September 8, 2023

SUBMITTED ELECTRONICALLY AT *https://comments.cftc.gov*

Commodity Futures Trading Commission
Attn: Christopher Kirkpatrick, Secretary of the Commission
Three Lafayette Centre
1155 21st St. NW
Washington, DC 20581

RE: Risk Management Program Regulations for Swap Dealers, Major Swap Participants, and Futures Commission Merchants (RIN 3038–AE59)

Dear Mr. Kirkpatrick,

The Natural Resources Defense Council (NRDC) welcomes the opportunity to comment on the Commodity Futures Trading Commission (CFTC)'s Advance Notice of Proposed Rulemaking (the Notice) titled "Risk Management Program Regulations for Swap Dealers, Major Swap Participants, and Futures Commission Merchants".[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, New Delhi 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.

Introduction

"Climate change," according to the Financial Stability Oversight Council, "is an emerging threat to the financial stability of the United States."[2] In announcing the

[1] Commodity Futures Trading Commission, *Risk Management Program Regulations for Swap Dealers, Major Swap Participants, and Futures Commission Merchants,* 88 Fed. Reg. 45826 (July 18, 2023).

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

formation of the Commission's Climate Risk Unit (CRU), Chairman Behnam noted the need for the Commission to "move urgently and assertively in utilizing our wide-ranging and flexible authorities" to address this emerging risk.[3]

We therefore encourage the Commission to:

- Include climate-related financial risk among the risks specifically enumerated in the RMP Regulations;
- Define climate-related financial risk in a manner that clarifies that it includes both physical and transition risk;
- Provide guidance to CFTC-regulated entities on the ways in which climate-related financial risk can manifest in the form of the traditional risks they already manage, including those risks currently enumerated in the RMP Regulations; and
- Consider aligning that guidance, as appropriate, with relevant aspects of the "Principles for the effective management and supervision of climate-related financial risks" published by the Basel Committee on Banking Supervision.[4]

If the Commission does not include climate-related financial risk as a specifically enumerated risk in the RMP Regulations, it should at a minimum state explicitly in the RMP Regulations that climate-related financial risk must be incorporated into the identification and management of the enumerated risks, and into written risk management policies and procedures and risk exposure reporting, under the RMP Regulations.

Our comment addresses Question B.7 in the Notice, and its subparts.

Background

An overarching goal of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act")[5] was to prevent a repeat of the global financial crisis of 2008. The Dodd-Frank Act's reforms were therefore designed to promote the safety and soundness of U.S. financial institutions and the financial system. They included, among other things, provisions that provide for the regulation of swap dealers and major swap participants (MSPs, and together with

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[3] Press Release No. 8368-21, Commodity Futures Trading Commission, CFTC Acting Chairman Behnam Establishes New Climate Risk Unit (Mar. 17, 2021), https://www.cftc.gov/ PressRoom/PressReleases/8368-21#:~:text= Washington%2C%20D.C.%20—%20Commodity%20Futures%20Trading,transitioning%20to%20a%20low%2Dcarbon

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

[5] Pub. L. No. 111-203, 124 Stat. 1376 (2010) ("Dodd-Frank Act").

swap dealers, SDs[6]), and that enhance the Commission's rulemaking authority with respect to all the entities subject to its oversight, including futures commission merchants (FCMs).

As outlined in the Notice, the Dodd-Frank Act added section 4s(j) to the Commodity Exchange Act, among other things requiring SDs to "establish robust and professional risk management systems adequate for managing [their] day-to-day business"[7], and directing the Commission to prescribe rules governing the duties of SDs, including the duty to establish risk management procedures.[8] The Commission subsequently adopted Regulation 23.600[9] establishing requirements for the development, approval, implementation, and operation of risk management programs (RMPs) by SDs. Seeking to enhance the protection of customers and customer funds held by FCMs, it later adopted Regulation 1.11[10] establishing RMP requirements for FCMs that are largely aligned with the corresponding requirements in Regulation 23.600 (together with those in Regulation 1.11, the "RMP Regulations"). Among other things, the RMP Regulations enumerate specified types of risks that RMPs are required to take into account.

