June 2, 2022

James P. Sheesley
Assistant Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street NW, Washington, DC 20429

Re: Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions [RIN 3064-ZA32]

Via comments@fdic.gov

Dear Mr. Sheesley:

I am pleased to provide these comments in response to the release by the Federal Deposit Insurance Corporation (FDIC) of its draft “Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions.”¹

General Comments

Section 1(a) of the Federal Deposit Insurance Act reads:

(a) Establishment of Corporation.--There is hereby established a Federal Deposit Insurance Corporation (hereinafter referred to as the "Corporation") which shall insure, as hereinafter provided, the deposits of all banks and savings associations which are entitled to the benefits of insurance under this Act, and which shall have the powers hereinafter granted. (emphasis added)

The FDIC mission statement reads:

The mission of the Federal Deposit Insurance Corporation (FDIC) is to maintain stability and public confidence in the nation's financial system. In support of this goal, the FDIC:

- Insures deposits,
- Examines and supervises financial institutions for safety and soundness and consumer protection,
- Works to make large and complex financial institutions resolvable, and
- Manages receiverships.²

There is nothing in the Federal Deposit Insurance Act or the FDIC mission statement about climate change, curing cancer or a hundred other worthy objectives.

“Climate-related” financial risks are only relevant to the FDIC’s actual mission if they are **material** to the safety and soundness of the supervised banks. As a factual matter, climate-related risks are generally not material to the safety and soundness of banks. Constant repetition by regulators and politicians that they are does not make it so. **But to the extent climate-related financial risks are actually financially material and determinable, current laws and regulations require that those risks be addressed. There is no need for additional rules.**

Indeed, virtually the entire “Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions” document reads as if Part 364 of Title 12 of the Code of Federal Regulations (relating to Safety and Soundness) and section 20.1 of the Risk Management Manual of Examination Policies (relating to “Risk-Focused, Forward-Looking Safety and Soundness Supervision”)³ were summarized and then the words “climate-related financial” were inserted in front of the word “risk” wherever it occurred.

There is no legitimate reason to single out climate-related risks for special treatment as compared to the hundreds of other types of material risk – risks that usually more important. If the FDIC stays in its lane and only addresses climate-related financial risks that are actually material and determinable under current bank supervision principles, then such an approach will do relatively little damage. There is good reason to believe, however, that is not what is really going on.

What is going on is submission to political demands from the White House to weaponize financial regulation in furtherance of progressive political objectives⁴ and to use bank supervision to allocate credit toward favored industries and away from disfavored industries. Attempting to further progressive political and social objectives unrelated to the FDIC’s actual mission will make any such regulation economically suspect and may well result in a court holding that the FDIC does not have the statutory authority to promulgate the regulation. FDIC attempts to circumvent the Administrative Procedure Act by the use of guidance or “principles” documents, examinations and enforcement actions will be similarly suspect.

Before this guidance document becomes the basis for any enforcement action or any bank examination, the FDIC needs to do the hard work of writing an Administrative Procedure Act compliant rule providing notice and seeking public comment. If it does so, the points made in the sections below regarding the complexity and deep ambiguity involved in undertaking the “climate-related” risk assessment enterprise will become quite evident. The FDIC also needs to seek OIRA clearance and, further, comply with Regulatory Flexibility Act, the Paperwork Reduction Act, Executive Order No. 12866 and related executive orders. It should not seek to evade the APA and other regulatory requirements by issuing guidance or principles documents that are really rules and then moving immediately to enforcement of the rule masquerading as

---
guidance by means of the bank supervision process. These deficiencies may well lead to a determination that the “Principles” are unlawful when subjected to judicial review.

Summary of the Problems with FDIC Regulation of “Climate-Related Financial Risk”

1. Additional Climate Change Requirements Would Impede the FDIC’s Important Mission. The important mission of the FDIC is to ensure the safety and soundness of banks and to insure deposits. Requirements relating to climate-related financial risk beyond those required under existing requirements related to material risks would impede rather than further that mission. It would affirmatively harm depositors, customers, bank shareholders, taxpayers, and the economy.

