March 30, 2023

SUBMITTED VIA ELECTRONIC MAIL TO *reg-comm@fca.gov*

Joseph T. Connor
Acting Director, Office of Secondary Market Oversight
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102–5090

Dear Mr. Connor,

The Natural Resources Defense Council (NRDC) thanks the Farm Credit Administration (FCA) for the opportunity to comment on its Advance Notice of Proposed Rulemaking (ANPR) on potential updates to the regulatory capital framework for the Federal Agricultural Mortgage Corporation ("Farmer Mac"). We recommend that as it considers adopting principles of the Basel Committee on Banking Supervision's ("Basel Committee") consolidated Basel Framework in the regulatory capital framework for Farmer Mac, the Farm Credit Administration also incorporate the guidance issued last year by the Basel Committee on bank management of climate-related financial risks.[1]

NRDC is an international nonprofit environmental organization with more than three 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 advocates for sensible financial regulation that allows our financial system to incorporate financial risks from climate change into day-to-day risk management.

Background

As described in the ANPR, Farmer Mac provides a secondary market for agricultural real estate mortgage loans, rural housing mortgage loans, and rural utilities loans. It purchases and securitizes these loans, adding its guarantee. In this

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[1] Basel Committee on Banking Supervision, *Principles for the effective management and supervision of climate-related financial risks* (June 2022), available at https://www.bis.org/bcbs/publ/d532.pdf

way, it provides liquidity to these loan markets, much as the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") provide liquidity in the U.S. home mortgage market.[2]

FCA has requested public input on the ANPR in order to assess whether and how it should enhance Farmer Mac's regulatory capital framework by incorporating elements of the consolidated Basel Framework, in order more broadly to promote Farmer Mac's safety and soundness through the maintenance of sufficient capital and reserves. While the Basel Framework addresses several categories of risk, we focus our comments on financial risks arising from climate change.

"Other Risk Categories": Climate-Related Financial Risk

"Climate change," according to the Financial Stability Oversight Council, "is an emerging threat to the financial stability of the United States."[3] Emerging physical and transition risks from climate change present credit, operational, market, and ultimately liquidity risks for the farm credit system.

Climate change has caused and will continue to cause serious harms to U.S. agricultural production. The U.S. Department of Agriculture ("USDA") has noted that the operations of agricultural producers and land managers across the country are being affected by shifting weather patterns and increasingly frequent and severe storms, floods, drought, and wildfires.[4] USDA's *Action Plan for Climate Adaptation and Resilience,* released in October 2021, identified a wide range of climate risks to U.S. agricultural operations:

1. Decreased agricultural productivity due to climate effects including changes in temperature and precipitation patterns and increased frequency and intensity of extreme weather events, as well as secondary effects such as increased pest and disease pressures, decline in pollinator health, reduced crop and forage quantity and quality, and infrastructure damage.
2. Threats to water quantity and quality as a result of earlier snowmelt, reduced water supply, more intense and frequent drought, degraded water quality, excess soil moisture, and greater flooding.

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[2] Federal Agricultural Mortgage Corporation Funding and Fiscal Affairs; Risk-Based Capital Requirements, 88 Fed. Reg. 4107, 4108 (Jan. 24, 2023).

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

[4] U.S. Dept. of Agriculture, *Climate Change Affects U.S. Agriculture and Rural Communities,* available at https://www.usda.gov/climate-solutions.

3. Shocks due to extreme climate events including hurricanes, floods, and fires.
4. Stress on natural and built infrastructure. Changes in flood frequency, wildfire intensity, sea level, and extreme precipitation events can cause damage to low-elevation infrastructure, threaten utilities and air quality, endanger coastal communities, and increase erosion and landslides.
5. Socially disadvantaged, low-income, minority, and rural populations as well as American Indians Alaska Natives, and sovereign Tribal governments are more likely to be vulnerable to these effects of climate change. These communities' ability to adapt to a changing climate is often limited by financial, social, and other constraints.[5]

A recent survey by Deloitte Consulting LLP and Environmental Defense Fund of 167 agricultural finance institutions in North America, Europe and India found that 87% of them expect climate change to pose a material risk to their business.[6] At the same time, only 24% – and only 8% of U.S. respondents – were significantly factoring climate change effects into their current decision-making.[7]

Financial risks arising from climate change are particularly relevant to Farmer Mac, because it purchases loans that are selected by the lending banks from their own portfolios. These loans are likely to be among the higher-risk loans originated by the lending banks. As the effects of climate change continue to increase, the related financial risks thus are likely to have a concentrated effect on Farmer Mac's loan portfolio and on its capital.

In its July 2021 meeting minutes, the FCA board announced the formation of a Climate Task Force to "investigate climate-related financial risks", in order to "evaluate any potential risk that climate poses to the Farm Credit System through possible impacts on land values, crop productivity, animal health, and rural economies."[8] We agree that there is value in examining and tracking the links between climate risk and the health of the FCA system. We also note in this respect that the Federal Reserve Board of Governors, the FDIC, and the OCC all have proposed principles for climate-related financial risk management for the largest financial institutions, that are intended to support efforts by those institutions to incorporate climate-related financial risks into their risk management

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5 U.S. Department of Agriculture*, Action Plan for Climate Adaptation and Resilience,* October 2021, available at https://www.sustainability.gov/pdfs/usda-2021-cap.pdf.

