March 31, 2023

Ms. Harriette Resnick
Acting Executive Deputy Superintendent, Climate Division
New York State Department of Financial Services
One State Street
New York, NY 10004
Banking_Climate_Guidance@dfs.ny.gov

Dear Ms. Resnick,

Thank you for the opportunity to comment on the New York Department of Financial Services' (NYDFS) *Proposed Guidance for New York State-Regulated Banking and Mortgage Institutions Relating to Management of Material Financial Risks from Climate Change*. The Mortgage Bankers Association (MBA)[1] and the New York Mortgage Bankers Association (NYMBA)[2] are supportive of efforts to ensure financial institutions are prepared for the uncertainties of climate change and appreciate the leadership of policy makers like NYDFS in raising these complicated issues and the need for solutions. Our organizations represent all elements of the real estate finance industry, and our member companies operating in the state hope this represents the beginning of a conversation with stakeholders regarding how best to manage associated risks from climate change.

The Proposed Guidance released for comment during December 2022 is sweeping in its scope and represents, in our view, one of the first attempts by a *state* financial services regulator to circulate regulatory expectations specifically designed to mitigate these risks. As you probably are aware, federal regulators have sought input on these challenging issues for mortgage

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 390,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets, to expand homeownership, and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of more than 2,000 companies includes all elements of real estate finance: independent mortgage banks, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies, credit unions, and others in the mortgage lending field. For additional information, visit MBA's website: www.mba.org.

[2] The New York Mortgage Bankers Association, Inc. (NYMBA), is a 501(c)(6) not-for-profit statewide organization devoted exclusively to the field of real estate finance. NYMBA's rapidly growing membership is comprised of both bank and non-bank mortgage lenders and servicers, as well as a wide variety of mortgage industry-related firms. NYMBA encourages its members to engage only in sound and ethical business practices and informs its members of changes in the laws and regulations affecting the mortgage business. The association helps those engaged in or affected by the mortgage business to be better informed and more knowledgeable. It is dedicated to the maintenance of a strong real estate finance system. This involves support for a strong economy, a public-private partnership for the production and maintenance of single and multi-family homeownership opportunities, and a strong secondary mortgage market. For additional information, visit www.nymba.org.

lenders and servicers in both residential and commercial-multifamily real estate finance. MBA has provided its views to these federal agencies in recent years. Most notably, on April 19, 2021, MBA submitted a letter to the Federal Housing Finance Agency (FHFA) in response to their request for comment on, *Climate and Natural Disaster Risk Management at the Regulated Entities*, which it released in January of that year.[3]

FHFA's actions on this issue are critical as it continues to serve as the conservator of both Fannie Mae and Freddie Mac (the GSEs) who together hold risk for approximately half of the residential and multifamily mortgage originations in the United States. In its regulatory role, FHFA ensures that the GSEs and the Federal Home Loan Banks fulfill their mission of operating in a safe and sound manner so that they may continue to serve as a reliable source of liquidity and funding for affordable housing finance and community investment during all economic conditions.

MBA's letter to FHFA voiced the real estate finance industry's views with respect to addressing and mitigating the financial risks of climate change on a mortgage asset, and we attach them here to inform your policy development process. It is critical that NYDFS align its efforts with its federal counterparts. NYDFS should leverage the work of the federal agencies, such as FHFA, to the maximum extent possible to help produce a common approach on mortgage-specific topics. Addressing climate risk needs an aligned approach between state and federal financial regulators.

As further outlined below, we urge the Department to do the following:

- Leverage our members' expertise, existing risk-management systems, processes and governance.
- Employ a principles-based approach rather than a prescriptive approach, leaving room for flexibility, tailoring and innovation.
- Leverage and harmonize the Department's approach to climate risk with the actions of other financial institution supervisors.
- Be mindful of any conflicts or tradeoffs between our members' need to manage climate risk and to provide financing to support affordable housing.
- With respect to scenario analysis, recognize that data may be limited, and our members may need to leverage assumptions or approximations in order to analyze scenario impacts.

It is important to also recognize that the industry is not without deep experience in risk management. Thus, we urge the Department to leverage our members' considerable efforts and familiarity in mitigating risks in both the residential and commercial and multifamily markets. This work represents multimillion dollar investments to develop methods and to operationalize them. Moreover, industry practices are not static, and lenders and servicers continuously monitor their best practices and improve them to enhance their respective institutional resilience.

In developing any final policies, NYDFS should seek gradual implementation to mitigate transition risk. In a June 2017 report, the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) noted "[t]ransitioning to a lower-carbon economy may entail extensive policy, legal, technology, and market changes to address mitigation and adaptation requirements related to climate change. Depending on the nature, speed, and focus

[3] https://www.fhfa.gov/Media/PublicAffairs/Documents/Climate-and-Natural-Disaster-RFI.pdf

of these changes, transition risks may pose varying levels of financial and reputational risk to organizations." Given these concerns, our organizations greatly appreciate the comments provided during the Department's January presentation which indicated that its process would be "proportionate and principles-based." We believe NYDFS will greatly benefit from its current iterative approach and be able to refine and improve supervision over time in a manner that compliments and enhances existing risk management frameworks.[4]

Mortgage lending is unlike other forms of lending and is delivered to consumers in an already tightly regulated environment by institutions with different business models (e.g., bank versus nonbank). Great care should be taken to incorporate the unique needs of all types of real estate finance firms. As state regulators begin laying out their expectations for climate risk mitigation, our organizations have concerns regarding potential for divergent standards among the more than 50 different state mortgage regulators, who may also issue mandates significantly different from the federal counterparts. We thank NYDFS for recognizing these concerns in its January presentation and for its commitment to ongoing industry dialogue.

