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National Association of Federally-Insured Credit Unions

June 26, 2023

Melane Conyers-Ausbrooks
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

RE: RFI on Climate Related Financial Risk (Docket No. NCUA-2023-0045)

Dear Ms. Conyers-Ausbrooks:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing in response to the Request for Information (RFI) issued by the National Credit Union Administration Board (Board), regarding current and future climate and natural disaster risks to federally insured credit unions (FICUs), related entities, their members, and the National Credit Union Share Insurance Fund (SIF). NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve 135 million consumers with personal and small business financial service products. NAFCU and its member credit unions appreciate the opportunity to provide input on this RFI and urge the Board to recognize the variety of climate risk profiles among the credit union industry and avoid attempts to issue comprehensive guidance on climate related financial risk. Additionally, absent an explicit Congressional mandate, NAFCU urges the NCUA to avoid issuing proposed regulation on climate related financial risk, and to defer to the Financial Oversight Stability Council (FSOC) as it formulates guidance, to ensure that credit unions are not unfairly burdened as compared to other financial institutions.

General Comments

NAFCU recognizes the evolving nature of climate risk and its associated impact on financial institutions such as credit unions, as well as the communities that credit unions serve. Credit unions are committed to helping support their members' efforts to fight the impacts of climate change as many credit unions offer green loans and support energy efficiency projects in their communities. NAFCU fought to ensure credit union inclusion in the Greenhouse Gas Reduction (GHGR) Fund process by working with the EPA and Congress to confirm appropriate implementation of the fund[1] and continues to seek clarity from the EPA about the design of the

[1] NAFCU, "Letter to EPA on Greenhouse Gas Reduction Fund Legal Memorandum" (Jan. 10, 2023) *available at* https://www.nafcu.org/letter-epa-greenhouse-gas-reduction-fund-legal-memorandum-File; NAFCU, "Comment Letter to EPA on Greenhouse Gas Reduction Fund" (Dec. 5, 2022) *available at* "https://www.nafcu.org/comment-letter-epa-greenhouse-gas-reduction-fund-File

program as credit unions stand ready to provide more green loan options and help communities in their commitments to reducing greenhouse gas emissions.[2]

Climate-related financial risk is real and significant; however it is as yet unclear that it is an existential risk in comparison to other risks already facing credit unions. Credit unions are exposed to various significant risks, including interest rate risk, liquidity risk, economic risk, credit risk, cyber-security risk, vendor management risk, fraud risk, competition risk, legal, compliance and regulatory risk, and even non-climate related natural disaster risks such as earthquakes. These risks are already a considerable threat to the financial viability of credit unions. All of these risks, including climate related financial risk, can be mitigated, to greater or lesser extents, through effective risk management.

Federally-insured credit unions already operate under significant regulatory oversight. The compliance burden imposed on credit unions is already substantial and can be overwhelming. Therefore, any additional regulations should have a well-justified basis. Implementing regulations specifically targeting the management of climate-related financial risk would entail substantial costs and require significant time and resources from credit unions. Furthermore, due to the evolving nature of climate-related financial risks, regulation on this issue would be susceptible to obsolescence over time, and represent a rigid structure that might be difficult to change or update in a way that guidance or principles might not be. Given the variable nature of the risks posed by climate events, the extant ability of credit unions to mitigate these risks, and the detrimental impact of the ever-growing regulatory burden, it is difficult to justify the imposition of such regulations. Climate risks to the financial system are significant, but currently, the best way to address them should be an ongoing dialogue and the diligent voluntary efforts of credit unions.

Uncertainty Around Impact

In April 2023, the NCUA's Office of the Chief Economist (OCE) released a research note titled "Estimating Credit Union Exposure to Climate-Related Physical Risks."[3] The note aimed to assess the vulnerability of credit unions to natural disasters by analyzing their geographical locations in relation to areas at high risk of such events. The analysis utilized the Federal Emergency Management Agency (FEMA's) National Risk Index (NRI), a comprehensive measure incorporating factors like expected annual loss, social vulnerability, and community resilience.

[2] NAFCU, "Letter to EPA on Clarification of Greenhouse Gas Reduction Fund Implementation Framework" (Jun. 5, 2023) *available at* https://www.nafcu.org/letter-epa-clarification-greenhouse-gas-reduction-fund-implementation-framework-File; NAFCU, "Letter to EPA on Greenhouse Gas Reduction Fund Proposed Implementation Framework" (May 12, 2023) *available at* https://www.nafcu.org/letter-epa-greenhouse-gas-reduction-fund-proposed-implementation-framework-File.