6 Environmental Defense Fund and Deloitte Consulting LLP, The Impacts of Climate Change on Agricultural Finance at 9 (2022), available at https://business.edf.org/files/impacts-climate-change-agricultural-finance-survey.pdf

7 Id. at 12.

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

frameworks.[9] As a safety and soundness regulator, the FCA should require Farmer Mac to begin to identify and quantify climate-related financial risks to its business, and to incorporate material climate risks into its capital adequacy assessment processes.

Basel Committee Guidance: Climate-Related Financial Risks

The Basel Committee has provided guidance that incorporates climate-related financial risks within the consolidated Basel Framework. To address these risks in the banking sector, in 2020 the Committee established a Task Force on Climate-Related Financial Risks. After analyzing the risks posed by climate change and the financial implications of those risks for banks and the banking system, the Committee considered the extent to which those risks may be addressed within the Framework, concluding that banks and banking supervisors could benefit from further guidance specific to climate risk.[10]

That guidance, issued by the Basel Committee in June 2022, includes 18 principles for banks and prudential supervisors. The principles are intended to accommodate a "diverse range of banking systems", and to be applied "on a proportionate basis depending on the size, complexity and risk profile" of the relevant bank or banking sector.[11] Principles 1 through 12 provide guidance on how banks can effectively manage climate-related financial risks.[12] Among these, Principle 5 ("Capital and liquidity adequacy") is particularly relevant to FCA's request for comment in the ANPR on whether there are other risk categories that it should consider in updating Farmer Mac's regulatory capital framework[13]:

> <u>Principle 5</u>: Banks should identify and quantify climate-related financial risks and incorporate those assessed as material over relevant time

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9 Principles for Climate-Related Financial Risk Management for Large Financial Institutions, 87 Fed. Reg. 75267 (Dec. 8, 2022) (Federal Reserve Board of Governors); Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions, 87 Fed. Reg. 19507 (Apr. 4, 2022) (FDIC); Office of the Comptroller of the Currency, Principles for Climate-Related Financial Risk Management for Large Banks (Dec. 2021).

10 Basel Committee on Banking Supervision, supra n.1 at 1.

11 *Id.* at 2.

12 *Id.* at 1. Principles 13 through 18 provide guidance for prudential supervisors, on prudential regulatory and supervisory requirements for banks and on responsibilities, powers and functions of supervisors. While we encourage FCA to consider these principles in its oversight of Farm Credit System financial institutions, they are not relevant to this ANPR.

13 Federal Agricultural Mortgage Corporation Funding and Fiscal Affairs; Risk-Based Capital Requirements, 88 Fed. Reg. 4107, 4111 (Jan. 24, 2023).

> horizons into their internal capital and liquidity adequacy assessment processes, including their stress testing programmes where appropriate.[14]

As delineated further in the guidance, this principle would imply the following (as applied to Farmer Mac):

- Farmer Mac should develop processes to evaluate the solvency impact of climate-related financial risks that may materialize within its capital planning horizons.
- Farmer Mac should include in its internal capital adequacy assessment process any climate-related financial risks it assesses as material over relevant time horizons, that may impair its capital position (through their effect on traditional risk categories).
- Farmer Mac should assess whether climate-related financial risks could cause net cash outflows or depletion of its liquidity buffers, assuming both business-as-usual and stressed conditions (considering severe but plausible scenarios). Farmer Mac should include in its internal liquidity adequacy assessment process any climate-related financial risks it assesses as material over relevant time horizons, that may impair its liquidity position.
- Incorporating material climate-related financial risks as described above includes, where appropriate, incorporating physical and transition risks that are relevant to Farmer Mac's business and exposure profile, and that are assessed as material over relevant time horizons, into Farmer Mac's stress testing programs in order to evaluate its financial position under severe but plausible scenarios. (As a resource for climate-related stress testing, FSA and Farmer Mac may wish to consider taking advantage of the hypothetical climate scenarios designed by the Network of Central Banks and Supervisors for Greening the Financial System.[15])
- Understanding that the methodologies and data used to analyze climate-related financial risks will continue to mature over time, Farmer Mac should begin building risk analysis capabilities by (i) identifying relevant climate-related risk drivers that may materially impair its financial condition, (ii) developing key risk indicators and metrics to quantify exposures to these risks, and (iii) assessing the links between climate-related financial risks and traditional financial risk types such as credit and liquidity risks.

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14 Basel Committee on Banking Supervision, supra n.1 at 4.

15 The Network of Central Banks and Supervisors for Greening the Financial System ("NGFS") is a group of central banks and supervisors that shares best practices and works to contribute to the development of environment- and climate-related risk management in the financial sector, among other things. https://www.ngfs.net/ngfs-scenarios-portal/about . The scenarios are available at https://www.ngfs.net/ngfs-scenarios-portal/

In sum, climate-related risks generate increasing financial risk that is likely to affect Farmer Mac's capital, and the Basel Committee has provided guidance specific to these risks that supplements the Basel Framework. We therefore encourage the Farm Credit Administration to include the Basel Committee's climate risk guidance in its update to Farmer Mac's capital framework, and to require Farmer Mac to identify and quantify climate-related financial risks and incorporate those assessed as material over relevant time horizons into its internal capital and liquidity adequacy assessment processes.

We thank FCA for its consideration of these comments, and are happy to provide further information on request.

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