2. Requiring Banks to Devote Resources and Inappropriately Weight Immaterial Climate Change “Risk” Will Increase Rather than Decrease Risk. Requiring banks to inappropriately weight climate-related financial risks that are not actually material and to devote resources to risks that are not actually material or determinable will reduce the focus on, and weight given to, risks that actually are material. Banks are likely to distort their risk assessments to satisfy a politicized FDIC. To the extent that banks begin focusing on immaterial or lesser “climate-related” risks out of concern for satisfying politicized regulators, instead of focusing on real, material risks, the risks borne by the financial system will increase, not decrease.

3. Climate Models and Climate Science are Highly Uncertain. There is a massive amount of variance among various climate models and uncertainty regarding the future of the climate.

I am no climate science expert. Nor, I suspect, is anyone at the FDIC since climate science is way outside of the FDIC’s lane. I do know a thing or two about modeling in an economics context. Models are typically highly dependent on a few relationships specified in their equations and parameters. A small number of assumptions about relationships and parameters drive results. For example, a model examining the impact of proposed tax policy might adopt a neoclassical view where the impact of the proposed tax changes on the user cost of capital and labor response are central (as specified in the equations) and the empirical parameters (as specified in the elasticities) governing investment and labor are key.\(^5\) Seemingly small adjustments to elasticities (even though within the bounds established in the empirical literature) result in significantly different results. A Keynesian “macroeconomic” approach focusing on aggregate demand would yield dramatically different results, operate on different principles and lead to different policy recommendations. And so on.

Climate modeling is, in principle, no different. A small number of equations and empirical parameters drive results. Even the conventional governmental source -- the Intergovernmental Panel on Climate Change -- shows massive variations in projections and shows the wide divergence in the ability of models to account for past warming\(^6\) and the degree of warming that

---


\(^6\) See, for instance, Byron A. Steinman, Michael E. Mann and Sonya K. Miller, “Atlantic and Pacific Multidecadal Oscillations and Northern Hemisphere Temperatures,” Science, February 27, 2015, Vol. 347, Issue 6225, pp 988-991, [https://science.sciencemag.org/content/347/6225/988#aff-1](https://science.sciencemag.org/content/347/6225/988#aff-1) and Joseph Majkut, “Climbing the Staircase of
is anthropogenic. The worst-case concentration pathway, for example, assumes unlikely projections regarding coal usage, high population growth, low economic growth and slow technological progress. Using the worst-case scenario of these emissions concentration pathways as the business-as-usual scenario will mislead the private sector, policymakers, and regulators on the estimated climate impacts and costs. In fact, in a normal financial context, the use of such a model with such assumptions would be regarded as fraudulent.

Once you broaden your reading to include those that do not have a financial or political interest in climate change alarmism, it becomes clear that the variance and uncertainty in climate modeling is even higher than the IPCC report indicates. It is clear that various models yield dramatically different results. Explaining the details of these dramatic differences in model outcomes is beyond the scope of this letter and my current competence. It is also beyond the ability of the FDIC and its bank examiners.

4. Economic Modeling of Climate Change Effects is Even More Uncertain. There is an even higher degree of variance and uncertainty associated with attempts to model or project the economic impact of highly divergent and uncertain climate models. Any estimate of the economic impact of climate change would have to rely on highly uncertain and divergent climate model results discussed above. In addition to this high degree of uncertainty would be added an entirely new family of economic ambiguity and uncertainty. Any economic estimate of the impact of climate change would also have to choose a discount rate to arrive at the present discounted value of future costs and benefits of climate change and to estimate the future costs and benefits of various regulatory or private responses. The choice of discount rate is controversial and important. Estimates would need to be made of the cost of various aspects of