[3] NCUA, "Estimating Credit Union Exposure to Climate-Related Physical Risks" (Apr. 19, 2023) *available at* https://ncua.gov/news/publication-search/climate-financial-risk/estimating-credit-union-exposure-climate-related-physical-risks.

The NRI is a complex index calculated at the census tract level and then scaled up to the county level.

NAFCU's Research division found that the NCUA's approach has weaknesses that call into question its conclusion that roughly one quarter of FCUs and one third of credit union assets are located in communities classified as having relatively high or very high risk of experiencing negative effects due to natural hazards. Firstly, the index includes non-structural and non-financial considerations, which may not directly relate to property damage caused by natural disasters. Secondly, the analysis focused on the location of credit unions' headquarters, without accounting for assets, loans, deposits, and members spread across multiple counties. Thirdly, the NCUA used county-level aggregation instead of the more detailed census tract level, potentially introducing bias if risk ratings vary within counties. Lastly, there is no established standard for evaluating climate-related physical risks, making it difficult to assess the significance of the NCUA's findings.

NAFCU Research took a different approach utilizing 2022 HMDA data (Home Mortgage Disclosure Act) to analyze approved loans by different types of lenders (banks, credit unions, and non-depository mortgage lenders). This approach provided better geographic granularity at the census tract level and focused solely on estimated annual loss on buildings, excluding social vulnerability and community resilience elements. This approach also allowed comparisons with other types of lenders. Comparing the two approaches, NAFCU's analysis using HMDA data resulted in a significantly different risk profile. While the NCUA's research suggested that one-third of system-wide assets were located in high-risk communities, NAFCU's approach estimated this figure to be just over 11 percent. Although both approaches have limitations, NAFCU believes that this divergence is indicative of the challenges inherent in attempting to determine the true extent of credit unions' exposure to physical climate risks and the dangers of relying on these methodologies as a basis for burdensome, premature regulation.

NAFCU's approach also facilitated a comparison with other lenders. The analysis showed that the share of 2022 mortgage loans originated by credit unions in high climate risk areas was similar to that of banks. Community banks had a lower share than credit unions, while large banks had a higher share, reflecting differences in their lending practices and geographic footprints. The research note from the NCUA's OCE highlighted the real consequences of climate-related risks, noting that two credit unions in Louisiana failed after Hurricane Katrina. However, the combined assets of these credit unions were relatively small ($20 million), and there is no extensive history of costly failures associated with climate-related risks.

Climate Regulation Alignment Among Federal Banking Regulators

In December, 2021, The Office of the Comptroller of the Currency (OCC) released draft principles to provide guidance to banks, particularly the largest ones, in managing climate-related financial

risks.[4] The OCC principles focused on the emerging risks of climate change and the transition to a low carbon economy for banks and the financial system and as in the RFI, include both physical risks and transition risks associated with climate change. The OCC noted that weaknesses in identifying, measuring, and controlling these risks could negatively impact a bank's safety and soundness and the overall financial system. Additionally, disadvantaged households and communities might be disproportionately affected. The principles covered areas such as governance, policies and procedures, strategic planning, risk management, data and reporting, and scenario analysis.

Similarly, in March 2022, the Securities and Exchange Commission (SEC) approved a proposed rule to enhance and standardize the disclosures publicly held institutions must provide investors regarding "climate-related risks that are reasonably likely to have a material impact on their business, results of operations, or financial condition."[5] Later in March 2022 and December 2022, the Federal Deposit Insurance Corporation (FDIC) and The Board of Governors of the Federal Reserve System (Board), respectively, also released proposed principles and a request for comment that were substantially similar to that of the OCC.[6] Of note, the request for comment from the Board included the following motivation for the timing and similarity of these principles: "The agencies seek to promote consistency in their climate risk management guidance and to clearly articulate risk-based principles on climate-related financial risks for large financial institutions."

It is crucial for the NCUA to ensure that any regulations or guidance issued to credit unions regarding climate-related financial risk align with those of other federal banking regulators. The harmonization of regulations across the financial sector is essential to maintain a level playing field and promote fair competition. If the NCUA were to impose more restrictive guidance or regulations on credit unions compared to other banking institutions, it could create a significant disadvantage for credit unions in terms of their viability and competitiveness. Such a disparity would place credit unions at a higher cost burden and hinder their ability to adapt to climate-related financial risks effectively. Furthermore, it could impede credit unions' capacity to serve their members and fulfill their mission of providing accessible and affordable financial services to communities across the country. Therefore, ensuring regulatory consistency across federal banking regulators is vital to preserve the strength and sustainability of credit unions.

