

Kevin J. Kramp
Director, Office of Regulatory Policy,
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090

Dear Mr. Kramp:

The Natural Resources Defense Council (NRDC) thanks the Farm Credit Administration for the opportunity to comment on its advance notice of proposed rulemaking on bank liquidity regulations, and particularly appreciates the Farm Credit Administration's willingness to consider comments that "identify and raise issues pertaining to other aspects of the liquidity framework for FCS banks and associations."¹

NRDC is an international nonprofit environmental organization with more than 3 million members and online activists. Since 1970, our lawyers, scientists, and other environmental specialists have worked to protect the world's natural resources, public health, and environment. NRDC has offices in New York City, Washington D.C., Los Angeles, San Francisco, Chicago, Montana, and Beijing. Through its finance and legal experts, NRDC remains engaged in financial regulation and views working with regulators as an integral part of confronting climate change.

Other Relevant Issues: Climate-Related Financial Risks

We recommend that as it considers revisions to its liquidity regulations and other risk-based regulations for the farm credit system, the Farm Credit Administration consider the distinct risks presented by climate change. "Climate change," according to the Financial Stability Oversight Council, "is an emerging threat to the financial stability of the United States."² Emerging physical and transition risks from climate change present credit, operational, market, and ultimately liquidity risks for the farm credit system.

To identify and respond to those risks, we encourage the Farm Credit Administration to require member institutions to specifically address climate risk in their liquidity policies, and to incorporate climate-related factors in their contingency funding plans and stress testing protocols. We also encourage the Farm Credit Administration to work with other regulators to identify data gaps in climate risk assessment, including following recommendations on data gathering from the Financial Stability Oversight Council.

¹ Bank Liquidity Reserve, 86 Fed. Reg. 34,645, 34,653 (June 30, 2021).

² Financial Stability Oversight Council, *FSOC Report on Climate-Related Financial Risk* at 3 (2021).

Climate-related financial risks fall into two categories, physical risks and transition risks. “Physical risks refer to the harm to people and property arising from acute, climate-related disaster events such as hurricanes, wildfires, floods, and heatwaves as well as longer-term chronic phenomena such as higher average temperatures, changes in precipitation patterns, sea-level rise, and ocean acidification.”³ Transition risks arise “from the shifts in policy, consumer and business sentiment, or technologies associated with the changes necessary to limit climate change.”⁴

In the July 2021 meeting minutes, the Farm Credit Administration board announced formation of a Climate Task Force, stating that [a]s the safety and soundness regulator of the Farm Credit System, [the Farm Credit Administration] should dedicate more resources to identifying the potential impact on the System’s portfolio . . . [and therefore] will investigate climate-related financial risks.”⁵ NRDC agrees that there is value in examining and tracking the links between climate risk and the health of the Farm Credit Administration system.

The Biden Administration recently identified the Department of Agriculture’s loan programs as a source of climate risk.⁶ Physical risk is an obvious concern for agriculture. Heat waves are a risk for agricultural workers,⁷ and crop yields and production patterns will be affected by changes in temperature and precipitation patterns as well as catastrophic events like storms, floods, and fires. Nationally, “[d]rought and heat damage caused more than \$17 billion worth of crop loss in 2012,” while a 2014 drought in California “cost Central Valley farmers more than \$1 billion in losses.”⁸ Temperature and rainfall variation affects crop yields. “Over the past few decades, climate variability has accounted for about one-third of the global yield variability for major commodity crops like corn, rice, wheat, and soybeans.”⁹ The

³ *Id.* at 12.

⁴ *Id.* at 13.

⁵ <https://www.fca.gov/template-fca/news/2021JulyBoardMinutes.pdf>, Exhibit D.

⁶ U.S. Climate-Related Financial Risk Executive Order 14030, “A Roadmap to Build a Climate-Resilient Economy” 29-30, <https://www.whitehouse.gov/wp-content/uploads/2021/10/Climate-Finance-Report.pdf>

⁷ Juanita Constible, Bora Chang, Clare Morganelli & Nikole Blandon, “On the Front Lines: Climate Change Threatens the Health of America’s Workers” 10-11, <https://www.nrdc.org/sites/default/files/front-lines-climate-change-threatens-workers-report.pdf>.

