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NY Department of Financial Services Statement on Climate Change: Implications for the Financial Sector

State regulatory statements and guidelines for climate change readiness are emerging independent of federal government action.

As climate change is not just about future impacts, financial institutions are compelled to immediately address its risks. In a letter dated October 29, 2020, the New York State Department of Financial Services ("NYDFS") issued guidance to the state's financial institutions to address "climate change and the impact on the safety and soundness of the individual financial institutions and the broader financial stability implications for the financial industry" (the "NYDFS Climate Guidance"). The NYDFS Climate Guidance applies to large banks and mortgage bankers and servicers as well as smaller community providers such as money transmitters, licensed lenders, sales finance companies, and virtual currency companies ("Regulated Organizations"). Although addressed to the New York market, the NYDFS Climate Guidance may be the template for financial institutions' own internal climate-risk strategies and prepare the financial sector for similar actions by other states.

CATEGORIES OF EXPECTED RISKS

The NYDFS Climate Guidance proposes that a range of climate-related concerns may impact financial institutions:

- **Transition Risks of Climate Change – and Opportunities**. Market shifts toward lower-carbon options may generate losses across fossil fuel-based energy sector and fossil-fueled industries including manufacturing, transportation, and agriculture, among others. However, possibilities for large-scale investment in lower-carbon energy, infrastructure and

consumer models may generate opportunities for return on financial investment and for leadership by the financial services industry in shaping a lower-carbon transition.

- **Physical Risks to Property and Assets**. Damage to physical property or assets that may be alleged to be climate-related, such as from wildfire, could result in business and supply chain disruptions and trigger risk of financial loss to Regulated Organizations.
- **Risks to Depository and Non-Depository Institutions**. For non-depository financial service providers, cascading risks of climate change such as business or income loss to such institutions' customer base may result in parallel risk to non-depositories. The NYDFS Climate Guidance also stresses that equipment and energy used in virtual currency activities may have significant carbon impacts, which could deter investors with sustainable-climate commitments.
- **Traditional Risk-Management Tools May Not be Up to the Task**. Because climate impacts can be volatile and are experienced differently across a range of industries and communities, traditional financial risk management tools may not solve climate-linked concerns. As options for New York financial institutions to consider, the NYDFS Climate Guidance highlights international risk assessment offerings, such as guidance by the European Central Bank, but there appears to be room for financial institutions to explore and design climate-savvy risk assessment tools.

NYDFS EXPECTATIONS OF NEW YORK REGULATED ORGANIZATIONS

Under the NYDFS Climate Guidance, NYDFS "expects" all Regulated Organizations to:

- Commence integrating financial risk from climate change into their governance frameworks, risk management processes, and business strategies.
- Designate a board member, board committee or equivalent and a senior management function to be accountable for the organization's climate change risk assessment and management.
- Commence developing an approach to climate-related financial risk disclosure, including possible engagement with third parties active in designing climate-related financial disclosure models, such as the Task Force for Climate - Related Financial Disclosures.
- Recognizing of the potential smaller size and community-based focus of Non-Depositories, Non-Depositories are expected to conduct a broad-scope climate risk assessment of physical and transition risks, both to the institutions themselves and to the communities and customers they serve, considering such impacts as business disruption, income loss, supply chain disruption, increased default rates and income loss, out-migration, and changes in investor and customer sentiment and to incorporate the findings into strategic planning.

Enforcement. The NYDFS Climate Guidance does not include enforcement mechanisms. However, "[NY]DFS is developing a strategy for integrating climate-related risks into its supervisory mandate and will engage with your organizations and work and coordinate with our U.S. and international counterparts to develop effective supervisory practices."

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State and local regulators should not be underestimated in their ability to impact markets beyond their immediate areas of operation. NYDFS oversees the activities of approximately 1,500 banking and other financial institutions with assets totaling more than $2.6 trillion according to the NYDFS Climate Guidance. This call of a regulatory body for measurable climate risk mitigation by the financial services industry may lead the way for other similar regulatory demands.

King & Spalding offers a global Environmental, Social, Governance and Sustainability-Linked Finance practice and a Climate Change Task Force, including attorneys experienced in U.S. and international climate change regulations, climate-related disclosure requirements and sustainability-linked financing, and governmental advocacy with respect to environmental and financial matters. If you have questions about the potential impacts of the NYDFS Climate Guidance on your business, are interested in reviewing your own climate-change mitigation and disclosure practices, or would like to learn more about ensuring your voice is heard by policymakers, please contact our lawyers noted in the contact section.