

## **Banking and Finance Law Daily Wrap Up, GOVERNMENT SPONSORED ENTERPRISES—FHFA provides guidance to Enterprises on managing climate-related risks, (May 28, 2024)**

Banking and Finance Law Daily Wrap Up

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Each Enterprise's climate-related risk management framework should include five core components.

An advisory bulletin from the Federal Housing Finance Agency (FHFA) provides guidance to Fannie Mae, Freddie Mac, and Common Securitization Solutions (the Enterprises, collectively) on managing climate-related risks. The bulletin instructs that each enterprise should establish and integrate an appropriate climate-related risk management framework into its existing enterprise risk management program and three lines structure ([Climate-Related Risk Management](#), AB 2024-01 (May 23, 2024)).

**Risks presented by climate change.** Climate change presents risks to the safety and soundness of the Enterprises and their ability to provide liquidity, stability, and affordability to the housing market, the bulletin states. The financial condition, operations, and counterparties of the Enterprises can be adversely affected by both the physical risks and transition risks associated with climate change. Climate-related risks can directly and indirectly impact the Enterprises' exposure to a range of risks, including financial, operational, legal, and reputational risk.

Physical risks, or harm people and property arising from the frequency, severity, and volatility of acute weather events and longer-term chronic shifts in climate can result in increased damages to collateral assets, mortgage delinquency rates, and foreclosures, causing financial stress for the Enterprises, as well as the financial system. Physical risks can also disrupt operations and the ability of the Enterprises to carry out their missions. Transition risk refers to the risks involved with shifting to a lower-carbon economy, driven by new policies and regulation, technological advancement, and changes in investor and consumer sentiment.

The bulletin instructs that the Enterprises should consider the range of climate-related risks that could affect them in the near and long term. While it is difficult to predict how and when climate-related risks will manifest, the Enterprises should be prepared to respond to the risks in order to operate in a safe and sound manner.

**Climate-related risk management framework.** Each Enterprise's climate-related risk management framework should include five components: (1) governance; (2) risk identification and assessment, controls, and risk monitoring processes; (3) metrics and data; (4) scenario analysis; and (5) risk reporting and communication processes. The Enterprises should take a risk-based approach when developing its climate-related risk management framework, commensurate with its size, complexity, business activity, and risk profile. The Enterprises should consider the evolving nature of climate-related risks in structuring and evaluating its climate-related risk management framework. Thus, a more iterative approach to climate-related risk management may be appropriate, as it would allow the Enterprises to incorporate developing climate-related risk management practices, methodologies, and climate-related datasets.

**Governance.** The Enterprises should integrate climate-related risks into its existing governance framework, possibly considering standalone climate-related governance approaches, including implementing a designated climate-related risk appetite, taxonomy, and policies, standards, and procedures. The approach should include strategy and business objectives, risk appetite, risk taxonomy, and roles and responsibilities.

**Risk identification and assessment, controls, and risk monitoring.** The Enterprises should develop and implement processes to identify, assess, control, and monitor climate-related risks that operate within each Enterprise's ERM program while achieving its public purposes and mission in a safe and sound manner. The

approach should be appropriate for each Enterprise's size, complexity, business activity, and risks profile. For each phase, the Enterprises should establish clear roles and responsibilities, as well as lines of authority across the three lines. The Enterprises should ensure input from a broad representation of relevant subject matter experts addressing the cross-cutting nature of climate-related risks and should consider short-, medium-, and long-term horizons for each phase, leveraging relevant climate-related data and metrics. The processes and procedures for each phase should be sufficiently documented.

**Metrics and data.** The Enterprises should develop appropriate and relevant climate-related risk metrics or incorporate relevant exposures into existing risk metrics that capture its risk exposure to the extent possible. Climate-related risk metrics should be developed for the Enterprises' climate-related strategies and risk management activities. The metrics should be clear, reliable, objective, and verifiable and should conform to industry standards and regulatory requirements. The Enterprises should also collect and use climate-related data that captures physical risks and transition risks to adequately assess the degree and scope of each of their climate-related risk exposure. The Enterprises should establish controls and processes to identify gaps in key climate-related data used as inputs for risk management, scenario analysis, and modeling.

**Scenario analysis.** Climate-related scenario analysis involves identifying and assessing a range of outcomes given a plausible future state, the bulletin states. This analysis would allow the Enterprises to understand how climate-related risks may affect strategy, business, and operations. The Enterprises should develop and implement a climate-related scenario analysis framework that is commensurate with its size, complexity, business, and risk profile. The model risk management framework can provide the necessary oversight, validation, and quality controls standards for its climate-related scenario analysis framework.

**Risk reporting and communication processes.** The bulletin advises the Enterprises to implement processes to adequately report and communicate relevant climate-related risks to appropriate internal stakeholders. The Enterprises should consider enhancing existing reporting and communication processes to facilitate information sharing, cross-functional collaboration, and comparability across the enterprise and its operations. The Enterprises should also implement mechanisms to effectively aggregate and report material and emerging climate-related risk exposures to the board and senior management in a timely manner. The bulletin advises the Enterprises to regularly evaluate and adapt its processes in reporting climate-related risks to external stakeholders and should monitor federal and state requirements for reporting climate-related risks and risk management activities to identify which laws and rules are appropriate.

Companies: Common Securitization Solutions; Fannie Mae; Freddie Mac

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