An important topic for the start of such a conversation with industry is the intersection, and potential conflict, of federal and state fair housing laws with regulator-mandated approaches to climate risk mitigation. Our members are unequivocally committed to obeying fair housing laws. They also mitigate risks in strict accordance with investor requirements, which can involve additional costs. For example, lending in flood prone areas requires that a borrower purchase flood insurance.

The NYDFS proposal notes that "climate-related financial risks could have an unintended but disproportionate impact on financially vulnerable communities," and that LMI and communities of color are harmed disproportionately by climate change and natural disasters. Critically, the Department then sets an expectation that regulated organizations must "minimize and affirmatively mitigate adverse impacts on these communities while managing climate-related financial risks." This must be achieved while "continuing to ensure fair access to capital and credit. [Regulated organizations] should not base their risk management response to climate change on the concept or practice of disinvesting from low-income communities or communities of color by making credit or banking more difficult or expensive for members of these communities to obtain."

Residence in an area subject to increased climate risk is not a protected class under law, and reducing exposure to potential loss or risk is a legitimate business necessity. Thus, it is imperative that NYDFS recognize that mitigation of climate risk in accordance with safe and sound operations for properties located in areas subject to such increased risk has the very real potential to make those properties less affordable. Our organizations respectfully request that the Department clarify that race-neutral efforts to meet NYDFS expectations with respect to climate risk mitigation would not have a prejudicial impact in any fair housing examination. The desired result of one set of regulatory expectations and requirements should not become the punishable offense of a separate set of state mandates. As the Department's proposal represents a national first for a state, it is important that it accept the burden that comes with this role and foster a conversation on the underlying conflict between climate risk and fair lending standards outlined in the climate guidance. Much more discussion is necessary to address the challenges MBA and NYMBA members would face in continuing to expand lending to LMI borrowers and communities given these expectations.

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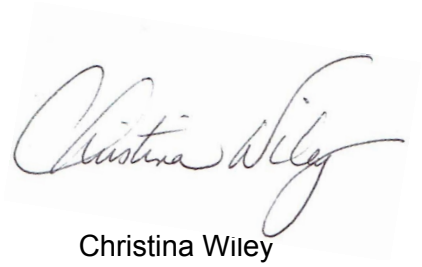
[4] "Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures," June 15, 2017. Available at: https://assets.bbhub.io/company/sites/60/2020/10/FINAL-2017-TCFD-Report11052018.pdf

Lastly, with respect to scenario analysis, it is important that the Department recognize that the development of some plausible scenarios for particular lines of business currently may be limited by available data and that lenders will need to be able to work with the methodologies and data that are reasonably available and refine them over time.

Once again, thank you for providing us with the opportunity to comment on proposed guidance related to climate change. Our associations welcome the opportunity to engage with you and other NYDFS staff further.

Respectfully,



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Attachment

- MBA Letter to FFHA, April 19, 2021 and available here: https://www.mba.org/industry-resources/resource/mba-letter-to-fhfa-on-climate-and-natural-disaster-risk-management-rfi-x279164

MBA

MORTGAGE BANKERS ASSOCIATION

April 19, 2021

The Honorable Mark Calabria
Director
Federal Housing Finance Agency
400 7th Street SW, 10th Floor
Washington, DC 20219

Re: Response to FHFA's Climate and Natural Disaster Risk Management RFI

Dear Director Calabria:

The Mortgage Bankers Association (MBA)[1] respectfully responds to the Federal Housing Finance Agency (FHFA) Request for Input (RFI) on climate and natural disaster risk management at the regulated entities, released January 19, 2021.[2]

MBA represents all elements of the real estate finance industry and maintains a strong interest in the operations and business activities of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks ("the regulated entities"), including any potential reforms to improve their safety and soundness, conduct in the marketplace, and ability to further their statutory missions. We commend FHFA for requesting information regarding the potential for increasing climate and natural disaster risk to impact its regulated entities and the broader real estate finance system. We anticipate that this RFI will mark the beginning of an ongoing conversation with stakeholders regarding how best to manage and mitigate associated risks.

FHFA's focus on climate change and natural disaster risk is timely. The frequency and severity of hurricanes, flooding, and wildfires have increased over the past several decades. This trend has had a significant impact on owners of real estate, property and casualty insurers, lenders and servicers, and the regulated entities. Climate models predict that this trend will continue, coupled with increasing risks of sea-level rise and the potential for many real estate markets to experience significant declines in property values as the economic viability of the underlying

[1]The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 330,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets, to expand homeownership, and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 1,700 companies includes all elements of real estate finance: independent mortgage banks, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies, credit unions, and others in the mortgage lending field. For additional information, visit MBA's website: www.mba.org.

[2] FHFA, "Climate and Natural Disaster Risk Management at the Regulated Entities," January 19, 2021. Available at: https://www.fhfa.gov/Media/PublicAffairs/Documents/Climate-and-Natural-Disaster-RFI.pdf.

collateral is threatened. Clearly, such changes have the potential to impose losses and costs on many actors within the real estate finance system.

MBA and its members are focused on the potential for direct losses from natural disasters and climate risks, for changing operational requirements for firms and the industry, for potential transitions for existing businesses and markets, and for potential changes to regulatory requirements that would impact real estate and real estate finance markets.

