CLIMATE AND NATURAL DISASTER RISK MANAGEMENT AT THE REGULATED ENTITIES

REQUEST FOR INPUT

January 2021

Office of the Director

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Introduction

The Federal Housing Finance Agency (FHFA or the Agency) is seeking information on the current and future climate and natural disaster risk to the housing finance system and to the regulated entities: Fannie Mae and Freddie Mac (the Enterprises) and the Federal Home Loan Banks (the FHLBanks). This information will enhance FHFA's ability to fulfill its statutory responsibilities to ensure that the regulated entities (*i*) operate in a safe and sound manner, (*ii*) fulfill their statutory missions, and (*iii*) foster the liquidity, efficiency, competitiveness, and resiliency of the national housing finance markets. FHFA also seeks input on opportunities to strengthen its supervision and regulation of the regulated entities' management of and reporting on the physical and transition risks that may arise from natural disasters and changes in climate patterns. Commenters are encouraged to note, as appropriate, distinctions and similarities between the Enterprises and the FHLBanks.

Public Input Instructions

FHFA invites interested parties to provide written comments on all aspects of this Request for Input (RFI) and the questions set out below no later than April 19, 2021. Comments can be submitted electronically using the response form at https://www.fhfa.gov/AboutUs/Contact/Pages/Request-for-Information-Form.aspx (select "Climate and Natural Disaster Risk" in the pull-down) or via mail to the Federal Housing Finance Agency, Office of the Director, 400 7th Street SW, 10th Floor, Washington, D.C. 20219. Generally, all comments received will be made public and posted without changes to FHFA's website. However, commenters that would like FHFA to consider any portion of their response exempt from disclosure must attach that portion separately and clearly mark it "confidential commercial information." The procedures for identifying "confidential commercial information" can be found in FHFA's regulations at 12 CFR § 1202.8, available on FHFA's website.

Background

A growing body of research is studying the risks that climate change and natural disasters pose to the stability of the economy, the financial system, the national housing finance markets, and FHFA's regulated entities. Some of this research has examined whether and to what extent government policies might exacerbate climate and natural disaster risks through moral hazard or by otherwise incentivizing risk-taking. Other areas of study include the current and future efficacy and availability of traditional climate risk mitigants, such as the National Flood Insurance Program and hazard insurance policies. This research has coincided with increasing interest in addressing these risks by domestic and international regulators and other policymakers.[1]

The regulated entities disclose in their Securities and Exchange Commission filings that major natural disasters could adversely affect their businesses or financial results. The Enterprises recognize that natural disasters could result in increased delinquency rates, default rates, credit losses, credit related expenses, and loan loss frequency and severity.[2] Similarly, the FHLBanks recognize that economic and financial disruptions and uncertainties arising from natural disasters could reduce demand for their lending, increase the risk of credit losses, and adversely affect their cost of and access to funding.[3] However, the ability to manage such risks using conventional risk-modeling techniques based on historical datasets may be limited.

As a prudential financial regulator, FHFA does not have expertise in climate science. As set forth in the questions below, FHFA is seeking input that would strengthen its ability to identify and assess the regulated entities' current and future climate and natural disaster risk. FHFA is also seeking input on opportunities to enhance the Agency's supervision and regulation of each regulated entity's management of such risks.

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[1] *See* The U.S. Commodity Futures Trading Commission, *Managing Risk in the U.S. Financial System: Report of the Climate-Related Market Risk Subcommittee*, September 9, 2020; The Board of Governors of the Federal Reserve System, *Financial Stability Report*, November 2020, p. 58-9; Senate Democrats' Special Committee on the Climate Crisis, *The Case for Climate Action: Building a Clean Economy for the American People*, August 25, 2020.
[2] *See* Fannie Mae 2019 Form 10-K, Annual Report for the fiscal year ended December 31, 2019, pp. 36-37, 116-117. Freddie Mac 2019 Form 10-K, Annual Report for the fiscal year ended December 31, 2019, p. 144.
[3] *See* Federal Home Loan Banks Combined Financial Report for the year ended December 31, 2019, p. 22.

Questions

I. Identifying and Assessing Climate and Natural Disaster Risk

1. How should FHFA define climate and natural disaster risk?

2. What are the climate and natural disaster risks to the regulated entities, including long- and short-term risks, and how might such risks change over time? To what extent, if any, could such risks now or in the future impede the ability of each regulated entity to operate in a safe and sound manner, fulfill its statutory mission, or foster liquid, efficient, competitive, and resilient national housing finance markets?

3. What methodologies, datasets, variables, assumptions, future climate scenarios, and measurement tools are used to measure and monitor climate risk to the national housing finance markets? Describe any gaps in available data that limit the ability to measure such risks. How could such data gaps be resolved?

4. What risk management strategies or approaches—including but not limited to those related to pricing, insurance, credit risk transfers (CRT), loss mitigation, and disaster response—do industry participants use to address climate and natural disaster risk?

