100 billion in consolidated assets. Our response, therefore, reflects a focus on the mortgage lending and servicing activities of covered banks, including commercial, multifamily, and single-family mortgage lending and servicing. Specifically, we are focused on the impact of climate-related events that could result in increases in the credit risk associated with mortgages – and how these risks are managed.

I. OVERVIEW

The OCC issued the Draft Principles to address its concern that banks' exposure to climate-related financial risks could affect the safety and soundness of banks and the overall financial system.

From the perspective of mortgage lending and servicing, MBA agrees with the general principle that climate-related impacts to credit risk can be analyzed across various dimensions, including sectoral and geographic, to assess both current and possible future credit risk exposure from physical and transition risks, including concentrations of risk.

¹ The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 390,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets, to expand homeownership, and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of more than 2,000 companies includes all elements of real estate finance: independent mortgage banks, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies, credit unions, and others in the mortgage lending field. For additional information, visit MBA's website: www.mba.org.

² OCC, *Principles for Climate-Related Financial Risk Management for Large Banks*, Dec. 16, 2021; available at: <https://www.occ.gov/news-issuances/bulletins/2021/bulletin-2021-62a.pdf>.

MBA also appreciates that the OCC is considering a principles-based rather than prescriptive approach, and is focused on leveraging existing risk management frameworks rather than calling for an entirely new framework. We urge the OCC to encourage other supervisors to adopt a similar approach, and we also urge supervisors to recognize that this an evolving area with an evolving understanding of the risks.

With respect to scenario analysis, we support the OCC's distinction between climate scenario analysis and regulatory stress testing and urge the OCC to recognize the exploratory nature of scenario analysis given the limited availability and nascent state of methodologies and models. Relatedly, the OCC should recognize that time horizons that may be appropriate for any particular scenario analysis will be a function of the purpose of each analysis, the context of the analysis, and possibly the availability of data.

II. THE PROPOSED PRINCIPLES

The Draft Principles arise from the OCC's concern that "[w]eaknesses in how banks identify, measure, monitor, and control the potential physical and transition risks associated with a changing climate could adversely affect a bank's safety and soundness, as well as the overall financial system." The OCC describes those physical and transition risks as follows:

Physical risks refer to the harm to people and property arising from acute, climate-related events, such as hurricanes, wildfires, floods, and heatwaves, and chronic shifts in climate, including higher average temperatures, changes in precipitation patterns, sea level rise, and ocean acidification.

Transition risks refer to stresses to certain banks or sectors arising from the shifts in policy, consumer and business sentiment, or technologies associated with the changes necessary to limit climate change.³

The OCC's Draft Principles address those concerns by providing a high-level framework for the safe and sound management of climate-related financial risks by large banks, "consistent with the existing risk management framework described in existing OCC rules and guidance."⁴ That framework includes general principles for:

- Governance;
- Policies, procedures, and limits;
- Strategic planning;
- Risk management;
- Data, risk measurement, and reporting; and
- Scenario analysis.

The Draft Principles also apply those general principles across the established risk areas of credit risk, liquidity risk, operational risk, legal/compliance risk, and other financial and non-financial risk.

Following its consideration of feedback on the Draft Principles as well as lessons learned and best practices from the industry and other jurisdictions, the OCC plans to issue guidance that

³ Draft Principles at p. 1.

⁴ Id.

would address the respective roles and responsibilities of boards of directors and management and, consistent with the OCC's risk-based approach to supervision, "appropriately tailor any resulting supervisory expectations to reflect differences in banks' circumstances such as complexity of operations and business models."⁵ A similar approach may be adopted by other supervisors that oversee smaller banks, credit unions, independent mortgage banks, and other institutions in the mortgage industry, in a manner commensurate with their exposures to climate-related financial risk.

III. CLIMATE CHANGE, CREDIT RISK, AND MORTGAGES

The Draft Principles describe the OCC's climate-related expectations around credit risk as follows:

Credit Risk. The board and management should consider climate-related financial risks as part of the underwriting and ongoing monitoring of portfolios. Effective credit risk management practices could include monitoring climate-related credit risks through sectoral, geographic, and single-name concentration analyses, including credit risk concentrations stemming from physical and transition risks. As part of concentration risk analysis, management should assess potential changes in correlations across exposures or asset classes. The board and management should determine credit risk appetite and lending limits related to these risks.⁶

This discussion of credit risk in the Draft Principles is of interest to MBA and its members who are engaged in mortgage finance. The impacts of climate-related physical and transition risks to mortgages are likely to be experienced principally in the form of credit risk.⁷ Acute climate-related events, such as hurricanes, wildfires, floods, heatwaves, and chronic shifts in climate, including higher average temperatures, changes in precipitation patterns, sea level rise, and ocean acidification that result in damage to property securing a mortgage can result in unexpected costs to borrowers or losses to income, and can reduce the value of the property, all of which increase credit risk. Shifts in policy, consumer and business sentiment, or technologies associated with the changes necessary to limit climate change can have similar impacts that also could increase credit risk.

