American Bankers Association
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G. Joseph Pigg
Senior Vice President
Regulatory Compliance and Policy
Phone: 202-663-5480
E-mail: jpigg@aba.com

April 19th, 2021

The Honorable Mark Calabria
Director
Federal Housing Finance Agency
400 Seventh Street, SW
10th Floor
Washington, DC 20219

RE: Climate and Natural Disaster Risk Request for Input

Director Calabria,

The American Bankers Association[1] appreciates this opportunity to provide input on the Federal Housing Finance Agency's Request for Input (RFI) on Climate and Natural Disaster Risk Management at the Regulated Entities (Fannie Mae, Freddie Mac (the GSEs) and the Federal Home Loan Banks (FHLBs)).[2] FHFA's request is one in a growing array of responses to concerns over climate and natural disaster risk, and we welcome the opportunity to engage on this important topic.

Like many organizations and industries, the American Bankers Association (ABA) has increased our focus on climate related risks. ABA recently joined the U.S. Climate Finance Working Group, a coalition of financial trade associations, in developing a set of principles to guide discussions and engagement on how the financial system and our regulators should address climate change issues. These principles are:

- Set science-based climate policy goals that align with the Paris Agreement
- Increase and strengthen U.S. international engagement
- Provide clear long-term policy signals that foster innovation in financial services
- Price carbon and leverage the power of markets
- Minimize costs and support jobs in the transition
- Foster international harmonization of taxonomies, data standards and metrics
- Promote more robust climate disclosure and international standards
- Ensure climate-related financial regulation is risk-based
- Build capacity on climate risk modeling and scenario analysis

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[1] The American Bankers Association is the voice of the nation's $21.9 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $17.8 trillion in deposits and extend nearly $11 trillion in loans.

[2] Fed. Hous. Fin. Agency, Climate and Natural Disaster Risk Management at the Regulated Entities: Request for Input (2021), https://www.fhfa.gov/Media/PublicAffairs/Documents/Climate-and-Natural-Disaster-RFI.pdf.

- Strengthen post-disaster recovery, risk mitigation and adaptation

We believe these principles should also guide FHFA as it looks into the issues regarding evaluating and potentially regulating the climate and natural disaster risk posed to the Regulated Entities. Our comments below are consistent with these principles. Nevertheless, just as the RFI notes that FHFA does not have expertise in climate science, neither do the ABA or most of the member banks that provided input into our comments. Therefore, our comments will focus primarily upon the foundational questions posed in the first of the two broad categories detailed in the RFI: "Identifying and Assessing Climate and Natural Disaster Risk," as well as providing recommendations for sources of expertise and for necessary collaborations in making determinations about the risks faced by the Regulated Entities. We do not believe that either FHFA or the banking industry currently have the expertise to recommend or make changes to enhance the supervisory and regulatory framework of the Regulated Entities with respect to climate-related factors.

Questions and Responses

The first three questions posed by the RFI focus on foundational matters: How should climate and natural disaster risk be defined; how do those risks apply to the Regulated Entities and how might they change over time; and what methodologies and tools can be used to measure and manage those risks. We address these three questions together as we believe it is essential for FHFA to collaborate and consult with a wide range of stakeholders, including other regulators and policy makers, before attempting to define climate and natural disaster risk and determining how to measure the Regulated Entities' efforts to manage them.

While certain climate and natural disaster risks to the Regulated Entities seem clear – such as flood risk – other potential risks – such as transition risks associated with an economic shift to a lower carbon economy – are not as clear. Many risks are evolving along with the impacts of climate change. It is essential that FHFA consider potential risks, how they may or may not evolve, and the methodologies that can be used to manage them in concert with the many stakeholders involved in the mortgage market.

The support to the mortgage origination market provided by the Regulated Entities involves a complex array of stakeholders, including primary market lenders, investors, appraisers, insurers, servicers, other governmental agencies, and the various state and federal prudential regulators of these stakeholders. Many of these stakeholders are also considering climate risk and how to respond to it, creating a complex matrix of potential responses and the very real possibility for inconsistencies. It is essential that analysis of these risks, and how to respond to them, not be undertaken in a vacuum by any entity, including FHFA. Coordination and collaboration will be essential to ensure that climate risk is assessed and regulated in a logical, efficient and orderly way that does not unnecessarily constrain access to credit or result in inefficient or contradictory regulatory response.