Direct physical risks are not the only changes for which firms must prepare. They also must prepare for changes that may arise as individuals, companies, investors, and governments globally are responding to climate and rising natural disaster risk in multiple ways. Some are taking specific actions to reduce their own carbon emissions or shift activities in ways that could directly mitigate climate risk. Others are working to put in place restrictions, regulations, requirements, or other guideposts that would push other actors within the economy to make such changes. By fostering market and other transitions, these actions have the potential to lead to losses or raise costs for lenders, servicers, insurers, and investors active in real estate finance.

Supervision of FHFA's regulated entities should focus on reducing externalities that are a product of under-insured risks. As we describe in more detail below, MBA encourages FHFA to align its actions on climate change and natural disaster risks with a set of core principles, such as the following:

1. Recognize FHFA's specific role with respect to climate-change and natural disaster policy responses, consistent with FHFA's statutory mission and authorities.
2. Leverage existing FHFA supervisory processes and practices.
3. Leverage the regulated entities' existing risk-management systems, processes, and governance.
4. Employ a principles-based rather than a prescriptive approach, leaving room for flexibility, tailoring, and innovation.
5. Leverage and harmonize FHFA's approach to climate change and natural disaster risk with the actions of other financial institution supervisors.
6. Establish national standards for the regulated entities' climate-related mortgage risks to avoid inconsistent regulation at the state level.
7. Be mindful of any conflicts or tradeoffs between the regulated entities' need to manage climate change and natural disaster risks and to fulfill their charter mandates.

In summary, FHFA should align with other regulators whenever appropriate to do so, but also recognize the unique business models of their regulated entities and work with them to foster a common approach for real estate finance markets. FHFA should also work closely with the government housing agencies to pursue a common approach on mortgage-specific topics. At a

macro level, recognizing that addressing climate risk more broadly will take a whole-of-government approach, FHFA should leverage the work of other agencies to the maximum extent possible.

The comments below describe MBA's views on how climate risks may impact various aspects of real estate finance and how FHFA might align its efforts with the principles above.

Real estate finance entails significant risk management

In considering the impacts of the physical and transitional risks of climate change and natural disaster risk, it is important to recognize that the real estate finance system is built on managing risks and already deploys a range of tools to address them. Within this context, climate change promises to heighten some existing risks and illuminate new ones. Many risks associated with climate change will most naturally fit with those already established to address natural disasters. Even for those risks that are new, they will need to be integrated – both within firms and throughout regulatory and other frameworks – with the broader risk management structure of the industry.

One must also consider the structure of the real estate finance industry and the roles of the various industry participants. The real estate finance system often separates the originator of the loan from the servicer and from the investor. In other parts of the market, for certain loans, a single lender holds the entire risk of a loan. Any effective strategy must consider the division of labor involved in each case, including potentially developing a mechanism by which data – created at origination – is communicated to all subsequent parties for their use in managing risk. With respect to loans sold to Fannie Mae and Freddie Mac, in particular, mortgage bankers are underwriting and servicing according to the requirements set by the investor, including the requirements for property and casualty and flood insurance.

As a result of the diversity of participants and roles within the real estate finance industry, FHFA must (a) make sure existing risk-management approaches capture the new and expanded risks stemming from climate change and (b) fill any gaps that may exist. FHFA currently evaluates the regulated entities with respect to their risk management capabilities. In MBA's view, managing climate risk may require FHFA to further focus supervision on the regulated entities' risk management capabilities, although the overall process of such supervision may not necessarily change.

a. Physical and transition risks

There is an emerging view that climate change and natural disaster risk can be viewed usefully as two separate elements of risk: physical risks and transition risks.

In a June 2017 report, the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) divided risks from climate change into these two broad categories, physical risks and transition risks, noting, "Physical risks resulting from climate change can be event driven (acute) or longer-term shifts (chronic) in climate patterns. Physical risks may have financial implications for organizations, such as direct damage to assets and indirect impacts from supply chain disruption. Organizations' financial performance may also be affected by

changes in water availability, sourcing, and quality; food security; and extreme temperature changes affecting organizations' premises, operations, supply chain, transport needs, and employee safety."

TCFD also noted, "Transitioning to a lower-carbon economy may entail extensive policy, legal, technology, and market changes to address mitigation and adaptation requirements related to climate change. Depending on the nature, speed, and focus of these changes, transition risks may pose varying levels of financial and reputational risk to organizations."[3]

Several other regulatory agencies including the Federal Reserve recently have taken a keen interest in the potential impact of climate change on the financial system. In a February 18, 2021 speech titled *The Role of Financial Institutions in Tackling the Challenges of Climate Change,* Federal Reserve Governor Lael Brainard highlighted the work of the TCFD, saying, "We are already seeing financial institutions responding to climate-related risks by encouraging borrowers to adapt to and manage the risks associated with a changing climate, responding to investors' demands for climate-friendly portfolios, and funding critical private-sector initiatives to move toward more climate-friendly business models. As noted by members of our Federal Advisory Council, '[t]here has been increasing awareness among financial institutions of the need to define and develop risk management frameworks that incorporate these [climate-related financial] risks into strategic decision making on multiple levels, including investment approaches and the long-term structuring of portfolios."

The physical and transition risks that may arise from natural disasters and changes in climate patterns are most likely to affect real estate finance in the areas of operational, credit, and market risk. We also highlight key risk management tools that can enable market participants to measure, manage, and mitigate these risks.

b. Operational Risk

Climate change will likely increase operational risks for the real estate finance system. This is most likely to come in two forms – risks that natural disasters or other climate-related changes will disrupt operations of key players in the system, and that natural disasters or other changes will lead to more frequent need for servicers to conduct disaster-relief operations. For operational risks, lenders, servicers, and others will turn to what is now a well-developed set of business continuity and resilience plans. The COVID-19 pandemic and a rash of recent natural disasters have certainly tested – and improved – the industry's resilience.