5. How, if at all, should FHFA incorporate into its assessment of the regulated entities' climate and natural disaster risk the potential for abrupt repricing of real estate properties exposed to acute natural hazards?

6. With respect to the foregoing questions, FHFA invites interested parties to submit any studies, research, data, or other qualitative or quantitative information that supports a commenter's response or is otherwise relevant to the regulated entities' climate and natural disaster risk.

II. Enhancing FHFA's Supervisory and Regulatory Framework

7. How should FHFA evaluate the adequacy of a regulated entity's ability to assess and manage the impacts of climate and natural disaster risk, particularly in light of the significant uncertainties and data limitations?

8. What specific processes and systems of a regulated entity should FHFA examine in its supervision of the regulated entities' climate and natural disaster risk management?

9. How should FHFA prioritize the various climate and natural disaster risks to the regulated entities?

10. Some government programs and interventions that mitigate disaster-related credit losses at the regulated entities are not available to all mortgage market participants and may not be available to the regulated entities in the future. How, if at all, should FHFA consider current risk mitigants and their uncertain future availability in its supervision and regulation of each regulated entity's management of climate and natural disaster risk?

11. What risks to the regulated entities' critical service providers and other third parties—including but not limited to mortgage servicers and insurers—should FHFA consider when assessing each regulated entity's management of climate and natural disaster risk?

12. What differences between the Enterprises and the FHLBanks should FHFA consider in tailoring its supervision and regulation of each regulated entity's management of climate and natural disaster risk?

13. Should FHFA implement a stress testing, scenario analysis, or similar program to assess the regulated entities' climate and natural disaster risk? If so, what factors should FHFA consider in defining the purposes, design, and scenarios of any such programs?

14. Are there alternative risk mitigation strategies, including but not limited to insurance or insurance-based financial instruments, that could transfer risk from the regulated entities' portfolios or products or assist with the market pricing of climate and natural disaster risks?

15. How might the regulated entities support their housing finance missions while minimizing the impact of climate and natural disaster risk?

16. Market discipline could potentially supplement FHFA's supervision and regulation of the regulated entities' climate and natural disaster risk appetite and management. Market discipline depends in part on the information that is available to shareholders, creditors, and other counterparties. Is the existing publicly available information sufficient for shareholders, creditors, CRT and other investors, and other counterparties to understand and exercise market discipline over a regulated entity's appetite for and management of climate and natural disaster risk? If not, what changes are needed? Should each regulated entity be required to disclose additional information, including but not limited to the extent to which its underwriting practices take into account climate and natural disaster risk?

17. What, if any, additional periodic or episodic reporting requirements for the regulated entities should FHFA consider to improve the publicly available information on the regulated entities' management of climate and natural disaster risk?

18. Policies to manage climate and natural disaster risk could increase the cost of housing, making it more difficult for lower income households in some areas to obtain affordable housing. Are there policies the regulated entities could pursue to mitigate such adverse effects for lower income households in vulnerable areas without undermining efforts to manage climate and natural disaster risk?

19. Minority borrowers exhibit higher rates of delinquencies for longer durations following natural disasters. Are there policies the regulated entities could pursue to mitigate such adverse effects for minority borrowers exposed to climate and natural disaster risk?

20. What type of organizational structures should FHFA and the regulated entities consider adopting for themselves to support the management of climate and natural disaster risk?

21. What specific issues or topics should FHFA consider for future research on climate and natural disaster risk to the regulated entities and the national housing finance markets?

22. What data or housing market information would be beneficial for FHFA to make available, to the extent permitted by privacy considerations, to researchers and other interested parties to support the assessment of climate and natural disaster risk to the regulated entities or the national housing finance markets?

23. What factors should FHFA consider in determining whether to formally participate in or informally partner with organizations or groups focused on climate and natural disaster risk management?

24. Are there existing or potential government agencies or programs that FHFA could partner with to enhance the Agency's supervision and regulation of climate and natural disaster risk to the regulated entities?

25. What, if any, other enhancements should FHFA consider to its supervision and regulation of each regulated entity's management of climate and natural disaster risk? Other enhancements could include but need not be limited to: (*i*) regulatory capital requirements or other loss-absorbing capacity requirements that ensure each regulated entity has the capacity to absorb impacts of climate and natural disaster risk; (*ii*) disclosure requirements to provide shareholders, creditors, CRT or other investors, and other counterparties with appropriate information about a regulated entity's climate and natural disaster risk; and (*iii*) changes to FHFA's supervisory program to enhance examination of or reporting on each regulated entity's infrastructure and processes for identifying, assessing, mitigating, and monitoring the regulated entity's management of climate and natural disaster risk.

26. To what extent, if any, should FHFA support efforts to develop standards of classification and data reporting on climate and natural disaster risk to the financial performance of companies, such as those by the Sustainability Accounting Standards Board, domestic and foreign government agencies, or others?