President Biden has announced that his Administration will take a "whole of government" approach to issues surrounding climate change. Even in these early days of this Administration, we are seeing that approach in action with Treasury Secretary Yellen announcing that under her

leadership the Financial Stability Oversight Council will make combating climate change a top priority. [3] It has also been reported that Secretary Yellen intends to appoint a high-ranking official within Treasury to coordinate climate-related efforts.[4] The Federal Reserve has recently formed two committees related to climate: the Supervision Climate Committee (SCC), which is focused on prudential regulation and the potential development of scenario analysis for individual bank assessment of climate risk, and a Financial Stability Climate Committee (FSCC) to identify, assess, and address climate-related risks to financial stability. The FSCC will approach this work from a macro-prudential perspective that considers the potential for complex interactions across the financial system.[5] The acting Chair of the Securities and Exchange Commission has issued a request for input on climate-related disclosures.[6] Related efforts from other agencies are expected. With former Senator John Kerry appointed as a cabinet level climate envoy and former Environmental Protection Agency head Gina McCarthy leading the domestic climate agenda, we anticipate the White House will play a major role in coordinating efforts across agencies. Additionally, on April 14, 2021, the Basel Committee announced its intention to spend this year studying gaps in climate-related risk information and analysis and then consider potential recommendations for regulatory responses (and did not include a timeline for making those recommendations).[7] This action signals further efforts related to climate on the international level. It is essential that these efforts be well coordinated and that consistent and agreed upon taxonomies and approaches be developed and applied appropriately.

All stakeholders, including financial regulators, should work together to create a framework to identify, evaluate and mitigate the risks of climate change on the housing system and financial system more broadly. Specifically, we recommend potential collaboration with non-partisan organizations such as the National Institute of Standards and Technology (NIST) to develop a risk taxonomy that can provide standards to assess climate risks and measure how those risks change over time as well as the proximity and severity of impacts, and assist with the development of risk pricing assessment tools.

FHFA must also recognize that any potential assessment or regulation imposed on or required by the Regulated Entities frequently becomes the "industry standard" for mortgage lenders in the United States. This can be a positive development, providing the mortgage industry with a common set of standards or requirements, but only if those standards are not in conflict with, or duplicative of, other requirements. This likelihood also requires FHFA to engage in broad coordination with other regulators.

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[3] U.S. Dept. of the Treasury, Remarks by Secretary Janet L. Yellen at the Open Session of the Meeting of the Financial Stability Oversight Council (2021), https://home.treasury.gov/news/press-releases/jy0092.
[4] Kate Davidson, Yellen Is Creating a New Senior Treasury Post for Climate Czar, THE WALL ST. J. (Feb. 12, 2019), https://www.wsj.com/articles/yellen-is-creating-a-new-senior-treasury-post-for-climate-czar-11613138479?page=1&adobe_mc=MCMID%3D66865849062703968213680530099089854607%7CMCORGID%3DCB68E4BA55144CAA0A4C98A5%2540AdobeOrg%7CTS%3D1617828743.
[5] Bd. of Governors of the Fed. Reserve Sys., Governor Lael Brainard, Financial Stability Implications of Climate Change, (2021), https://www.federalreserve.gov/newsevents/speech/brainard20210323a.htm.
[6] Sec. & Exch. Comm'n, Acting Chair Allison Herren Lee, Public Input Welcomed on Climate Change Disclosure (2021), https://www.sec.gov/news/public-statement/lee-climate-change-disclosures.
[7] Bank for International Settlements, Basel Committee Publishes Analytical Reports on Climate-Related Financial Risks (Apr. 14, 2021), https://www.bis.org/press/p210414.htm?source=email.

The current requirements for private flood insurance are an instructive example. The mandatory purchase requirement mandates flood insurance on any building in a Special Flood Hazard Area (SFHA) financed with federal assistance, which includes secondary market purchase by Fannie Mae and Freddie Mac. Banks making mortgage loans are examined by the prudential regulators for compliance with the mandatory purchase requirement. In 2012, the Biggert Waters Flood Insurance Reform Act (BWA) explicitly allowed for private flood insurance policies to meet the mandatory purchase requirement. Previously, only FEMA's National Flood Insurance Protection (NFIP) was widely available to meet the insurance requirements of the Flood Disaster Protection Act. The development of the private market for flood insurance has been hampered by inconsistency between GSE and prudential regulatory requirements for private flood policies. The prudential regulators implemented a final rule governing lender acceptance of private flood policies in July 2019, including the use of a "compliance aid" to assist lenders in accepting private flood policies. However, Fannie Mae and Freddie Mac have not adopted for the same approach, creating operational issues for lenders who must accept private flood policies under BWA but wish to sell those loans on the secondary market. This discrepancy has deterred some borrowers from obtaining private flood coverage, which in many cases provides more affordable and comprehensive coverage than that available under the NFIP.

Where possible and appropriate, regulatory agencies should consider leveraging other well-established frameworks and taxonomies in place, such as Special Flood Hazard Area (SFHA) designations which include designations for properties at risk for coastal flooding, which may also be susceptible to sea level rise. Another example of an existing framework is FEMA's National Risk Index.

Defining the risks, the taxonomy used to describe them, and the metrics used to measure them will be a major undertaking. It must be well coordinated with the broad range of stakeholders involved in the mortgage markets to ensure that those definitions, metrics, and taxonomies are widely accepted and agreed upon in order to avoid conflicts or duplications that undermine effectiveness or lead to unnecessary constrictions of credit or other undesirable outcomes.