Physical Risk

Climate-related physical risks affecting the credit union industry may include floods, sea-level rise, hurricanes, winds, wildfires, and drought. These risks can have implications for credit union operations, commercial and residential real estate, agricultural lending, commercial lending,

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[4] OCC, "Principles for Climate-Related Financial Risk Management for Large Banks" (Dec. 16, 2021) *available at* https://www.occ.treas.gov/news-issuances/news-releases/2021/nr-occ-2021-138a.pdf.
[5] 87 FR 29059.
[6] 87 FR 19507; 87 FR 75267.

small business lending, and consumer lending. Over time, the impact of physical risks on credit unions and their members may change due to various factors. For example, the frequency and severity of climate-related events may increase, leading to greater potential disruptions in credit union operations and increased damage to real estate properties. Additionally, changing weather patterns and long-term shifts in local climates can affect the economic viability of certain industries, impacting lending activities.

The impacts of physical risks are dynamic, influenced by factors such as infrastructure development, community resilience efforts, advancements in risk management practices, and changes in insurance coverages. The vulnerability of credit unions and their members to climate-related physical risks may evolve as new mitigation strategies, technological advancements, and adaptation measures are implemented. Credit unions diligently work to stay informed about the evolving nature of climate-related physical risks and consider integrating resilience measures into their operations. This involves assessing the vulnerability of office buildings, diversifying supply chains to mitigate disruptions, and incorporating climate risk assessments into lending decisions to manage potential loan defaults. By proactively addressing physical risks, credit unions are better able protect their operations, assets, and the financial well-being of their members.

In order to prepare for or minimize the effects of physical risk credit unions can, and do, implement risk management strategies including:

1. Conducting comprehensive risk assessments: Credit unions assess their exposure to physical risks by evaluating the vulnerability of their operations, assets, and lending portfolios to climate-related events. This assessment can help identify areas of potential impact and inform risk mitigation strategies.
2. Implementing business continuity plans: Credit unions develop and maintain robust business continuity plans to ensure uninterrupted operations in the face of climate-related events. This may involve identifying alternative locations, establishing backup systems, and establishing communication protocols to maintain member services during disruptions.
3. Enhancing disaster response and recovery capabilities: Credit unions frequently improve their response and recovery capabilities by establishing partnerships with local emergency management agencies, training staff in emergency procedures, and developing protocols for member assistance during and after climate-related events.
4. Diversifying lending portfolios: Some credit unions mitigate the concentration risk associated with specific industries or regions vulnerable to physical risks by diversifying their lending portfolios. This can reduce the potential impact of localized climate-related events on the credit union's overall loan portfolio.
5. Collaborating with stakeholders: Credit unions also engage with community organizations, local governments, and industry partners to develop joint strategies for resilience and adaptation. Sharing best practices and knowledge allows credit unions to better understand and address physical risks.

Each of these risk management strategies, in concert with one another and appropriately tailored to each credit union, can help to mitigate much of the physical risk associated with climate change and natural disasters. However, the climate risk profiles of each credit union are as varied as the industry itself. Efforts to mandate specific risk management actions or impose examination structures at the Federal level would be counterproductive and impose significant costs on credit unions that ultimately possess the first-hand knowledge to address climate-related financial risk. Instead, Federal regulators should focus on providing guidance and support rather than mandating specific actions. The NCUA can help institutions address physical risks by sharing best practices and providing guidance, promoting information sharing, and encouraging research and development.

Specifically, the NCUA, in consultation with other federal agencies that possess climate-risk expertise, and guided by the FSOC, should aid credit unions by developing resources, educational materials, and industry best practices to assist in understanding and managing physical risks. This might include providing information on risk assessment methodologies, resilience strategies, and case studies. Additionally, the NCUA and industry trade associations such as NAFCU, through industry forums, webinars, or conferences, can facilitate knowledge exchange among credit unions and other financial institutions to promote collaboration and the sharing of lessons learned in addressing physical risks. To accomplish this, NAFCU urges the NCUA to host a "Climate Risk Summit" where participants can share strategies and discuss risk management and the unique challenges they are facing in their regions and within their fields of membership (FOMs). Finally, the NCUA should support research initiatives that contribute to the understanding of climate-related physical risks and their financial implications to help identify emerging risks, develop innovative risk management solutions, and promote the adoption of resilient practices. By taking a collaborative approach and providing guidance and support, the NCUA will be well positioned to assist credit unions in effectively managing physical risks without mandating specific actions or regulations.