Rising natural hazard risks will likely involve more frequent interruption of the daily operations of mortgage businesses. Operational responses are two-fold. First, companies must adapt their internal operations so that employees can fulfill their duties in the wake of a disaster. An organization may need to enable remote work for its employees more frequently. To manage this operational challenge, lenders will continue to advocate for specific regulatory and agency flexibilities. A company moving to remote work would have to ensure they are fulfilling any

[3] "Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures," June 15, 2017. Available at: https://assets.bbhub.io/company/sites/60/2020/10/FINAL-2017-TCFD-Report-11052018.pdf

applicable state mortgage loan officer licensing requirements.

Second, lenders and servicers must ensure their operational procedures and policies regarding the execution and servicing of loan contracts comply with temporary, event-specific guidance from investors, regulators, and federal agencies.

After a disaster hits, immediate relief for homeowners with federally-backed mortgages consists of forbearances, foreclosure moratoria, waived late fees, and suspension of negative credit reporting. These typically begin automatically after an impacted area receives a Presidentially Declared Major Disaster Declaration and last up to 90 days, with opportunities for extension based on conditions on the ground. After Hurricane Harvey, lenders and servicers worked closely with the federal housing agencies and the Consumer Financial Protection Bureau (CFPB) to streamline loss mitigation programs for those impacted by natural disasters and identify areas where additional guidance or exceptions were needed.

One of the developments that came from these discussions was Fannie Mae and Freddie Mac's extension modification for borrowers who were current prior to the disaster and were able to resume making their regular contractual payment but needed assistance in paying back the forborne amount. These programs continued to be refined over the next several years and now servicers rely on them in natural disaster situations.[4] Many of these options and temporary policies were developed with industry feedback, and the FHFA's regulated entities and the federal housing agencies should remain open to further suggested refinements.

The COVID-19 national pandemic and the associated policy responses – such as widespread stay-at-home orders – fully stress-tested the disaster readiness of the mortgage industry. The industry showed tremendous adaptability. Mortgage originators and servicers alike not only had to transition their own business operations to remote work, but also expertly deployed temporary origination flexibilities and requirements, and large-scale forbearance plans and agency-specific loss mitigation programs for borrowers who were financially impacted by the COVID-19 pandemic. These programs were streamlined, with minimal or no documentation requirements, and largely were standardized across federally-backed mortgage programs. This allowed for a faster transition from forbearance to a permanent resolution for homeowners and a more efficient operation for servicers.

With almost $4 trillion in single-family origination volume in 2020 and more than 4.5 million forbearance plans put in place through the pandemic, the industry has more than demonstrated its ability to continue operations amid disaster conditions. Additionally, the industry pushed for adoption of new policies like remote online notarization that will continue to streamline processes for borrowers. Many temporary policies developed to streamline processes during remote work and social distancing may persist even when the world returns to "normal."

c. Credit risk

[4] MBA has published a consumer-oriented resource regarding natural disaster responses See: "Disaster Recovery: A Resource for Homeowners," May 14, 2018. Available at:https://www.mba.org/2018-press-releases/may/mba-releases-disaster-recovery-guide

Credit risk is the risk that a borrower will fail to repay a loan in accordance with its terms (likelihood of default) and that the collateral property, credit support, or other mitigants will be insufficient to make the lender whole under the terms of the loan (loss severity). Credit risk in the context of climate change and increasing natural disaster risk will likely manifest as an increasing likelihood of property damage and the potential for more frequent and potentially more persistent economic shocks.

The physical impacts of climate change and natural disasters may damage homes and other properties and can also disrupt borrowers' ability to repay by causing a loss of employment or a reduction in income. Examples include scenarios in which a factory is damaged, workers are unable to get to work, or business activity slows because customers are adversely affected by a natural disaster. Transition impacts also can disrupt a borrower's ability to repay if the borrower's industry is adversely affected by climate-related policy actions or changing market preferences, thereby affecting borrower income.

For a multifamily property, a loss of rental income from damaged units, or a need to tap into reserves for repairs could impair the borrower's ability to repay the loan. In addition, the climate-related factors described above for single-family borrowers (both physical and transitional risk) could affect renters, which then could reduce the property owner's rental income, as well.

Climate-related physical and transitional risk also could affect loss severity. Homes and apartment buildings that are damaged by natural disasters can lose value, both as the result of realized damage and any heightened risk of future natural disaster damage. The value of properties also can be adversely affected by transitional risk as certain locations become less valuable as a result of changes in regional employment that could result from climate-related policies or changes in market preferences.

