

September 14, 2023

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

**Re: RIN 3038–AE59, ANPRM, Risk Management for Swap Dealers and Futures
Commission Merchants; Amendments (88 FR 45826)**

Dear Mr. Secretary,

We are writing to provide comments on the Commodity Futures Trading Commission’s (CFTC) Advance Notice of Proposed Rulemaking regarding potential regulatory amendments under the *Commodity Exchange Act* governing the risk management programs of swap dealers, major swap participants, and futures commission merchants (“the ANPRM”).

[Ceres](#) is a nonprofit organization with over 30 years of experience working on climate change with the world’s leading global investors and companies to drive sustainability in the bottom line. Our [Investor Network](#) currently includes over 220 institutional investors that collectively manage over \$50 trillion in assets. Our [Company Network](#) includes more than 50 of the largest global companies and banks with whom we work on an in-depth basis on climate strategy and disclosure, among other issues. Our [Policy Network](#) includes companies with whom we work on a range of state and federal policy issues. And our [Accelerator for Sustainable Capital Markets](#) works to transform the practices and policies that govern capital markets in order to reduce the worst financial impacts of the climate crisis.

Our comments on the ANPRM specifically address one of several types of risks the CFTC contemplates enumerating in the Risk Management Program (RMP) regulations: climate-related financial risk. Question 7 of the ANPRM asks: “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?”¹

¹ <https://www.federalregister.gov/documents/2023/07/18/2023-15056/risk-management-program-regulations-for-swap-dealers-major-swap-participants-and-futures-commission>

We urge the CFTC to enumerate climate-related financial risk in the RMP regulations or otherwise require supervised market participants to consider the risks that climate change poses to their trading books. CFTC attention on this topic will incentivize the serious study and measurement of climate risks in a market that has not received appropriate attention, accelerating firms' development of risk management capabilities and hastening the maturation of trustworthy data sources and classification systems to aid in that risk management. As we wrote in our response to the CFTC's 2022 [request for information](#) on climate-related financial risk:

[The CFTC] has regularly exercised its authority over Swaps Dealers, Major Swaps Participants, Derivative Clearing Organizations (DCOs), and Futures Commission Merchants, including with regard to how capital requirements are set considering, *inter alia*, market risk, and for establishing risk management programs designed to monitor and manage the risks associated with its activities, including certain enumerated risks and 'any other applicable risks.' The CFTC should use that authority, in coordination with other regulators where necessary, to ensure that the increasing climate change-related risks are considered in all aspects of required risk management programs and in evaluating capital requirements.²

The CFTC was an early leader among federal financial regulators in publicly classifying climate change as a systemic risk and building internal capacity accordingly. The Climate-Related Market Risk Subcommittee's 2020 report was the first-ever climate report by a U.S. financial regulator, and we were further encouraged by the creation of the CFTC's Climate Risk Unit in 2021. Your subsequent request for information indicated that the information collected may be used to inform potential future actions, including new guidance or regulations. We hope this ANPRM helps form the basis for the CFTC's first concrete regulatory action to address climate-related financial risk in derivatives markets.

Climate-related financial risks are systemic, as the CFTC has repeatedly affirmed. There are multiple transmission channels by which physical and transition risks could drive financial markets into a sudden and disorderly correction, with an initial revaluation of assets in the real economy spreading throughout the banking sector and financial system as secondary shocks.³ Ceres has examined this risk in the banking sector on several occasions, including in the October 2020 report, [Financing A Net-Zero Economy: Measuring and Addressing Climate Risk for Banks](#); its successor, the September 2021 report, [The Consequences of Physical Climate Risk for Banks](#); and most recently, a September 2022 report, [Derivatives & Bank Climate Risk](#).

Federal prudential regulators have taken important preliminary steps to outline climate-related risk management expectations for regulated entities. While the prudential regulators have more work

² <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70930>

³ <https://www.ceres.org/sites/default/files/reports/2020-10/Ceres%20Bank%20Risk%20Report%202020%20FINAL.pdf>

to do, the CFTC also has regulatory responsibilities over an important and often under-addressed part of banks’ business. Enumerating climate risks in the RMP regulations would go a long way toward ensuring that the derivatives business is as insulated against climate risks as other aspects of the banks’ business. The prospect of “harmonizing the RMP regulations with the risk management regimes of any prudential or other regulator” is a goal Chair Rostin Behnam identified as a potential area of interest in February 2023 remarks,⁴ and one Commissioner Christy Goldsmith Romero recently recommended in remarks of her own.⁵

Climate change poses risks to derivatives market participants that are currently unaccounted for, and swap dealers and futures commission merchants must address these threats like they would any other type of risk. To be clear, climate-related financial risk is not necessarily a discrete or novel form of risk; climate risks permeate all other categories of risk and can serve to exacerbate more well-established risk types such as credit risk, market risk, or liquidity risk. More sophisticated market participants may already have ways of determining how climate risks are permeating other risk categories, whereas less sophisticated firms likely need to start the process of understanding how to measure physical and transition risks. Either way, supervised institutions would benefit from uniformity in regulatory expectations, which requires an explicit discussion of climate-related financial risk management in all applicable regulatory contexts.