Transition Risk

As noted in the RFI, transition risks from climate change pose potential challenges for credit unions across various areas of business activities. In terms of operations, credit unions may face risks stemming from government policy changes, such as alterations to zoning laws, as well as shifts in federal, state, and local laws and regulations. Additionally, technological advancements and changes in consumer and market demand can impact credit unions' operations. In terms of lending activities, climate-related transition risks can influence real estate lending by affecting the value of properties and the creditworthiness of borrowers. Similarly, commercial lending, small business lending, and agriculture lending may be affected by changes in policy, technology, and market demand. Changing insurance regulations, coverage, underwriting, and pricing practices may also impact collateralized lending.

To prepare for and minimize the effects of transition risk, credit unions may implement several risk management strategies. They can begin by conducting climate risk assessments to identify specific vulnerabilities across their operations and lending portfolios. Diversifying loan portfolios could help reduce concentration risk in climate-sensitive sectors by promoting lending to industries with lower climate-related risks or exploring opportunities in emerging green sectors. Finally, collaboration and partnerships with other financial institutions, industry associations, and regulators can enable knowledge sharing and collective efforts in addressing transition risks.

Scenario analysis may also be valuable in assessing the potential impacts of different climate-related scenarios on loan portfolios and business operations. Currently the Board of Governor of the Federal Reserve System (Federal Reserve) is conducting a pilot climate scenario analysis (CSA) exercise to learn about large banking organizations' climate risk-management practices and challenges and to enhance the ability of both large banking organizations and supervisors to identify, measure, monitor, and manage climate-related financial risks.[7] The outcomes of this pilot have the potential to provide valuable guidance to other regulators in determining the optimal steps to take when quantifying climate-related financial risk. NAFCU recommends that the NCUA avoid taking action until after the results of the pilot program have been released, and to incorporate those findings into future climate-related financial risk efforts.

Regulators such as the NCUA also have a role to play in helping credit unions address transition risks. They can provide guidance and issue best practices that help credit unions understand and effectively manage climate-related transition risks. Promoting the adoption of standardized climate-related data and disclosure practices could also assist credit unions in assessing and communicating their exposure to transition risks.

Impact on financially vulnerable populations

Physical and transition risks associated with climate change may have outsized effects on financially vulnerable populations, including lower-income communities, communities of color, Native American communities, and other under-resourced communities. These populations often face greater challenges in coping with the impacts of climate change due to limited financial resources and social vulnerabilities. Physical risks can lead to property damage, displacement, and disruptions in livelihoods, making it harder for these communities to access financial services and recover from losses. Transition risks can also have adverse effects on vulnerable populations by impacting employment opportunities, access to affordable housing, and overall economic stability.

To mitigate transition risks and ensure continued lending to these populations, many credit unions focus on community engagement and outreach, building relationships with vulnerable communities in order to gain a deeper understanding of their specific needs and challenges. By

[7] Federal Reserve, "Pilot Climate Scenario Analysis Exercise" (Jan, 2023) *available at* https://www.federalreserve.gov/publications/climate-scenario-analysis-exercise-instructions.htm.

actively collaborating with community organizations and leaders, credit unions are able to develop tailored solutions and support systems that address the unique circumstances of financially vulnerable populations. Additionally, credit unions prioritize financial education and empowerment programs targeted at vulnerable communities. These initiatives enhance the financial literacy and resilience of members, providing them with knowledge and skills to navigate the impacts of climate change and make informed financial decisions. These include educating members about insurance options, emergency savings, and available resources for disaster preparedness and recovery. Finally, credit unions, to the extent permitted by NCUA regulations, offer innovative lending products and services designed to meet the specific needs of financially vulnerable populations and the underserved. These include loan programs that facilitate affordable housing, energy-efficient upgrades, and other measures to increase resilience and reduce the long-term costs associated with climate-related risks.

Credit unions have a proven track record of serving low-income and disadvantaged communities, and actively seek to serve these communities, whereas other institutions have retreated from these areas. By extending research originally published by the Federal Reserve, NAFCU has found that between 2012 and 2019, community banks decreased rural branches by 5 percent and large banks decreased rural branches by 19 percent, while credit unions grew their branch presence in rural areas by 2 percent over that span.[8] Furthermore, credit unions are already working to ensure that financially vulnerable populations have access to green lending through the GHGR Fund. Some of NAFCU's members have already established an eligible non-profit organization, Ecority, through a consortium of credit unions and CDFI credit unions that are ready and willing to assist the EPA in dispersing funds to communities that have historically lacked access to credit. The vast network of credit unions and their partners are prepared to mobilize billions of dollars on their balance sheets to support this effort to promote clean energy and reduce greenhouse gas emissions.