Importantly, Regulations 23.600 and 1.11 were adopted over and nearly a decade ago, respectively.[11] Since that time, climate-related financial risk has increased and become more visible and quantifiable. At the same time, regulators and market participants have gained a greater understanding of the different ways in which climate risk can manifest as financial risk. The Commission has gathered insights over the last 10 years into the workings of the RMP Regulations, including enumerated areas of risk. We applaud the Commission's determination to revise these regulations, and we believe that explicitly incorporating climate-related financial risk in the RMP Regulations will help to clarify the Commission's "understanding of how specific risk exposures are being monitored and managed

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6 As stated in the Notice, there are currently no registered MSPs, and the requirements of section 23.600 apply to both swap dealers and major swap participants.

7 7 U.S.C. § 6s(j)(2).

8 7 U.S.C. § 6s(j)(7).

9 17 C.F.R. § 23.600 ("Risk Management Program for swap dealers and major swap participants").

10 17 C.F.R. § 1.1 ("Risk Management Program for futures commission merchants").

11 Swap Dealer and Major Swap Participant Recordkeeping, Reporting, and Duties Rules; Futures Commission Merchant and Introducing Broker Conflicts of Interest Rules, and Chief Compliance Officer Rules for Swap Dealers, Major Swap Participants, and Futures Commission Merchants, 77 Fed. Reg. 20128 (April 3, 2012); Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations, 78 Fed. Reg. 68506 (Nov. 14, 2013).

by individual SDs and FCMs over time, as well as across SDs and FCMs during a specified time period."[12]

Question B.7. Are there any other types of risk that the Commission should consider enumerating in the RMP Regulations as risks required to be monitored and managed by SDs' and FCMs' RMPs? . . . Climate-related financial risk, including physical risk and transition risk such as the energy transition?

We encourage the Commission to include climate-related financial risk among the enumerated risks in the RMP Regulations. Emerging physical and transition risks from climate change present market, credit, operational, and ultimately liquidity risks for various sectors relevant to commodity derivatives market participants. For one, 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.[13] 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.[14] At the same time, only 24% – and only 8% of U.S. respondents – were significantly factoring climate change effects into their current decision-making.[15] As another example, in the event of a speedy transition to a net-zero economy, the fossil fuel industry – representing roughly three-quarters of U.S. energy production – may suffer from stranded assets totaling in the trillions of dollars.[16] Financial market participants dealing in these commodities must adapt to this new landscape by devising new ways to price and manage climate-related financial risk.

Many financial institutions may fail to manage climate-related financial risk for the simple reason that they fail to recognize it, in particular if their primary regulators fail to focus on climate risk as a financial risk. The Federal Reserve Board of

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12 88 Fed. Reg. at 45828.

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

14 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

15 *Id.* at 12.

16 *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 (Sept. 2020), at 19 (internal citations omitted) ("CFTC Climate Subcommittee Report").

Governors' report issued recently on the failure of Silicon Valley Bank highlights among its conclusions that a "foundational piece of any risk-management framework is the ability to identify material risks," and that severe consequences can flow from weak risk identification.[17]

We urge the Commission therefore to move forward with rule amendments to explicitly require the risk management programs of SDs and FCMs to effectively identify material climate-related financial risks and incorporate the management of those risks into their policies and procedures, risk tolerance limits, risk exposure reporting, monitoring, and all other aspects of their risk management programs. The best way to ensure that SDs and FCMs will recognize and manage climate-related financial risk is to include it among the enumerated risks in the RMP Regulations. If the Commission does not include climate-related financial risk as a specifically enumerated risk, it should at a minimum state explicitly in the RMP Regulations that climate-related financial risk must be incorporated into the identification and management of the enumerated risks, and into written risk management policies and procedures and risk exposure reporting, under the RMP Regulations.

Question B.7.a. Should these potential new risks be defined in the RMP Regulations?

Climate-related financial risk should be defined in the RMP Regulations in a manner that clarifies that it encompasses two broad categories of risk: physical risk and transition risk.