The ability to mitigate the severity of loss by reliance on third parties to provide insurance or credit enhancements could be adversely affected by climate change and natural disasters. Insurance coverage for certain types of natural disasters could become unavailable or prohibitively expensive in light of high loss experience or an inability to accurately underwrite and price the risk. Similarly, third-party providers of credit enhancement could suffer from unexpectedly high levels of losses and might withdraw from providing coverage or could offer to do so only under terms and conditions that are unworkable.

d. Particular challenges of flood risk

The industry faces a challenging problem in establishing risk management strategies for properties that have experienced repeated flood or other natural disaster events. The mismatch between mandatory flood insurance purchase requirements and the areas with substantial flood risk leave a residual credit risk gap for the Enterprises or others holding the credit risk of single-family mortgage loans. MBA commends the Federal Emergency Management Agency's (FEMA) work to try to improve the risk sensitivity of the National Flood Insurance Program (NFIP).[5]

[5] Frazin, Rachel, "FEMA Unveils New Flood Insurance Calculation It Says Will Be More Equitable," *The Hill*, April 1, 2021. Available at:https://thehill.com/policy/energy-environment/546093-fema-unveils-new-flood-insurance-calculation-it-says-will-be-more

A recent FHFA Office of the Inspector General report[6] notes that the Enterprises are exposed to the risk of loss from flood events, as many single-family mortgages are not adequately covered by flood insurance. The Enterprises rely on FEMA mapping of special flood hazard areas – mapping that increasingly fails to comprehensively capture areas that pose substantial flood risks. Similarly, a recent report noted a similar large exposure to flood risk for the Federal Housing Administration (FHA).[7] More accurate assessments of potential flood risk clearly are needed.[8]

As more borrowers find themselves in repetitive flood areas (or frequent earthquake zones, high tornado frequency areas, or the like), it may become incumbent upon the government to rescue families from properties that cannot be resold. FEMA's buyout program offers families an escape from properties that become unmarketable due to severity of the flooding problem. This approach also could be applied for properties that become unmarketable due to the extremely high cost of insurance on the property.

Flood risk is an area where the differences between the single-family residential and commercial/multifamily markets can be quite stark. Policy, in the form of the structure of the NFIP, is a primary factor driving real estate and real estate finance decisions in the single-family markets subject to significant flood risk. However, given the cap on NFIP coverage, it is a less important consideration for many larger commercial and multifamily properties. The availability and pricing of private insurance coverage can have a greater impact on these properties. These price signals from the private insurance market may well provide valuable information for policymakers concerned about the impact of increasing flood risk in different markets.

e. Market Risk

Market risk is the risk of loss arising from movements in market prices. For purposes of considering the impacts of climate change and natural disaster risk, what may be most relevant for FHFA is the risk that the market prices of the Enterprises' mortgage-backed securities (MBS) change as a result of climate change or natural disaster-related policies or changes in investor preference. Market risk management entails conducting portfolio selection, hedging, and funding activities to mitigate the impact of sudden changes in value of the assets.

The growing momentum of environmental, social, and governance (ESG) focused investors is causing companies across the economy and around the world to devote more attention to the environmental and climate risks connected with their investments, the social impact of these activities, and the corporate governance of entities with which they interact. The force of this push from investors already is resulting in significant market transitions for companies, within and outside of real estate finance, who do not emphasize these factors. The move by investors

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[6] FHFA, Office of the Inspector General, *Disaster Risk for Enterprise Single-Family Mortgages* (March 23, 2021). Available at: https://www.fhfaoig.gov/WhitePaper/disaster-risk-enterprise-single-family-mortgages.
[7] Frank, Thomas, "U.S. Housing Agency Faces 'Systemic Risk' from Floods", *E&E News*, February 16, 2021. Available at: https://www.eenews.net/stories/1063725133
[8] See, for example, , Berman, Michael D., "Flood Risk and Structural Adaptation of Markets: An Outline for Action." Available at: https://www.frbsf.org/community-development/files/02_Berman.pdf

to place a substantial premium on ESG-favored activities and assets, while trading away from those disfavored, opens a new source of market risk for many in real estate finance.

Market perceptions of the properties underlying the Enterprises' MBS could affect the prices investors would pay for them, as a factor separate from the characteristics (e.g., prepayment risk) that investors historically have considered. The acceleration of the ESG movement could lead to abrupt repricing of many assets, including both real estate values and associated loans and securities. ESG-focused investors (and credit risk transfer (CRT) investors) are requesting additional disclosures to more clearly identify credit and operational risks that may result from the increasing pace of natural disasters and climate change. ESG is an emerging investment standard. As a result, investor expectations, industry standards for ESG, and appropriate disclosures to investors are still emerging.

The Mortgage Industry Standards Maintenance Organizations (MISMO), the real estate finance industry's standards organization and a subsidiary of MBA, stands ready to collaboratively engage with lenders, servicers, mortgage insurers, investors, vendors, regulators, the regulated entities, and other market participants to facilitate the development and adoption of standards to support the exchange of ESG information, including, but not limited to, data, terms, and definitions. MISMO's work is grounded in an open process to develop, promote, and maintain voluntary consensus-based standards that allow market participants to exchange information more securely, efficiently, and economically. As an initial step, MISMO is soliciting feedback from various stakeholders to determine whether and how it can best support the needs of market participants with respect to ESG.

We note that the Securities and Exchange Commission (SEC) has been active in the ESG space. This includes announcing a task force for ESG and climate, listing ESG and climate-related risks among its 2021 examination priorities, including ESG- and climate-related risks in the SEC's Division of Examinations' 2021 examination of potential risks to investors and the integrity of US capital markets, and launching an ESG and climate task force in its enforcement division, noting investors' increasing use of and demand for ESG- and climate-related disclosures from SEC registrants.

The Enterprises have developed products to respond to the emerging ESG appetite. Fannie Mae offers Green MBS, and Freddie Mae offers a suite of Green Advantage offerings. FHFA provided incentives to engage in green lending in the structure of the multifamily caps from 2016 until the fourth quarter of 2019. Those caps had provided an exemption from the caps for multifamily loans that financed certain energy and water efficiency improvements.

f. Risk Management Tools

Managing and mitigating climate-related physical and transition risks will require a range of actions. The regulated entities and other industry participants use a waterfall of tools to identify, assess, mitigate, underwrite, insure against, and price risks:

- Identify: As new risks arise that impact the performance of mortgage loans and counterparties, industry participants work to identify and quantify these risks. With the

advent of advanced data and analytical tools, the industry's ability to target specific credit risks – such as borrower default, flood, earthquake, and more – has increased. Increasing awareness and modeling of climate risk is the latest addition to the list.