Importance of Individualized Risk Management

Each credit union is unique, with its own set of characteristics, membership demographics, and geographical locations, resulting in varying risk profiles when it comes to climate-related risks. It is important to recognize that the impact of climate change and natural disasters can differ significantly across regions and communities. Therefore, proposing comprehensive regulations that would force all credit unions to comply may not be appropriate or effective. The NCUA should consider the diverse nature of credit unions and the specific risks they face and defer to the judgment of each credit union's leadership regarding their risk management strategy.

Additionally, it is crucial to acknowledge that the NCUA may have limited expertise in assessing the precise impact of climate change and natural disasters on credit unions. Given the complex and evolving nature of climate-related risks, it would be more beneficial for the NCUA to

[8] See NAFCU, Report on Credit Unions, 18 (2020), *available at* https://www.nafcu.org/sites/default/files/2020%20NAFCU%20Annual%20Report%20on%20Credit%20Unions.pdf.

collaborate with industry experts and stakeholders to develop tailored guidelines and provide support to credit unions based on their individual risk profiles. This approach would ensure that credit unions can address climate-related risks in a manner that is most suitable for their unique circumstances, thereby promoting effective risk management and the long-term sustainability of the credit union sector.

Credit unions are capable of assessing, on an individual basis, the particular level of risk that climate and natural disasters pose to their credit union. Individual credit unions, as the entities operating on the ground and interacting directly with their members and local communities, are better positioned to develop their own climate risk management strategies compared to a centralized authority like the NCUA in Washington, DC. Credit unions have an in-depth understanding of their membership demographics, geographic locations, and unique risk exposures. They are familiar with the specific climate-related challenges and vulnerabilities faced by their communities. By leveraging their local knowledge and expertise, credit unions can tailor their risk management approaches to address the specific climate risks they face. This localized approach allows credit unions to be nimble, responsive, and proactive in implementing measures that best protect their members and the credit union's financial stability.

Credit unions would benefit from clarity from the NCUA regarding how NCUA examiners will evaluate the risk management strategies employed by a credit union. Additionally, the NCUA should provide guidance on its posture toward lending and investments to the extent that those activities intersect with physical or transition-based climate related financial risk. While the NCUA can provide guidance and support, empowering individual credit unions to develop their own climate risk management strategies ensures that the solutions are contextually relevant and effectively address the specific challenges faced at the local level. Additionally, as climate-related financial risk rapidly evolves, a more flexible framework will allow credit unions to more easily adjust to new scenarios without being bogged down by a lengthy, complex rulemaking process.

To the extent that the NCUA does issue guidance based on the information gathered in this RFI, it should work with other federal banking regulators to ensure that such guidance is aligned. Failure to do so could place a heavier regulatory burden on one particular category of financial institutions and reduce the viability and competitiveness of that category of financial institution. NAFCU urges the NCUA to work with the Financial Stability Oversight Council (FSOC) and allow that monitoring body to take the lead on this issue to ensure that regulators have a consistent approach. Furthermore, NAFCU urges the NCUA to avoid rulemaking on climate-related financial risk until such time as there has been Congressional action. This conforms to the position of Federal Reserve Chair Jerome Powell, who states, "Without explicit congressional legislation, it would be inappropriate for us to use our monetary policy or supervisory tools to promote a greener economy or to achieve other climate-based goals…We are not, and will not be, a 'climate policymaker.'"[9]

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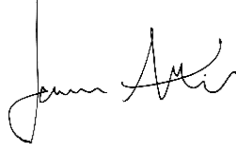
[9] CNBC, "Powell reiterates Fed is not going to become a 'climate policymaker'" (Jan. 10, 2023) *available at* https://www.cnbc.com/2023/01/10/powell-reiterates-fed-is-not-going-to-become-a-climate-policymaker.html.

Conclusion

NAFCU appreciates the opportunity to comment on the RFI regarding climate related financial risk. NAFCU strongly encourages the Board to acknowledge the diverse range of climate risk profiles within the credit union industry and avoid a uniform approach when issuing guidance on climate-related financial risk, recognizing that each credit union may face unique challenges. Moreover, unless explicitly mandated by Congress, NAFCU urges the NCUA to refrain from proposing regulations regarding climate-related financial risk. Instead, the NCUA should defer to the Financial Oversight Stability Council (FSOC) as it formulates guidance to ensure fair treatment of credit unions compared to other financial institutions and prevent undue burdens. If you have any questions, please do not hesitate to contact me at 703-842-2268 or jakin@nafcu.org.

Sincerely,



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