⁸ NRDC, “Improving Climate Resilience and Soil Health,”

<https://www.nrdc.org/issues/improve-climate-resilience-and-soil-health>

⁹ Claire O’Connor & Lara Bryant, “Covering Crops: How Federal Crop Insurance Program Reforms Can Reduce Costs, Empower Farmers, and Protect Natural

reduction in yields has been even steeper in some regions. “For example, more than 60 percent of the yield variability for parts of the midwestern United States is explained by fluctuations in temperature and precipitation.”¹⁰ A changing climate will also present changing pest and disease pressures on crops.¹¹ Transition risk should not be underestimated either. Regulatory and technological changes needed to respond to physical risks could also affect agriculture, for example, governments may need to adopt new land use policies or water conservation practices. Transition and physical risk must be dealt with simultaneously, as they have the potential to occur simultaneously and in ways that amplify the underlying shocks to the financial system.

Climate risks present market, credit, operational and liquidity risks for farm lenders. The physical risks outlined above – floods, droughts, wildfires, and storms – create repayment risks for farm loans. “For example, following severe flooding in the spring of 2019, bankers lending in the Midwest reported to the Federal Reserve Bank of Chicago that about 70 percent of their borrowers were at least moderately affected by extreme weather events in the first half of the year. At the same time, the portion of the region’s agricultural loan portfolios reported as having ‘major’ or ‘severe’ repayment problems hit its highest level in 20 years.”¹² Those risks will be geographically concentrated. Most agriculture banks are in the Midwest, and many of them “are small and highly exposed to impacts that reduce farmers’ ability to service their debts, including climate-exacerbated extreme weather events.”¹³ On a sufficiently wide scale, weather events that impact the farm lending system could imperil farmers’ access to credit,¹⁴ with downstream market and liquidity risks for the farm lending system itself. Typically, climate change-driven liquidity risks will first appear as credit, market, or operational risks “because typically climate change risk is unlikely to make an asset less liquid without making the asset lose value, making a borrower insolvent, or disrupting financial infrastructure.”¹⁵ Transition risks – particularly the risk of changes in investor

Resources” at 5, <https://www.nrdc.org/sites/default/files/federal-crop-insurance-program-reforms-ip.pdf>.

¹⁰ *Id.*

¹¹ Ben Chou, Claire O’Connor & Lara Bryant, “Climate-Ready Soil: How Cover Crops Can Make Farms More Resilient to Extreme Weather Risks” at 2, <https://www.nrdc.org/sites/default/files/climate-ready-soil-IB.pdf>.

¹² Managing Climate Risk in the U.S. Financial System: Report of the Climate-Related Market Risk Subcommittee, Market Risk Advisory Committee of the U.S. Commodity Futures Trading Commission at 34-35 (2020).

¹³ *Id.* at 35.

¹⁴ *Id.*

¹⁵ Nahomy Alvarez, Alessandro Cocco & Ketan B. Patel, “A New Framework for Assessing Climate Change Risk in Financial Markets” Chicago Fed Letter No. 448 (Nov. 2020), <https://www.chicagofed.org/publications/chicago-fed-letter/2020/448>. A proactive approach to climate-related liquidity risk is warranted here because, as noted

appetite for certain issuers – can create independent liquidity risks, however, if secondary purchasers decided to no longer accept certain types of loans or collateral, making those loans illiquid.¹⁶

Innovative farming practices can mitigate climate risks, however. Many farmers are undertaking practices to boost soil health and use water more efficiently to make their farms more resilient to climate change. NRDC has identified practices with positive benefits, including increasing the diversity of crops, animals, and ecosystems on farms,¹⁷ planting cover crops,¹⁸ using crop rotation techniques and reducing mechanical tilling,¹⁹ reducing reliance on synthetic inputs like fertilizers and herbicides,²⁰ and composting to reduce methane emissions and promote closed-loop practices and reduce waste.²¹ These practices are doubly beneficial because they are resilient against the effects of climate change while also reducing agriculture’s overall contribution to climate change.