Physical risks are the risks of harm to people and property from acute, climate-related disaster events such as hurricanes, wildfires, floods, and heatwaves, as well as longer-term chronic phenomena like higher average temperatures, droughts and other changes in precipitation patterns, sea level rise, and ocean acidification.[18] They include the potential for higher frequency and severity of such disruptive events and phenomena. All of these can cause financial losses to farmers, ranchers, and producers; these losses in turn affect the commodity derivatives markets. Acute climate events may also cause mass displacements of

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17 Board of Governors of the Federal Reserve System, *Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank* (April 2023), 95-96, https://www.federalreserve.gov/publications/review-of-the-federal-reserves-supervision-and-regulation-of-silicon-valley-bank.htm

18 *See, e.g.,* Financial Stability Oversight Council, *Climate-related Financial Risk: 2023 Staff Progress Report* (July 2023), 3, https://home.treasury.gov/system/files/261/FSOC-2023-Staff-Report-on-Climate.pdf

people, which may have negative consequences for financial institutions and markets with activities focused in the affected region.

Transition risks are associated with the uncertain financial effects that could result from the economy and society's movement to reduce greenhouse gas emissions and transition to renewable energy; these risks can result from technological breakthroughs or limitations, policy changes, and shifts in consumer preferences and social norms. Examples include risks of declining value of fossil fuel reserves, declining vitality of fossil fuel production and service businesses, and adverse economic effects on fossil fuel commodity prices. Transition risk could pose widespread challenges to financial markets as entire industries face restructuring during a shift to a low-carbon economy.

The physical and transition risks associated with climate change may affect the commodities and derivatives markets in a range of ways, including the sudden and disruptive repricing of assets, financial intermediaries experiencing significant losses, the impairment of financial market functioning, and the need for markets and market participants to adapt to rapid changes in policy, technology, and consumer preferences. Finally, physical and transition risks are likely to unfold in parallel, interacting in unforeseeable ways, and exacerbating pre-existing financial system vulnerabilities (for example, high interest rates and persistent inflation[19]).

Question B.7.b. With respect to each newly suggested enumerated risk, what, if any, specific risk considerations should an SD's or FCM's RMP policies and procedures be required to include?

Climate-related financial risks can manifest in the form of a wide range of traditional risks to financial institutions, including the risks currently enumerated in the RMP Regulations. We encourage the Commission, in adopting amendments to the RMP Regulations, to issue guidance on the forms these climate-related financial risks may take. For example, with respect to many of the risks currently enumerated in the RMP Regulations:

- *Market risk.* The Commission considers market risk to include, among other things, market exposure, price volatility, basis and correlation risk, leverage, sensitivity of option positions, and position concentration.[20] Climate-related events can have a significant effect on commodity prices. Commodities like raw materials and agricultural products have supply

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19 *See, e.g.,* U.S. Dept. of Treasury, *Financial Stability Report* (May 2023) at 3, 7, https://www.federalreserve.gov/publications/files/financial-stability-report-20230508.pdf

20 17 C.F.R. § 23.600(c)(4)(i)(A).

chains that are particularly vulnerable to climate risk. The prices of assets exposed to physical climate risks or transition risks may be inflated due to market opacity, underestimation of the relevant risks, and the potentially correlated nature of risks. A significant climate event can trigger a sudden re-valuation of assets or asset classes. A re-valuation can also be triggered by businesses' efforts to mitigate their exposure to such an event; for example, by suddenly exiting short-term assets that are exposed to climate-related financial risk.[21]

- *Credit risk.* The Commission considers credit risk to include, among other things, credit exposure, and valuation and safeguarding of collateral used to cover credit exposures.[22] Counterparties whose business or balance sheet is centered on particular commodities are particularly vulnerable to the market risks described above; credit risk analyses must take account of these counterparty risks.
- *Liquidity risk.* The Commission considers liquidity risk to include, among other things, liquidity needs, the ability to liquidate non-cash collateral in a timely manner and without a significant effect on price, and appropriate collateral haircuts.[23] Climate disasters may lead to commodity price volatility, for example when storage facilities are damaged, raising costs for contracting parties supplying the physical commodity. High volatility, in turn, may result in margin calls by clearinghouses and greater pressure on short-term funding markets. This may coincide with other institutions, such as insurers and reinsurers, tapping the markets to fund payouts related to the same disaster, resulting in a liquidity crunch that temporarily interferes with the smooth functioning of futures markets.[24]

- *Foreign currency risk.* The Commission considers foreign currency risk to include, among other things, fluctuations in the value of foreign currency.[25] Both geographic factors and national policy choices can influence the manner and extent to which climate change is likely to affect the economic

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21 *See, e.g.,* Graham Steele, *Confronting the Climate "Lehman Moment": The Case for Macroprudential Regulation,* Cornell Journal of Law and Public Policy 30:109, 124-25 (2020).