Many risk management procedures rely heavily on historical data and are therefore not suitable to evaluate climate risk, which is already manifesting at an unprecedented scale and will only accelerate. We encourage the CFTC to emphasize the need for forward-looking analysis, as climate change is shifting fundamental environmental parameters. This could include scenario tests that stress market participants’ books in specific ways that historical datasets would not.

Public attention on climate risk exposure in the banking sector has largely centered on banks’ lending activities. However, as we detail in our [Derivatives & Bank Climate Risk](#) report, derivatives activities necessitate a climate-specific risk management approach. Derivatives can amplify climate risk at a systemic level because banks’ counterparties across lending, derivatives, and other asset classes can overlap significantly. In the event of a disorderly asset revaluation tied to climate risk, banks’ losses across different asset classes could be highly correlated, increasing stress on individual banks and amplifying risk across the financial system. These same factors could severely stress non-bank derivatives market participants with less sophisticated risk management tools. Climate-related failures in derivative clearing organizations, swaps dealers, or major swaps participants could have broad waterfall effects on the national and international financial system.

A regulatory focus on climate risk exposure in firms’ lending books alone—insufficient as that regulatory scrutiny has been so far—leaves a significant blind spot in banks’ trading books. If

⁴ <https://www.cftc.gov/PressRoom/SpeechesTestimony/opabehnam31>

⁵ <https://www.cftc.gov/PressRoom/SpeechesTestimony/oparomero10>

derivatives market participants are not properly assessing their climate risk, they could underestimate the probability of counterparty default and allocate insufficient reserves across their portfolio of transactions. A survey by the International Swaps and Derivatives Association (ISDA) and EY found that banks do not view climate as a new type of risk to their trading books, but rather as a driver of existing risks. However, there is little evidence that firms are adequately considering the transmission channels by which climate-related financial risks may amplify existing risk types. Climate-related scenario analysis in banks' trading books remains underdeveloped relative to their banking book capabilities, due in part to banks' perception of low materiality.⁶

Notably, the ISDA/EY survey found appetite among market participants for “increased regulatory engagement, guidance and exploratory exercises on climate risk scenario assessment for the trading book.” Because there has been limited climate-related regulatory focus on trading activity thus far, banks employ “a variety of approaches to the categorization of portfolios and application of shocks,” and would benefit from more standardization facilitated by regulators.⁷

The attention on climate risk management in firms' lending activities, to the exclusion of derivatives and other trading activities, may stem in part from the perception that assets in the banking book are longer-dated and therefore more vulnerable to climate shocks. However, to use interest rate swaps as an example, 60% of banks' exposure is short-term (less than a year), 26% is mid-term (between one and five years) and 14% is long-term (more than five years). Although much of banks' exposure is short-term, there is still significant mid- and long-term exposure in this market, which accounts for over 70% of the notional amount of derivative contracts transacted by U.S. banks.⁸ It would be imprudent to assume that swap market participants' risk exposure is sufficiently short-term to avoid regulatory scrutiny—and moreover, the nature of certain climate risks that can trigger catastrophic events means that even short- and medium-term exposures can carry significant risk that needs to be measured and addressed.

Derivatives activity, particularly in over-the-counter swaps, is both highly material to banks' revenue and highly concentrated among the largest banks. Furthermore, specialized swap dealers may be exposed to concentrated climate-related risks in specific areas that have not been fully explored. Consideration of climate risks in derivatives markets must be integrated into firms' risk management frameworks. Regulated entities should undertake detailed climate-related risk analysis of their derivatives portfolios and consider those findings in tandem with other enterprise risks.

The size and concentration of the derivatives market justifies climate-specific risk management expectations for CFTC-registered swap dealers, futures commission merchants, and other affiliates of financial firms. The development of climate risk management capabilities in firms' derivatives

⁶ <https://www.isda.org/a/e55gE/Climate-Risk-Scenario-Analysis-for-the-Trading-Book.pdf>

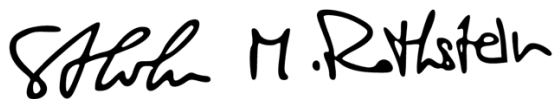
⁷ <https://www.isda.org/a/e55gE/Climate-Risk-Scenario-Analysis-for-the-Trading-Book.pdf>

⁸ <https://www.ceres.org/resources/reports/derivatives-bank-climate-risk>

activities has not kept pace with the effort to quantify and manage those risks in firms' banking books. The CFTC should join its prudential regulatory counterparts in establishing clear climate-related supervisory expectations. We urge the CFTC to specifically enumerate climate-related financial risk in the RMP regulations. To the extent the CFTC determines that current RMP regulations are an adequate framework within which regulated entities can consider climate-related risks, we urge the CFTC at least to issue principles for how entities should mitigate climate risks through their existing risk management frameworks. The CFTC would also do well to engage standard setters like the Partnership for Carbon Accounting Financials and the International Sustainability Standards Board to advance the body of knowledge on how these risks manifest in derivatives markets.

We thank the Commission for its leadership on this critical issue and are happy to discuss any questions you may have about our feedback. Please contact Jake Rascoff (jrascoff@ceres.org) at your convenience.

Respectfully submitted,



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