The Federal Crop Insurance Program is another program imbedded into the credit system capable of helping to manage climate risk. Recently, the Department of Agriculture created the Pandemic Cover Crop Program (PCCP), providing a \$5 per acre subsidy for farmers to plant cover crops.²² For individual farmers, and the lending institutions participating in the Farm Credit System, greater participation in the good steward credit for cover crops is a tool to manage climate risk.²³ Another element of

by the Farm Credit Administration in its Advanced Notice of Proposed Rulemaking, “the System depends on continuing access to the capital markets to obtain the funds necessary to extend credit to agriculture, aquaculture, rural utilities, and rural housing.” Bank Liquidity Reserve, 86 Fed. Reg. at 34,646. In the event of capital markets disruptions, System “banks must have enough readily available funds and assets that can be quickly converted into cash to continue operations and pay maturing obligations. Unlike commercial banks, the System does not have a lender of last resort and does not have a guaranteed line of credit from the U.S. Treasury or the Federal Reserve.” *Id.*

¹⁶ *Id.*

¹⁷ Arohi Sharma, Lara Bryant, Ellen Lee & Claire O'Connor, “Regenerative Agriculture Part 3: The Practices,” <https://www.nrdc.org/experts/aro-hi-sharma/regenerative-agriculture-part-3-practices>.

¹⁸ Chou, O'Connor & Bryant, *supra* n. 12, at 4.

¹⁹ *Id.* at 5.

²⁰ Sharma, Bryant, Lee & O'Connor, *supra* n. 12.

²¹ *Id.*

²² <https://www.farmers.gov/cover-crops>

²³ As the FCA reviews the impacts of the cover crop program as a climate smart practice that can decrease long term climate risk, the United States Department of Agriculture’s Risk Management Agency may be able to provide modeling and data on utilization of

managing that risk involves assisting beginning and small farmers, many of whom are particularly vulnerable to the uncertainties posed by the changing climate. Given that the FCA is statutorily directed to help young, beginning, and small farmers and ranchers pursuant to 12 U.S.C. § 2207, there is a link between managing the risk of these loans and helping these farmers participate innovative practices that make their operations more resilient.²⁴

Recommendations

“Congress established the Farm Credit System in order to ‘improv[e] the income and well-being of American farmers and ranchers by furnishing sound, adequate, and constructive credit . . . to them.’” *La. Fed. Land Bank Ass’n, FLCA v. Farm Credit Admin.*, 336 F.3d 1075, 1078 (D.C. Cir. 2003) (quoting 12 U.S.C. § 2001(a)). The FCA has authority to regulate and conduct oversight of the Farm Credit System, including by prescribing capital requirements and liquidity practices at System institutions. 12 U.S.C. §§ 2243, 2252, 2254(a); *see also id.* § 2015(b)(4)(A). As the Farm Credit Administration considers revisions to its liquidity regulations, we recommend that it consider the following issues:

- Member institutions should specifically address climate risk in their liquidity policies, and incorporate climate-related factors in their contingency funding plans and stress testing protocols. Among other factors, liquidity-related policies at member institutions should consider and appropriately weigh the benefits of climate resilient farming practices.
- Member institutions should be encouraged to track and promote programs like the Pandemic Cover Crop Program (PCCP) as good stewardship financial management tools.
- The Farm Credit Administration should join with other regulators to identify data gaps in climate risk assessment, including following recommendations on data gathering from the Financial Stability Oversight Council.
- Consistent with the Financial Stability Oversight Council’s recent recommendations, we encourage the Farm Credit Administration to remember that “[t]he adverse effects of climate change are likely to be disproportionately borne by financially vulnerable communities, including low-income communities, communities of color, and Native-American communities. . . . [A]ddressing the impacts of climate change

the Pandemic Cover Crop Program (PCCP). PCCP utilization could be a proxy data point as member institutions seek to limit climate risk, and by association strengthen the stability of the farm credit system.

²⁴ Chou, O’Connor & Bryant, *supra* n. 12, at 4.

on disadvantaged communities will require thoughtful and balanced policy responses developed through a coordinated approach involving stakeholders across the public and private sectors.”²⁵

- The FCA’s young, beginning, and small farmers and rancher assistance program could be a tool for educating farmers about the risks to climate change and as a tool to decrease the risk profile of these loans.
- Finally, if the Farm Credit Administration adopts the Basel III Liquidity Framework, it should also issue guidance to member institutions on how climate risk should be considered under that framework. At a minimum, FCA’s guidance should incorporate any changes to the Basel III Framework in the Basel Committee’s forthcoming climate risk recommendations.²⁶

We thank the Farm Credit Administration for its consideration of our comments. Please let us know if we can be of further assistance.



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²⁵ Financial Stability Oversight Council, *supra* note 2, at 4.

²⁶ Press Release, Bank for International Settlements, *Basel Committee advances work on addressing climate-related financial risks, specifying cryptoassets prudential treatment and reviewing G-SIB assessment methodology* (Nov. 9, 2021), <https://www.bis.org/press/p211109.htm>.