22 17 C.F.R. § 23.600(c)(4)(ii).

23 17 C.F.R. § 23.600(c)(4)(iii).

24 CFTC Climate Subcommittee Report, *supra* n. 16 at 29.

25 17 C.F.R. § 23.600(c)(4)(iv).

growth, national productivity and capital flows of particular nations, in turn affecting currency markets.[26]

- *Legal risk.* Climate-related risk may affect the legal and regulatory environment in which commodities businesses operate. Energy companies, for example, are facing a range of lawsuits seeking to compel adaptive measures[27], or seeking money damages to redress climate-related harms.[28]

- *Operational risk.* The Commission requires the management of operational risk to include, among other things, secure and reliable operating and information systems (with independence from business trading units); safeguards to detect, identify, and promptly correct deficiencies in those systems; and the ability to reconcile data and information in those systems.[29] Regional climate disasters could result in widespread impairment of commodity market infrastructures or systems. For instance, a weather disaster may affect the physical operations of FCMs/SDs themselves, or the operations of multiple counterparties or clearing houses, causing cascading failures across other institutions or sectors. Risk management units should consider how acute climate events or long-term climate shifts may adversely effect operations and operational resilience across business lines, including third-party operations.[30]

Climate-related financial risk therefore can be managed within the existing programs and frameworks for managing risk. At the same time, market participants should note that unique difficulties in calculating climate-related financial risks can result in failures to manage those risks adequately. Climatological forecasts suggest the risk of increasing new disruptions in weather systems, water supplies, agricultural production, and the habitability of different

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[26] *See, e.g.,* Greg Ritchie, "Barclays Says Climate Disaster Will Collapse Major Currencies", Bloomberg, June 14, 2022, https://www.bloomberg.com/news/articles/2022-06-14/barclays-says-climate-disaster-will-collapse-major-currencies#xj4y7vzkg

[27] *See, e.g.,* Conservation Law Foundation v. ExxonMobil Corp., Case 1:16-cv-11950-MLW (D.Mass., pending).

[28] *See, e.g.,* State of Rhode Island v. Chevron Corp, PC-2018-4716 (R.I. Super. Ct. 2020); Mayor & City Council of Baltimore v. BP P.L.C., 388 F. Supp. 3d 538 (D. Md. 2019); City of Oakland v. BP P.L.C., 325 F. Supp. 3d 1017 (N.D. Cal. 2018); City of New York v. BP P.L.C., 325 F. Supp. 3d 466 (S.D.N.Y. 2018). *See generally* Gundlach, J., "Climate risks are becoming legal liabilities for the energy sector". Nature Energy, 5, 96 (2020).

[29] 17 C.F.R. § 23.600(c)(4)(vi).

[30] *See, e.g.,* Office of the Comptroller of the Currency, *Principles for Climate-Related Financial Risk Management for Large Banks* (Dec. 2021), https://www.occ.gov/news-issuances/bulletins/2021/bulletin-2021-62a.pdf , at 5.

regions.[31] As a result of these shifts, traditional backward-looking risk assessments and existing climate-economic models are inherently flawed when it comes to calculating certain climate-related risks. Traditional risk management approaches generally are based on historical data and on assumptions that shocks are normally distributed. But climate-related risks have only begun to materialize; as a result, extrapolating based on historical trends may result in mispricing of those risks.[32]

Question B.7.c. Are there international standards for risk management with which the Commission should consider aligning the RMP Regulations?

We suggest that in devising guidance for SDs and FCMs, the Commission consider the "Principles for the effective management and supervision of climate-related financial risks," published by the Basel Committee on Banking Supervision. While proposed in the context of the consolidated Basel Framework for prudential regulation of banks, many of the Principles can be applied to the climate-related financial risks faced by SDs and FCMs.[33]

To address climate-related financial risks in the banking sector, in 2020 the Basel 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 concluded that banks and banking supervisors could benefit from further guidance specific to climate risk.[34]

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 business entity

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31 *Id. See, e.g.*, National Climate Assessment, *Impacts, Risks, and Adaptation in the United States* (Report), Vol. 2 (Nov. 23, 2018), https://nca2018.globalchange.gov

32 *See* Patrick Bolton et al., *The green swan: Central banking and financial stability in the age of climate change,* at iii, 21 (Bank for International Settlements 2020), https://www.bis.org/publ/othp31.pdf.