- Assess: Lenders and others in the real estate finance markets have developed a wide range of tools to help them assess the risks associated with a particular asset or counterparty. This assessment becomes a part of the lending process, providing key information to the relevant parties so they can make appropriate decisions about whether and how to address any risks that are identified. Credit reports, employment checks, appraisals, physical inspections, flood maps, earthquake zone assessments, and other tools are all part of the assessment toolbox. Understanding of the future impacts of climate change is still developing, but more and more climate-risk related tools are becoming operational, including updated hazard models. As these models gain greater accuracy, they can and will be incorporated by the appropriate parties.
- Mitigate: One key approach to dealing with identified risks is to mitigate them directly. Lenders and/or other parties most directly affected by a specific risk factor ensure that a borrower takes actions to eliminate or lessen the gravity of that risk. Required property repairs, lead abatement, building code requirements, and other examples demonstrate the effectiveness of mitigation for certain types of risks. For climate and natural disaster risk, any mitigation efforts will need to be site-specific and verifiable, but local building codes and insurance requirements form a strong base on which the industry is already relying. FHFA and its regulated entities should carefully consider the effectiveness of existing risk mitigation techniques before adding to requirements.
- Underwrite: The underwriting process is used to structure loans to reduce credit risks that cannot be fully mitigated. Lenders assess the borrower and property against the known credit risks and make loan decisions based upon that assessment. Decisions include whether to make the loan, as well as decisions about loan sizing, loan characteristics, and more. As more information and analysis about risks related to climate change become available, loan underwriting will be a critical tool to determine the degree to which those risks remain with the borrower or are (partially or wholly) transferred to other parties in the mortgage finance system.
- Insure: Lenders have a variety of methods of insuring against different exposures to risks. Property and casualty, flood, earthquake, terrorism, business interruption, private mortgage, and other forms of insurance are all examples of ways the real estate finance system currently uses insurance contracts to carve-out certain risks and remove them from the core mortgage investment. Many risks stemming from climate change will be directly addressed by existing insurance programs – and those insurance programs will be affected by the changing nature of those risks. Others will be borne by credit risk transfer structures, either through capital markets or reinsurance programs. The insurance market will need to adjust to changing risks that are not mitigated. It is also important to note that while existing insurance structures may reduce the risk of loss against damage to the property, they may not prevent loss of long-term value due to changing condition of the underlying land and the economic viability of the local economy.

- Price: Risks that are not fully mitigated, underwritten, or insured against may be priced. Active capital markets are extremely effective at developing information and methodologies to price risks, as can be seen in the trading of interest rate, prepayment, and credit risks in residential and commercial mortgage-backed securities and CRT structures. The greater the transparency into property and mortgage characteristics, the more efficient and effective the transmission of the pricing signals from investors to lenders will be. As our understanding of climate-related risks grows, pricing mechanisms have the potential to take the lead in identifying and signaling where climate risks are and are not being addressed by other "upstream" tools.

How should FHFA approach supervising its regulated entities' management of climate and natural disaster risk?

Climate and natural disaster risk is a rapidly developing area but, given the level of activity in this space in recent years, financial institutions and their supervisors are not starting from scratch. We recommend that FHFA consider several high-level principles as it determines how to approach supervising regulated entities' management of climate and natural disaster risk:

1. Recognize FHFA's specific role with respect to climate change and natural disaster policy responses.
2. Leverage existing FHFA supervisory processes and practices.
3. Leverage the regulated entities' existing risk-management systems, processes, and governance.
4. Employ a principles-based rather than a prescriptive approach, leaving room for flexibility, tailoring, and innovation.
5. Leverage and harmonize with other financial institution supervisors.
6. Establish national standards for the regulated entities' climate-related mortgage risks to avoid inconsistent regulation at the state level.
7. Be mindful of any conflicts or tradeoffs between the regulated entities need to manage climate change and natural disaster risks and to fulfill their charter mandates.

1. Recognize FHFA's specific role with respect to climate change and natural disaster policy responses.

FHFA has primary supervisory authority over the regulated entities, including their safety and soundness, so it would be appropriate for FHFA to focus its finite resources on ensuring that FHFA and the regulated entities understand the nature of their exposures to climate-change and natural disaster risk, and that the regulated entities appropriately manage those risks. Other agencies, with other missions, will be charged with developing and implementing policies to directly address the separate topic of reducing the rate of climate-change and reducing future natural disaster risks.

2. *Leverage existing FHFA supervisory processes.*

FHFA has considerable experience and expertise in supervising the regulated entities' management of risk. FHFA and its predecessor, the Office of Federal Housing Enterprises Oversight (OFHEO), have experience supervising institutions under changing risk conditions, including the Great Financial Crisis and the COVID-19 National Emergency. As a result, FHFA should be able to leverage its existing supervisory processes and practices, integrating climate change and natural disaster risk into them. We applaud FHFA's efforts in this RFI to step back and seek public input before fully establishing its supervisory approach to climate change and natural disaster risk.

3. *Leverage existing risk management at the regulated entities.*

As a general matter, we believe that FHFA should leverage the regulated entities' existing systems, processes, reporting, and governance, as well as FHFA's existing supervisory and regulatory processes. The regulated entities have substantial experience in identifying and managing risk, and have frameworks of systems, processes, and governance in place to manage those risks.