The fourth question posed by the RFI focuses on risk management strategies used by industry participants to address climate and natural disaster risk. The most common risk management strategy employed by our members, and likely most customers of the regulated entities, is insurance, both hazard insurance and NFIP or private flood insurance policies.

Insurance policies have three fundamental purposes, primarily focused on mitigating risk directly or through encouraging other changes to mitigate risk indirectly:

- *Collateral Protection*. Lending, at a cost conducive to economic growth, is only possible if the lender and borrower collaborate to secure insurance protection sufficient to replace either the collateral or to retire the debt against it.

- *Behavior Modification*. Insurers have evolved policies and review procedures, especially in property and casualty (liability) environments, which guide borrowers/owners into both less risky practices – like credit for adhering to building codes – or more sustainable practices – such as environmentally friendly buildings.

- *Public Policy Adoption.* Implementing fire codes, raising building elevations, adopting green materials standards, reducing weather-related risk, or any combination of these innovations, initially raise borrowing costs. Reduced insurance costs are generally a longer-term reward for upgrading or changing structural components or locations.

The insurance industry has been engaged in managing direct weather risk to structures for centuries and the metrics of this business are well-understood. Commercial and residential Property and Casualty policies can protect against and encourage greater insolation from damages associated with storms/fires/seismic and many other risks; however, insurance tends to retreat from catastrophic losses or from concentration of loss.

For every peril there tends to be pre-event remediation credit in most hazard policies; for example, replacing wooden shingles with concrete versions tends to lower risk (and thus premium) in wildfire prone areas; similarly, raising structures' base flood elevation results in lower flood premiums.

We believe that insurance should continue to play a significant role as a tool in mitigating risk to the Regulated Entities and the customers they serve. Insurance coverage, cost and availability will evolve along with the risks presented, and FHFA's potential assessment and regulation must be coordinated and calibrated with the insurance industry, and the state regulators of that industry, as well as with governmental actions that address changes or evolutions to that industry.

The fifth question posed by FHFA asks how, if at all, FHFA should incorporate into assessment of the Regulated Entities' risk the potential for abrupt repricing of real estate properties exposed to acute natural hazards.

The potential for abrupt repricing as a result of climate or natural disaster risk involves a number of extremely complicated and interrelated issues involving many stakeholders. We do not recommend that FHFA incorporate assessment of these risks into regulation at this time, as these issues present the risk of significantly reducing the availability of credit and the value of existing properties. We recognize FHFA's interest as a safety and soundness regulator in assessing these risks to the Regulated Entities, but we believe that any action taken by FHFA, absent careful coordination with other stakeholders and policymakers could result in severe unintended consequences.

To illustrate, a number of events in recent years have shown that one outcome of a natural catastrophe is much higher premiums (to the point of unaffordability) or the non-renewal of voluntary insurance, which results in borrowers being put into the lender-placed insurance market (which can be even more expensive) or of insurers leaving the market entirely. Three events – hurricanes Andrew in 1992 and Katrina in 2005 and the Northridge Earthquake in 1994 – resulted in the largest property/casualty insurers leaving the gulf states, Florida and California. These states then established wind and seismic funds into which insurers had to pay annual subsidies. Without this action by the states, actuarial rates would have been unaffordable and a very high percentage of mortgaged properties would have faced foreclosure.

If FHFA were to take actions that restrict the Regulated Entities from providing credit – or that increase the cost of that credit significantly – a similar result could occur, triggering the very risk of repricing that FHFA is trying to assess. In extreme situations, increasing the cost of credit, or reducing its availability, could result in the same outcome: a loss of affordable insurance coverage and a wave of foreclosures.

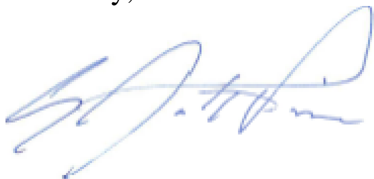
Given the gravity of these risks, we believe this issue must be addressed with great care and with direction from the legislative process with public input and accountability for decisions made by elected leaders.

Conclusion

Climate and natural disaster risk involve a complex set of issues and a wide range of stakeholders. Assessing those risks and adjusting regulation for them is a daunting task. Most stakeholders are only in the early stages of developing the necessary expertise. We commend FHFA for issuing the RFI to begin to assess the risks that climate and natural disaster risk pose today and in the future. We hope that our comments are helpful in furthering the FHFA's efforts in this area, and we stand ready to engage further with FHFA and the many other stakeholders that must be involved in future policy responses.

If you have questions or would like to discuss any of our comments and recommendations in greater detail, please do not hesitate to contact the undersigned.

Sincerely,



G. Joseph Pigg
Senior Vice President, Sustainable Banking and Mortgage Finance
Regulatory Compliance and Policy