33 The Commission will also take note, of course, of the various proposed Principles for Climate-Related Financial Risk Management published by U.S. banking regulators. Board of Governors of the Federal Reserve System, *Principles for Climate-Related Financial Risk Management for Large Financial Institutions,* 87 Fed. Reg. 75,267 (Dec. 8, 2022); Federal Deposit Insurance Corporation, *Statement of Principles for Climate- Related Financial Risk Management for Large Financial Institutions,* 87 Fed. Reg. 19507 (Apr. 4, 2022); Office of the Comptroller of the Currency, *Principles for Climate-Related Financial Risk Management for Large Banks* (Dec. 2021), https://www.occ.gov/news-issuances/bulletins/2021/bulletin-2021-62a.pdf

34 Basel Climate Risk Principles, *supra* n.4, at 1.

or sector.[35] Principles 1 through 12 provide guidance on how banks can effectively manage climate-related financial risks.[36] These Principles can be usefully applied to SDs and FCMs; we reference "businesses" below where the Principles reference banks. (More detail on the implementation of each Principle can be found in the Basel Committee's guidance.)

> ***Corporate Governance.*** Principle 1 requires businesses to develop and implement sound processes for assessing potential effects of climate-related risk drivers on their organizations and on the environments in which they operate, and to incorporate material climate-related financial risks "into their overall business strategies and risk management frameworks." This Principle requires consideration of both physical and transition risk, and would be broadly addressed in the first instance by including climate risk as an enumerated risk in the RMP Regulations. Principle 2 requires boards and senior management to clearly assign climate-related responsibilities to members and/or committees, and to identify responsibilities for climate-related risk management throughout the organizational structure; Principle 3 requires businesses to adopt and implement policies, procedures and controls across the entire organization to ensure effective management of climate-related financial risks. Both the latter Principles may be addressed in part through the written policies and procedures required by Regulations 23.600(b)(2) and 1.11(c)(2), and the assignment of climate-related responsibilities in those written policies and procedures. We encourage the Commission also to state clearly in its guidance that boards and senior management have the final overarching responsibility to exercise effective oversight of climate-related financial risks.
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> ***Internal control framework.*** Principle 4 requires businesses to "incorporate climate-related financial risks into their internal control frameworks across the three lines of defence to ensure sound, comprehensive and effective identification, measurement and mitigation of material climate-related financial risks." As regards the RMP Regulations, the incorporation of climate-related financial risks into internal control frameworks across the first (business units/management) and second (risk management) lines of defense may be implemented through Regulations 23.600(b)(1)-(2) and (5) ("Risk management program", "Written policies

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35 *Id.* at 2.

36 *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 the Commission to consider the potential applicability of these principles in its oversight of the businesses subject to its jurisdiction, our comment will not address them.

and procedures", "Risk management unit"), and Regulation 1.11(c)(1)-(2) and (d) (same). Internal audit (the "third line of defense") will then be in a position to independently evaluate the quality and effectiveness of the firm's risk management controls with respect to those risks.

Capital and liquidity adequacy. Principle 5 requires businesses to identify and quantify climate-related financial risks and, where material over relevant time horizons, incorporate them into their internal capital and liquidity adequacy assessment processes. This Principle may be implemented through those elements of Regulations 23.600(c) and 1.11(e) that relate to capital and liquidity risk management.

Risk management process. Principle 6 generally requires businesses to identify, monitor and manage all climate-related financial risks that could materially impair their financial condition, to consider those risks in their risk appetite and risk management frameworks, and to establish a reliable approach to identifying, measuring, monitoring and managing those risks. This Principle would be broadly addressed by including climate risk as an enumerated risk in the RMP Regulations, and more specifically may be implemented through Regulations 23.600(b)(1) and (c)(1), and Regulation 1.11(c)(1) and (d) ("Risk management program", "Identification of risks and risk tolerance limits").

