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The Fed will conduct climate-related scenario analysis with six major banks

Article

The news: The Federal Reserve will conduct a 2023 climate-related scenario analysis pilot in which six major banks will participate, per Banking Dive.

Exploratory analysis: The study will begin in early 2023 and conclude around the end of next year. Participants include **Bank of America**, **JPMorgan Chase**, **Citi**, **Morgan Stanley**, **Goldman Sachs**, and **Wells Fargo.**

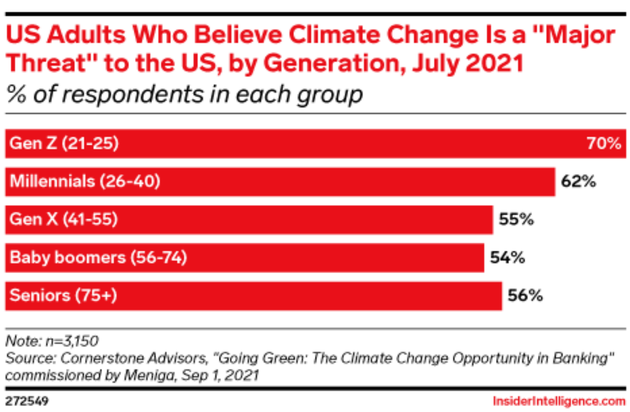
- Before the pilot starts, the Fed will outline the scenarios it will test, including climate, economic, and financial variables.
- Results from the study will be published in aggregate when the pilot ends. Firm specific details will not be published.

The study seeks to provide insight into how firms can measure and manage climate-related financial risk. The pilot is exploratory and separate from the annual stress tests that the Fed conducts, and it won't impact capital requirements.

An emerging trend? The pilot resembles the climate-related scenario analysis that the European Central Bank (ECB) conducted, along with its biennial bank stress testing earlier this year.

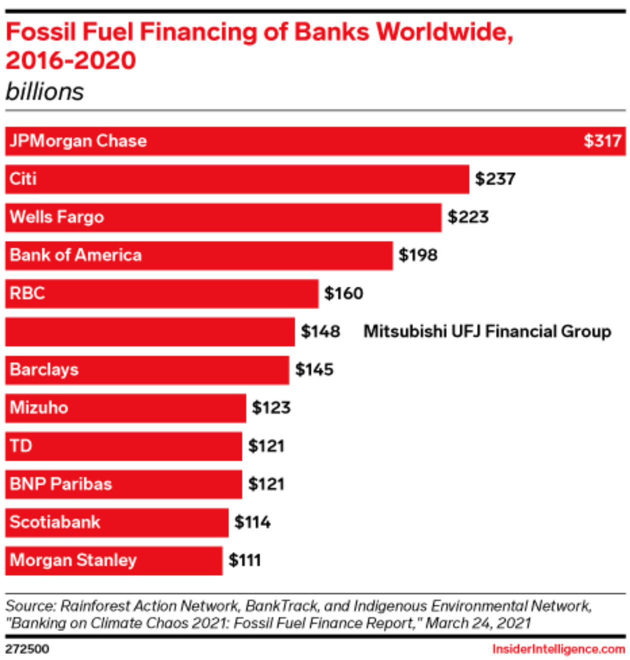
- Those tests evaluated how banks would hold up through various scenarios, and consisted of three modules: a questionnaire on banks' capacity to conduct the climate stress tests; a comparative analysis on the sustainability of the banks' business models and their exposure to companies that produce the most emissions; and a bottom-up stress test.

With the US conducting similar tests—further details will be released in the coming months—we could see these scenarios becoming a larger part of bank stress testing globally.



A confusing time for climate initiatives: Banks globally have made huge promises to reduce carbon emissions to zero and to cut investment in fossil fuels and other climate-harming industries. But they're realizing that reaching these goals is going to be difficult, and it's also straining their relationships with some investors.

- Over this past month, two pension funds left the Glasgow Financial Alliance for Net Zero (Gfanz), and now a number of large banks, like JPMorgan and Bank of America, are threatening to leave as well due to uncertainty around the legal risks tied to strict targets on cutting fossil fuel use.
- Multiple states in the US have banned doing business with banks that are pledging to cut ties with oil and gas industries. This has triggered firms like Goldman Sachs and JPMorgan to compose letters highlighting the billions of dollars in financing that they provide to the fossil fuel industry.



Our take: Banks are understandably concerned about their bottom line and they're in a tough position when it comes to balancing climate-related risk and growing their profits. But they need to keep the bigger picture in mind.

- The ECB said **it expects to converge on a methodology for climate-related stress tests that will eventually inform capital reserve requirements.**
- Additionally, consumers are vocal about banks' climate efforts. **One in four customers said they'd leave their bank over poor environmental and social track records**, per Kearney data.

Banks that include climate-related risk assessments in their planning will have greater long-term success with consumers and regulators.

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