The general principle that climate-related impacts to credit risk can be analyzed across various dimensions, including sectoral and geographic, to assess both current and possible future credit risk exposure from physical and transition risks, including concentrations of risk, is reasonable as applied to mortgage credit risk. To the extent that identified climate-related credit risk is material,

⁵ Id. at p. 2.

⁶ Id. at p. 4.

⁷ Any increased mortgage default risk due to climate-related events could interact with liquidity risk for loans that are securitized, as well. Depending on the nature of the securitization, banks may be contractually required to advance payments to investors, even if borrowers fail to make these payments. Most of the current mortgage securitization market is comprised of loans and securities that include insurance or guarantees from government agencies or government-sponsored enterprises. As such, advanced payments typically are reimbursed by the relevant insurer or guarantor, though the entity servicing these loans needs sufficient liquidity to make advances until reimbursement occurs. The experience of the COVID-19 pandemic, in which millions of borrowers across the country exercised forbearance and skipped payments, showed that banks were well-equipped to meet these short-term liquidity demands.

it would be reasonable for those risks to be reflected in applicable elements of a bank's risk appetite.

We note that geography inherently is a key factor when assessing the risk of a loan secured by real property. Improvements over time in key tools, such as flood- or wildfire-risk maps and models, should foster improvements in the quality of such assessments. Assessing chronic physical risks, or transition risks such as those arising from changes in building emission standards or changes in consumer taste, will be more challenging.⁸ While there may be a geographic dimension to such risks, it may be more challenging to project appropriately stressful and plausible scenarios as to where or how such transition risk events could unfold.

IV. MBA FEEDBACK

In response to the OCC's invitation, MBA respectfully provides feedback below on the overall approach taken in the Draft Principles, scenario analysis, time horizons, and impacts on households and communities.

A. Overall approach

We appreciate the overall approach to climate-related financial risk reflected in the Draft Principles. Climate-related financial risk is a long-standing risk factor that is likely growing more acute and is, therefore, subject to increased attention and analysis. The collective understanding of this risk, however, remains in its relative infancy. The OCC's principles-based approach is, therefore, welcome and preferable to a more prescriptive approach.

In the Draft Principles, the OCC also recognizes that addressing climate-related financial risk will require banks to leverage and enhance their existing risk-management frameworks – and not establish independent new frameworks for addressing this risk. While climate-related financial risk is not fully understood, it is important to recognize that banks do not face that risk unarmed.

Consistent with its approach of leveraging existing risk-management frameworks, the Draft Principles also do not treat emerging climate-related financial risk as a separate, new category of risk. Rather, the Draft Principles recognize that climate change is a financial risk driver that may manifest itself in impacts on established areas of risk: credit risk, liquidity risk, other financial risk, operational risk, legal/compliance risk, and other non-financial risk.

We note that these elements of the OCC's approach are consistent with the approaches across prudential regulators described in a recent Financial Stability Oversight Council (FSOC) report on climate-related financial risk:⁹

⁸ A recent Federal Reserve Bank of New York staff report shares this view as to the relative challenge of the different elements of climate change credit risk. See Blickle et al., *How Bad Are Weather Disasters for Banks?*, NY Fed. Staff Report, p. 3 (Nov. 2021, rev. Jan. 2022) ("Our findings suggest that the acute, physical risks to banks are not first-order. Banks' resilience against such risks should reinforce the financial system more broadly. More chronic physical risks and transition risks may warrant more focus." (citation omitted)); available at [sr990.pdf \(newyorkfed.org\)](https://www.newyorkfed.org/outreach/sr990.pdf)

⁹ See *FSOC Report on Climate-Related Financial Risk*, pp. 27-32 Oct. 21, 2021; available at <https://home.treasury.gov/system/files/261/FSOC-Climate-Report.pdf>.

Regulators and supervisors of depository institutions—the FDIC, FRB, OCC, NCUA, and state banking supervisors (depository institution regulators)—expect supervised institutions to manage all material risks and undertake steps to operate in compliance with laws and regulations and in a safe and sound manner. As noted previously, climate-related financial risks may manifest through traditional prudential risk categories that are supervised under safety and soundness mandates.

As part of their supervisory activities, the depository institution regulators expect to review within traditional prudential risk categories, as relevant, how effectively institutions incorporate climate-related financial risks into their risk management systems and frameworks, appropriate to their size, complexity, risk profile, and location.¹⁰

These elements of the Draft Principles effectively put banks on notice that the OCC expects them to be actively engaged in incorporating climate change risks into their existing risk-management processes. In addition, they also provide room for banks to have the flexibility needed to continue to develop approaches to identify, measure, monitor, and control the potential physical and transition risks associated with a changing climate that are tailored to their respective institutions.