7 The sixth IPCC Synthesis Report is due out in September, 2022 https://www.ipcc.ch/reports/. See Climate Change 2014 Synthesis Report, Intergovernmental Panel on Climate Change https://www.ipcc.ch/site/assets/uploads/2018/02/SYR_AR5_FINAL_full.pdf. See, for example, “The Representative Concentration Pathways,” (p. 57); “Box 2.3, Models and Methods for Estimating Climate Change Risks, Vulnerability and Impacts,” (pp. 58-59); “Table 2.1, Projected Change in Global Mean Surface Temperature and Global Mean Sea Level Rise for the Mid- and Late 21st Century, Relative to the 1986–2005 Period,” (p. 60); “Cumulative Total Anthropogenic CO2 Emissions from 1870 (GtCO2),” (p. 63); “Table 2.2, “Cumulative Carbon Dioxide (CO2) Emission Consistent with Limiting Warming to Less than Stated Temperature Limits at Different Levels of Probability, Based on Different Lines of Evidence,” (p. 64).


climate change (sea level rises, the impact on agriculture, etc.). Estimates would need to be made of the cost of various remediation techniques. Guesses would need to be made about the rate of technological change. Guesses would need to be made about the regulatory, tax and other responses of a myriad of governments. Estimates would need to be made using conventional economic techniques regarding the economic impact of those changes which, in turn, would reflect a wide variety of techniques and in many cases a thin or non-existent empirical literature. Guesses would need to be made of market responses to all of these changes since market participants will not stand idly by and do nothing as markets and the regulatory environment change.

Then, after making decisions regarding all of these extraordinarily complex, ambiguous and uncertain issues, banks would then need to assess the likely impact of climate change on their specific business years into the future – a business that may by then bear little resemblance to its existing business. Then, the FDIC would need to assess the accuracy of the banks “risk assessment” based on this speculative house of cards. The idea that all of this can be done in a way that will meaningfully improve the regulation of the safety and soundness of banks is not credible.

5. The FDIC Does Not Possess the Expertise to Competently Assess Climate Models or the Economic Impact of Climate Change. The FDIC has neither the expertise to assess climate models nor the expertise to assess economic models purporting to project the economic impact of divergent and uncertain climate projections.

6. The FDIC Has Neither the Expertise nor the Administrative Ability to Assess the Accuracy of Banks’ Climate Change Risk Assessments. The FDIC does not have the expertise or administrative ability to assess the accuracy, or lack thereof, of banks’ “climate change risk assessments” based on bank-specific speculation regarding the impact of climate change which would be based on bank-specific choices regarding highly divergent and uncertain economic models projecting the economic impact of climate changes based on bank-specific choices regarding highly divergent and uncertain climate models.

7. FDIC Resources Are Better Spent Furthering Its Mission. Imposing these requirements and developing the expertise to police such climate change risk assessment, even if limited to large banks, will involve the expenditure of very substantial resources. If the FDIC ever extends these rules to the roughly 3,100 supervised institutions, the expenditure by the FDIC would be mammoth. These resources would be much better spent furthering the FDIC’s actual mission.

8. The Costs Imposed on Regulated Entities Would be Large. Requiring regulated entities to develop climate modeling expertise, the ability to make macroeconomic projections based on these models and then make firm-specific economic assessments based on these climate and economic models will be expensive, imposing costs that will amount to hundreds of millions of dollars (if limited to large banks) and billions of dollars if generalized. These expenses must be recovered by the banks one way or another. They would harm investors by reducing shareholder returns or customers by increasing costs (to borrowers) or returns (to depositors or other lenders).
9. If these Rules are Generalized to Apply to All Banks, Climate Change Risk Assessment Requirements Would Further Reduce the Attractiveness of Forming a New Bank and Have a Disproportionate Adverse Impact on Small Banks. Regulatory requirements imposed on large banks have a way of eventually being imposed on all banks. The large bank requirement is a trial run, a pilot program if you will. Regulatory costs do not increase linearly with size. The cost of creating a climate change risk assessment model is not much greater for a large bank than for a small one. And so on. Imposing comparable costs on small banks as large banks will make them less competitive since the costs must be spread over a smaller customer base.