The real estate finance system is built on managing risks, with climate change promising to heighten some existing risks and to bring new ones. As Governor Brainard noted in her February 2021 speech, tools are increasingly becoming available to enable institutions to incorporate climate risk impacts into the governance, risk-identification, and risk-management processes:

"Improved data, disclosures, and modelling techniques will be crucial to reducing uncertainty around the potential magnitude of risks related to climate change. … Supervised institutions are beginning to adapt their governance, risk-identification, and risk-management processes, and business models to reflect climate-related risks. It is clear that physical and transition risks could have significantly different impacts on institutions of varying sizes, complexities, and business models, and with exposures to different geographies. Banks have told us that, "prospective guidance and regulation should be (1) designed to assist institutions of all types and sizes to measure, monitor, and disclose the associated financial risks [from climate change]; and (2) tailored to the complexity of specific types of institutions."[9]

4. *Employ a principles-based rather than a prescriptive approach, leaving room for flexibility, tailoring, and innovation.*

Because the understanding of climate change and natural disaster risks, and the tools for managing those risks, are evolving, it is critical that supervisory approaches favor principles-based rather than prescriptive approaches, coupled with supervisory monitoring. The regulated entities will need room to consider and apply new approaches and should have the flexibility to change their approach based on their business judgment without fear of adverse supervisory

[9] Brainard, Lael, "The Role of Financial Institutions in Tackling the Challenges of Climate Change," February 18, 2021. Available at: https://www.federalreserve.gov/newsevents/speech/brainard20210218a.htm.

action. Moreover, the issue may not be the policy but rather the circumstance. The concern operationally and for risk-mitigation may not necessarily require a new policy, e.g., a specific form of forbearance to help consumers struggling to make payments, but rather the flexibility to make such policy available in different events, e.g., a hurricane in Florida and a flood in Michigan. The regulated entities should be able to tailor their approaches to managing climate change and natural disaster risks to their specific risk exposures and not to a hypothetical or generic risk exposure. Finally, the regulated entities should be empowered to responsibly innovate in their management of climate change and natural disaster risks.

5. Leverage and harmonize with other federal and state financial institution supervisors.

We urge FHFA to leverage the work of other supervisors and to harmonize its approaches to the extent applicable to the businesses and risk management practices of the regulated entities. Such an approach can leverage the wisdom of the supervisory crowd and better enable the regulated entities to leverage approaches other financial institutions employ to meet other supervisors' expectations.

Many US and other supervisors are also actively engaged in developing approaches to supervising regulated institutions' management of climate change and natural disaster risks. For example:

- **July 2018.** The International Association of Insurance Supervisors issued a paper on Climate Change Risks of the Insurance Sector. The paper catalogued governmental and international agency recognition to date that climate change will affect the financial system.
- **September 2019.** The New York Department of Financial Services (DFS) announced the agency joined the international Network for Greening the Financial System (NGFS). DFS was the first U.S. regulator to join the NGFS.
- **November 2019.** The Federal Reserve Bank of New York warned that risk managers should do all they can to ensure their institutions build resilience to the substantial risks that climate change poses.
- **November 2019.** The Federal Reserve Bank of San Francisco held a conference on "The Economics of Climate Change." The conference was a first for the Federal Reserve System and was intended to bring "together researchers from around the globe to discuss quantifying the climate risk faced by households, firms, and the financial system; measuring the economic costs and consequences of climate change; accounting for the effects of climate change on financial asset prices; and understanding the potential implications of climate change for monetary, supervisory, and trade policy." See also the previously-cited speech by Governor Lael Brainard at that conference.
- **May 2020.** The NGFS issued a technical document: Guide for Supervisors: Integrating climate-related and environmental risks into prudential supervision.

- **May 2020.** The European Central Bank issued a "Guide on climate-related and environmental risks: Supervisory expectations relating to risk management and disclosure."
- **September 2020.** The New York DFS issued Insurance Circular Letter No. 15 (2020) on Climate Change and Financial Risks.
- **October 2020.** The New York DFS issued an Industry Letter outlining its risk assessment and risk management expectations related to addressing the financial risks from climate change to all New York-regulated banking organizations and non-depositories.
- **November 2020.** The Federal Reserve listed climate change for the first time in its annual financial stability report.
- **December 2020.** The Federal Reserve approved the decision to join the NGFS by a 6-0 vote.

6. *Establish national standards for climate-related mortgage risks to avoid inconsistent regulation at the state level*

The pace of federal engagement on climate change has increased markedly since the start of the current administration. This included a Day One Order setting climate change policies;[10] a notice that the United States would be rejoining the Paris Accord;[11] and efforts across the SEC, federal banking, and other agencies to establish climate change as a priority and to establish the organizational infrastructure to support that priority.

Federal action is needed to establish national standards for climate risk mitigation to avoid the development of a patchwork set of requirements promulgated by states. Governors of the nation's largest states already have announced aggressive agendas to combat climate change, and New York State has gone a step further by establishing regulatory and examination expectations specifically for climate change risk mitigation for its state-licensed companies. Other states are likely to follow.