For these reasons, we urge the OCC to continue the high-level, principles-based approach towards managing climate-change risk facing OCC-supervised banks and to work with other prudential supervisors to encourage them to adopt an aligned approach to their supervision of financial institutions' management of climate-related financial risk.

We also urge the OCC to appropriately temper its expectations by balancing its intent to increase banks' efforts in the area of climate-related financial risk with the recognition that this an evolving area and, as such, banks are at the early stages of learning to assess and understand the nature of the associated risks. With such a balance, we urge the OCC to facilitate progress in banks' efforts to integrate climate-related financial risk into their existing risk-management frameworks by engaging in constructive dialogue at different stages with banks and sharing information on applicable risk-management best practices. The Draft Principles may provide an appropriate foundation for such initial constructive dialogue.

B. Scenario analysis

One of the Draft Principles is that climate-related scenario analysis is emerging as an important approach for identifying, measuring, and managing climate-related risks.¹¹ As the OCC describes, climate scenario analysis is a forward-looking assessment of the potential impact on a bank of changes resulting from climate-related risks. In contrast to traditional regulatory stress tests, climate-related scenario analyses may address a longer time horizon and explore various “what if” paths rather than near-term changes to economic or financial conditions.

¹⁰ Id. at pp. 27-28.

¹¹ Draft Principles at p. 4.

We appreciate that the discussion of scenario analysis in the Draft Principles provides a framework of expectations without specifying prescriptive requirements for any particular type of scenario analysis.

- Scenario analysis can be applied alongside existing risk management practices;
- Climate-related scenario analysis frameworks should be commensurate to the bank's size, complexity, business activity, and risk profile;
- Scenarios should include clearly defined objectives that reflect the bank's overall climate risk management strategies, which could include identifying and measuring vulnerability to relevant climate-related risk factors, including physical and transition risks, and estimating climate-related exposures and potential losses across a range of plausible scenarios;
- Climate-related scenario analyses should be subject to oversight, validation, and quality control standards that would be commensurate to their risk; and
- Climate-related scenario analysis results should be clearly and regularly communicated to all relevant individuals within the bank, including an appropriate level of information necessary to effectively convey the assumptions, limitations, and uncertainty of results.

This element of the Draft Principles might also usefully include recognition of the relative immaturity of underlying data and methodologies. Many data providers, for example, are still in the process of developing and expanding on datasets that banks can integrate into their scenarios. As a result, banks may reasonably employ data assumptions or approximations to analyze the impacts of some scenarios.

Consistent with the approach taken under Other Financial Risk, it would be useful to recognize that banks necessarily will work with the methodologies and data that are reasonably available and refine them over time.¹² This particularly will be the case in scenario analyses designed to assess exposure to transition risk – for example, arising from future changes to building emission standards or changes in consumer tastes that could affect mortgage credit risk. We recognize, of course, that the assumptions, limitations, and uncertainty of results with respect to any scenario analyses should be documented and provided along with any communication of results, so that decisionmakers can gauge the level of reliance they can reasonably place on those results.

¹² See *id.* at p. 5 (Under heading Other Financial Risk: “While market participants are still researching how to measure climate price risk, the board and management should use the best measurement methodologies reasonably available to them and refine them over time.”).

C. Time horizons

The Draft Principles raise the question of the appropriate time horizons for risk assessment both in the context of determining when a climate-related financial risk is material¹³ and specifically in the context of the discussion of scenario analysis.¹⁴

This raises the question of whether there may be any preferred time horizons that banks will be expected to apply. There can be no single answer to that question. Time horizons can vary with the specific purpose of the scenario analysis. A scenario analysis used to assess the risk of a bank's current mortgage portfolio, for example, may employ a time horizon that correlates with the expected durations of the mortgages in that portfolio. A scenario analysis for the purpose of assessing the risks of a bank's business strategies, in contrast, may employ a much longer time horizon. In effect, the appropriate time horizon will be affected by the purpose of the analysis, the context of the analysis, and possibly by the availability of data. Longer time horizons, of course, also mean greater uncertainty as to the results.

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MBA appreciates the opportunity to provide feedback on the OCC's principles and vision for large bank management of climate-related financial risks. This is an important and emerging area of risk that warrants attention. We urge the OCC to continue to rely largely on a principles-based approach to managing this risk, one that leverages existing risk management and supervisory processes, and that also provides sufficient flexibility both to tailor risk management to the risks of individual institutions as well as to the evolving state of climate change risk and the evolving state of the assessment of that risk.

Sincerely,



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¹³ See *id.* at p. 6 (Question 6: "What time horizon do banks consider relevant when identifying and assessing the materiality of climate-related financial risks?").

¹⁴ See *id.* at p. 4 (Under the heading Scenario Analysis: "Risk identification includes assessment of climate-related financial risks across a range of plausible scenarios and under various time horizons.").