10. Climate Change Risk Assessment Requirements Would Create a New Compliance Eco-System and a New Lobby to Retain the Requirements. The imposition of such requirements would result in the creation of a new compliance eco-system and pro-complexity lobby composed of the economists, accountants, attorneys and compliance officers that live off of the new requirements. This is already starting to happen.¹¹

11. Banking Laws are a Poor Mechanism to Address Externalities. Externalities, such as pollution, should be addressed by either enhancing property rights or, in the case of unowned resources such as the air and waterways, by a regulatory response that carefully assesses the costs and benefits of the regulatory response. Banking safety and soundness regulation is the wrong place to try to address externalities. Policing externalities is far outside of the scope of FDIC’s mission and the purpose of the banking laws.

12. Efforts to Redefine Materiality or the Broader Purpose of Business should be Opposed. There is a major push to redefine what is deemed material for securities regulation purposes. This “Principles” document is the beginning of a similar push with respect to determining what is material risk in banking regulation.

Simply because some politically motivated investors seek to impose a disclosure requirement on issuers, for example, does not make such a requirement material. The effort to redefine materiality in the securities laws (and now banking) is part of an increasingly strident effort to redefine the purpose of businesses more generally to achieve various social or political objectives unrelated to earning a return, satisfying customers, or treating workers or suppliers fairly. This is being done under the banner of social justice; corporate social responsibility (CSR); stakeholder theory; environmental, social and governance (ESG) criteria; socially responsible investing (SRI); sustainability; diversity; business ethics; common-good capitalism; or corporate actual responsibility. The social costs of ESG and broader efforts to repurpose business firms will be considerable. Wages will decline or grow more slowly, firms will be less productive and less internationally competitive, investor returns will decline, innovation will slow, goods and services quality will decline and their prices will increase.

Banking regulation risk assessments should be limited to those risks that impose a substantial, material financial risk for banks. Period. Full stop. While climate-related risks can fall into that category, they rarely do. And, more importantly, to the extent that they do, no additional regulation is required. The current rules would cover material risks associated with climate change.

The Social Costs of ESG

The broader social costs associated with ESG requirements can, in principle, be quantified. This section provides an analytical framework that may be useful in analyzing the social welfare costs of ESG requirements.

To the extent ESG objectives are not pursued by businesses for the purpose of making a profit, $R > R_{ESG/CSR}$, where $R$ is the rate of return on investment in the absence of ESG, CSR, sustainability requirements, diversity requirements, or stakeholder theory implementation, and $R_{ESG/CSR}$ is the rate of return after implementation of those requirements. The difference, $R - R_{ESG/CSR}$, is economically analogous to a tax. It is a reduction in return due to the pursuit of ESG objectives. Thus, $R - R_{ESG/CSR} = Tax_{ESG/CSR}$. This means that various techniques used in public finance to analyze the social welfare impact of taxes may be used to quantitatively analyze the social welfare cost of these provisions (i.e., $Tax_{ESG/CSR}$).

A tax has an excess burden or deadweight loss that can be calculated.\(^{12}\) By introducing a wedge ($Tax_{ESG/CSR}$) between, in this case, the gross return and the net return, ESG/CSR reduces the size of the capital market and therefore output and employment. In a well-functioning market, the price of a capital asset should be equal to the present value of the expected future income stream generated by the asset net of taxes and depreciation.\(^{13}\) Introducing a new tax (in this case $Tax_{ESG/CSR}$) would reduce the expected future income stream, and therefore, the price of the asset. It would also cause investment to flow out of the affected sector or jurisdiction.