From the perspective of a multistate licensed mortgage company, a collage of varying requirements among the nation's nearly 60 different state mortgage regulators is not just undesirable, but also likely to lead to unintended conflicts. In turn, lenders and servicers could well face unnecessary litigation and enforcement risk. For example, without consulting with federal housing program officials, the New York DFS on October 29, 2020 directed all regulated organizations to begin integrating financial risks from climate change into their governance

[10] White House, "Executive Order on Protecting Public Health and the Environment and Restoring Science to Tackle the Climate Crisis," January 20, 2021. Available at: https://www.whitehouse.gov/briefing-room/presidential-actions/2021/01/20/executive-order-protecting-public-health-and-environment-and-restoring-science-to-tackle-climate-crisis/.
[11] White House, "Paris Climate Agreement," January 20, 2021. Available at: https://www.whitehouse.gov/briefing-room/statements-releases/2021/01/20/paris-climate-agreement/.

frameworks, risk management processes, and business strategies. The New York DFS also expressed an expectation that these companies would consider engaging with the TCFD's framework and other established initiatives when developing their plans. Lastly, the New York DFS expressed the expectation that non-depositories conduct a risk assessment of the physical and transition risks of climate change, whether or not these risks impact them or the communities they serve directly in terms of business disruptions, loss of income and higher default rates, supply chain disruptions, and changes in investor and consumer sentiments, as well as to start developing risk mitigation plans.[12]

In a more recent development, the Chair of the California Senate Natural Resources & Water Committee introduced legislation (SB-449),[13] which would establish new climate change reporting requirements on regulated mortgage lenders and others. Specifically, the bill would require a bank, corporation, credit union, finance lender, insurer, investment advisor, real estate investment trust, and mortgage lender, on or before January 1, 2023, and annually thereafter, to prepare a climate-related financial risk report. The bill further would require each company to submit its report to the California Department of Financial Protection and Innovation (DFPI) and post it to their company's website. Lastly, the bill would require those financial institutions to submit a statement to DFPI affirming that the climate-related financial risk report discloses all climate-related financial risk.

7. *Be mindful of any conflicts or tradeoffs between the regulated entities' need to manage climate change and natural disaster risks and to fulfill their charter mandates.*

The charters of the regulated entities focus on their requirements to provide liquidity to the mortgage market on a nationwide basis and to support the provision of affordable housing. Without a doubt, some efforts to mitigate climate risk have the potential to raise costs or direct activity in a manner that could adversely impact the homeowners and tenants that the regulated entities' missions are most trying to support.

As federal policymakers consider options to aid low- and moderate-income (LMI) borrowers and communities at high risk for flooding or other impacts of climate change, it is worth considering providing grants or vouchers for mitigation activities. Mitigation activities can lower the cost of insurance premiums and thus avoid the necessity for a potential buyout by FEMA or other more extreme government action. It also could prevent displacement of historically underprivileged communities. According to an analysis by Redfin, "there are $107 billion worth of homes at high risk of flooding in parts of the U.S. that were designated undesirable for mortgage lending under the racist 1930s-era practice known as redlining."[14] While there is incentive for private industry

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[12] New York Department of Financial Services, "RE: Climate Change and Financial Risks," October 29, 2020. Available at: https://www.dfs.ny.gov/industry_guidance/industry_letters/il20201029_climate_change_financial_risks.
[13] California SB-449. Available at: https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=202120220SB449.
[14] Katz, Lily. "Formerly Redlined Areas Have 25% More Home Value At High Flood Risk." *Redfin Real Estate News*, March 15, 2021. Available at: www.redfin.com/news/redlining-flood-risk/.

to construct retaining walls and other measures around high-cost properties, the government should consider whether it has a role in subsidizing these kinds of activities for more vulnerable populations.

LMI borrowers may choose to avoid purchasing higher-risk (higher insurance cost) properties if such information is disclosed clearly and comprehensively. For low-income households who currently own properties experiencing rising insurance premiums, situations can arise where they find themselves stuck as buyers for properties at greater risk may be scarce. FHFA should develop programs in which the regulated entities could help these borrowers, with an expansion of the NFIP's buyout program being a likely solution.

Clearly, FHFA should carefully balance the benefits of climate-risk mitigation related actions against their regulated entities' Congressionally-mandated missions to support the provision of affordable housing across the country. We need to acknowledge that certain communities, as a result of historical biases, are in areas prone to be hard-hit by climate change. Given their housing missions, FHFA and its regulated entities must be a voice for the importance of affordable housing, speaking out against any negative consequences for affordability of any mitigation costs.

Concluding Remarks

As noted above, we commend FHFA for taking this step to initiate an industrywide discussion regarding the impact of increasing natural disaster and climate risk on its regulated entities and the broader real estate finance system.

While this effort presents new challenges, MBA believes that the responses can be usefully implemented within the existing risk management practices of the regulated entities, and the existing supervisory practices of FHFA. Ongoing focus on developing robust servicing procedures to help borrowers and the system be more resilient following a crisis will be critically important. Efforts to continue to re-evaluate underwriting and other credit risk management practices in the presence of changing economic and other conditions will be necessary. MBA's view is that these are evolutionary rather than revolutionary changes in risk management.

With respect to process around this initiative, MBA recommends that FHFA leverage existing resources, as well as supervisory processes and practices to the maximum extent possible. In summary, FHFA should align with other regulators whenever appropriate to do so, but also recognize the unique business models of its regulated entities and work with them to foster a common approach for real estate finance markets. FHFA should also work closely with the government housing agencies to pursue a common approach on mortgage-specific topics. At a macro level, recognizing that addressing climate risk more broadly will take a whole-of-government approach, FHFA should leverage the work of other agencies to the maximum extent possible.

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Thank you in advance for your consideration of these comments. Should you have questions or wish to discuss further, please contact Mike Fratantoni, Chief Economist and SVP of Research and Industry Technology, at (202) 557-2935 or mfratantoni@mba.org.

Sincerely,

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