Management monitoring and reporting. Principle 7 requires that risk data aggregation capabilities and internal risk reporting practices account for climate-related financial risks. and that internal reporting systems monitor those risks and produce timely information to ensure effective board and senior management decision-making. This Principle may be addressed through Regulations 23.600(c)(2)(i) and 1.11(e)(2)(i) ("Periodic Risk Exposure Reports") requiring quarterly written risk exposure reports to senior management and governing bodies.

Comprehensive management of credit, market, liquidity, operational and other risks. Principles 8, 9, 10 and 11 more specifically require businesses to understand the impact of climate-related risk drivers on their market risk positions, credit and liquidity risk profiles, and operational and other risks, and to ensure that their corresponding risk management systems and processes account for material climate-related financial risks.

Scenario analysis. Principle 12 requires businesses to make use of scenario analysis, where appropriate, to assess the resilience of business models and strategies to a range of plausible climate-related pathways and to determine the effect of climate-related risk drivers on their overall risk

profile. Scenario analysis is a tool that challenges assumptions made for the purposes of risk analysis. A key purpose is to analyze alternative scenarios that may significantly alter the basis for "business-as-usual" assumptions – i.e., extreme but plausible scenarios.

The Climate-Related Market Risk Subcommittee of the Commission's Market Risk Advisory Committee has noted that climate-related scenario analysis can be a useful tool for understanding and managing climate-related financial risks, helping organizations integrate climate risks and opportunities into broader risk management frameworks and understand the potentially far-reaching effects of specific triggering events.[37] At the same time, the Subcommittee has cautioned that climate scenarios and the models used to analyze them have important limitations. In particular, most have been developed for purposes other than financial risk analysis, and are not likely to capture all relevant potential financial effects of climate- and policy-driven triggers. Accordingly, scenario analysis should be used only with careful consideration of what it can and cannot do.[38]

We strongly support the use of scenario analysis as a valuable tool for evaluating climate risk exposure. We note that scenario analysis exercises are distinct from stress tests: they are exploratory in nature and do not involve potential capital consequences. By considering a range of possible future climate pathways and associated economic and financial developments, scenario analysis can assist firms and supervisors in understanding how climate-related financial risks may manifest and differ from historical experience.

The Federal Reserve Board recently launched a pilot climate scenario analysis exercise to be undertaken by six of the largest bank holding companies, and anticipates publishing insights gained from the pilot at an aggregate level, reflecting lessons learned about climate risk management practices.[39] The Commission may wish to consider the insights derived

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37 CFTC Climate Subcommittee Report, *supra* n. 16 at iv.

38 *Id.*

39 Press Release, Board of Governors of the Federal Reserve System, Federal Reserve Board announces that six of the nation's largest banks will participate in a pilot climate scenario analysis exercise designed to enhance the ability of supervisors and firms to measure and manage climate-related financial risks (Sept. 29, 2022), https://www.federalreserve.gov/newsevents/pressreleases/other20220929a.htm

from this pilot exercise in order to better understand how to craft climate scenario analysis requirements appropriate to its regulated institutions.[40]

Conclusion

Climate change is already having profound effects on U.S. commodities markets and imposing costs on the U.S. economy. Those costs are likely to increase, potentially affecting the financial health of U.S. derivatives markets and market participants. Climate risk can pose financial risks that may be realized in ways that are difficult to predict with specificity and to contain. Market participants must begin to identify and incorporate those financial risks into their business planning and internal controls. We therefore urge the Commission to explicitly address climate-related financial risks in its rules and guidance for SDs and FCMs.

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

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[40] The Board has also recommended, in its report on the failure of Silicon Valley Bank, that it may be useful for bank supervisors to engage in "narrative-based 'pre-mortem' exercises or reverse stress testing to think critically about idiosyncratic scenarios and tail events that could lead to acute distress at individual firms." Board of Governors of the Federal Reserve System, *Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank* (April 2023), 97, available at https://www.federal reserve.gov/publications/review-of-the-federal-reserves-supervision-and-regulation-of-silicon-valley-bank.htm. The Commission similarly may wish to consider requiring the use of this type of narrative-based exercise by its regulated entities.