Who bears the actual economic burden of the corporate income tax is an open question.\(^{14}\) The analysis of who bears the burden of $Tax_{ESG/CSR}$ would be the same. One thing is certain: It cannot be corporations. A corporation is a legal fiction, and legal fictions do not pay taxes—people pay

---


\(^{14}\)In the economics literature, this question is usually phrased as, “What is the incidence of the corporate income tax?”
taxes. The corporate tax could be borne by corporate shareholders in the form of lower returns;\textsuperscript{15} owners of all capital (again in the form of lower returns);\textsuperscript{16} corporate customers in the form of higher prices;\textsuperscript{17} or employees (in the form of lower wages).\textsuperscript{18} It is, almost certainly, some combination of these.\textsuperscript{19} The economics profession has changed its thinking on this issue several times over the past four decades, but the latest—and highly plausible—consensus is that workers probably bear \textit{more than half} of the burden of the corporate income tax because capital is highly mobile.\textsuperscript{20} Labor’s share of the corporate tax burden is potentially as high as three-quarters.\textsuperscript{21}


\textsuperscript{16}The non-corporate sector can be affected because competition will eventually cause wages, prices, and after-tax returns in the corporate and non-corporate sectors to be the same. For a more detailed explanation, see Arnold C. Harberger, “The Incidence of the Corporation Income Tax,” \textit{Journal of Political Economy}, Vol. 70, No. 3 (June 1962), pp. 215–240.

\textsuperscript{17}The focus of the economics profession to date has been almost exclusively the impact on capital and labor rather than customers.


\textsuperscript{21}Ibid.
Shareholders (investors) probably bear most of the remainder. Initially (i.e., in the short run), the impact on shareholder returns would be greater. Adjustments take time. In the long run, ESG requirements (TaxESG/CSR) would have a disproportionately negative impact on labor due to capital factor mobility.

**Specific Requests for Comment**

Question 2: How could future guidance assist a financial institution in developing its climate-related financial risk management practices commensurate to its size, complexity, risk profile, and scope of operations?

Answer 2: The FDIC has to move beyond simply making abstract demands on banks and do the hard work of explaining how climate modeling, economic modeling, bank specific assessments of climate relating risk, projections of future government policy and so forth can actually be done to the FDIC’s satisfaction. There is, quite literally, nothing in the Principles document that provides any meaningful guidance to banks about how to do these things.

Question 3: What challenges do financial institutions face in incorporating these draft principles into their risk management systems? How should the FDIC further engage with financial institutions to understand those challenges?

Answer 3: As discussed above, the challenges are legion and the FDIC, while making inordinate demands, has done nothing to address the actual problems that banks will face when they attempt to comply with these demands. Banks will be forced to choose a climate model and choose an economics model notwithstanding the enormous variance and uncertainty associated with these models. They will then be forced to make a series of guesses built on speculation about the impact on their bank and its customers based on those models and speculation about future government policies and market responses. All with no meaningful guidance from the FDIC.

Question 7: What time horizon do financial institutions consider relevant when identifying and assessing the materiality of climate-related financial risks?

Answer 7: The proper answer to this question is that they should not consider a particular time horizon but should appropriately discount the future so that costs far into the future will be discounted and only be material if extremely large. As discussed above, the choice of discount rate is extremely important.

Question 12: How could existing regulatory reporting requirements be augmented to better capture financial institutions’ exposure to climate-related financial risks?

Answer 12: The Securities Exchange Commission has proposed and will probably adopt climate change disclosure requirements that will apply to these large banks (since they are all public companies). The SEC has estimated that these rules will triple the cost of being a public company (See PRA Table 4 in the proposing release). That is enough.

---

22 As opposed to non-corporate capital and customers.
Sincerely,

[Signature]

David R. Burton  
*Senior Fellow in Economic Policy*  
The Heritage Foundation  
214 Massachusetts Avenue, NE  
Washington, DC 20002  
202-608-6229 (direct dial)  
David.Burton@heritage.org